

RATING REPORT

Naveena Exports Limited

REPORT DATE:

January 31, 2020

RATING ANALYSTS:

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RATING DETAILS

Rating Category	Latest Ratings		Previous Ratings	
	Long-term	Short-term	Long-term	Short-term
Entity	A	A-1	A-	A-1
Rating Date	January 31, 2020		April 8, 2019	
Rating Action	Upgrade		Upgrade	
Rating Outlook	Stable		Positive	

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 (Managing Director)

Shareholding:

Mr. Asif Riaz – 35%
 Mr. Masood Riaz – 37%
 Mr. Saqib Riaz – 26%
 Mr. Asad Asif – 2%

APPLICABLE METHODOLOGY(IES)

Applicable Rating Criteria: Industrial Corporates (April 2019)

<https://s3-us-west-2.amazonaws.com/backupsqvis/docs/Corporate-Methodology-201904.pdf>

Naveena Exports Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE
<p>Naveena Exports Limited (NEL) was incorporated in 1989. The Company is currently operating as a Public Unlisted Company.</p> <p>NEL is a family owned business managed by three brothers: Mr. Asif Riaz (Chairman), Mr. Masood Riaz (Chief Executive Officer) and Mr. Saqib Riaz (Managing 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.</p> <p>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.</p>	<p>Naveena Exports Limited (NEL) is engaged in the business of manufacturing and sale of yarn and denim fabric. NEL operates through three manufacturing units located at Karachi and Lahore. NEL also has investments in various sectors including steel, real estate and renewable energy sector. Over the rating horizon, NEL plans to undergo 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. These comprise textile (NEL), steel (Naveena Steel Mills) and real estate (Naveena Developers and Naveena Builders). Company's renewable energy sector project (Lakeside Energy) shall remain in the books of NEL.</p> <p>Within textile segment, 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. During FY 2018-19, the company completed BMR at its manufacturing units whereby it replaced 70 looms in Karachi unit and 51 looms in Lahore unit with new technology yielding higher efficiency and production. Going forward, NEL plans to consistently continue incurring BMR capex through surplus cash flows in order to enhance efficiency and capacity. 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).</p> <p>Around 90% of sales revenue is contributed by denim fabric segment. Country-wise sales illustrate that Bangladesh remains the largest export market for the company representing around one-third of sales. During FY19 and 1QFY20, growth has been noted in fabric sales to Egypt. Despite higher geographic concentration risk, ratings draw comfort from long term association with end clients. In order to support sales, management is pursuing additional compliance requirements of potential clients.</p> <p><u>Key Rating Drivers:</u></p> <p>Moderate business risk profile supported by stable demand for denim products</p> <p>Business risk profile is supported by stable and growing demand for denim products. However, local and international expansion by major players is expected to keep pricing power and hence margins slightly under pressure for industry players. Keeping pace with rapid changes in fashion trends is considered important. VIS expects demand for denim products to remain stable over the medium term. Given the favorable policies & incentives of the government on enhancing exports and imposition of duties on Chinese exports to USA, there is significant opportunity for Denim players to enhance exports. In this regard, NEL is well positioned to tap this opportunity given the successful completion of BMR at its manufacturing facilities yielding higher efficiencies and significant focus on product innovation.</p> <p>Net sales depicted strong double digit growth during FY19. Profitability was also supported by higher margins on the back of rupee devaluation and increase in value added sales</p> <p>NEL has depicted consecutive year-on-year growth in net sales over the past five years recording compound annual growth rate (CAGR) of 11.2% (FY14-19) during the period. In FY19 and 1QFY20, net sales depicted significant increase vis-à-vis corresponding period last year mainly on account of higher average selling prices emanating from value-added products and rupee depreciation.</p> <p>Gross margins have consistently increased on a timeline basis. Rupee devaluation, favorable sales mix with increase in the proportion of direct exports and higher value added goods (fabric</p>

manufacturing using LYCRA yarn, man-made & dual core fiber and increase in sales of finer count product) alongwith cost optimization positively impacted margins during the period under review. However, due to unavailability of quality cotton locally, NEL has recently had to shift towards imports, which may partly dilute the impact of rupee devaluation on margins. Margins of NEL are on the higher side vis-à-vis peers given the focus on research & product development and increasing proportion of value added sales. However, sustaining margins at current levels will remain an important rating driver.

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 to optimize cost. Consequently, given improving margins and efficient cost management, profit after tax depicted healthy growth. Around 80% of total borrowings are on concessionary rates; therefore, impact of higher policy rates on finance cost is expected to be limited. Going forward, some volumetric growth along with higher average prices are expected to be key profitability drivers.

Sound liquidity profile with strong cash flow and debt servicing coverages

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 42.1% (FY19: 38.5%; FY18: 30.5%) and 99.1% (FY19: 89.9%; FY18: 158%) during 1QFY20. Debt servicing coverage ratio was reported at 8.03(x) during 1QFY20. The company's liquid assets comprise cash & bank balances and short term investments. Short term investments comprise exposure in mutual funds. With current assets being greater than current liabilities, current ratio of NEL was reported greater than 1(x) at end-1QFY20. 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. Liquidity profile of the company over the rating horizon is expected to remain strong given projected profitability profile. Moreover, limited capex requirements and funding requirement for investments is expected to support profitability profile over the rating horizon.

Leverage indicators remain within manageable levels

Equity base has increased on a timeline basis on account of profit retention. Around three-fifth 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 at end-Sep'2019 where gearing levels stood at 0.71x (FY19: 0.71x, FY18: 0.68x) at end-Sep'2019. Gearing levels are projected to remain below 1(x) over the rating horizon. Comfort is drawn from no projected increase in long term financing 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.

Naveena Exports Limited

Appendix I

FINANCIAL SUMMARY <i>(amounts in PKR millions)</i>				
<u>BALANCE SHEET</u>	FY17	FY18	FY19	1QFY20
Paid Up Capital	849	849	850	850
Total Equity	7,679	8,879	11,316	12,026
<u>INCOME STATEMENT</u>				
Net Sales	10,716	12,109	15,612	4,589
Profit Before Tax	957	1,301	2,482	758
Profit After Tax	833	1,199	2,437	710
<u>RATIO ANALYSIS</u>				
FFO	1,255	1,842	3,083	892
Current Ratio (x)	1.49	1.35	1.55	1.50
Gearing (x)	0.62	0.68	0.71	0.71

* Annualized numbers

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 III			
Name of Rated Entity	Naveena Exports Limited				
Sector	Textile Industry				
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				
	31/01/2020	A	A-1	Stable	Upgrade
	8/4/2019	A-	A-1	Positive	Upgrade
	19/4/2018	A-	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	Name		Designation	Date	
	1	Mr. Waqas Hanif	General Manager Finance	08-Jan-2020	