The Pakistan Credit Rating Agency Limited

Rating Report

Ellcot Spinning Mills Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
24-Sep-2021	A-	A2	Stable	Maintain	-
25-Sep-2020	A-	A2	Stable	Maintain	-
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

Ellcot Spinning Mills Limited, incorporated in 1988 as public limited company, is a part of one of the oldest medium-sized textile group in Pakistan - Nagina Group. The group has presence in local spinning and weaving sector through Nagina Cotton Mills Limited and Prosperity Weaving Mills Limited. The Company is engaged in production of cotton and blended yarn and operates with a spinning unit comprising 61,968 spindles. The ratings reflect Ellcot Spinning's improving business profile; as evident by increased profitability. During 9MFY21, the Company’s revenues increased by ~10% YoY, to stand at PKR 4.9bln on account of enhanced capacity utilization and concerted management efforts towards increased profitability. The Company largely caters to the needs of local market and it has developed a reputable clientele over the years. During the period, margins have improved along with increased net income of PKR 451mln. Improved profitability and reduced finance cost have strengthened the cashflows and the coverages. Moreover, the Company's reliance on short-term borrowings have decreased on account of better cashflows. However, the Company's capital structure possess modest leveraging. Prices have also improved on both local and international fronts recently along with increased demand. The Company is expected to benefit from these improved industry dynamics in the medium run. The assigned ratings derive comfort from Ellcot Spinning’s association with Nagina Group. Textile exports of the country recorded a double-digit increase of ~23% for FY21 to stand at USD 15.4bln as compared to USD 12.5bln in FY20 due to an increase in demand for textile products internationally, led by good recovery around the globe post-pandemic. Going forward, the textile sector’s outlook is expected to stay stable in the medium term where the demand for textile products is expected to increase. The probability of little attrition in demand remains on the horizon attributable to the outbreak of COVID-19 variants.

The ratings are dependent on the Company’s ability to increase business margins through operational efficiencies and product quality. Meanwhile, any significant deterioration of cashflows culminating in notable impact on the coverages may affect the ratings. Prudent management of investment portfolio is also critical.

Disclosure	
Name of Rated Entity	Ellcot Spinning Mills Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating(Jun-21),Criteria | Correlation Between Long-term & Short-term Rating Scales(Jun-21),Criteria | Rating Modifiers(Jun-21)
Related Research	Sector Study | Spinning(Sep-20)
Rating Analysts	Sehar Fatima | sehar.fatima@pacra.com | +92-42-35869504

Profile

Legal Structure Ellcot Spinning Mills Limited (Ellcot) was incorporated in 1988 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 61,968 Spindles. The total energy requirement of the Company is ~6MW which is wholly met through captive plant; comprising ~5.3MW gas-based, ~3MW diesel-based and ~4.6MW furnace oil-based grantors. Furthermore, the Company has LESCO connection as alternative source.

Ownership

Ownership Structure Ellcot is majorly (~71%) 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, however the transfer of ownership to the next generation is not documented. Moreover, third generation is already in business, serving at various positions.

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; i) Ellcot Spinning Mills, ii) Prosperity Weaving Mills, and iii) Nagina Cotton Mills Limited and six private limited companies. Nagina Group's private limited companies include Monell (Pvt.) Limited, Icaro (Pvt.) Limited, Haroon Omer (Pvt.) Limited, Ellahi International (Pvt.) Limited, ARH (Pvt.) Limited, and Pacific Industries (Pvt.) Limited.

Governance

Board Structure Ellcot's board comprises ten members out of which five members are non-executive and two members occupy executive roles including CEO, while three directors are 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.

Board Effectiveness Three committees: Audit, Executive and Human Resource & Remuneration, are in place to assist the board in relevant matters and ensure proper oversight.

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 FY20.

Management

Organizational Structure The management team is headed by the CEO Mr. Haroon Shahzada Ellahi Sheikh. The organizational structure of the Company is divided into various functional departments, namely; (i) Marketing, (ii) Finance, (iii) Accounts, (iv) Administration & Corporate, (v) Commercial (fixed asset procurement), (vi) Export, and (vii) Internal Audit.

Management Team Mr. Haroon Shahzada Ellahi Sheikh is CEO of the Company. He is well verse with the textile business and has strong business acumen. He is supported by a team of seasoned professionals, supplementing his expertise. Mr. Shafqat Ellahi Shaikh is the Executive Director. He is associated with Ellcot Spinning since its inception, he is well verse with the textile business and has strong business acumen.

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. The Company's MIS can be classified into three categories on the basis of periodicity – Daily, Weekly and Monthly.

MIS Nagina Cotton, partnering with A.F. Ferguson implemented an Oracle-based ERP solution – Oracle E-Business Suite 12.1.3 – with five operational modules including i) Order management, ii) Procurement, iii) Inventory, iv) Fixed Assets, and v) Cash management.

Control Environment The Company is accredited with multiple certifications for compliance and quality assurance, namely; 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 Textile exports of the country recorded a double digit increase of ~23% for FY21 to stand at USD 15.4bln as compared to USD 12.5bln in FY20 due to increase in demand for textile products internationally, Led by good recovery around the globe post pandemic. Going forward, the textile sector's outlook is expected to stay stable in the medium term where the demand for textile products is expected to increase. The probability of little attrition in demand remains on horizon attributable to outbreak of COVID-19 variants. In the local market, textile sector has recorded strong performance. The relief measures introduced by State Bank of Pakistan such as, deferment of loan payments for one-year, low interest rates and salary refinance scheme also provided comfort to the sector.

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 Revenue grew by ~10% (9MFY21: PKR 4,863mln; 9MFY20: PKR 4,863mln) on the back of improved prices when compared with same period last year. The Company followed a sales mix dominated by local revenue, whereas exports constituted only ~16% in 9MFY21 (9MFY20: 17%).

Margins During 9MFY21, gross margin experienced a significant improvement (9MFY21: 15.2%; 9MFY20: 12.4%) on the back higher prices. This translated in to improved operating margin (9MFY21: 11.1%; 9MFY20: 8.9%). Net margin also registered a significant improvement (9MFY21: 8.4%; 9MFY20: 5.0%) attributable to increased gross profit accompanied by reduced finance cost (9MFY21: PKR 93mln; 9MFY20: PKR 143mln); resulting in increased net income (9MFY21: 451mln; 9MFY20: 242mln). The Company also has a small investment portfolio worth PKR 297mln (9MFY20: 373mln), which includes equity investments as well as investment in mutual funds.

Sustainability The management of the company is focusing on efficient sales mix and product differentiation strategy along with consistent monitoring of areas where measures can be taken to reduce cost and enhance the value of the company through profitably and market growth. With the financial support schemes implemented by the Government, coupled with reduced policy rates by SBP, Ellcot Spinning is able to maneuver through the difficulties posed by the pandemic.

Financial Risk

Working Capital In 9MFY21, net working capital cycle largely remained stagnant at 117 days (9MFY20: 118 days). Furthermore, room-to-borrow at the trade level significantly increased (9MFY21: PKR 2,181mln; 9MFY20: PKR 1,224mln) due to a significant contraction in short-term borrowing (9MFY21: PKR 255mln; 9MFY20: PKR 1,552mln); culminating in higher ST trade leverage adequacy (9MFY21: ~86%; 9MFY20: ~43%).

Coverages The Company recorded higher free cash flows (9MFY21: PKR 757mln; 9MFY20: PKR 588mln) on account of improved profitability; coupled with reduced finance cost (9MFY21: PKR 93mln; 9MFY20: PKR 143mln). This significantly strengthened interest coverage (9MFY21: 8.3x; 9MFY20: 4.2x) and marginally strengthened debt coverage (9MFY21: 1.9x; 9MFY20: 1.8x).

Capitalization Ellcot Spinning fulfills its working capital needs through a mix of internal cash flows and short term borrowing. During 9MFY21, Company's leverage decreased to ~56% (9MFY20: ~67%), but remained adequately high. The total debt decreased and stood at PKR 2,819mln (9MFY20: PKR 3,509mln); out of which, short term borrowing constituted only ~9% (9MFY20: ~44%).

Cash Flows & Coverages

Liquidity

Capital Structure

PKR mln

Ellcot Spinning Mills Limited Spinning	Mar-21 9M	Jun-20 12M	Jun-19 12M	Jun-18 12M
A BALANCE SHEET				
1 Non-Current Assets	2,725	2,460	2,460	2,652
2 Investments	297	353	558	451
3 Related Party Exposure	-	-	-	-
4 Current Assets	2,788	2,564	2,575	3,140
a Inventories	*1,964*	*1,743*	*1,510*	*1,821*
b Trade Receivables	*510*	*552*	*548*	*741*
5 Total Assets	5,810	5,377	5,593	6,243
6 Current Liabilities	554	642	504	431
a Trade Payables	*94*	*107*	*47*	*46*
7 Borrowings	2,819	2,833	3,357	4,129
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	173	148	98	134
10 Net Assets	2,264	1,755	1,634	1,549
11 Shareholders' Equity	2,264	1,755	1,634	1,549
B INCOME STATEMENT				
1 Sales	5,361	6,153	6,347	5,563
a Cost of Good Sold	*(4,545)*	*(5,395)*	*(5,706)*	*(5,156)*
2 Gross Profit	816	758	641	407
a Operating Expenses	(223)	(215)	(207)	(175)
3 Operating Profit	593	543	433	231
a Non Operating Income or (Expense)	*29*	*8*	*19*	*16*
4 Profit or (Loss) before Interest and Tax	622	551	452	247
a Total Finance Cost	*(93)*	*(189)*	*(285)*	*(115)*
b Taxation	*(78)*	*(135)*	*37*	*(1)*
6 Net Income Or (Loss)	451	226	205	131
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*757*	*803*	*657*	*341*
b Net Cash from Operating Activities before Working Capital Changes	*649*	*803*	*398*	*290*
c Changes in Working Capital	*(263)*	*2*	*720*	*(1,352)*
1 Net Cash provided by Operating Activities	386	805	1,118	(1,062)
2 Net Cash (Used in) or Available From Investing Activities	(309)	(51)	(170)	(1,530)
3 Net Cash (Used in) or Available From Financing Activities	(48)	(858)	(836)	2,593
4 Net Cash generated or (Used) during the period	29	(103)	112	1
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	16.2%	-3.1%	14.1%	14.3%
b Gross Profit Margin	15.2%	12.3%	10.1%	7.3%
c Net Profit Margin	8.4%	3.7%	3.2%	2.3%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	9.2%	13.1%	21.7%	-18.2%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	27.6%	12.6%	11.8%	11.0%
2 Working Capital Management				
a Gross Working Capital (Average Days)	122	129	133	128
b Net Working Capital (Average Days)	117	125	130	126
c Current Ratio (Current Assets / Current Liabilities)	5.0	4.0	5.1	7.3
3 Coverages				
a EBITDA / Finance Cost	9.2	4.3	2.6	3.5
b FCFO / Finance Cost+CMLTB+Excess STB	1.9	3.1	1.3	1.6
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	2.9	3.3	5.0	8.2
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	55.5%	61.7%	67.3%	72.7%
b Interest or Markup Payable (Days)	97.0	94.5	54.6	170.2
c Entity Average Borrowing Rate	3.9%	6.0%	7.2%	3.9%

Credit Rating

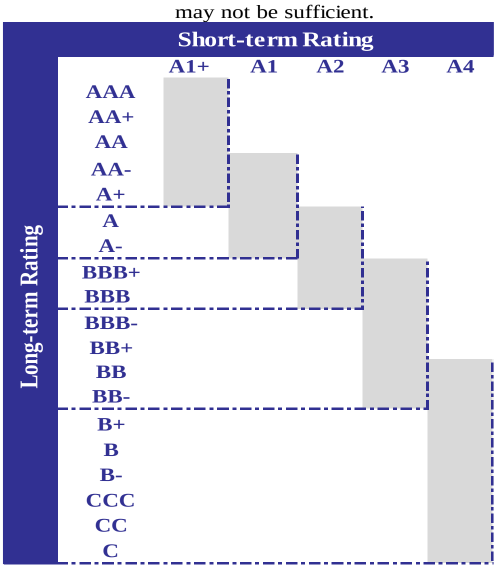
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA 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.
A+ A 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.
BBB+ BBB 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.
BB+ BB 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.
B+ B 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.
CCC CC C	**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.
D	Obligations are currently in default.

Short-term Rating

Scale	Definition
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

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 some material identifiable event with indeterminable rating implications. 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 rating 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) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

Entities
a) Broker Entity Rating
b) Corporate Rating
c) Financial Institution Rating
d) Holding Company Rating
e) Independent Power Producer Rating
f) Microfinance Institution Rating
g) Non-Banking Finance Companies (NBFCs) Rating

Instruments
a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk Rating

Regulatory and Supplementary Disclosure

(Credit Rating Companies Regulations,2016)

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

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(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)

Independence & Conflict of interest

(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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