RATING REPORT

Best Fibres (Pvt.) Limited (BFL)

REPORT DATE:
January 3, 2020

RATING ANALYSTS:
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RATING DETAILS		
	Initial Rating	
Rating Category	**Long-term**	**Short-term**
Entity	A-	A-2
Rating Date	*31st December, 2019*	
Rating Outlook	Stable	

COMPANY INFORMATION	
Incorporated in 2017	**External auditors:** RSM Avais Hyder Liaquat Nauman Chartered Accountants
Private Limited Company	**Chairman of the Board:** Sheikh Zulfiqar Ali
	Chief Executive Officer: Sheikh Zulfiqar Ali
Key Shareholders: (Above 5%)	
Sheikh Zulfiqar Ali 53.60% Ms. Madiha Asif 45.48%	

APPLICABLE METHODOLOGY
VIS Entity Rating Criteria: Corporates (May 2019) ***https://www.vis.com.pk/kc-meth.aspx***

OVERVIEW OF THE INSTITUTION

Best Fibres (Pvt.) Limited was incorporated in 2017 as a private limited company The principal object of the company is to manufacture and sale of viscose and cotton yarn.

Profile of Chief Executive Officer

Sheikh Zulfiqar Ali has 50 years of experience in the textile sector. He started his career from the yarn market of Faisalabad and laid the foundation of Best Group of Companies in early 2000.

Financial Snapshot

Core Equity: end-FY19: Rs. 928.2; end-FY18: Rs. 536.6m; FY17: Rs. 313.2m

Assets: end-FY19: Rs. 2.6b; end-FY18: Rs. 3.1b; FY17: Rs. 2.3b

Profit After Tax: FY19: Rs. 375.6m; FY18: 223.4m; FY17: NA

RATING RATIONALE

Best Fibres (Pvt.) Limited (BFL) is a medium-sized spinning unit located in Faisalabad, with shareholding vested within sponsoring family. The ratings assigned take into account higher sales, improved margins, adequate coverages and considerable relevant experience of the sponsor. Leverage indictors have improved on a timeline basis, though still on a higher side. The ratings also incorporate management's focus on expanding its operations based entirely on internal sources while enhancing operational efficiencies. However, the ratings remained constrained by vulnerability of spinning sector to raw material prices, impact of currency fluctuations on imported raw material, and any adverse changes in regulatory duties. Further, corporate governance framework has considerable room for improvement.

Key Rating Drivers:

Decline in cotton production and yarn exports on a timeline basis: The lower end of textile value chain is faced with many challenges. Increase in distribution cost owing to higher fuel prices has also skewed the domestic players towards local markets. Cotton trade has also been affected as the Federal Board of Revenue imposed 10 percent sales tax on cotton that would be collected at the ginners' level. Global demand of Pakistani yarn has experienced downward pressure, owing to shifting of spinning mills from China to Vietnam coupled with reduced export orders from China in light of the prevailing US-China trade tensions. On the flip side, volume led growth in value-added exports has enhanced local consumption of yarn resulting in limited export surplus for the same. Nevertheless, signing of FTA phase 2 (Free Trade Agreement) with China presents an opportunity for spinning mills to enhance exports to China.

Cost pressures for the industry are reflective of the global and local cotton production data which shows scaled down cultivation area and production at both end. Resultantly, local cotton prices have gone up. With respect to spinning segment, dependence on imported cotton, particularly from India, has been on the higher side given its identical quality with the local cotton. However, sprained relations with India and significant rupee devaluation would further increase raw material costs for the spinning segment. Margins and financial performance of the players in the industry have depicted volatility due to inherent cyclicality of crop levels and oscillations in cotton prices.

Company's profile: Previously, both Spinning and weaving units were operating under the umbrella of Best Exports (Pvt.) Limited (BEL); however, the owners decided to divide the company's assets as at June 30, 2017, amongst sponsoring family and operate the spinning and weaving units independently. After division of assets, Sheikh Zulfiqar Ali, retained the ownership of spinning unit comprising 72,912 spindles under the name of BFL. Stitching and weaving unit with 562 shuttle-less Sulzer looms and 45 stitching machines, under the name of BEL, is solely owned and managed by his son, Mr. Waqas Ali. Meanwhile, the ownership of another spinning unit comprising 50,000 spindles was transferred to Mr. Danish Ali, brother of Mr. Waqas, under the name of Z.A Corporation Pvt Limited.

Now, BFL has total spindles of 76,080 with installed capacity of 33,609,492 Kgs (after conversion into 20/s count). Capacity utilization remained optimal at 97% (FY18: 90%) during FY19. To ensure operational efficiency, the company has added plant and machinery costing Rs. 201.7m, which majorly comprised four Schlafhorst autoconers, two simplex frames, one draw frames Rieter, six ring frames and 51-set compact Astrosun spinning. Additionally, land having area of 1.95 Acre was purchased in FY19 for new godowns as a part of expansion plan. The production and capacity utilization statistics are tabulated below:

	FY17	FY18	FY19
Installed Spindles	-	72,912	76,080
Operational Spindles	-	72,912	76,080
Shifts Per Day	-	3	3
Production Capacity 20/S count (Kgs)	-	32,218,754	33,609,492
Actual Production 20/S count (Kgs)	-	29,027,089	32,655,920
Capacity Utilization	-	90%	97%

Current power requirement of BFL is 8MW. The company has gas sanctioned load of 2.5MMCFD with 7 Jenbacher-320 Gas generators (having capacity of 7 MW) and a 4.95MW dedicated line is available from WAPDA. Given regular supply of gas and relatively lower per unit cost (~Rs. 11/unit), total energy requirement was primarily met through gas engines during FY19.

Expansion of operations: Contemplating higher demand, to further cater yarn market, the management is pursuing an expansion plan of adding 25,344 spindles (47 Ring Frames) to its existing operations. Total estimated capex on this project is expected to be around Rs. 922m, which entailed total machinery cost of Rs. 650m (including complete imported spinning unit and local machinery), complete grid station (132 KV/11) worth Rs. 200m, civil work on existing land amounting Rs. 35m and acquisition of land (5-Acre) for Rs. 37m. The project is likely to be concluded by end-FY23, meanwhile civil work on godowns will be completed by end-FY20. The said project will be completely funded through internal sources, which also includes equity injection by sponsors amounting Rs. 170 m in FY20.

Procurement of raw material: BFL uses only imported raw material. Raw viscose constituting 96.4% (FY18: 95.1%) of the total procurement, was imported from Hong Kong, China, Indonesia, UK and Austria while Indian cotton constituted 3.6% of total procurement. Viscose is purchased throughout the year. Cotton is purchased on a need basis; high quality cotton is generally available throughout the year. In normal practice, the company used to hold 3-6 months of inventory, however, in the ongoing year the management has reduced the stock holding due to higher financial carrying cost and imposition of sales tax at the rate of 17% associated with it.

Change in sales mix going forward, as a result of government efforts to document economy: BFL product mix mainly constituted viscose (of 20s-40s count) and cotton yarn (of 10s-60s count), sold in the local market. The company sells viscose yarn in yarn market and has majority share in local supply. During FY19, around 88% of the yarn was supplied in Faisalabad yarn market, Multan and Jhang constituted 5% and 6% of the total sales, while a fractional sale was made in Lahore and Gujranwala cities. According to the management, yarn market is majorly unorganized; characterized by less than 1% registered players. Given the government recent efforts to document economy, the unorganized sector has come under stress. BFL has therefore planned to alter its sales mix to 60:40 cotton and viscose yarn in the ongoing year. Going forward, the management plans to enhance focus on the manufacturing of cotton yarn. On account of aforementioned reason and to reduce the financing cost, the company has reduced its raw material and finished goods stock, which has resulted in lower stock in trade at Rs. 707.0m (FY18: Rs. 1.3b) by end-FY19.

Augmentation in sales on the back of both higher volumes and increase in yarn prices: The company's topline registered an increase of 43.9% to Rs. 8.2b (FY18: Rs. 5.7b) during FY19 vis-à-vis preceding year. Viscose yarn accounting for 79.8% (FY18: 89.9%) of the sales revenue, has remained the main revenue driver, while cotton yarn merely constituted 6.2% (FY18: 3.2%) of the net sales. The company is also involved in sales of other material comprising raw viscose staple fibre, which accounted for 13.8% (FY18: 6.6%) of the net sales during the review period. As the raw material sale is of lower margin, the management intends to reduce its proportion. According to management, the sales are made entirely on cash basis; it is norm in the yarn market to receive the payment in advance or in cash or post-dated cheques against sales, hence trade debts have remained at a modest level of Rs. 1.6m (FY18: Rs. 0.6m) at the end-FY19.

The company sold 420,477 bags (FY18: 343,018 bags) of viscose yarn during FY19, followed by 24,637 bags (FY18: 9,089 bags) of cotton yarn. Higher gross margin during FY19, is a function of increase in average viscose yarn prices to Rs. 15,545/bag (FY18: Rs. 14,921/bag) and average cotton yarn prices to Rs. 20,554/bag (FY18: Rs. 19,935/bag). Cost of sales stood higher at Rs. 7.5b (FY18: Rs. 5.2b), mainly on account of increase in raw material consumed, though its contribution to cost of goods manufactured has remained almost at the prior year's level (FY19: 79%; FY18: 78%). Salaries, wages and benefits increased mainly on account of annual salary adjustments. Fuel and power expense increased to Rs. 684.7m (FY18: Rs. 629.8m) in line with higher production during FY19. Further, stores and spares consumed increased to Rs. 82.0m (FY18: Rs. 32.3m) due to general rise in prices and overhauling of back process. Further, packing material increased to Rs. 83.8m (FY18: 54.8m) due to higher sales and increase in prices, during the same period. Purchases amounted to Rs. 1.0b, pertained to viscose staple fibre, for re-sale purpose. As a result of higher average selling prices of its products and rationalized increase in cost of sales gross margins stood higher at 9.0% (FY18: 7.9%) during FY19.

Administrative expenses increased to Rs. 60.6m (FY18: Rs. 32.9m) mainly as result of revision in director's remuneration and salaries and benefits. Depreciation charge stood higher due to higher operating assets during FY19. Increase in all other administrative expenses is aligned with higher sales and general inflation. Other operating expenses related to worker's welfare fund and worker's profit participation fund amounted to Rs. 36.5m (FY18: Rs. 23.6m). Further, other income comprising profit on deposits and sale of scrap stood at Rs. 5.0m (FY18: Rs. 3.1m). Given increase average borrowings and higher interest rates, finance cost increased to Rs. 121.1m (FY18: Rs. 77.1m) during FY19. Accounting for taxation, the company reported higher net profits of Rs. 375.6m (FY18: 223.4m) during review period. Management projects the topline to remain stagnant due to change in sales mix, meanwhile gross margins to remain range bound between 9.0-9.6 percent during the next three years on the assumption that increase in product prices will compensate for increase in cost of sales.

Adequate liquidity as evident from cash flows in relation to outstanding obligations and adequate debt service ability: Higher profit before taxation during FY19 has resulted in increase in funds from operations (FFO) to Rs. 502.4m (FY18: Rs. 379.0). FFO to total debt and FFO to long-term debt improved to 0.45x and 1.49x (FY18: 0.21x and 0.82x), respectively, due to higher FFO and decrease in overall debt levels by end-FY19. Debt service Coverage Ratio (DSCR) is considered adequate at 2.52x during FY19 and largely remained at prior year's level due to higher finance cost paid and long-term repayment during the period, despite increase in FFO.

Short-term advances stood lower at Rs. 302.4m (FY18: Rs. 349.4m; FY17: na) mainly on account of lower advances made to suppliers (FY19: Rs. 195.0m; FY18: 284.6m), however, advance income tax paid increased to Rs. 104.9m (FY18: Rs. 63.3m). Tax refunds due from government increased to Rs. 43.0m (FY18: Rs. 15.6m) owing to higher sales tax refunds; given that the government has started releasing these refunds, its impact on liquidity is expected to be alleviated to a certain extent, according to the management.

Capital expenditure payable including current portion *(representing payable against acquisition of spinning unit from BEL; payable in three equal installments of Rs. 180.7m, commenced from June 30, 2018)* stood at Rs. 180.7m (FY18: Rs. 313.8m; FY18: Rs. 453.3m) by end-FY19. This payable is interest free and subordinated to financing facilities from banks. Further, it was recognized at amortized cost using prevailing market interest rate of 6.79% in 2018. The difference of Rs. 44.05m (FY18: Rs. 88.87m) by-end-FY19, between the carrying amount and the fair value of this payable is recognized as deferred revenue. Meanwhile, trade and other payables stood lower at Rs. 208.5m (FY18: Rs. 319.2m) due to lower advances from customers, by end-FY19.While current liabilities decreased, mainly due to lower short-term borrowings, current ratio decreased marginally to 0.78x (FY18: 0.85x; FY17: 0.74x) primarily on account of lower stock in trade by end-FY19. Trade-debts plus stock in trade to short-term borrowing ratio decreased to 0.89x (FY18: 1.01x; FY17: 2.91x) by end-FY19.

Augmentation in equity mainly on back of profit retention; leverage indicators though improved, remained on higher side: Equity base enhanced to Rs. 928.2m (FY18: Rs. 536.6m; FY17: Rs. 313.2m) by end-FY19 mainly on back of profit retention. Moreover, Sponsors injected equity worth Rs. 11.5m FY19 that increased paid-up capital to Rs. 326.5m (FY18: 315.0; FY17: 315.0m) by end-FY19. Long-term borrowings mobilized mainly for the purchase of machinery, stood lower at Rs. 336.2m (FY18: Rs. 460.7m; FY17: Rs. 573.1m) by end-FY19. Given lower debt levels and higher equity base, gearing and leverage decreased to 1.22x and 1.85x (FY18: 3.34x and 4.84x; FY17: 2.74x and 6.31x) respectively, by end-FY19.

Around two-third of the debt of the company consisted of short-term borrowings. The same stood lower at Rs. 792.1m (FY18: Rs. 1.3b; FY17: Rs. 286.2m). Cash finances are secured against pledge of raw material, while finance against trust receipts are secured against trust receipts of the company. Running finances are secured against first pari passu charge over fixed and current assets of the company. Effective mark-up rate charged during the year ranged from 7.39% to 13.92% (FY18: 7.07% to 8.02%). The aggregate unavailed short-term lines stood at Rs. 2.4b (FY18: Rs. 935.2m; FY17: Rs. 289.5m) at end-FY19. Capitalization indicators are likely to improve in line with decrease in debt levels and increase in equity base, going-forward.

BALANCE SHEET	FY17	FY18	FY19
Property, plant & Equipment	1,405	1,352	1,482
Store, Spares and Loose Tools	7	11	15
Stock-in-Trade	834	1,337	707
Trade Debts	0	1	2
Advances	1	349	302
Tax Refunds Due from Government	0	16	43
Cash & Bank Balances	16	17	43
Other Assets	27	50	50
Total Assets	2,290	3,133	2,644
Trade and Other Payables	575	319	209
Capital Expenditure Payable *(including current maturity)*	453	314	181
Long Term Debt *(including current maturity)*	573	461	336
Short Term Debt	286	1,330	792
Other Liabilities	89	174	198
Total/Tier-1 Equity	313	537	928
Paid-up Capital	315	315	327
INCOME STATEMENT	**FY17**	**FY18**	**FY19**
Net Sales	0	5,695	8,193
Gross Profit	0	449	739
Operating Profit	(2)	416	679
Profit Before Tax	(2)	318	526
Profit After Tax	(1.8)	223	376
Funds from Operations	-	379	502
RATIO ANALYSIS	**FY17**	**FY18**	**FY19**
Gross Margin (%)	-	7.9	9.0
Net Margins	-	3.9	4.6
Current Ratio (x)	0.74	0.85	0.78
Net Working Capital	(279)	(316)	(320)
FFO to Total Debt (x)	-	0.21	0.45
FFO to Long Term Debt (x)	-	0.82	1.49
Debt Leverage (x)	6.31	4.84	1.85
Gearing (x)	2.74	3.34	1.22
DSCR (x)	-	2.53	2.52
DSCR (incl. payment of capital expenditure payable)	-	1.23	1.47
ROAA (%)	-	8.2	13.0
ROAE (%)	-	52.6	51.3
(Stock in Trade+Trade Debt) to Short-Term Borrowing Ratio	2.91	1.01	0.89

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.vis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details.www.vis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES	Appendix III
Name of Rated Entity	Best Fibres (Pvt.) Limited
Sector	Textile
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see table below

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
31-12-2019	A-	A-2	Stable	Initial

Instrument Structure	N/A
Statement by the Rating Team	VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
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