The Pakistan Credit Rating Agency Limited

Rating Report

Ellcot Spinning Mills Limited

Report Contents

1. Rating Analysis
2. Financial Information
3. Rating Scale
4. Regulatory and Supplementary Disclosure

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
23-Sep-2022	A-	A2	Stable	Maintain	-
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 a public limited company, is a part of one of the oldest medium-sized textile groups in Pakistan - Nagina Group. The group has a presence in the local spinning and weaving sector through Nagina Cotton Mills Limited and Prosperity Weaving Mills Limited. The Company is engaged in the production of cotton and blended yarn and operates with a spinning unit comprising 62,400 spindles. The ratings reflect Ellcot Spinning's improving business profile; as evident by increased profitability. During 9MFY22, the Company's revenue increased by 48% YoY to stand at PKR 7.9bln on account of enhanced capacity utilization and concerted management efforts towards profitability. The Company largely caters to the needs of the local market and it has developed a reputable clientele over the years. During the period, margins have improved along with an increased net income of PKR 1,185mln. Improved profitability has strengthened the cashflows and coverages. Moreover, the Company's reliance on short-term borrowings has enhanced. However, the Company's capital structure reflects modest leveraging. The financial risk matrix of the company has shown improvement over the years. The assigned ratings derive comfort from Ellcot Spinning's association with the Nagina Group. During FY22, Pakistan's textile exports surged to $19.3bln (recording a growth of 26%). Exports grew owing to increased volumetric growth of (16% YoY) in the value-added segment, a steep rise in global demand, and record high cotton prices. Under the value-added category, the knitwear segment remained the top performer by posting 34% YoY growth in exports to $5.1 billion in FY22 due to a sharp rise in global demand, especially in the US and European countries. Other value-added segments such as ready-made garments, bed wear, and towel posted YoY growth of 29%, 19%, and 19% to $3.9 billion, $3.3 billion, and $1.1 billion respectively. However, a slowdown is expected in textile demand amid burgeoning inflationary pressures in the exporting destinations, especially in the US and European countries.

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. The equity base of the company is satisfactory and should be beefed up, going forward.

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-22),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jun-22),Methodology | Rating Modifiers(Jun-22)
Related Research	Sector Study | Spinning(Sep-21)
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 62,400 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 (70.93%) 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 FY21; whereas audit of the financial statements for FY22 is underway.

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 OEKOTEX, Global Organic Textile Standards (GOTS), Organic Content Standard, Organic Content Standard 100, and Organic Content Standard Blended.

Business Risk

Industry Dynamics During FY22, Pakistan's textile exports surged to $19.3bln (recording a growth of 26%). Exports grew owing to increased volumetric growth of (16% YoY) in the value-added segment, a steep rise in global demand, and record high cotton prices. Under the value-added category, the knitwear segment remained the top performer by posting 34% YoY growth in exports to $5.1 billion in FY22 due to a sharp rise in global demand, especially in the US and European countries. Other value-added segments such as ready-made garments, bed wear, and towel posted YoY growth of 29%, 19%, and 19% to $3.9 billion, $3.3 billion, and $1.1 billion respectively. However, a slowdown is expected in textile demand amid burgeoning inflationary pressures in the exporting destinations, especially in the US and European countries.

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 114,108 spindles which strengthens Ellcot’s market position. However, on standalone basis, Ellcot’s share in local spinning industry is minimal.

Revenues During 9MFY22, the company's revenue grew by 48% to stand at PKR 7,924mln; (9MFY21: PKR 5,361mln) on the back of improved prices. The company followed a sales mix dominated by local revenue, whereas exports constituted only 1% (9MFY21: 16%).

Margins During 9MFY22, gross margin experienced a significant improvement to stand at 23.7% (9MFY21: 15.2%) on the back improved prices. This translated into improved operating margin at 20.9% (9MFY21: 11.1%). Net margin also registered a significant improvement to 15% (9MFY21: 8.4%) attributable to increased gross profit. Finance cost increased to PKR 116mln (9MFY21: PKR 93mln) due to hike in policy rate. Net income increased to PKR 1,184mln (9MFY21: 451mln).

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. BMR/ expansion program of the company is continuing at a steady pace. At end-Mar22, 25,200 spindles have been installed and has started production. Further 16,800 spindles will be added to production during FY23. The total installed production capacity will be increased to 79,200 spindles.

Financial Risk

Working Capital At end-Mar22, net working capital cycle largely remained stagnant at 101 days (FY21: 100 days). Furthermore, room-to-borrow at the trade level significantly increased to stand at PKR 4,129mln (FY21: PKR 2,292mln) due to a significant increase in trade assets (9MFY22: PKR 5,215mln; FY21: PKR 2,399mln); culminating in lower ST trade leverage adequacy (9MFY22: 79%; FY21: 96%).

Coverages During 9MFY22, the company recorded higher free cash flows, clocking in at PKR 1,697mln (9MFY21: PKR 757mln) on account of improved profitability. Finance cost increased to PKR 116mln (9MFY21: PKR 93mln). Higher FCFO strengthened interest coverage to 15.5x (9MFY21: 8.3x). Subsequently, debt coverage improved 3.9x (9MFY21: 1.9x). Debt payback improved to 1.7 years (9MFY21: 2.9 years).

Capitalization At end-Mar22, the company's leverage increased to 54.9% (FY21: 50.7%), remained adequately high. The total debt increased to stand at PKR 4,528mln (FY21: PKR 2,628mln); out of which, short term borrowing constituted only 22%. The Equity base of the company increased to stand at PKR 3,721mln (FY21: 2,552mln).

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Financial Summary
PKR mln

Ellcot Spinning Mills Limited Textile | Spinning	Mar-22 9M	Jun-21 12M	Jun-20 12M	Jun-19 12M
A BALANCE SHEET				
1 Non-Current Assets	4,176	2,843	2,460	2,460
2 Investments	217	721	353	558
3 Related Party Exposure	-	-	-	-
4 Current Assets	5,541	2,626	2,564	2,575
a Inventories	*2,808*	*1,455*	*1,743*	*1,510*
b Trade Receivables	*1,080*	*639*	*552*	*548*
5 Total Assets	9,934	6,189	5,377	5,593
6 Current Liabilities	1,052	701	642	504
a Trade Payables	*87*	*64*	*107*	*47*
7 Borrowings	4,528	2,628	2,833	3,357
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	633	308	148	98
10 Net Assets	3,721	2,552	1,755	1,634
11 Shareholders' Equity	3,721	2,552	1,755	1,634
B INCOME STATEMENT				
1 Sales	7,923	7,716	6,153	6,347
a Cost of Good Sold	*(6,046)*	*(6,316)*	*(5,395)*	*(5,706)*
2 Gross Profit	1,877	1,399	758	641
a Operating Expenses	(225)	(235)	(215)	(207)
3 Operating Profit	1,652	1,164	543	433
a Non Operating Income or (Expense)	*(66)*	*(32)*	*8*	*19*
4 Profit or (Loss) before Interest and Tax	1,586	1,132	551	452
a Total Finance Cost	*(116)*	*(116)*	*(189)*	*(285)*
b Taxation	*(286)*	*(203)*	*(135)*	*37*
6 Net Income Or (Loss)	1,185	814	226	205
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*1,697*	*1,309*	*803*	*657*
b Net Cash from Operating Activities before Working Capital Changes	*1,596*	*1,168*	*803*	*398*
c Changes in Working Capital	*(2,752)*	*(8)*	*2*	*720*
1 Net Cash provided by Operating Activities	(1,156)	1,160	805	1,118
2 Net Cash (Used in) or Available From Investing Activities	(1,023)	(918)	(51)	(170)
3 Net Cash (Used in) or Available From Financing Activities	2,185	(232)	(858)	(836)
4 Net Cash generated or (Used) during the period	6	10	(103)	112
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	36.9%	25.4%	-3.1%	14.1%
b Gross Profit Margin	23.7%	18.1%	12.3%	10.1%
c Net Profit Margin	15.0%	10.5%	3.7%	3.2%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	-13.3%	16.9%	13.1%	21.7%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Shareholders' Equity)]*	50.4%	37.8%	13.3%	12.9%
2 Working Capital Management				
a Gross Working Capital (Average Days)	103	104	129	133
b Net Working Capital (Average Days)	101	100	125	130
c Current Ratio (Current Assets / Current Liabilities)	5.3	3.7	4.0	5.1
3 Coverages				
a EBITDA / Finance Cost	16.6	12.7	4.3	2.6
b FCFO / Finance Cost+CMLTB+Excess STB	3.9	2.7	3.1	1.3
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	1.7	2.2	3.3	5.0
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	54.9%	50.7%	61.7%	67.3%
b Interest or Markup Payable (Days)	91.8	74.7	94.5	54.6
c Entity Average Borrowing Rate	4.1%	3.7%	6.0%	7.2%

Credit Rating

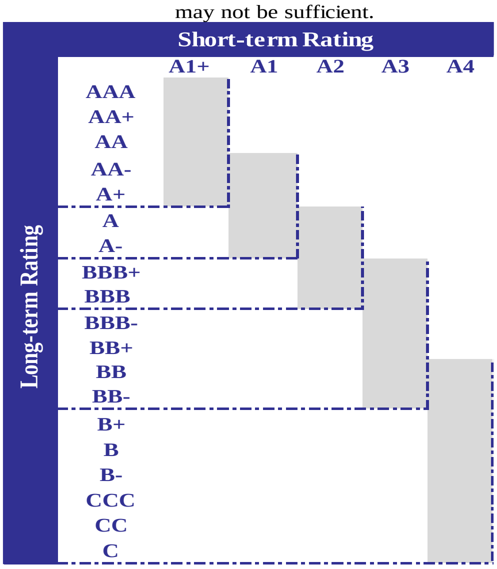
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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 | Clause 11-(A)(p).
(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