The Pakistan Credit Rating Agency Limited

Rating Report

Reliance Cotton Spinning Mills Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
08-Apr-2024	A-	A2	Stable	Maintain	-
14-Apr-2023	A-	A2	Stable	Maintain	-
14-Apr-2022	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Pakistan's spinning industry is highly fragmented and consists of ~368 dedicated spinning units with an estimated size of ~PKR 775bln and ~13.4mln number of spindles installed as of FY23 according to an economic survey of Pakistan. The projected cotton production estimate is revised and projected to be ~11.5mln bales and currently, the production has reached upto ~8.26mln bales, surpassing FY23 total production of ~4.91mln bales. During FY24, better local raw cotton yield is expected to supplement the industry for import substitution. Pakistan's requirement for imported cotton has increased from ~3.5mln bales to ~4mln bales for the ongoing year. The recent hike in energy tariffs further elevated the challenges for the industry. Overall, the industry's cashflow, thus liquidity remains stretched. Consequently, the industry's overall outlook is on the Watch.
The assigned ratings of Reliance Cotton Spinning Mills Limited ('Reliance Cotton" or 'the Company') reflects strong backing of Sapphire Group. The Company holds an adequate position in the peer universe, on standalone basis. Reliance Cotton is known for its superior quality and wide range of yarn products both, nationally and internationally. The product mix includes 6 Ne to 80 Ne (single & double yarn), plied, slubs, mélanges, and blends. The Company has installed capacity of high quality ~57,600 spindles. By producing premium quality products, the Company mainly generates revenue from exports (~83%) and locally (~17%). Reliance Cotton enjoys an established customer base with several export destinations in Italy, Portugal, Argentine, and Bangladesh along with a renowned local customer base. Despite of the current economic trends, the topline, margins and in turn profits posts stability; however, remains lean. Going forward, the current economic conditions pose challenges to sustain the Company's business risk profile. The financial risk profile of the Company remains adequate supported by manageable leveraging with dependence on financing facilities. Capital structure remains considerably strong.

Ratings incorporate the association 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. Sustained capacity utilization and strengthening the business risk profile framework remain crucial for ratings.

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(Jul-23),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jul-23),Methodology | Rating Modifiers(Apr-23)
Related Research	Sector Study | Spinning(Sep-23)
Rating Analysts	Nabia Rauf | nabia.rauf@pacra.com | +92-42-35869504

Profile

Legal Structure Reliance Cotton Spinning Mills Limited (‘Reliance Cotton’ or ‘the Company’) was incorporated in Jul-91 as a public listed company, listed on PSX.

Background The Company is a part of Sapphire Group ('the Group'), that has been striving since 1970. Today, the Group is a renowned textile conglomerate and has expanded business to include dairy, power generation, and retail, all while maintaining our commitment to innovation, design, and exceptional service.The Company was established in 1991 and started production in Jul-92.

Operations The Company is engaged in the production and selling of high-quality yarn; 6 Ne to 80 Ne (single & double), plied, Slubs, melanges, blends and variety of yarns. The Company has ~57,600 spindles and a production capacity of 36.5mln pounds per annum. The production facilities are located in Sheikhupura.

Ownership

Ownership Structure Major stake of the Company (~66%) is held by associated companies of the Sapphire Group. Directors hold (~8%) stake, Financial Institutes and Joint stock Companies hold (~5%) stake of the Company. While, the remaining stake of (~21%) is held by General Public.

Stability Ownership of the Company seems to remain stable as major stake resides with the Sponsors.

Business Acumen 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.

Financial Strength The Company gathers financial strength from the Sapphire Group, if needs be. PACRA rates other Group entities aswell, namely: Diamond Fabrics Ltd.(A-/A2), Sapphire Electric Company Ltd.(AA-/A1+), Sapphire Fibres Ltd.(A+/A1), Sapphire Finishing Mills Ltd.(A/A1), and Sapphire Retail Ltd.(A-/A2).

Governance

Board Structure Overall control of the Company lies with the seven member Board, comprising one Executive, four Non-Executive, two Independent Directors. The BoD has a dominating presence of sponsoring family with one female Director.

Members’ Profile The Chairman, Mr. Shahid Abdullah has been associated with Sapphire Group since 1980 and has expertise in spinning, weaving, knitting, dyeing, finishing, and power generation. Other BoD members hold strong and diversified experiences that adds value to policy framework.

Board Effectiveness The Board met four times during the year. The BoD meetings have full attendance and minutes are properly recorded. There are three subcommittees in place to assist the Board on relevant matters: Audit Committee, Risk Committee and Human Resource Committee. Audit and Human Resource Committees are chaired by an Independent Director. Risk Committee is chaired by the CEO.

Financial Transparency External Auditors M/S. Shinewing Hameed Chaudhri & Co. Chartered Accountants issued an unqualified audit report on financial statements for FY23. The firm is QCR rated and on SBP's panel in category "A".

Management

Organizational Structure The Company’s overall operations are managed by eleven key management personnel including the 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.

Management Team The Company’s CEO, Mr. Shayan Abdullah, is the CEO of the Company for the last ~12 years. Mr. Farrukh Raza Bashir, an Executive Director, possesses 38 years of industry experience. Mr. Jawwad Faisal, Director Finance, is an FCA and possesses ~23 years of experience.

Effectiveness The Company lacks prescence of management committees. However, 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 has an outsourced internal audit function from M/S. KPMG Taseer Hadi & Co. reportable to the Board Audit Committee. The Company’s monthly MIS comprises comprehensive performance reports which are reviewed frequently by senior management. For chemical treatment of cloth for the products, the Company has outsourced testing to international labs to ensure quality control.

Business Risk

Industry Dynamics Pakistan's spinning industry is highly fragmented and consists of ~368 dedicated spinning units with an estimated size of ~PKR 775bln and ~13.4mln number of spindles installed as of FY23 according to an economic survey of Pakistan. The projected cotton production estimate is revised and projected to be ~11.5mln bales and currently, the production has reached upto ~8.26mln bales, surpassing FY23 total production of ~4.91mln bales. During FY24, better local raw cotton yield is expected to supplement the industry for import substitution. Pakistan's requirement for imported cotton has increased from ~3.5mln bales to ~4mln bales for the ongoing year. The recent hike in energy tariffs further elevated the challenges for the industry. Overall, the industry's cashflow, thus liquidity remains stretched. Consequently, the industry's overall outlook is on the Watch.

Relative Position The Group holds strong presence in the country’s textile sector, while Reliance Cotton with 57,600 spindles acquires a position in the middle tier players of the spinning segment.

Revenues The Company manufactures and sells a wide range of yarn. During 6MFY24, the Company’s topline increased by ~41% (6MFY24: ~PKR 6.7bln, 6MFY23: ~PKR 4.7bln). The increase has been witnessed in both i.e. local sales and export sales. The increase in revenue can be attributed to increase in price along with volumes, post installation of more spindles to meet the demand.

Margins During 6MFY24, the gross profit increased ~19% (6MFY24: ~PKR 1.2bln, 6MFY24: ~PKR 1bln), owing to increase in prices. Cost of goods sold increased by ~59% and reported at ~PKR 5.4bln (6MFY23: ~PKR 3.7bln). Resultantly, gross profit margin of the Company reduced and stood at ~18.6% (6MFY23: ~21.9%). Operating profit margin of the Company also reduced and stood at ~16% (6MFY23: ~17.9%). Net profit margin reduced significantly and stood at ~9% (6MFY23: ~13%).

Sustainability Regular BMR in the spinning and weaving segments in FY24 are likely to have a positive impact on productivity, going forward.

Financial Risk

Working Capital Working capital requirements are met by combination of internal generation and bank borrowings. Net working capital days reduced and stood at 223days (6MFY23: 233days), owing to decreased inventory days. Inventory days stood at 176days (6MFY23: 199days). Trade payable days stood at 5days (6MFY23: 25days). Trade receivables days stood at 53days (6MFY23: 59days). Borrowing cushion reduced and stood at ~56% (6MFY23: ~75%).

Coverages The Company recorded EBITDA ~PKR 1.2bln (6MFY23: ~PKR 1bln), showing an increase of ~26%. Free Cash Flows from Operations (FCFO) of the Company increased ~47% and stood at ~PKR 1.1bln (6MFY23: ~PKR 0.7bln). Finance cost increased ~239% and reported at ~PKR 383mln (6MFY23: ~PKR 113mln). Thus, the intertest cover of the Company reduced and stood at 3x (6MFY23: 7.1x).

Capitalization Total equity of the Company increased ~11% and reported at ~PKR 7.6bln (6MFY23: ~PKR 6.8bln), owing to increase in accumulated profit. Profit accumulation increased by ~11% and reported at ~PKR 7.3bln (6MFY23: ~PKR 6.6bln). Total borrowings increased ~57% and reported at ~PKR 5bln (6MFY23: ~PKR 3bln). Short term borrowings increased ~157% and long term borrowings decreased ~13%. Thus, debt-to-equity ratio decreased ~40.6% (6MFY23: ~32.6%).

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Financial Summary
PKR mln

Reliance Cotton Spinning Mills Limited	Dec-23	Jun-23	Jun-22	Jun-21
Textile - Spinning	6M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	4,279	3,600	3,250	2,172
2 Investments	21	14	53	55
3 Related Party Exposure	714	518	92	92
4 Current Assets	9,592	9,251	7,551	4,399
a Inventories	*6,805*	*6,203*	*4,706*	*2,837*
b Trade Receivables	*1,872*	*2,013*	*1,783*	*1,015*
5 Total Assets	14,606	13,384	10,946	6,719
6 Current Liabilities	1,650	1,911	1,678	1,069
a Trade Payables	*694*	*891*	*630*	*485*
7 Borrowings	5,205	4,297	2,888	2,007
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	147	142	92	72
10 Net Assets	7,604	7,034	6,287	3,571
11 Shareholders' Equity	7,604	7,034	6,287	3,571
B INCOME STATEMENT				
1 Sales	6,741	11,049	11,386	7,682
a Cost of Good Sold	*(5,489)*	*(9,343)*	*(7,680)*	*(5,923)*
2 Gross Profit	1,252	1,705	3,707	1,759
a Operating Expenses	(171)	(354)	(336)	(243)
3 Operating Profit	1,082	1,352	3,371	1,516
a Non Operating Income or (Expense)	*24*	*4*	*(191)*	*(41)*
4 Profit or (Loss) before Interest and Tax	1,105	1,355	3,180	1,475
a Total Finance Cost	*(427)*	*(351)*	*(237)*	*(195)*
b Taxation	*(74)*	*(166)*	*(171)*	*(81)*
6 Net Income Or (Loss)	605	839	2,772	1,200
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*1,177*	*1,423*	*3,042*	*1,705*
b Net Cash from Operating Activities before Working Capital Changes	*793*	*1,126*	*2,824*	*1,496*
c Changes in Working Capital	*(629)*	*(1,209)*	*(2,332)*	*285*
1 Net Cash provided by Operating Activities	164	(83)	491	1,781
2 Net Cash (Used in) or Available From Investing Activities	(987)	(1,076)	(1,301)	(309)
3 Net Cash (Used in) or Available From Financing Activities	866	1,329	830	(1,471)
4 Net Cash generated or (Used) during the period	43	170	20	1
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	22.0%	-3.0%	48.2%	28.3%
b Gross Profit Margin	18.6%	15.4%	32.6%	22.9%
c Net Profit Margin	9.0%	7.6%	24.3%	15.6%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	8.1%	1.9%	6.2%	25.9%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Shareholders' Equity)]*	16.5%	12.6%	56.2%	40.5%
2 Working Capital Management				
a Gross Working Capital (Average Days)	229	243	166	179
b Net Working Capital (Average Days)	207	218	148	166
c Current Ratio (Current Assets / Current Liabilities)	5.8	4.8	4.5	4.1
3 Coverages				
a EBITDA / Finance Cost	3.3	5.2	16.8	9.7
b FCFO / Finance Cost+CMLTB+Excess STB	2.2	2.2	7.1	4.7
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	1.2	1.8	0.7	0.8
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	40.6%	37.9%	31.5%	36.0%
b Interest or Markup Payable (Days)	38.5	106.8	73.1	61.1
c Entity Average Borrowing Rate	17.3%	9.2%	8.1%	6.5%

Credit Rating

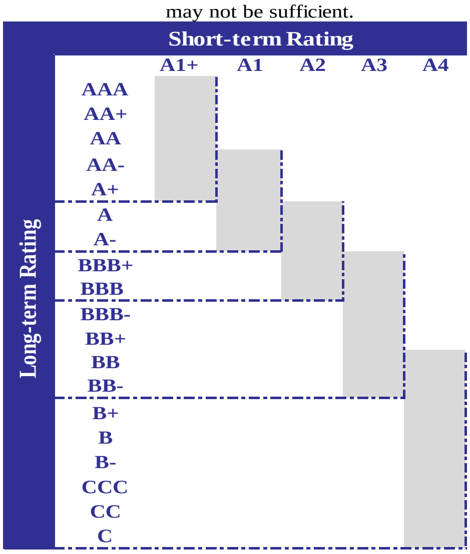
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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 | 17-(a)
(19) PACRA reviews all the outstanding ratings periodically, on annual basis; Provided that public dissemination of annual review and, in an instance of change in rating will be made; | Chapter III | 17-(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 | 17-(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 | 17-(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 | 14-3(f)(vii)
Proprietary Information