



The Pakistan Credit Rating Agency Limited

Rating Report

Reliance Cotton Spinning Mills Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
14-Apr-2023	A-	A2	Stable	Maintain	-
14-Apr-2022	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The assigned ratings of Reliance Cotton reflect the association of the Company with Sapphire Group and good standalone positioning in the peer universe. The current installed capacity is 57,600 spindles. The Company manufactures a wide variety of premium quality yarn from 6 Ne to 80 Ne (single & double), plied, slubs, mélanges, and blends. Board has seven members, five from sponsoring families and two independent directors. The Company's management has experienced professionals overseeing the operations of the Company, aided by comprehensive reporting. The Company enjoys an established customer base with several export destinations in Italy, Portugal, Argentine, and Bangladesh along with a renowned local customer base. The sales mix, dominated by direct and indirect exports, display improvement over the years. During FY22, the Company's revenues stood at PKR 11.3bln (FY21: PKR 7.6bln); this year reflected a significant increase in operating profits and net profitability while maintaining decent margins. In 1HFY23, the topline clocked in at PKR 4.7bln whilst net profitability clocked in at PKR 695mln where margins witnessed slight adjustments owing to rationalization in the demand pattern and prices. The financial matrix reflects an increase in the net working capital cycle, a decline in coverage though remained comfortable, and a moderate capital structure. During 7MFY23, the textile exports were valued at \$10.08bln compared to \$10.93bln, reflecting an 8% decline YoY – the declining trend has been recorded in the last few months. The decline in exports is driven by attrition in the demand pattern of export avenues. The hike in cotton prices and low demand for yarn in international markets is also a challenge. The analysis of 5MFY23 reveals that among value-added items, bedwear has witnessed the largest decline of 19% (on an MoM basis), down to \$217 million. Knitwear remained on the downward path in October 2022 and declined by 10% to \$392 million. Among non-value-added items, cotton yarn has shown the largest decline of 35%. Moreover, a slowdown is prevailing in textile demand amid burgeoning inflationary pressures in the exporting destinations, especially in the US and European countries. The demand pattern is expected to improve post-Jun-23.

Ratings incorporate the association of the company with the renowned Sapphire Group which enjoys a distinguishing presence in various sectors. The ratings are dependent upon the management's ability to capitalize on growth opportunities in a competitive landscape, operate at an optimal level and sustain margins.

Disclosure

Name of Rated Entity	Reliance Cotton 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-22)
Rating Analysts	Sehar Fatima sehar.fatima@pacra.com +92-42-35869504

Profile

Legal Structure Reliance Cotton Spinning Mills Limited ('Reliance Cotton' or 'the Company') is a public company listed on Pakistan Stock Exchange (PSX). The Company has been operating since July 1992.

Background The Company is a public limited company established in June 1990 under Sapphire Fibers Limited and listed on Pakistan Stock Exchange in June 1993. It manufactures and sells yarn, starting production in July 1992.

Operations Reliance Cotton is a high-quality spinning company with 57,600 spindles and a production capacity of 36.5 million pounds per annum. Its facilities are located in Sheikhpura, and it produces a variety of yarns ranging from 6 Ne to 80 Ne.

Ownership

Ownership Structure The associated companies of Sapphire Group own majority shareholding of the Company i.e., ~65%. The directors directly own 16% of the shareholding whereas the general public owns rest of the shareholding.

Stability Sapphire Group is owned and controlled by Mr. Mohammad Abdullah's four sons, with each having ownership and operational control of their companies. Sapphire Holding Limited manages investments in subsidiaries and associated companies, providing stability for Reliance Cotton.

Business Acumen Founded in 1969 by Mr. Mohammad Abdullah after he migrated to Pakistan, the Group has expanded to become one of the most distinguished business groups in Pakistan. The Group has acquired expertise in textiles ranging from spinning, denim weaving, and finishing to home textiles and garments.

Financial Strength Sapphire Group is one of the largest vertically integrated textiles setups in Pakistan. The group possesses more than 20 companies, with over 16,000 employees and more than 30 production units. The Group's products are marketed to the industry's biggest names in Asia, Europe, Australia, and North America.

Governance

Board Structure Reliance Cotton's board comprises seven members, including the Chairman - Mr. Shahid Abdullah, and Chief Executive Officer (CEO) - Mr. Shayan Abdullah, and two independent directors (one of them is female). Overall, the Board comprises five sponsoring family members. Four of the sponsors are in a non-executive role.

Members' Profile Mr. Shahid Abdullah has been with Sapphire Group since 1980 and has expertise in spinning, weaving, knitting, dyeing, finishing, and power generation. Mr. Shayan Abdullah is the CEO of Reliance Cotton Spinning Mills Limited for the past 12 years.

Board Effectiveness The board meetings have full attendance of directors with properly recorded minutes, boding well for the board's effectiveness. There are two sub-committees in place to assist the Board on relevant matters: Audit Committee and Human Resource Committee. Both committees are chaired by the Independent Director.

Financial Transparency ShineWing Hameed Chaudhri & Co. Chartered Accountants are the external auditors of the company. The auditor is listed in Category "B" of the State Bank's panel of auditors. They have expressed an unqualified opinion on the financial statements of the company for the year ending June 30th, 2022. The Company has also implemented an in-house internal audit function reportable to Audit Committee.

Management

Organizational Structure The Company's overall operations are managed by eleven key management personnel including CEO. Three of them are designated as employed directors. Technical Director is reportable to the Executive Director, who is, in turn, reportable to the Director of Finance/COO. Department heads of ERP, Exports, Local Sales, Accounts, Finance, Tax, and HR also report to the Director of Finance/COO. The Company does not possess any management committees

Management Team The company's CEO, Mr. Shayan Abdullah, has been the Chief Executive Officer of the Company for the last 12 years. Mr. Farrukh Raza Bashir, Executive Director, is a Textile Engineer from National Textile University and possesses 38 years of industry experience. Mr. Jawwad Faisal, Director-Finance, is a Chartered Accountant and possesses 23 years of experience.

Effectiveness While the company has formed no formal management committees, MIS reports relating to daily operations are generated and submitted to senior management for discussion on regular basis. Furthermore, there are regular need-based meetings to proactively manage the affairs.

MIS Recognizing the need for quality information systems to control and maintain the efficiency of operations, the company has implemented an Oracle-based ERP solution – Oracle E-business suite – version which was initially implemented in 2006.

Control Environment The company's monthly MIS comprises comprehensive performance reports which are reviewed frequently by senior management. Since the company performs chemical treatment of cloth for its products, it outsources testing to international labs to ensure quality control.

Business Risk

Industry Dynamics During 7MFY23, the textile exports were valued at \$10.08bln compared to \$10.93bln, reflecting an 8% decline YoY – the declining trend has been recorded in the last few months. The decline in exports is driven by attrition in the demand pattern of export avenues. The hike in cotton prices and low demand for yarn in international markets is also a challenge. The analysis of 5MFY23 reveals that among value-added items, bedwear has witnessed the largest decline of 19% (on an MoM basis), down to \$217 million. Knitwear remained on the downward path in October 2022 and declined by 10% to \$392 million. Among non-value-added items, cotton yarn has shown the largest decline of 35%. Moreover, a slowdown is prevailing in textile demand amid burgeoning inflationary pressures in the exporting destinations, especially in the US and European countries. The demand pattern is expected to improve post-Jun-23.

Relative Position Overall, Sapphire Group has a strong presence in the country's textile sector, while Reliance Cotton with 57,600 spindles has been able to maintain its position in the middle tier of the spinning segment of the textile industry.

Revenues Reliance Cotton produces and sells a wide range of yarn, including premium quality yarn from 6 Ne to 80 Ne (Single & Double), plied, slubs, melanges, blends, and others. During FY22, its topline increased by 48% YoY to PKR 11,386mln due to growth in local and export sales, with exports making up ~80% of total sales. The increase in revenue is due to the textile industry's overall progression and the installation of more spindles to meet demand. During 1HFY23, the topline clocked in at PKR 4,789mln whereas the net profitability was recorded at PKR 695mln.

Margins The Company's gross margin increased to 32.6% in FY22, up from 22.9% in FY21, while its operating profit margin also increased to 29.6% from 19.7%. In FY22, the company recorded a net profit of PKR 2,772mln, resulting in a net profit margin of 24.3%. However, in 1HFY23, both the gross profit margin and net profit margin declined to 21.9% and 14.5%, respectively.

Sustainability Regular Balancing, Modernization, and Replacement (BMR) in spinning and weaving segments in FY22 are likely to have a positive impact on productivity going forward. Furthermore, continuous BMR has resulted in improving the turnover and margins of the Company, and the benefits are expected to sustain, going forward.

Financial Risk

Working Capital Reliance Cotton's net working capital cycle decreased to 148 days (FY22) from 166 days (FY21), driven by a decline in inventory days. Short-term borrowings increased by 28% to PKR 1,043mln (FY22), while short-term trade leverage improved by 13.2% to 77%. In 1HFY23, short-term borrowings increased to PKR 1,311mln, and short-term trade leverage decreased to 2.3%. However, the net working capital cycle recorded a significant increase to 233 days.

Coverages During FY22, interest coverage ratio increased to 16.8x (FY21: 9.7x) whereas debt coverage ratio increased to 7.1x (FY21: 4.7x). This improvement in coverage is driven by augmentation in free cash flows (FCFO) which clocked in at PKR 3,042mln (FY21: PKR 1,705mln). As of Dec'22, the interest and core coverage moved to 9.0x and 3.3x respectively.

Capitalization As of end-Jun22, the Company's capital structure remained moderately leveraged at 31.5% (FY21: 36.0%); leveraging improved YoY attributable to addition in equity base was recorded primarily by high unappropriated profits (FY22: PKR 6,184mln, FY21: 3,468mln). The Company recorded a total equity base of PKR 6,287mln (FY21: 3,571mln). During 1HFY23, the company's leveraging remained stable at 32.6%.



The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Reliance Cotton Spinning Mills Limited Textile - Spinning	Dec-22 6M	Jun-22 12M	Sep-21 3M	Jun-21 12M
A BALANCE SHEET				
1 Non-Current Assets	3,549	3,250	2,460	2,172
2 Investments	47	53	55	55
3 Related Party Exposure	92	92	92	92
4 Current Assets	8,291	7,551	5,748	4,399
a Inventories	5,734	4,706	3,456	2,837
b Trade Receivables	1,308	1,783	1,631	1,015
5 Total Assets	11,979	10,946	8,355	6,719
6 Current Liabilities	1,697	1,678	914	1,069
a Trade Payables	685	630	699	485
7 Borrowings	3,319	2,888	3,148	2,007
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	114	92	77	72
10 Net Assets	6,849	6,287	4,216	3,571
11 Shareholders' Equity	6,849	6,287	4,216	3,571
B INCOME STATEMENT				
1 Sales	4,789	11,386	2,551	7,682
a Cost of Good Sold	(3,739)	(7,680)	(1,738)	(5,923)
2 Gross Profit	1,050	3,707	812	1,759
a Operating Expenses	(191)	(336)	(77)	(243)
3 Operating Profit	859	3,371	735	1,516
a Non Operating Income or (Expense)	21	(191)	(30)	(41)
4 Profit or (Loss) before Interest and Tax	880	3,180	705	1,475
a Total Finance Cost	(122)	(237)	(36)	(195)
b Taxation	(63)	(171)	(24)	(81)
6 Net Income Or (Loss)	695	2,772	645	1,200
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	797	3,042	778	1,705
b Net Cash from Operating Activities before Working Capital Changes	675	2,824	735	1,496
c Changes in Working Capital	(532)	(2,332)	(1,504)	285
1 Net Cash provided by Operating Activities	143	491	(769)	1,781
2 Net Cash (Used in) or Available From Investing Activities	(416)	(1,301)	(392)	(309)
3 Net Cash (Used in) or Available From Financing Activities	351	830	1,158	(1,471)
4 Net Cash generated or (Used) during the period	79	20	(3)	1
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	-15.9%	48.2%	32.8%	28.3%
b Gross Profit Margin	21.9%	32.6%	31.8%	22.9%
c Net Profit Margin	14.5%	24.3%	25.3%	15.6%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	5.5%	6.2%	-28.5%	25.9%
e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Shareholders' Equity)]	21.2%	56.2%	66.3%	40.5%
2 Working Capital Management				
a Gross Working Capital (Average Days)	258	166	160	179
b Net Working Capital (Average Days)	233	148	139	166
c Current Ratio (Current Assets / Current Liabilities)	4.9	4.5	6.3	4.1
3 Coverages				
a EBITDA / Finance Cost	9.0	16.8	24.2	9.7
b FCFO / Finance Cost+CMLTB+Excess STB	3.3	7.1	9.7	4.7
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	1.5	0.7	0.5	0.8
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	32.6%	31.5%	42.7%	36.0%
b Interest or Markup Payable (Days)	77.2	73.1	61.5	61.1
c Entity Average Borrowing Rate	7.2%	8.1%	5.0%	6.5%

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.

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

Scale	Short-term Rating 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 conditions.
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 surveil 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

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(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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(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

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(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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