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
22-Sep-2023	A-	A2	Stable	Maintain	-
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

The Ellcot Spinning Mills Limited ("the Company" or "ESML") ratings emanate from the strapping profile of the sponsoring group- Nagina group. Three Companies primarily operate under the umbrella of the Nagina group which includes Nagina Cotton Mills Limited, Prosperity Weaving Mills Limited & ESML. The group has a presence in the local & export-oriented spinning and weaving sector through Nagina Cotton Mills Limited, ESML, and Prosperity Weaving Mills Limited. The rating takes comfort from the financial strength of the sponsoring group. The core operating activity of the Company is the production of cotton and blended yarn with a production capacity of 62,400 spindles. The Companies dedicated to spinning only have an inherent risk of 100% single product concentration and dependency on a sole raw material, primarily raw cotton. This situation can lead to potential vulnerabilities in the supply chain if the supply side disrupts. During FY24, the raw cotton production target is estimated to be at 12.80mln bales and the cotton yield is expected to ameliorate this year to supplement local production demand in comparison to last year when a substantial portion of Pakistan had a detrimental impact on cotton crops, potentially posing a barrier to local raw material availability and experience a 55% shortfall in its targeted production of domestic cotton. Availability of electricity at subsidized rates, the surge in tax burden, and massive PKR devaluation are other challenges specific to the industry. Currently, due to the consistent surge in the policy rate, the Company is not expected to execute any CAPEX during FY24. According to the Pakistan Textile Mills Association (APTMA) Pakistan's textile sector exports witnessed a significant decline of 15% in July, clocking in at USD1.3bln compared to USD1.54bln last year. Despite the economic crisis in Pakistan during 9MFY23, the top line of the Company has a growth of 9.0% QoQ basis mainly dominated by local sales and driven by inflationary impact in yarn prices coupled with minute hike in volumetric levels.. The Company primarily caters to the needs of the local market and it has developed a reputable clientele over the years. During the period under review, the elevated cost of production, the surge in energy cost, and the magnifying interest burden have caused a dip in the margins and profitability matrix of the Company. The financial risk profile is considered moderate as the management of inventory at an optimal level to cater for the stable demand of Yarn has augmented the working capital management of the Company. The cash flows of the Company are considered moderate accompanied by adequate coverages. Capital structure is leveraged where borrowings are dominated by long-term borrowings (LTFF) for BMR previously executed and working capital requirements primarily met through internally generated cashflows which supplement the financial risk score.

The ratings are dependent on the Company's ability to increase business margins through operational efficiencies and product quality. The sustainability of cashflows and coverages at a comfortable level remains critical for the ratings along with prudent management of the investment portfolio. Going forward, consistent growth in accumulated profits should supplement the equity levels.

Disclosure	
Name of Rated Entity	Ellcot Spinning Mills Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating(Jul-23),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jul-23),Methodology | Rating Modifiers(Apr-23)
Related Research	Sector Study | Spinning(Sep-22)
Rating Analysts	Muhammad Harris Ghaffar | harris.ghaffar@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 a presence in the 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 a captive plant; comprising ~5.3MW gas-based, ~3MW diesel-based and ~4.6MW furnace oil-based grantors. Furthermore, the Company has a LESCO connection as an 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 the general public

Stability The considerable positions in the Nagina Group are held by the Ellahi Family. The Group has a structured line of succession, however, the transfer of ownership to the next generation is not documented. Moreover, the third generation is already in business, serving in various positions

Business Acumen Nagina Group is one of the oldest medium-sized textile houses in Pakistan. Operating under Ellahi for five decades, developing credential expertise in spinning and weaving over a period of time. The Group has adequately expanded its operations despite the 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 in the 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 an unqualified opinion on the financial statements of the Company for FY22 and an Audit of FY23 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 a daily basis with follow-up points to resolve or proactively address operational issues, if any, eventually ensuring a smooth flow of operations. The Company's MIS can be classified into three categories on the basis of periodicity – Daily, Weekly, and Monthly.

MIS The system has been upgraded from the FOXPRO technology to Oracle systems previously implemented. It allows the user to enter loom-wise packed production of produced fabric efficiently. The system includes Bam Wise's Warping, Sizing, Loom, and Folding Processes recording

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 Exports of Pakistan's textile sector witnessed significant decline of 20%, clocking in at $1.31bln in May in comparison to $1.64bln recorded in the same month of the previous year, as per the provisional data released by the All-Pakistan Textile Mills Association (APTMA). Given the trajectory of decline, Pakistan is liekly to fall short by $3 billion in textile exports from the exports achieved last year of $19.4bln without considering any increase in the newly installed capacity. In addition, economic recession and catastrophic flooding in a substantial portion of Pakistan have had a detrimental impact on cotton crops, potentially posing a barrier to raw material availability. As a result, the cost of production is likely to rise, and as a result, finished goods cost, such as yarn, are predicted to increase as well. Stiff competition from textile-based countries internationally and locally as well. Internationally India is the main competitor as their government gives a rebate of 7% to their exporters of yarn which gives big hit to the Pakistan exporters of yarn.

Relative Position Nagina Group has a long operating history in Pakistan and has developed a prominent position in the local spinning industry. Currently, the Group's spinning capacity stands at 114,108 spindles which strengthens Ellcot's market position. However, on a standalone basis, Ellcot's share in the local spinning industry is minimal.

Revenues During 9MFY23, the company's revenue increased by 9% to stand at PKR 8,633mln (9MFY22: PKR 7,923mln) owing to better yarn prices in international market. The optimal profitability of the company is achieved by assessing better price availability in both the local and international markets, which then determines its sales mix

Margins During FY22, the company's gross margins increased to 19.8% (FY21: 18.1%). This translated into strengthened operating margins clocking in at 17% (FY21: 15.1%). Finance cost increased to stand at PKR 163mln (FY21: PKR 116mln). Net income increased significantly to stand at PKR 1,231mln (FY21: PKR 814mln) owing to strengthened topline. Subsequently, net margin increased (FY22: 11.3%, FY21: 10.5%). During 9MFY23, the company's gross margins decreased to 8.8% (9MFY22: 23.7%). Net margin declined to 3.9% (9MFY22: 15%).

Sustainability The company's management is dedicated to achieving an effective sales mix and implementing a product differentiation strategy. They are also consistently monitoring opportunities for cost reduction and value enhancement, thereby promoting profitability and market growth. The company's BMR/expansion program is progressing steadily.

Financial Risk

Working Capital At the end of March '23, the company's net working capital cycle extended to 129 days (9MFY22: 101 days), mainly on account of higher inventory days (9MFY23: 97 days; 9MFY23: 74 days). Trade assets of the company witnessed a decline of 16% (9MFY23: PKR 4,381mln; 9FY22: PKR 5,215mln) majorly due to lower advances (9MFY23: PKR 188mln; 9MFY22: PKR 1,327mln). ST trade leverage adequacy inclined (9MFY23: 88%; 9MFY22: 79.2%)

Coverages During FY22, the company experienced an increase in operating cash flows clocking in at PKR 1,940mln (FY21: PKR 1,309mln) owing to improved profitability at the operating level. Interest coverage inclined owing to improved FCFO (FY22: PKR 13.4x; FY21: PKR 12x). Likewise, debt coverage also improved (FY22: PKR 3.3x; FY21: PKR 2.7x). During 9MFY23, the company experienced a decrease in operating cash flows clocking in at PKR 643mln (9MFY22: PKR 1,697mln).

Capitalization At end-Mar23, the company's leverage increased slightly to 55.7% (9MFY23: 54.9%) as the total borrowings increased (9MFY23: PKR 4,959mln; 9MFY22: PKR 4,528mln). The equity base of the company increased to stand at PKR 3,938mln (9MFY22: PKR 3,721mln)

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Ellcot Spinning Mills Limited Textile | Spinning	Mar-23 9M	Jun-22 12M	Jun-21 12M	Jun-20 12M
A BALANCE SHEET				
1 Non-Current Assets	5,341	4,082	2,843	2,460
2 Investments	541	635	721	353
3 Related Party Exposure	-	-	-	-
4 Current Assets	4,798	4,664	2,626	2,564
a Inventories	*3,066*	*3,053*	*1,455*	*1,743*
b Trade Receivables	*1,107*	*1,033*	*639*	*552*
5 Total Assets	10,681	9,380	6,189	5,377
6 Current Liabilities	1,104	997	701	642
a Trade Payables	*77*	*66*	*64*	*107*
7 Borrowings	4,959	3,922	2,628	2,833
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	679	722	308	148
10 Net Assets	3,938	3,739	2,552	1,755
11 Shareholders' Equity	3,938	3,739	2,552	1,755
B INCOME STATEMENT				
1 Sales	8,633	10,873	7,716	6,153
a Cost of Good Sold	*(7,870)*	*(8,725)*	*(6,316)*	*(5,395)*
2 Gross Profit	763	2,149	1,399	758
a Operating Expenses	(237)	(302)	(235)	(215)
3 Operating Profit	527	1,846	1,164	543
a Non Operating Income or (Expense)	*24*	*(55)*	*(32)*	*8*
4 Profit or (Loss) before Interest and Tax	551	1,792	1,132	551
a Total Finance Cost	*(128)*	*(163)*	*(116)*	*(189)*
b Taxation	*(87)*	*(398)*	*(203)*	*(135)*
6 Net Income Or (Loss)	335	1,231	814	226
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*643*	*1,940*	*1,309*	*803*
b Net Cash from Operating Activities before Working Capital	*466*	*1,800*	*1,168*	*803*
c Changes in Working Capital	*149*	*(1,888)*	*(8)*	*2*
1 Net Cash provided by Operating Activities	614	(89)	1,160	805
2 Net Cash (Used in) or Available From Investing Activities	(1,446)	(1,485)	(918)	(51)
3 Net Cash (Used in) or Available From Financing Activities	871	1,589	(232)	(858)
4 Net Cash generated or (Used) during the period	39	16	10	(103)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	5.9%	40.9%	25.4%	-3.1%
b Gross Profit Margin	8.8%	19.8%	18.1%	12.3%
c Net Profit Margin	3.9%	11.3%	10.5%	3.7%
d Cash Conversion Efficiency (FCFO adjusted for Working C	9.2%	0.5%	16.9%	13.1%
*e Return on Equity [Net Profit Margin * Asset Turnover * (T*	11.6%	39.1%	37.8%	13.3%
2 Working Capital Management				
a Gross Working Capital (Average Days)	131	104	104	129
b Net Working Capital (Average Days)	129	102	100	125
c Current Ratio (Current Assets / Current Liabilities)	4.3	4.7	3.7	4.0
3 Coverages				
a EBITDA / Finance Cost	6.9	14.7	12.7	4.3
b FCFO / Finance Cost+CMLTB+Excess STB	1.5	3.3	2.7	3.1
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Fi	6.5	1.9	2.2	3.3
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equit	55.7%	51.2%	50.7%	61.7%
b Interest or Markup Payable (Days)	192.0	111.0	74.7	94.5
c Entity Average Borrowing Rate	3.6%	3.8%	3.7%	6.0%

Credit Rating

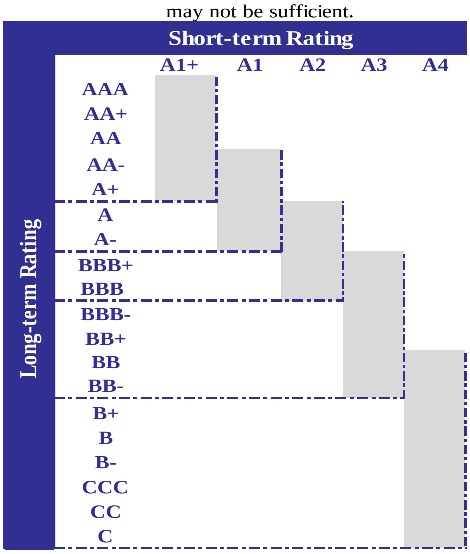
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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):

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