RATING REPORT

Naveena Exports Limited

REPORT DATE:
April 4, 2019

RATING ANALYSTS:

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RATING DETAILS				
	Latest Ratings		Previous Ratings	
Rating Category	Long-term	Short-term	Long-term	Short-term
Entity	A-	A-1	A-	A-2
Rating Date	*April 4, 2019*		*April 19, 2018*	
Rating Outlook	**Positive**		**Stable**	

COMPANY INFORMATION

Incorporated in 1989	**External auditors:** Ibrahim, Shaikh & Co. Chartered Accountants
Public Unlisted Company	**Managing Directors:** - Mr. Asif Riaz (Chairman) - Mr. Masood Riaz (CEO) - Mr. Saqib Riaz
Shareholding (5% or more): Mr. Asif Riaz – 35% Mr. Masood Riaz – 37% Mr. Saqib Riaz – 26% Mr. Asad Asif – 2%	

APPLICABLE METHODOLOGY(IES)

Applicable Rating Criteria: Industrial Corporates (May, 2016)
http://www.vis.com.pk/kc-meth.aspx

Naveena Exports Limited

OVERVIEW OF THE INSTITUTION

Naveena Exports Limited (NEL) was incorporated in 1989. The Company is currently operating as a Public Unlisted Company.

NEL is a family owned business managed by three brothers: Mr. Asif Riaz (Chairman), Mr. Masood Riaz (Chief Executive Officer) and Mr. Saqib Riaz (Director). Mr. Asif Riaz possesses over 30 years of experience in the textile sector. He was the Chairman of Pakistan Knitwear & Sweater Exporters Association (Oct'03-Sep'04) and Pakistan Denim Manufacturers and Exporters Association (Oct'10-Sep'11). He has been associated with Naveena since its inception.

NEL is fully compliant with International Social and Environmental & Quality standards. The company has a liaison office in Bangladesh with sales representatives in US, South America, Europe and Turkey.

RATING RATIONALE

Naveena Exports Limited (NEL) is engaged in the business of manufacturing and sale of yarn and denim fabric. The Company is currently undergoing restructuring whereby ownership of the Company will be transferred to Naveena Group (Private) Limited (Naveena Group) which will act as a holding Company for various investments of the Group. Accordingly, NEL's long-term investments in various sectors will be transferred to Naveena Group by end-FY20. These comprise steel sector (Naveena Steel Mills), real estate sector (Naveena Developers and Naveena Builders) and renewable energy sector (Lakeside Energy).

NEL operates through three manufacturing units located at Karachi and Lahore. Capacity utilization of both segments (yarn and denim fabric) has remained high with revenues of the company almost entirely comprising export sales (direct and indirect).

Spinning division, with 43,200 spindles, produces yarn which is mainly utilized in-house for production of denim fabric. Further, denim fabric division currently has 232 looms installed for production of denim fabric. Going forward, NEL is planning BMR capex in order to enhance efficiency and capacity.

More than four fifth of sales revenue is contributed by denim fabric segment. Country-wise sales illustrate that Bangladesh remains the largest export market for the company representing one-third of sales. However, end clients are mainly based in US and Europe.

Key Rating Drivers:

Improving business risk profile

Business risk profile is supported by stable and growing demand for denim fabric. However, local and international expansion by major players is expected to keep pricing power and hence margins under pressure. Moreover, significant investment required by customers as part of sustainability initiative is expected to add to cost pressures for denim manufacturers. The company's operations are currently concentrated with exposure entirely to the denim industry which might significantly impact business risk profile in case of change in demand patterns or any other industry specific factors. Therefore, keeping pace with rapid changes in fashion trends is considered important. JCR-VIS expects demand for denim products to remain stable over the medium term which along with supportive policies of the government towards the textile sector and sizeable rupee depreciation are expected to bode well for the competitiveness of the sector.

Net sales increased on the back of volumetric growth, higher selling prices and exchange gain. Gross margins improved on the back of rupee depreciation and higher value added sales

NEL has depicted consecutive year-on-year growth in net sales over the past five years recording compound annual growth rate (CAGR) of 7% (FY14-18). The company reported growth of 13.0% in sales in FY18. In 1HFY19, net sales depicted significant increase vis-à-vis 1HFY18 mainly on account of higher sales volume, increase in selling prices (higher value added products) and rupee depreciation. In addition, government's export rebate scheme helped the company and sector to be competitive with regional competitors. In order to support sales and maintain margins, management is pursuing additional compliance requirements of potential clients.

Gross margins have increased on a timeline basis. Rupee depreciation, favorable sales mix with increase in the proportion of direct exports and higher value added goods, cost reduction and implementation of maintenance schemes positively impacted margins during period under review. However, due to unavailability of quality cotton locally, NEL had to shift towards imports, which diluted impact of rupee depreciation. Margins of NEL are on the higher side vis-à-vis peers given the focus on research and new product development. However, sustaining margins at current levels will remain a challenge.

Raw material and power cost remain two of the largest cost components. In order to manage production cost, the company resorted to strategic cotton procurement (imported vs. local). Additionally, power consumption mix was altered with greater use of natural gas. With controlled expenses and higher other income, profit after tax depicted growth. Around two-third of borrowings are non-KIBOR based; therefore, impact of any rise in policy rates on finance cost is expected to be limited to only one-third of outstanding borrowings.

Sound liquidity profile with enhanced cash flow coverage indicators

Liquidity profile of the company is considered strong in view of sufficient cash flows in relation to outstanding obligations and ageing profile of trade debts which remain within manageable levels. FFO to total debt and FFO to long-term debt were reported at 37% (FY18: 31%) and 111% (FY18: 158%) during 1HFY19. Debt servicing coverage ratio was reported at 5.3(x) during 1HFY19. The company's liquid assets comprise cash & bank balances and short term investments. In FY18, the company reduced its investment portfolio by almost half. Liquidity generated from the same was deployed for funding investment in subsidiaries and purchase of inventory. With current assets being greater than current liabilities, current ratio of NEL was reported greater than 1(x) at end-FY18. With majority payment of cotton being made upfront, and higher collection and inventory days, NEL's working capital cycle necessitates utilization of short term borrowing.

Leverage indicators remain manageable levels

Equity base has increased on a timeline basis on account of profit retention. Around two-third of debt carried on balance sheet comprises short term debt to fund working capital requirements while remaining represents long term borrowings. Leverage indicators remained around prior year's level in FY18, however, the same increased notably in 1HFY19 on account of long term debt mobilization. Gearing levels stood at 0.80x at end-Dec'18 and 0.68x (FY17: 0.62x) at end-FY18. Divestment of investment in subsidiaries by end-FY20 will result in decrease in equity base. Moreover, funding of BMR capex through long term financing facility is expected to result in higher total debt by end-FY20. As a result, gearing levels are projected to rise close to 1(x) over the rating horizon.

Adequate corporate governance

Overall scope and functioning of internal audit and IT function are considered adequate. NEL has employed an Oracle based ERP with in-house developed modules integrated with the ERP. Adequate back-up procedures are in place. Given the company's status as a Public Unlisted Company, there is room for improvement in board composition and oversight. In view of ongoing restructuring underway at the group level, corporate governance practices of NEL may witness enhancement.

ISSUE/ISSUER RATING SCALE & DEFINITION 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 Exports Limited
Sector	Textile Industry
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see table below
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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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
3/4/2019	**A-**	**A-1**	**Positive**	**Upgrade**
19/3/2018	**A-**	**A-2**	**Stable**	**Initial**