



The Pakistan Credit Rating Agency Limited

Rating Report

Ellecot Spinning Mills Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
28-Sep-2019	A-	A2	Stable	Maintain	-
30-Mar-2019	A-	A2	Stable	Maintain	-
28-Dec-2018	A-	A2	Stable	Maintain	-
30-Jun-2018	A-	A2	Stable	Maintain	-
28-Dec-2017	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect Ellecot Spinning Mills Limited's (Ellecot) improving business profile. The Company largely caters to the needs of local market and it has developed a reputable clientele over the years. Textile industry in general and spinning industry in particular has suffered from low international commodity prices. Moreover, lower demand for cotton yarn from China owing to trade war with USA has suppressed the demand in international market. Similarly, imposition of sales tax in local market may slowdown sales. However, rupee devaluation and subsidized rates for gas and electricity has provided a breather to local textile industry. The Company has sustained its business profile on the back of higher product quality and volumetric growth, a factor of recent BMR. The Company's financial risk profile is constrained by significant leveraging, in turn, higher finance cost resulting in declined adequate coverages. Ellecot intends to gradually build a sizable investment portfolio. This exposes the Company to market risk as exhibited by historic volatility in stock exchange. Any significant decline in investments leading to losses, and eventually equity erosion, will impact the financial profile of the Company. The assigned ratings derive comfort from Ellecot's association with Nagina Group.

The ratings are dependent on the Company's ability to generate sufficient cash flows to fulfill its financial obligations, while sustaining business margins. Maintaining sales volume is crucial. Any significant deterioration in the Company's coverages may impact the ratings. At the same time, prudent management of investment portfolio is critical.

Disclosure

Name of Rated Entity	Ellecot Spinning Mills Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	PACRA_Methodology_Corporate_FY19(Jun-19),PACRA_Criteria_LT ST Relationship_FY19(Jun-19),PACRA_Criteria_Rating Modifiers_FY19(Jun-19)
Related Research	Sector Study Spinning(Sep-19)
Rating Analysts	Muhammad Hassan muhammad.hassan@pacra.com +92-42-35869504

Profile

Legal Structure Ellcot Spinning Mills Limited (Ellcot) was incorporated in 1991 as a public limited company.

Background Ellcot is associated with Nagina Group since its inception. The group has presence in local spinning and weaving sector through Nagina Cotton and Prosperity Weaving. The Company's manufacturing facility is located in District Kasur, Punjab.

Operations The Company's current operational capacity comprises 61,698 Spindles. The total energy requirement of the Company is ~6MW which is wholly met through captive plant. Furthermore, the Company has LESCO connection as alternative source.

Ownership

Ownership Structure Ellcot is majorly (~58%) owned by Nagina Group, through group companies and sponsoring individuals. The remaining stake rests with financial institutions and general public.

Stability The considerable positions in Nagina Group are held by Ellahi Family. The Group has a structured line of succession, reflected from equal distribution of shareholding among Ellahi brothers and their family members. Meanwhile, third generation has already been in business, serving at various capacities.

Business Acumen Nagina Group is one of the oldest medium-sized textile houses in Pakistan. Operating under Ellahi's for five decades, developing credential expertise in spinning and weaving over the period of time. The Group has adequately expanded its operations despite competitive textile industry.

Financial Strength Nagina Group comprises three listed public limited companies, namely; Ellcot Spinning Mills, Prosperity Weaving Mills and Nagina Cotton Mills Limited and has six private limited companies. This portrays adequate financial strength of the Group to support the Company, if needed.

Governance

Board Structure Ellcot's board comprises seven members out of which five members are non-executive and one member occupies an executive role, the CEO while one director is independent.

Members' Profile Mr. Shahzada Ellahi Shaikh – the Chairman – holds a bachelor's degree in Economics and International Relations. The board members carry vast knowledge and extensive experience on textile industry, though diversity in experiences also exists which benefits the board in efficient decision making.

Board Effectiveness Three committees: Audit, Executive and Human Resource & Remuneration, are in place to assist the board in relevant matters and ensure proper oversight. Attendance of board members remains strong and meeting minutes were formally documented. Out of total, seven directors are Nagina Group nominees (including six sponsoring family individuals). Their dominance on board along with control over key management positions poses limited challenge to the management, thus, hampers effective governance.

Financial Transparency M/s. Rahman Sarfaraz Rahim Iqbal Rafiq, Chartered Accountants are the external auditors of the Company. They have expressed unqualified opinion on the financial statements of the Company for the periods ending FY18 and 1HFY19.

Management

Organizational Structure The management team is headed by Mr. Shafqat Ellahi Shaikh (CEO), with defined reporting line. The Company has seven functional departments and all HOD's reports directly to the CEO.

Management Team Mr. Shafqat Ellahi is one of the sons of Mr. Shaikh Enam Ellahi. He holds a graduate degree from Colombia University and has been associated with the Company since its inception. He is well verse with the textile business and has strong business acumen. He is supported by a team of seasoned professionals which supplements his expertise.

Effectiveness The management meetings are held on daily basis with follow-up points to resolve or pro-actively address operational issues, if any, eventually ensuring smooth flow of operations. In addition to this, daily and weekly reports are generated for top management with main focus on production and liquidity position of the Company. Whereas, on monthly basis the Company's P&L is presented and discussed in the meetings.

MIS The Company has in place Oracle based Enterprise Resource Planning (ERP) system with comprehensive MIS reporting.

Control Environment The Company is compliant with multiple safety and quality assurance standard, majorly including; ISO 9001:2008, Standard 100 by OEKO-TEX, Global Organic Textile Standards (GOTS), Organic Content Standard, Organic Content Standard 100, and Organic Content Standard Blended.

Business Risk

Industry Dynamics The export performance of Pakistan's textile industry remained stagnated during FY19, despite ~34% currency devaluation and incentives introduced by the government to promote exports. Even though leading textile categories including ready-made garments, knitwear and cotton cloth displayed double-digit volumetric growth, the hit to unit prices on account of exporters having to share the benefit of the currency depreciation with buyers in the extremely competitive international market, curbed overall growth. Meanwhile, cotton yarn exports fell by ~18% YoY. This decline was driven by falling yarn prices due to decreasing trend in international cotton prices during the year, as well as volumetric decline owing to the US-China trade war. The withdrawal of zero rating status may cause liquidity crunch for the companies with majority exports. This, along with restriction on sales to unregistered person has resulted in a slowdown in textile's operations, in local market.

Relative Position Nagina Group has a long operating history in Pakistan and has developed prominent position in local spinning industry. Currently, the Group's spinning capacity stands at 115,446 spindles which strengthens Ellcot's market position. However, on standalone basis, Ellcot's share in local spinning industry is minimal.

Revenues Since FY16, the Company's revenues are on growing trajectory. The similar trend continued in 9MFY19, as the Company's revenues clocked in at PKR 4,856mln, posting a growth of ~21%. This is mainly attributable to rupee devaluation and recently completed BMR which has yielded better volumes. In FY18, GoP had incentivized local textile industry with 4% rebate on yarn exports, so the Company pushed for higher exports. However in FY19, unavailability of export rebate and attractive prices in local market has made local sales more feasible which has resulted a decline in exports of the Company.

Margins The Company's gross margin has posted a notable growth (9MFY19: 9.4%, 9MFY18: 6.7%) on account of subsidized utilities and better pricing in local market a factor of rupee devaluation. This was followed by higher than proportionate increase in operating margins (9MFY19: 6.3%, 9MFY18: 3.7%), achieved, on account of lower distribution cost, a factor of declined exports. The Company received dividend income of ~PKR 20mln (9MFY18: PKR 15mln). Meanwhile, finance cost has increased significantly (9MFY19: PKR 319mln, 9MFY18: PKR 71mln) due to increased STB for working capital as well as higher interest rate. Abnormally high finance cost has restricted the Company's profitability as its bottom line stood at PKR 76mln in 9MFY19, reporting a minimal growth of ~7% on YoY basis.

Sustainability The Company has incurred BMR of PKR 1,406mln in FY18, which include replacement of 25,200 obsolete spindles with fully automated latest spindles. This has yielded automation, energy efficiency and wider product range, eventually adding to the Company's margins. Going forward, the Company's profitability is expected to remain limited; constrained by higher finance cost and lower demand of yarn in international market, especially from China. Meanwhile, the Company has an investment portfolio of ~PKR 498mln which constitutes 32% of its equity base in 9MFY19.

Financial Risk

Working Capital In 9MFY19, the Company's reliance on STB has increased (9MFY19: PKR 1,932mln, 9MFY18: PKR 1,423mln), on the back of higher cotton prices and increased working capital needs, a factor of recently completed BMR. At the same time, STB remains well covered when compared to net trade assets (9MFY19: 28%, 9MFY18: 27%). In addition to this, considerable increase in inventory days, lead to higher gross working capital days (9MFY19: 146days, 9MFY18: 106days); though remain in line with other industry players.

Coverages During 9MFY19, the Company's operating cash flows (FCFO) increased by ~64% (9MFY19: PKR 463mln, 9MFY18: PKR 211mln), largely led by improved profitability. Meanwhile, the interest expense has almost tripled, resulting in deteriorated interest coverage (9MFY19: 2.2x, 9MFY18: 3.1x); though remained modest. Likewise, debt coverage has witnessed a decline (9MFY19: 1.4x, 9MFY18: 1.6x). Going forward, higher reliance on STB for working capital may stretch the Company's coverages, amid higher interest rates.

Capitalization The Company has significantly leveraged capital structure ~71.5% in 9MFY19 (9MFY18: 66.0%), the total debt stood at PKR 3.86bln with STB constituting 50%.



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Financial Summary

PKR mln

Ellcot Spinning Mills Limited Spinning	Mar-19 9M	Jun-18 12M	Jun-17 12M	Jun-16 12M
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A BALANCE SHEET

1 Non-Current Assets	2,512	2,652	1,180	1,221
2 Investments	498	451	546	120
3 Related Party Exposure	-	-	-	-
4 Current Assets	3,065	3,140	1,628	1,530
a Inventories	2,026	1,821	850	738
b Trade Receivables	494	741	390	281
5 Total Assets	6,075	6,243	3,354	2,870
6 Current Liabilities	532	431	293	251
a Trade Payables	57	46	31	35
7 Borrowings	3,862	4,129	1,490	1,082
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	143	134	122	119
10 Net Assets	1,539	1,549	1,449	1,418
11 Shareholders' Equity	1,539	1,549	1,449	1,418

B INCOME STATEMENT

1 Sales	4,756	5,563	4,869	4,228
a Cost of Good Sold	(4,308)	(5,156)	(4,552)	(3,983)
2 Gross Profit	449	407	317	245
a Operating Expenses	(147)	(175)	(144)	(141)
3 Operating Profit	301	231	173	104
a Non Operating Income	(6)	16	5	5
4 Profit or (Loss) before Interest and Tax	295	247	178	109
a Total Finance Cost	(219)	(115)	(58)	(51)
b Taxation	-	(1)	(43)	12
6 Net Income Or (Loss)	76	131	77	70

C CASH FLOW STATEMENT

a Free Cash Flows from Operations (FCFO)	463	332	264	169
b Net Cash from Operating Activities before Working Capital Changes	278	281	233	126
c Changes in Working Capital	260	(1,352)	(234)	(323)
1 Net Cash provided by Operating Activities	538	(1,071)	(2)	(197)
2 Net Cash (Used in) or Available From Investing Activities	(151)	(1,530)	(528)	(240)
3 Net Cash (Used in) or Available From Financing Activities	(332)	2,593	369	465
4 Net Cash generated or (Used) during the period	54	(8)	(161)	28

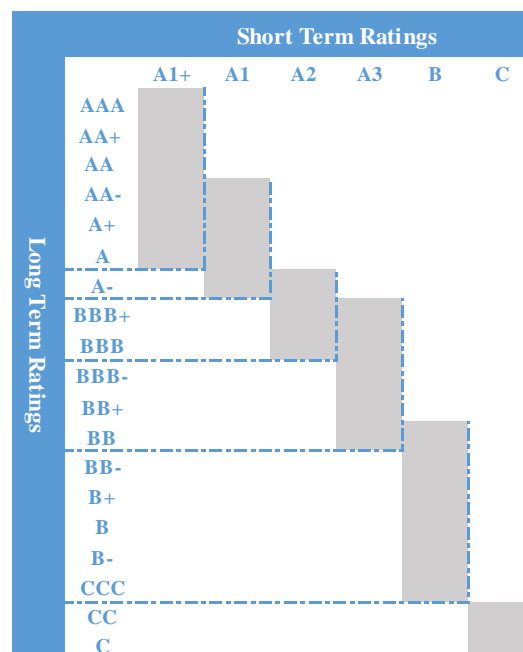
D RATIO ANALYSIS

1 Performance				
a Sales Growth (for the period)	14.0%	14.3%	15.2%	-7.9%
b Gross Profit Margin	9.4%	7.3%	6.5%	5.8%
c Net Profit Margin	1.6%	2.3%	1.6%	1.7%
d Cash Conversion Efficiency (EBITDA/Sales)	11.0%	6.8%	6.4%	5.4%
e Return on Equity (ROE)	6.6%	8.7%	5.3%	5.0%
2 Working Capital Management				
a Gross Working Capital (Average Days)	146	125	85	82
b Net Working Capital (Average Days)	143	122	82	79
c Current Ratio (Total Current Assets/Total Current Liabilities)	5.8	7.3	5.5	6.1
3 Coverages				
a EBITDA / Finance Cost	2.5	3.4	5.7	4.8
b FCFO / Finance Cost+CMLTB+Excess STB	1.4	1.5	2.1	1.2
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	5.7	8.6	2.7	5.1
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	71.5%	72.7%	50.7%	43.3%
b Short-Term Borrowings / Total Borrowings	0.5	0.5	0.6	0.4
c Average Borrowing Rate	7.0%	3.9%	4.3%	5.7%

Credit Rating Scale & Definitions

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings		Short Term Ratings	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
AA+	Very high credit quality. Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.	A1	A strong capacity for timely repayment.
AA		A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
AA-		A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
A+	High credit quality. Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.	B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
A		C	An inadequate capacity to ensure timely repayment.
A-			
BBB+	Good credit quality. Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.		
BBB			
BBB-			
BB+	Moderate risk. Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.		
BB			
BB-			
B+	High credit risk. A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.		
B			
B-			
CCC	Very high credit risk. Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.		
CC			
C			
D	Obligations are currently in default.		



Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.	Rating Watch Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.	Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.	Withdrawn A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults, or/and f) PACRA finds it impractical to surveil the opinion due to lack of requisite information.	Harmonization A change in rating due to revision in applicable methodology or underlying scale.
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Disclaimer: PACRA's ratings are an assessment of the credit standing of entities/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA's opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security's market price or suitability for a particular investor.

Rating Team Statements

(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) Conflict of Interest

- i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
- ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
- iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term “family members” shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions

- (3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
- (4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
- (5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business

- (6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
- (7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
- (8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
- (9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
- (10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
- (11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

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- (12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA’s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
- (13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers’ associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
- (14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
- (15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
- (16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst’s area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
- (17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review

- (18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
- (19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
- (20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
- (21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)

Probability of Default

(22) PACRA’s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA’s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA’s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)

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