RATING REPORT

Naveena Industries Limited (NIL)

REPORT DATE:

December 31, 2021

RATING ANALYST:

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RATING DETAILS				
Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A-	A-2	BBB+	A-2
Rating Outlook	Stable		Stable	
Rating Date	December 31, 2021		November 20, 2020	
Rating Action	*Upgrade*		*Maintained*	

COMPANY INFORMATION	
Incorporated in June 1989	**External auditors:** Ibrahim Shaikh & Co.
Public Unlisted Company	**Chairman:** Mr. Iftikhar Ahmed Khalid
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Shazad Khalid
Naveena Holdings Limited (99.9%)	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria Methodology – Industrial Corporates (August 2021)
https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

Naveena Industries Limited (NIL)

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

Naveena Industries Limited (NIL) was incorporated as a Private Limited Company in March 1966. Later, in 2011 the company was converted to unquoted public limited company in March 2011. ***The principal business of the company is manufacturing and export of grey cloth.*** *The registered office of the company is situated in Karachi.*

External auditors of the company lie in Category C of the SBP Panel of Auditors.

Naveena Industries Limited (NIL), incorporated in 1966, is primarily involved in the manufacturing and sale of grey cloth. Around four-fifth of the company's sales comprise exports sales, as it has signed a manufacturing bond, requiring it to export around 80% of the yearly output. NIL's holding entity, Naveena Holdings also owns a spinning unit by the name of Ahmed Oriental Textile Mills Limited. Such a vertically integrated structure helps the company to benefit from economies of scale and ensure improved operational efficiency.

NIL's production facilities are located in Karachi and Rahim Yar Khan. At present, the company operates a mix of air-jet and shuttle-less looms. In view of projected growth in demand, the entity initiated a BMR project, as part of which 84 shuttle less looms at Karachi unit are to be replaced with air jet looms which will increase annual production capacity to 52m meters/annum. The cost of the project is estimated at Rs. 1.8b, 75% (Rs. 1.4b) of which is projected to be financed by debt (LTFF and TERF) while the remaining will be funded by internal cash generation. The project is expected to commence operations by Jan-Feb'2022.

Production Details			
	FY19	**FY20**	**FY21**
Total number of looms	411	411	411
Installed capacity (million meters per annum)	45	45	45
Actual production (million meters per annum)	44	36	37
Capacity utilization	97%	80%	82%

Rating Drivers

Recovery in industry wide exports post ease in COVID-19 lockdown measures support business risk profile of the company.

- Subsequent to posting export contraction in FY20 - owing to the pandemic-induced slowdown experienced in H2'FY20 – Pakistan's export base grew by 14% in FY21, which is partly attributable to a low base effect. Pakistan's export proceeds have oscillated in the range of USD 22-25b during the past decade (FY11-FY21). So the uptick is largely aligned with historical numbers and is not considered material.
- Share of textile exports in total exports has oscillated in the range of 54-59%, coming in at 57% during the past 2-years (FY20-21). In FY21, owing to the similar low-base effect, as discussed above, textile exports were up 13%.
- In USD' terms textile exports have grown at a CAGR of 4.4% during the past 3-year period (FY19-FY21), despite depreciation in average USD/PKR parity of 24%, 16%, and 1% in FY19, FY20 and FY21 respectively.
- As illustrated in the table above, textile exports in Q1'FY22 were 37% higher than SPLY. Inclusive of textile exports for Oct'2021, the number for 4M'FY22 textile exports came in

at USD 6b. With additional capacities coming online in January 2022, textile exports for FY22 are likely to exceed the annualized figure of USD 18b.

- As illustrated in the table below, the composition of textile exports has depicted improvement in the last 4-yar period, with contribution from higher value added segment increasing from 72.9% in FY18 to 80.7% in FY21 of aggregate textile exports.
- Cotton production in Pakistan, on the other hand, was at its lowest level in decades for FY21. Cotton prices rose to a new 11-year high of ~Rs. 13,000/maund as a result of the production shortage, and cotton imports have climbed by 59.8% in quantity and 68.1% in USD terms, for FY21 vis-à-vis preceding year.
- Given favorable weather conditions, cotton production in Pakistan posted strong growth in FY22, with cotton crop for Jul-Nov'22 (Rabi) season being 81% higher than SPLY. Nevertheless, the upward momentum in cotton pricing continued in FY22, with prices as of November 2022 hovering at ~Rs. 16,000 per mound.
- The margins of textile operators have broadly depicted improvement despite the uptick in raw material costs, given that the same was offset by exchange rate movement. Nevertheless, higher raw material pricing has increased the working capital requirements for textile operators, which is likely to weigh on the liquidity of textile players. VIS expects the order book for the industry to remain adequate in the ongoing year along with transfer orders of neighboring countries, easing our business risk concerns

Increase in top-line was manifested by higher volumetric sales in the local market due to higher freight cost and shipment delays for exports sales.

Net sales were reported at Rs. 7.0b in FY21 (FY20: Rs. 6.7b, FY19: Rs. 6.4b). Growth in revenue was attributable to a volumetric growth in the local market. Share of direct exports fell from 80.7% to 76.3%, as there was a substantial increase in freight costs as well as shipment delays, making it difficult to fulfil such orders. However, management's focus is expected to remain towards exports sales, going forward. Client concentration remains on the higher side with top 10 client accounting for 70.2% (FY20: 63.0%) and 94.7% (FY20: 88.6%) of the export and local sales during the outgoing year, respectively. Client concentration risk is partly mitigated due to long-term association with clients, with management intending to diversify client base going forward. Geographic concentration in exports sales is tilted towards European countries for home-textile and USA for pocket-lining. With projected increase in capacity, the company plans to diversify in new countries, in the medium term.

Gross margins have remained range-bound and were reported higher at 13.5% (FY20: 13.2%, FY19: 13.8%). Net profit margin went up to 6.8% (FY20: 4.4%, FY19: 5.3%), which was mainly ensured by lower finance cost along with one-off income generated from the disposal of machinery and one-off gain on sale of long term investment during FY21 to the tune of Rs. 35m and 2.3m, respectively. With rising interest rates and elevated debt levels, higher finance costs are projected to remain a drag on overall profitability, going forward with profit margins projected to remain in the range of 4-5% on account of higher finance costs. Given timely completion of planned BMR, sales revenue for the next two years are projected to witness a double-digit growth.

Sufficient liquidity profile

In absolute terms, funds from operations (FFO) for FY21 increased by 36% to Rs. 626m (FY20: Rs. 461.2m) on the back of higher profit for the year. Consequently, FFO to total debt, FFO to long-term debt, and debt servicing coverage ratio (DSCR) all showed an improvement and were reported at 23.2% (FY20: 17.4%), 62.3% (FY20: 61.3%), and 3.6x (FY20: 1.5x) during FY21. Current ratio has remained above 1.0x, with stock-in-trade and trade debts providing sufficient coverage for short-term debt. Given elevated debt levels at end-Sep'21, cash flow coverages against outstanding obligations reduced. In line with improving profitability, liquidity indicators are projected to improve going forward. Ratings remain dependent on maintaining projected liquidity levels.

Given BMR expansion plans on board, capitalization indicators of the company have increased at end-Sep'21. Improvement in the same in through projected increase in equity base led by profit retention is considered important from a ratings perspective.

At end-Q1FY22, company's total equity base was reported at Rs. 2.8b (FY21: Rs. 2.8b, FY20: Rs. 2.4b). Leverage and gearing ratios have gone up to 1.8x (FY21: 1.28x, FY20: 1.46x) and 1.5x (FY21: 0.96x; FY20: 1.12x) at end-Sep'21, respectively to finance working capital requirements and BMR expansion. Major portion of the long term debt comprise low rate facilities (LTFF and TERF). Given limited debt drawdown going forward, improvement in leverage indicators through projected increase in equity base led by profit retention is considered important from a ratings perspective.

ISSUE/ISSUER RATING SCALE &DEFINITIONS Appendix I

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.vis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details.www.vis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES					Appendix II
Name of Rated Entity	Naveena Industries Limited (NIL)				
Sector	Textiles				
Type of Relationship	Solicited				
Purpose of Rating	Entity Rating				
Rating History	**Rating Date**	**Medium to Long Term**	**Short Term**	**Rating Outlook**	**Rating Action**
	RATING TYPE: ENTITY				
	31/12/2021	A-	A-2	Stable	Upgrade
	20/11/2020	BBB+	A-2	Stable	Maintained
	24/04/2020	BBB+	A-2	Rating Watch - Negative	Maintained
	28/02/2020	BBB+	A-2	Positive	Maintained
	31/12/2018	BBB+	A-2	Stable	Initial
Instrument Structure	N/A				
Statement by the Rating Team	VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.				
Probability of Default	VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.				
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Due Diligence Meetings Conducted	**S.No**	**Name**	**Designation**	**Date**	
	1	Mr. Muhammad Junaid	CFO	December 03, 2021	
	2	Mr. Hasan Saleem	General Manager Finance & Accounts	December 03, 2021	