The Pakistan Credit Rating Agency Limited

Rating Report

Nagina Cotton Mills Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
25-Sep-2020	A-	A2	Stable	Maintain	-
28-Sep-2019	A-	A2	Stable	Maintain	-
30-Mar-2019	A-	A2	Stable	Maintain	-
23-Nov-2018	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Nagina Cotton Mills Limited, incorporated in 1967 as public limited company, is the flagship company of the one of the oldest medium-sized textile group in Pakistan - Nagina Group. The ratings reflect Nagina Cotton's adequate business profile. The Company’s revenues are on growing trajectory over the years, a factor of continuous BMR translating into operational efficiencies and higher production volumes. Topline, during 9MFY20, grew ~19%, however, higher raw material prices and operating expenses, couple with increased finance cost led to reduced margins. Moreover, the Company's operations came to a halt for an entire week during the last quarter of FY20, as a result of the COVID-19 outbreak and nationwide lockdown imposed. The entire textile chain suffered due to lockdowns in Pakistan and internationally. Production resumed on 7th April, 2020; since the Government allowed export-oriented sector to recommence operations, which included Nagina Cotton Mills Limited. Meanwhile, the Company's financial profile is constrained by stretched working capital cycle and significantly high leverage with adequate coverages. Nagina Cotton's investment portfolio exposes the Company to market risk; which is evident from the portfolio performance during 9MFY20; due to pandemic induced volatility in stock market. Any significant losses booked against the investments may have an impact on the financial profile of the Company. The management’s ability to manage this risk is critical. Going forward, the Company's leveraging is expected to increase due to debt based BMR/Expansion. SBP's concessionary rates will be applicable on the incoming debt. The demand is beginning to recover, prompting price correction by market forces, which is allowing the yarn prices to gradually recuperate; both locally and internationally. Nonetheless, the likelihood of a second wave of pandemic is also lurking around; which is a cause of concern for a few countries around the world, while some other economies have reopened. The assigned ratings derive comfort from Nagina Cotton’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 profitability under the current, pandemic-led, economic slowdown. At the same time, prudent management of investment portfolio is also critical.

Disclosure	
Name of Rated Entity	Nagina Cotton Mills Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-20),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria | Rating Modifier(Jun-20)
Related Research	Sector Study | Spinning(Sep-19)
Rating Analysts	Adil Kaleem | adil.kaleem@pacra.com | +92-42-35869504

Profile

Legal Structure Nagina Cotton Mills Limited (Nagina Cotton) was incorporated in 1967 as a public limited company.

Background Nagina Cotton is the pioneer company of Nagina Group. Over the period the Group has managed to grow from a single spinning company to multiple spinning entities and a weaving company.

Operations Nagina Cotton's current operational capacity comprises 53,748 Spindles. The total energy requirement of the Company is ~6.4MW which is Wholly met through captive plant. Furthermore, the Company has a HESCO connection as backup.

Ownership

Ownership Structure Nagina Cotton is majorly (~83%) owned by Nagina Group, through group companies and sponsoring individuals. The remaining stake of the Company 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 yet to be seen. Meanwhile, 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 capacities 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 Nagina Cotton's board constitutes nine members out of which four are non-executive, three occupy executive roles, including the CEO and CFO, while two directors are independent.

Members' Profile Mr. Shahzada Ellahi Shaikh – the Chairman – holds a bachelor's degree in Economics & International Relations. The board member carries vast knowledge and diversified experience. The directors' expertise in textile sector 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 remained 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. Deloitte Yousuf Adil, Chartered Accountants are the external auditors of the Company.

Management

Organizational Structure Management control vests with Ellahi Family, with well-defined reporting line. The Company's organizational structure is broadly divided into five operational departments with all HoD's reporting directly to the CEO.

Management Team In January, 2020, Mr. Amin Ellahi Shaikh replaced his uncle; Mr. Shaukat Ellahi Shaikh as the CEO of Nagina Cotton. Mr. Amin Ellahi has ten years of experience in textile sector, working in non-executive roles on the boards of other group companies.

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 Textile exports of the country increased by ~14% for 1MFY21 to stand at ~USD 1.3bln as compared to ~USD 1.1bln in 1MFY20. Although the demand for textile products internationally deteriorated on account of lock downs in major export destinations, the export market had under-performed in 1MFY20. Furthermore, economies around the world have been gradually reopening as businesses recommenced in the past month. Hence, the exports in 1MFY21, experienced an upward trend despite prior lockdowns. Going forward, uncertainty still prevails with regards to full resumption of businesses around the globe and a return to normality. Locally, textile sector has found comfort in relief measures introduced by State Bank of Pakistan such as, deferment of loan payments for one year, low interest rates and salary refinance scheme.

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 Nagina Cotton's market position.

Revenues During 9MFY20, volumetric increase in sales and better prices boosted revenue by ~19% YoY, standing at PKR 5,937mln (9MFY19: PKR 4,976mln). Moreover, the sales mix displayed slightly more focus on exports (9MFY20: 57%; 9MFY19: 51%). The Company enjoys low concentration risk as its top customer only constitutes ~7% of the total sales.

Margins Nagina Cotton experienced a decline in gross margin (9MFY20: 9.0%; 9MFY19: 10.5%), despite an increase in revenue. This occurred as the proportionate increase in cost of sales; led by increased raw material and fuel prices, was higher than that registered by the revenue. Moreover, elevated operational expenses resulted in reduced operating margin (9MFY20: 5.3%; 9MFY19: 6.7%). The Company did receive a dividend and rental income in the region of ~PKR 50mln in total. However, due to higher finance cost (9MFY20: PKR 202mln; 9MFY19: PKR 148mln), the non-operational income could not provide the necessary safety and the Company recorded a reduction in net margin (9MFY20: 1.3%; 9MFY19: 2.9%), resulting in net income of PKR 80mln (9MFY19: PKR 147mln).

Sustainability Due to the lockdown enforced by the Government, the production had shut down for a week ending on 7th April, 2020; after which, the Company was partially operation. The pandemic had caused the demand to deteriorate around the world, which had reduced yarn prices globally. However, off late, the demand has started to recover and yarn prices are bouncing back. With the financial support schemes implemented by the Government, coupled with reduced policy rates by SBP, Nagina Cotton is able to maneuver through the difficulties posed by the pandemic. Going forward, the Company projects the revenue to end up at PKR 6,014mln in FY20; with a significant increase expected in FY21; resulting in PKR 7,276mln in sales. However, the margins are projected to decline slightly in FY21 due to forecasted higher raw material prices.

Financial Risk

Working Capital The Company fulfills its working capital requirement through a mix of internal cash generation and short-term borrowing; however, the reliance on STB is significant. During 9MFY20, the Company's net working capital cycle widened (9MFY20: 142 days; 9MFY19: 140 days), on account of higher inventory level (9MFY20: PKR 2,918mln; 9MFY19: PKR 1,937mln). Moreover, net trade assets also increased due to the same reason (9MFY20: PKR 4,123mln; 9MFY19: PKR 3,207mln). This expanded the room-to-borrow (9MFY20: PKR 1,659mln; 9MFY19: PKR 1,323mln), however, ST trade leverage adequacy still experienced an insignificant decline (9MFY20: ~39%; 9MFY19: 40%) on account of higher proportionate increase in net trade assets when compared with room-to-borrow.

Coverages Nagina Cotton witnessed a decline in free cash flows (9MFY20: PKR 377mln; 9MFY19: PKR 388mln) on account of lower profitability. This, along with higher finance cost (9MFY20: PKR 202mln; 9MFY19: PKR 148mln), culminated in shrunken interest coverage (9MFY20: 2.0x; 9MFY19: 2.9x); however, it remained healthy. Debt coverage experienced a similar fate (9MFY20: 1.4x; 9MFY19: 1.5x).

Capitalization The Company maintains a highly leveraged capital structure. The leverage, during 9MFY20, increased to ~71% (9MFY19: 58%), on the back of LT finance taken out for expansion project. The total debt stands at PKR 4,660mln (9MFY19: PKR 2,558mln); out of which, short-term borrowing constitutes ~53% (9MFY19: 73%). Whereas, ~23% of the total debt is borrowed at SBP's concessionary rates.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Nagina Cotton Mills Limited	Mar-20	Jun-19	Jun-18	Jun-17
Textile	9M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	3,008	2,022	1,440	1,555
2 Investments	366	474	461	549
3 Related Party Exposure	-	-	-	-
4 Current Assets	4,591	3,321	3,030	1,553
a Inventories	*2,918*	*1,200*	*1,234*	*716*
b Trade Receivables	*577*	*1,636*	*954*	*455*
5 Total Assets	7,965	5,817	4,931	3,657
6 Current Liabilities	1,261	1,052	795	600
a Trade Payables	*83*	*70*	*61*	*57*
7 Borrowings	4,660	2,622	2,169	1,216
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	127	119	100	85
10 Net Assets	1,917	2,024	1,867	1,756
11 Shareholders' Equity	1,917	2,024	1,867	1,756
B INCOME STATEMENT				
1 Sales	5,937	6,932	5,879	5,242
a Cost of Good Sold	*(5,401)*	*(6,100)*	*(5,364)*	*(4,889)*
2 Gross Profit	536	832	514	353
a Operating Expenses	(222)	(267)	(216)	(214)
3 Operating Profit	315	566	298	139
a Non Operating Income	*44*	*9*	*43*	*36*
4 Profit or (Loss) before Interest and Tax	359	575	341	175
a Total Finance Cost	*(202)*	*(213)*	*(117)*	*(64)*
b Taxation	*(77)*	*(53)*	*(65)*	*(32)*
6 Net Income Or (Loss)	80	309	158	78
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*377*	*614*	*394*	*234*
b Net Cash from Operating Activities before Working Capital Changes	*194*	*486*	*346*	*202*
c Changes in Working Capital	*(1,194)*	*(391)*	*(778)*	*(49)*
1 Net Cash provided by Operating Activities	(1,000)	95	(432)	153
2 Net Cash (Used in) or Available From Investing Activities	(1,075)	(843)	33	(539)
3 Net Cash (Used in) or Available From Financing Activities	1,945	379	899	371
4 Net Cash generated or (Used) during the period	(129)	(369)	500	(15)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	14.2%	17.9%	12.1%	--
b Gross Profit Margin	9.0%	12.0%	8.7%	6.7%
c Net Profit Margin	1.3%	4.5%	2.7%	1.5%
d Cash Conversion Efficiency (EBITDA/Sales)	8.3%	10.5%	7.9%	5.8%
e Return on Equity (ROE)	5.4%	15.9%	8.7%	4.5%
2 Working Capital Management				
a Gross Working Capital (Average Days)	146	132	104	78
b Net Working Capital (Average Days)	142	129	101	74
c Current Ratio (Total Current Assets/Total Current Liabilities)	3.6	3.2	3.8	2.6
3 Coverages				
a EBITDA / Finance Cost	2.6	3.6	4.3	5.3
b FCFO / Finance Cost+CMLTB+Excess STB	1.4	1.7	1.6	1.4
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	8.9	2.9	2.8	5.1
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	70.9%	56.4%	53.7%	40.9%
b Short-Term Borrowings / Total Borrowings	0.5	0.6	0.6	0.3
c Average Borrowing Rate	7.0%	8.5%	6.3%	4.7%

Credit Rating

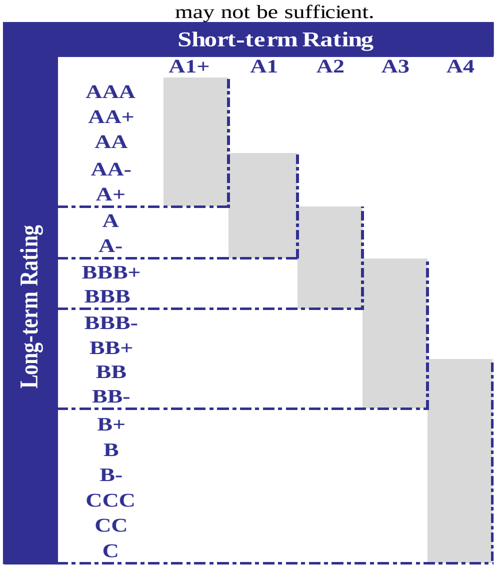
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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

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)

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)

Proprietary Information