The Pakistan Credit Rating Agency Limited

ELLCOT SPINNING MILLS LIMITED

ENTITY RATINGS

	INITIAL [DEC-17]
Entity	
Long Term	A-
Short Term	A2
Outlook	Stable

REPORT CONTENTS
1. RATING ANALYSES
2. FINANCIAL INFORMATION
3. RATING SCALE
4. REGULATORY AND SUPPLEMENTARY DISCLOSURE

DECEMBER 2017

Profile & Ownership

- Incorporated in Nov 1991, Ellcot is a textile spinning company listed on PSX.
- Spinning unit – 61,728 spindles at end-Oct17 - for production of yarn.
- Majority-owned (~71%) by Nagina Group (NG), via group companies and sponsoring individuals.

Governance & Management

- Seven-member board dominated by sponsoring family: five NG affiliates, including CEO, and two independent directors. Six non-executives on the board.
- Though independent directors bring diversity on the table, experience of majority of directors is mostly limited to NG.
- In Sep16, after the demise of Mr. Shaikh Enam Ellahi, his elder son, Mr. Shahzada Ellahi Shaikh, assumed the role of Chairman. The CEO – Mr. Shafqat Ellahi Shaikh – is one of the sons of Mr. Shaikh Enam Ellahi. Associated with Ellcot since its inception, he is well verse with the textile business.
- A lack of segregation between governance and management exists as control of the latter vests with the sponsors. Meanwhile, the board is compliant with Code of Corporate Governance (CCG).

Operational Risk

- The company, partnering with A.F. Ferguson in May14, implemented an Oracle-based ERP solution. Comprehensive MIS reporting is carried out.
- Daily management meetings to identify and resolve bottlenecks
- Production re-profiling and constant Balancing Modernization and Replacement (BMR) activities leading to productivity gains and cost-efficiencies.

Business Risk

- Local: export mix, balanced in FY15, in recent years has become almost completely dominated by local sales.
- Revenues, after declining for two successive years on the back of industry-wide falling exports, rose by 15% in FY17 to PKR 4,869mln largely driven by growth in local sales (39%), countering a decline in exports.
- Lower than proportionate increase in cost of sales (~14%) led to improved business margins (gross - FY17: 6.5%, FY16: 5.8% - operating - FY17: 3.6%, FY16: 2.5%), though remained low in comparison to peers. Despite high input costs for local producers, lower exports led to a drop in distribution costs.
- Finance costs creeped up by ~14% as short-term borrowings (STBs) more than doubled during the period, limiting the growth of bottomline (FY17: ~PKR 78mln, FY16: ~PKR 71mln).
- For 1QFY18, the company's turnover kept the increasing trend, growing by ~15% YoY to PKR 1,190mln. The company's margins stayed on the rise as savings on distribution costs was repeated.
- In the domestic market, the top ten customers' concentration is high (61 %), though it has been gradually falling.
- Build-up of investment book; board-approved limit increased recently. High exposure to market risk (stock market investments at end-Jun17: PKR 559mln, end-Jun16: PKR 120mln) is mitigated via selection of blue-chip scrips. Meanwhile, long-term investment strategy remains conservative.
- Successful installation of 7,200 spindles in FY17. The company is currently undergoing an expansion program – 25,200 spindles (cost: ~PKR 1.6bln).

Financial Risk

- The company manages its working capital requirements via a mix of internal cash generation and STBs; utilization of the latter increased (end-Sep17: PKR 691mln, end-Jun16: PKR 453mln). Trading-working capital needs saw an increase in line with higher available production capacity. In 1QFY18, requirements further increased due to seasonality dynamic of cotton purchase.
- Net cash cycle is on the rise (end-Sep17: 97days), though at par with peers.
- Operating cash flows improved (~56%) on YoY basis on the back of higher pre-tax profitability. Debt servicing ability is comfortable at present. Unutilized STB lines are also available to meet urgent needs of funding.
- Increased leveraging in recent years (end-Jun17: 51%, end-Jun16: 43%, end-Jun15: 30%) due to debt-driven expansion as well as higher investment outlays.

RATING RATIONALE

The ratings reflect Ellcot Spinning Mills Limited adequately maintained business profile despite suppressed domestic textile sector fundamental. The company's revenues have taken hit in past few years mainly due to price decline in exports and local segments. Recently, revenues have started to pick up, benefiting from local volumes. Textile industry in general and spinning industry in particular continues to suffer from low international commodity prices and high cost of doing business in Pakistan. Consequently, performance volatility, featured by cotton price fluctuations, is considered high on standalone basis. Moreover, the announced export package by the state and its materialization would benefit the company. The company has built a sizeable investment portfolio enhancing the exposure to market risk. However, comfort can be drawn from conservatively need blue chip stocks. The management plan to find its BMR actively through additional borrowing and restricted operating cash flows impacts the financial risk profile that remains stretched. The designed repayment pattern provides carefully support. However the assigned rating drive comfort from the company's liquid investment, ability to manage financial risk, and association with Nagina Group.

KEY RATING DRIVERS

The rating is dependent on the company's ability to math cash flows in case it plans to accumulate more debt in future

Ellcot Spinning Mills Limited

BALANCE SHEET	30-Sep-17	30-Jun-17	30-Jun-16	30-Jun-15
	3MFY17	FY17	FY16	FY15
Non-Current Assets	**1,262**	**1,180**	**1,221**	**1,027**
Investments (incl. Associates)	**469**	**546**	**120**	**170**
Equity	469	546	120	170
Debt Securities (incl. income funds)	-	-	-	-
Current Assets	**1,538**	**1,628**	**1,530**	**1,180**
Inventory	883	850	738	669
Trade Receivables	264	390	281	217
Others	391	387	510	294
Total Assets	**3,269**	**3,354**	**2,870**	**2,378**
Debt/Borrowings	**1,374**	**1,490**	**1,082**	**579**
Short-Term	691	923	453	146
Long-Term (incl. Current Maturity of Long-Term Debt)	684	567	629	432
Other Short-Term Liabilities	328	293	251	281
Other Long-Term Liabilities	121	122	119	133
Shareholder's Equity	**1,446**	**1,449**	**1,418**	**1,385**
Total Liabilities & Equity	**3,269**	**3,354**	**2,870**	**2,378**
INCOME STATEMENT				
Turnover	**1,190**	**4,869**	**4,228**	**4,589**
Gross Profit	88	317	245	292
Other Income	(14)	6	6	(1)
Financial Charges	(20)	(58)	(51)	(60)
Net Income	**18**	**78**	**72**	**54**
Cash Flow Statement				
Free Cash Flows from Operations (FCFO)	66	264	169	187
Net Cash changes in Working Capital	156	(234)	(323)	267
Net Cash from Operating Activities	203	(1)	(197)	404
Net Cash from InvestingActivities	(64)	(528)	(240)	(275)
Net Cash from Financing Activities	(115)	369	465	(114)
Net Cash generated during the period	24	(160)	28	15
Ratio Analysis				
Performance				
Turnover Growth (v.s same period last year)	15.6%	15.2%	-7.9%	-27.7%
Gross Margin	7.4%	6.5%	5.8%	6.4%
Net Margin	1.5%	1.6%	1.7%	1.2%
ROE	4.9%	5.4%	5.1%	4.6%
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	97	89	79	59
Leveraging (Total Debt/Total Debt+Equity)*	48.7%	50.7%	43.3%	29.5%

**Total Debt = Long-Term Debt + Short-Term Debt*

CREDIT RATING
SCALE & DEFINITIONS

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 Ratings

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 Ratings

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.

B: The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.

C: An inadequate capacity to ensure timely repayment.

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, a) some material identifiable event and/or b) deviation from expected trend. 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 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) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) PACRA finds it impractical to surveill the opinion due to lack of requisite information

Regulatory and Supplementary Disclosure

Rated Entity

Name of Issuer	Ellcot Spinning Mills Limited
Sector	Textile
Type of Relationship	Solicited
Purpose of the Rating	Independent Risk Assessment

Rating History

Dissemination Date	Long Term	Short Term	Action	Outlook
28-Dec-17	A-	A2	Initial	Stable

Related Criteria and Research

Specific Methodology: Corporate Rating Methodology
Research: Textile Sector Overview - 2016

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