



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-2022	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The assigned ratings of Reliance Cotton reflect association of the Company with Sapphire Group and good standalone positioning in the peer universe. The current installed capacity is 46,944 spindles with a plan in place to enhance this capacity. The Company manufactures 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 family and two independent directors. The Company's management involves experienced professionals overseeing operations of the Company, aided by comprehensive reporting. The Company enjoys established customer base with several export destinations in Italy, Portugal, Argentine and Bangladesh along-with renowned local customer base. Sales mix, dominated by direct and indirect exports, display improvement over the years. During FY21, the Company's revenues stood at PKR 7.7bln (FY20: PKR 6.0bln). Operating profits and net profitability recorded sizable improvement in the recent year whilst margins remained good. The financial risk matrix reveals moderate leveraging and improvement in coverages and working capital management compared to last year. During the period July-December FY21-22, textile exports of Pakistan surged 26 percent YoY, fielding \$9.39 billion in total export remittances, as compared to \$7.44 billion in the same period last year. This is attributable to increase in demand for textile products internationally and channeling of export orders towards Pakistani market. On a YoY basis, the exports of value-added textile items increased in both quantity and value in December 2021. Going forward, the textile sector's outlook is expected to stay positive in the medium term where the demand for textile products is expected to sustain. In the local market, the textile sector has recorded strong performance. The relief measures introduced by the State Bank of Pakistan such as deferment of loan payments for one year, low-interest rates, and salary refinance scheme also provided comfort to the sector. Many players have also availed the TERF scheme announced by the Central Bank. This will lead to overall leverage of the sector to increase; however, on relaxed financing rates. The sustainability of demand pattern for the current higher orders from Europe and USA remains essential for the feasible utilization of added capacity by textile players.

Ratings incorporate association of the company with renowned Sapphire Group which enjoys 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 optimal level and sustain margins, going forward.

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-21),Criteria Correlation Between Long-term & Short-term Rating Scales(Jun-21),Criteria Rating Modifiers(Jun-21)
Related Research	Sector Study Spinning(Sep-21)
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Profile

Legal Structure Reliance Cotton Spinning Mills Limited ('Reliance Cotton' or 'the Company') is a public company listed on Pakistan Stock Exchange (PSX).
Background Reliance Cotton was incorporated in June 1990 as a public limited company under the umbrella of Sapphire Fibers Limited and was listed on Pakistan Stock Exchange Limited in June 1993. The principal activity of the Company is manufacturing and sale of yarn.
Operations Reliance Cotton is primarily engaged in spinning with ~46,944 spindles generating total capacity of ~31.0mIn lbs. per annum.

Ownership

Ownership Structure Sapphire Group companies own majority shareholding of the Company i.e., ~65%. The directors directly own ~16% of the shareholding whereas various Modarabas and Mutual Funds own ~13% of the shareholding.
Stability Sapphire Group companies are divided between the four sons of Mr. Mohammad Abdullah, with formal documentation capturing the ownership structure and operational control resting with each family member. A Group holding company, Sapphire Holding Limited, also exists for managing investments in subsidiary and associated companies.
Business Acumen Sapphire Group has expanded to become one of the most distinguished business groups of Pakistan. The Group has acquired expertise in textile ranging from spinning, denim weaving and finishing to home textiles and garments.
Financial Strength Sapphire Group is one of the largest vertically integrated textiles set ups in Pakistan. The group possesses more than 20 companies, with over 30 production units. The Company is backed by the committed support of the Sapphire Group.

Governance

Board Structure Reliance Cotton's board comprises seven members, including the Chairman - Mr. Shahid Abdullah and CEO - Mr. Shayan Abdullah and two independent directors. Overall, the Board comprises five sponsoring family members.
Members' Profile Mr. Shahid Abdullah has been associated with Sapphire Group since 1980. He has achieved considerable experience of spinning, weaving, knitting, dyeing, finishing and power generation. He also has presence on boards of Sapphire Textile Mills Ltd and Sapphire Fibers Ltd. Mr. Shayan Abdullah is a foreign graduate and has been CEO of Reliance Cotton for the last 11 years. He oversees raw material procurement, accounts and marketing for spinning divisions of Sapphire Fibers Limited and Amer Cotton Mills Limited as well.
Board Effectiveness Board meetings have full attendance of directors with properly recorded minutes. There are two sub-committees in place to assist the Board on relevant matters: Audit Committee and Human Resource Committee.
Financial Transparency EY Ford Rhodes and Co. Chartered Accountants are the external auditors of the Company. They have expressed an unqualified opinion on the financial statements of the company for the year ended June 30th, 2021. 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 Executive Director, who is in-turn reportable to Director Finance/COO. Department heads of ERP, Exports, Local Sales, Accounts, Finance, Tax and HR also report to Director Finance/COO. The Company does not possess any management committees.
Management Team Mr. Jawwad Faisal FCA - Director Finance/COO - possesses 23 years of experience. He is associated with the Company for 5 years. Previously, he has noticeably worked for Servis, Servaid and KPMG. Mr. Farrukh Raza Bashir - Executive Director - is a Textile Engineer from National Textile University and possesses 38 years of industry 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 The company has implemented an Oracle based ERP solution - Oracle E business suite - version 12.1.3. Initially implemented in 2006, it is annually updated by Oracle Corporation based on agreement with the company.
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 the period July-December FY21-22, textile exports surged 26 percent YoY, fielding \$9.39 billion in total export remittances, as compared to \$7.44 billion in the same period last year. This is attributable to increase in demand for textile products internationally and channeling of export orders towards Pakistani market. Going forward, the textile sector's outlook is expected to stay positive in the medium term where the demand for textile products is expected to sustain.
Relative Position Overall, Sapphire Group has a strong presence in the country's textile sector, while Reliance Cotton with 46,944 spindles has been able to maintain its position in the middle tier of spinning segment of textile industry.
Revenues During FY21, Reliance Cotton's topline increased by 28% to PKR 7,682mIn (FY20: PKR 5,987mIn). The increase has been witnessed in both i.e., local sales and export sales. At PKR 6,191mIn (FY20: PKR 4,800mIn), exports made up 73.3% (FY20: 72.5%) of total sales. The increase in revenue can be attributed to overall progression of textile industry. In 1QFY22, the Company recording a revenue of PKR 2,551mIn (1QFY21: PKR 1,816mIn), an increase of 40% period on period.
Margins During FY21, the Company's gross margin increased to 22.9% (FY20: 15.5%) on back of overall growth in revenue. Operating profit margin also increased to 19.7% (FY20: 12%). Margins witnessed further improved in 1QFY22. Gross profit margin increased to 31.8% and operating profit margin improved to 28.8%. During FY21, the Company recorded a net profit of PKR 1,200mIn (FY20: net profit PKR 274mIn). This resulted in net profit margin to 15.6% (FY20: 4.6%). Reliance Cotton recorded a net profit of PKR 645mIn during 1QFY22 (1QFY21: PKR 126mIn), showing a significant increase of 5.1 times.
Sustainability Regular Balancing, Modernization, and Replacement (BMR) in spinning and weaving segments in FY21 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 during FY21 to 166days (FY20: 188 days) driven by 7.7% decrease in inventory days (FY21: 132 days; FY20: 143 days). During 1QFY22, net working capital cycle further improved to 139 days. During FY21, Short-term borrowings were reduced by 68% to PKR 815mIn (FY20: PKR 2,519mIn). This decrease also resulted in improvement of Short-term trade leverage to 68.9% (FY20: 35.9%). However, in 1QFY22, the short-term borrowings increased to PKR 1,735mIn. Resultantly, Short-term trade leverage decreased to 55.4%.
Coverages During FY21, interest coverage ratio increased to 9.6x (FY20: 2.5x) whereas debt coverage ratio increased to 4.7x (FY20: 2.4x). This improvement in coverages is driven by augmentation in free cash flows (FCFO) which clocked in at PKR 1,705mIn (FY20: PKR 835mIn).
Capitalization During FY21, the Company's capital structure remained moderately leveraged at 35.5% (FY20: 59.0%). The Company's leveraging improved addition in equity base primarily by high unappropriated profits (FY21: PKR 3,471mIn, FY20: 2,273mIn). The Company recorded total equity of PKR 3,571mIn (FY20: 2,360mIn).



The Pakistan Credit Rating Agency Limited

Financial Summary

PKR mln

Reliance Cotton Spinning Mills Limited Textile - Spinning	Sep-21 3M	Jun-21 12M	Jun-20 12M	Jun-19 12M
A BALANCE SHEET				
1 Non-Current Assets	2,460	2,172	2,060	1,997
2 Investments	55	55	42	50
3 Related Party Exposure	92	92	89	89
4 Current Assets	5,748	4,399	4,222	3,214
<i>a Inventories</i>	3,456	2,837	2,700	1,989
<i>b Trade Receivables</i>	1,631	1,015	987	761
5 Total Assets	8,355	6,719	6,414	5,350
6 Current Liabilities	914	1,069	599	613
<i>a Trade Payables</i>	699	485	84	190
7 Borrowings	3,148	1,964	3,392	2,519
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	77	115	63	49
10 Net Assets	4,216	3,571	2,360	2,169
11 Shareholders' Equity	4,216	3,571	2,360	2,169
B INCOME STATEMENT				
1 Sales	2,551	7,682	5,987	5,379
<i>a Cost of Good Sold</i>	(1,738)	(5,923)	(5,059)	(4,562)
2 Gross Profit	812	1,759	928	817
<i>a Operating Expenses</i>	(77)	(243)	(212)	(176)
3 Operating Profit	735	1,516	716	641
<i>a Non Operating Income or (Expense)</i>	(30)	(41)	(40)	(2)
4 Profit or (Loss) before Interest and Tax	705	1,475	676	638
<i>a Total Finance Cost</i>	(36)	(195)	(341)	(221)
<i>b Taxation</i>	(24)	(81)	(61)	(27)
6 Net Income Or (Loss)	645	1,200	274	391
C CASH FLOW STATEMENT				
<i>a Free Cash Flows from Operations (FCFO)</i>	778	1,705	835	656
<i>b Net Cash from Operating Activities before Working Capital Changes</i>	735	1,496	426	392
<i>c Changes in Working Capital</i>	(1,504)	285	(1,049)	(637)
1 Net Cash provided by Operating Activities	(769)	1,781	(623)	(244)
2 Net Cash (Used in) or Available From Investing Activities	(392)	(309)	(249)	(656)
3 Net Cash (Used in) or Available From Financing Activities	1,158	(1,471)	873	899
4 Net Cash generated or (Used) during the period	(3)	1	(0)	(1)
D RATIO ANALYSIS				
1 Performance				
<i>a Sales Growth (for the period)</i>	32.8%	28.3%	11.3%	--
<i>b Gross Profit Margin</i>	31.8%	22.9%	15.5%	15.2%
<i>c Net Profit Margin</i>	25.3%	15.6%	4.6%	7.3%
<i>d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)</i>	-28.5%	25.9%	-3.6%	0.4%
<i>e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Shareholders' Equity)]</i>	66.3%	40.5%	12.1%	18.0%
2 Working Capital Management				
<i>a Gross Working Capital (Average Days)</i>	160	179	196	167
<i>b Net Working Capital (Average Days)</i>	139	166	188	154
<i>c Current Ratio (Current Assets / Current Liabilities)</i>	6.3	4.1	7.0	5.2
3 Coverages				
<i>a EBITDA / Finance Cost</i>	24.2	9.7	2.8	3.8
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	9.7	4.7	2.4	2.9
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>	0.5	0.8	1.7	1.3
4 Capital Structure				
<i>a Total Borrowings / (Total Borrowings+Shareholders' Equity)</i>	42.7%	35.5%	59.0%	53.7%
<i>b Interest or Markup Payable (Days)</i>	61.5	61.1	67.6	80.8
<i>c Entity Average Borrowing Rate</i>	5.0%	6.6%	11.2%	8.4%

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+	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	
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	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.
CC	
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):

<p>Entities</p> <ul style="list-style-type: none"> 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 	<p>Instruments</p> <ul style="list-style-type: none"> a) Basel III Compliant Debt Instrument Rating b) Debt Instrument Rating c) Sukuk Rating
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- 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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- (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)
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- (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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