AZGARD NINE LIMITED (ANL)

Ratings (MARCH 2005)

AZGARD NINE LIMITED

	NEW	PREVIOUS
ENTITY*		
Long Term	A	A
Short Term	A1	A1
TFCs		
Secured		
PKR 2,000mln	A+	n.a.

** Applicable to senior unsecured creditors*

Outlook Positive

Financial Data

PKR (mln)

	30/09/04	30/09/03
Total Assets	6,297.2	4,829.7
Net Turnover	3,155.9	2,428.1
Net Income	375.3	228.2
EBITDA	712.4	604.7
EBITDA/ Interest (x)	5.8	3.3
Net Interest Cover	4.20	2.34
Total Debt/ Equity (%)	231.09	187.10

ANALYSTS

Ambreen Irfan
+92 42 5869504
ambreen@pacra.com

Shahzad Saleem
+92 42 5869504
shahzad@pacra.com

TFC ISSUE:

The company is planning to issue a secured TFC of PKR 2,000mln in the current year. Proceeds from the issue will be utilized towards meeting the company's expansion plans, as well as BMRE expenditure. The TFC issue is of a seven-year tenure, and will carry a profit rate of 6 months KIBOR +240 basis points, with no cap or floor. Principal redemption will be in ten unequal semi-annual installments starting from the thirtieth month from date of disbursement after an initial grace period of two years. The TFC contains a 25% conversion option. This allows TFC holders the right of conversion of up to 25% of the value of their TFCs into ordinary shares at a 30% discount to the preceding three months average share price of ordinary shares, at any time between Jan- 2008 to Mar-2008. It is secured by way of first 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 "A+", a one-notch higher rating than the entity rating.

Rating Rationale

Assessment

- The ratings reflect the company's dynamic long-term vision, an outcome of its management's progressive efforts to transcend any cultural and geographical barriers to sales of its products. This is reflected in continuous improvement in turnover. While the company's risk absorption capacity registered a temporary decline declined due to higher leverage, the company's overall financial profile is expected to keep improving despite an increasingly competitive international marketplace.
- A decline in ANL's FY04 gross margins was mainly due to an increase in cotton prices without a commensurate increase in sales price. The company's net margins, however, improved due to a significant decrease in financial charges, and a reduction in the tax incidence. Combined with increased sales volume, this resulted in an improvement in bottom-line earnings. However, this could not translate into a higher ROE because of the enhanced equity base, a function of the company's policy to build a redemption reserve for its preference share issue. The trend of improvement in net income persisted in 1QFY05, helped by an improvement in gross margins as cotton prices fell. The impact of the latter, combined with increased sales volumes due to further expansion in the current year, is expected to keep performance trends positive.
- Two major developments that are affecting the current landscape of textile industry operations is the phase-out of the MFA regime. The other adverse development for Pakistan is the withdrawal of GSP concessions. This has made business for export-oriented companies-especially those operating with a lower amount of value-addition- more challenging, and more prone to volatility in demand and margins. The niche that ANL has painstakingly carved for itself through emphasis on quality in every sphere of activity provides an effective insulation from the adverse impact of these factors. Thus, demand and price for its products in the local and international market has not been affected. The impact of duties on garments is being offset by the removal of quota costs. While plans for a foreign acquisition remain under way- the requisite funds have been obtained-ANL has embarked on an expansion plan, and has set up marketing offices in several countries to enhance its global stature. While these developments are expected to yield positive long-term results, they are increasing overall debt levels, and have led to increased gearing. However, given the prudent profit retention policy, ANL's capital structure is unlikely to weaken further.
- While cash flows improved slightly, they remained under stress due to the company's policy of maintaining a large level of inventory, compelling it to rely almost entirely on external funding to meet discretionary and non-discretionary expenditure. Coverages improved due to increased profitability and reduced financial charges, and are expected to remain adequate after the proposed TFC issue.

Background

- Legler Nafees Denim Mills started commercial production in 1997 as a joint venture between the Colony Group of Pakistan and Legler Spa, Italy. In 2004, its name was changed to Azgard Nine Limited (ANL) as symbolic of the decreased role of Legler Spa in the company's operations, and the company attaining its own unique positioning. ANL is listed on the Karachi stock Exchange.
- ANL is a vertically integrated unit, comprising of spinning, weaving, stitching, dyeing and finishing. It is currently one of the top quality manufacturers and exporters of denim fabrics and garments. The manufacturing facility of ANL is located 2.5 kms off Manga-Raiwind road, district Kasur, and the other unit is located in Muzaffargarh. The company is planning the erection of a new denim-weaving unit at the former site, as well as expansion in its spinning and garment stitching facilities. It also intends to make investment in BMRE and a power plant to reduce its energy costs. The majority of sales are export-based. Although significant sales, especially in terms of its yarn production, are to the local market, the orientation of the company is geared towards emphasis on, and expansion in, export sales.
- The highly professional management of the company is embarked upon a vision of fully leveraging the company's strategic assets-physical and human-to become a truly global player. A comprehensive strategy is, therefore, in place to emulate best international practices in corporate governance, production efficiencies and environmental standards.