



AZGARD NINE LIMITED

- A total of nine rating actions within a period of six years preceding “default”

1.1 Azgard Nine Limited (ANL) started commercial production in 1997 as Legler Nafees Denim Mills Limited. This was a joint venture between the Colony Group of Pakistan pioneered by the Sheikh family and Legler Spa, Italy. In 2004, the company’s name was changed to Azgard Nine Limited (ANL) as a symbol of the decreased role of Legler Spa in the company’s operations, and the company attaining its own unique positioning. PACRA assigned first entity ratings to ANL in April 2004 and till March 2011 a total of nine rating actions were taken, including two upgrades and four downgrades.

Long-term Entity Rating History – Azgard Nine Limited											
AA											AA
AA-											AA-
A+											A+
A			RW								A
A-							RW	⚠			A-
BBB+											BBB+
BBB											BBB
BBB-											BBB-
BB+								RW	⚠		BB+
BB											BB
BB-											BB-
B+											B+
B											B
B-											B-
CCC											CCC
CC											CC
C											C
SD/D											SD/D
	Apr-04	Apr-05	Apr-06	Jul-06	Sep-07	Nov-08	Mar-10	Jun-10	Sep-10	Mar-11	

Entity Ratings 
 Rating Watch **RW**
 Negative Outlook 

1.2 The upward transition in ratings reflected the company’s sustained progression towards higher value addition in denim products, supplemented by efficient vertical integration of textile operations, and long-standing relationships with customers. In a gradual manner, ANL enhanced the proportion of value added products in its product mix, which increased its gross margin. Although the company’s profitability was under pressure, owing to sizable finance cost on account of high borrowings, the ratings recognized the beneficial implications of the acquisition of Agritech Limited, erstwhile Pak American Fertilizers Limited, for the overall risk profile of ANL. The fertilizer industry in Pakistan has been well placed to take full advantage of the strong urea demand amidst continuing supply deficit. This meant stable cashflows to Agritech Limited, supplemented through trading operations of DAP. Agritech provided support to ANL’s financial profile through strong dividend payouts after takeover. Moreover, the management embarked upon a plan to re-profile ANL’s borrowings. This was done through issuance of a long term instrument to meet short term obligations. In the meantime, to enhance its denim operations and strengthen its marketing infrastructure, the company acquired a foreign brand, Montebello, in Italy in 2008.

1.3 ANL’s credit profile suffered significant financial constraint in later half of 2009 owing to global economic downturn, which also impacted ANL’s primary sales market – Europe.

Montebello, operating in the European market, accumulated a significant amount of overdues (PKR 1bln) from customers. Besides impacting ANL's liquidity, this also reduced operational capability of the company. The ensuing financial crisis was further accentuated by tightened credit markets in Pakistan limiting access to fresh borrowings amidst high interest rates, resulting in perpetual asset/liability mismatch. At that time, there was immense pressure on PKR-dollar parity, which forced ANL to wind up interest rate SWAP transactions. This caused a sizable loss, amounting PKR 1.9bln, to the company. The company had tried to cushion its stressed financial profile through divestment of a sizable stake in Agritech. Firstly, negotiations with a foreign party took more than expected time, which finally did not materialize. Thereafter, ANL decided to offload about 20% stake of Agritech in the domestic market; however, this process also went longer than expected. Moreover, the cashflows generated through the offer were insufficient to meet the burgeoning asset/liability gap. Taking notice of the emerging situation, PACRA issued a press release on March 19, 2010, while downgrading entity and TFCs ratings by two notches (**long-term: A-** from A+; **TFCs I¹: A** from AA- and **TFCs II²: A-** from A+) highlighting the: i) increase in business and financial risk of the company, and ii) delay in the divestment of strategic investment (Agritech Limited). Meanwhile, PACRA assigned a negative outlook to these ratings mentioning that ANL's capacity for timely payments of financial commitments may be susceptible to adverse changes in business, economic, or financial conditions. Cognizant of that, the management embarked upon a debt-restructuring program, the outcome and timeliness of which was considered critical for the ratings.

1.4 The entity and TFCs ratings remained under surveillance and were further downgraded on June 30, 2010 by four notches taking the entity and TFCs II ratings in speculative grade – “BB+”, while, rating of TFCs I was revised to “BBB-” (lowest investment grade rating) – a notch higher than entity rating – capturing the security structure of the instrument. These ratings indicated that credit risk was developing, particularly as a result of adverse economic change over time. By that time, the management was focusing on a twofold strategy: i) divestment of its remaining stake in Agritech Limited and (ii) restructuring of its borrowings, including revival and expansion in working capital lines. The divestment was at an early stage of due diligence by interested investors. Restructuring was at an advanced stage of finalization. Both TFCs had been restructured though these experienced a certain amount of delay in execution thereof. The company had principal restructuring consent of lenders for other borrowing lines, wherein documentation was in process. Also, the ratings were placed on *Rating Watch* emphasizing the ongoing restructuring process, where timely completion was critical. Meanwhile, outlook on ratings remained negative highlighting high business risk, in addition to financial risk, underpinning the criticality of active revival of profitable core operations.

1.5 On September 29, 2010, PACRA downgraded the entity ratings of ANL to “SD” (Selective Default), denoting that a portion of the financial obligations was in default at that time. Meanwhile, the ratings of both TFCs were revised to “CCC”. The ratings, in addition to security structure, reflected the cushion available for the repayment (beginning 1QCY11) by which time the entire restructuring process was expected to complete, supporting cashflow generation of the company.

1.6 On March 31, 2011, PACRA took the entity and TFCs ratings to “D”, reflecting the materialized financial risk leading to non-performance on most financial obligations – accumulated interest overdues on financial liabilities.

1.7 Just before the default, the company had completed restructuring of its borrowings. A 'Master Restructuring and Intercreditor Agreement' was signed by all the stakeholders in Dec-10. The agreement, while capturing various aspects of debt restructuring, stipulated a number of

¹ Secured listed TFCs of PKR 2,144mln issued by ANL in September 2005.

² Secured privately placed TFCs of PKR2,500mln issued by ANL in December 2007.

qualitative covenants including special audit, quality of external auditors, and divestment of Agritech Limited. As part of this restructuring arrangement, ANL has been provided fresh working lines of above PKR 2.5bln, though with a delay. ANL has now managed to gain sizeable upturn in its capacity utilization, running at overall ~60% capacity, with its spinning unit operating at close to 85% level. Although the company is still incurring cash losses, its improved revenue stream has reduced the quantum. A key element of the overall restructuring process is divestment of ANL's ~80% equity stake in Agritech Limited, which is still pending. This is expected to yield above PKR 8bln to the company. The proceeds, while mainly utilized for debt reduction, would fund current losses of the company. Although the management is hopeful of early closure of sale transaction, the timing remains uncertain.

1.8 Going forward, prospects of spinning industry are sanguine and ANL is also regaining its lost denim business. However, the ability of the company to manage working capital constraints to achieve high capacity utilization is critical. At the same time, timely sale of Agritech is important to rationalize overall debt profile.

1.9 As per PACRA Default Recognition Policy (“What is Default”), entity ratings, put on the default counter (whether D or SD), remain under surveillance on a best-effort basis and updated using both public and non-public sources, till the time: (i) the rating relationship is terminated at the client’s request or made to terminate by PACRA on account of a lack of cooperation, particularly at a time when the company is experiencing financial distress and refuses to provide all the information needed to continue surveillance on the ratings, and / or (ii) when an entity ceases to exist as a result of a merger / acquisition. An entity rating, hence withdrawn, marks the end of the rating relationship with PACRA. Thereafter, a fresh rating mandate is agreed in order for entity ratings to be assigned. Instruments, assigned a D rating, remain under surveillance (till fully settled) and are updated using both public and non-public sources, on a best effort basis.

Key References:

March 31, 2011	PACRA Updates Ratings of Azgard Nine Limited
September 29, 2010	PACRA Downgrades Ratings of Azgard Nine Limited To "SD"
June 30, 2010	PACRA Revises Ratings of Azgard Nine Limited....:Remains on Rating Watch with Negative Outlook
March 19, 2010	PACRA Downgrades Ratings of Azgard Nine Limited; Placed on Watch

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