

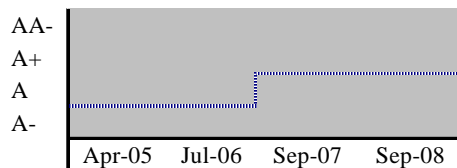
Azgard Nine Limited (ANL)

RATINGS (SEPTEMBER 2008)

AZGARD NINE LIMITED

ENTITY	NEW	PREVIOUS
Long Term	A+	A+
Short Term	A1	A1
TFCs (PKR in mln)		
2,144	AA-	AA-
2,500	A+	A+

RATING HISTORY



FINANCIAL DATA

PKR in mln	31-Dec-07	31-Dec-06
Total Assets	23,632.6	22,983.0
Equity	9,959.1	9,431.5
Turnover	6,628.3	4,889.7
Operating Profits	1,572.2	795.0
Net Income	1,079.5	1,144.5
Gross Margin (%)	30.3	24.3
RoE (%)	11.1	17.9
Equity / Total Assets (%)	42.1	41.0

ANALYSTS

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PROFILE

Azgard Nine Limited (ANL) – listed on the Karachi Stock Exchange – started commercial production in 1997. ANL is a vertically integrated unit, comprising spinning, weaving, stitching, dyeing and finishing facilities. It is currently one of the top quality manufacturers and exporters of yarn, denim fabric and garments. ANL has three manufacturing units, located in Lahore, Muzaffargarh and Kasur. The company acquired full ownership of Pak American Fertilizers Limited (PAFL), during 2006, through the privatization process. PAFL is the 5th largest fertilizer company of the country and enjoys around 8% market share. Shaikh family has a majority stake (40%) in ANL, followed by JS Group (36%).

The CEO, Mr. Ahmed Humayun Shaikh, Economics Baccalaureate from Brown University, has been associated with the company since its inception and is assisted by a team of experienced professionals. The BoD of the company mainly consists of members having significant professional experience, enriched by domestic and international exposure.

RATING RATIONALE AND KEY DRIVERS

- The ratings reflect the company's sustained progression towards higher value addition in denim products, augmented by an efficient production and marketing infrastructure. In addition, recent acquisition of a foreign company, with a portfolio of denim brands, is expected to further improve ANL's product mix, though the extent of related benefits and the timeline remain to be seen. Meanwhile, the company's fertilizer operations, with low business risk and stable cash flows, have positive implications for its overall risk profile, currently constrained due to relatively high leveraging.
- These ratings are dependent on sustained competitiveness of ANL's products in the changing dynamics of the international denim market. Meanwhile, any material deterioration in margins, thereby constraining the company's cash flows stream, may have negative implications for the ratings.

ASSESSMENT

- During 2007, ANL's turnover experienced sizeable growth, attributable to both improved product prices and increase in volumes on the back of additional capacity. Gross margins also witnessed appreciable improvement, mainly an outcome of the management's ongoing efforts to enhance the proportion of value added products in the sales mix. Although operating expenses increased mainly due to expansion in human resource base, the same declined as a proportion of turnover. Meanwhile, ANL's profitability was augmented by a marginal contribution of capital market operations and a sizeable, though YoY lower, dividend income from the wholly owned subsidiary – PAFL. However, the company's bottomline depicted a moderate decline on YoY basis due to increased burden of finance cost mainly related to acquisition of PAFL. ANL maintained the growth momentum during 1H08 as well.
- ANL has recently acquired the marketing infrastructure of Farital AB (FAB) at around Euro 24mln. FAB, incorporated in Sweden, manages around a dozen denim fabric brands through a wholly owned subsidiary Montebello SRL in Italy. Montebello was experiencing pressure on its competitiveness, attributable to rising cost of production. ANL, while keeping the sales network intact (above 20 employees), intends to meet Montebello's sales requirements through relatively low cost domestic production, thereby making a reasonable margin at the current pricing. Montebello signifies first direct exposure of the company to the dynamics of international denim market, whereby its success remains critical. ANL, to service new business acquired through Montebello, is enhancing its weaving capacity by adding 66 looms. Furthermore, gradual increase in the utilization of existing capacity is also expected to reflect in improved turnover, thereby augmenting the profitability of the company. However, ANL's bottomline is likely to remain under pressure on account of hefty finance cost. Meanwhile, PAFL, to enhance available capacity, have undertaken a leveraged BMR program, whereby dividend prospects, though constrained over the short period, are positive in the long run.
- ANL's working capital requirement is mainly a function of cotton procurement, for which the company resorts to short-term credit lines. Inventories usually experience a build-up in the beginning of each year with the arrival of fresh crop.
- ANL has a leveraged capital structure, mainly attributable to borrowings related to acquisition of its wholly owned subsidiary. The company successfully re-profiled a portion of its debt towards the end of 2007, availing significant grace period and reduction in finance cost. ANL has plans to finance the recent acquisition of Farital AB through a combination of medium term debt and internal generation including liquidation of investments, if need be. Meanwhile, the related payment has been structured in five instalments spread over 2008 to avoid sudden impact (50% repayment already made). Consequently, ANL's cash flows are expected to remain under pressure, translating into subdued though manageable coverages.

TFC ISSUES

- The company issued a secured TFC of PKR 2,144mln in 2005 to meet its expansion plans as well as BMR expenditure. The TFC is of a seven-year tenor, and carries profit at the rate of 6-month KIBOR plus 240 basis points, with no cap or floor. Principal redemption, to be made in ten unequal semi-annual instalments, started in Mar-08. The TFC is secured by way of first parri passu charge on the present and future fixed assets of the company with a 25% margin. Considering the security and margin, the TFC is assigned a rating of "AA-", a one-notch higher rating than the long term entity rating.
- The company issued a secured subordinate TFC of PKR 2,500mln, during Dec 07, by way of private placement for retiring the debt due for redemption in Jan 2008. The TFC is of a seven-year tenor, and carries profit, payable semi-annually, at the rate of 6-month KIBOR plus 225 basis points, with no floor and cap. The TFC is secured by way of a ranking charge over all present and future fixed assets of the company. Principal repayment will be made in 10 equal semi-annual instalments, beginning 30th month after the issuance (May2010). Considering the security structure, the TFC has been assigned a rating of "A+", at par with the long term entity rating.