



The Pakistan Credit Rating Agency Limited

Rating Report

Liberty Mills Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
09-Apr-2018	A+	A1	Stable	Maintain	-
12-Jun-2017	A+	A1	Stable	Maintain	-
14-Jun-2016	A+	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Liberty Mills ratings reflect diversity in revenue stream emanating from textile business topped up with non-core recurring income from investments. The holding company structure of the entity strengthens its profile; investment book constitutes ~53% of the equity base and related income provides a significant buffer to bottomline (81%). Strategic holding in IPP – Liberty Powertech is reaping strong dividends. Liberty Mills, a family-owned textile company, operates in value-added segment - processing of fabric and made-ups. While this insulates it against volatility in cotton prices, the company's resilient business profile from core operations featured by business margins which, though reduced recently, remains in comfortable range. With an export market orientation, the company focuses on its established niche of quality-conscious institutional buyers. Although this has led to customer concentrations, longevity of relationship with big-name clients in addition to sustained quality helps manage the risk. A plunge in the revenue growth is observed owing to intense competition in the region. Liberty's strong financial risk profile is characterized by limited long-term debt, healthy cash flows, and, in turn, strong debt-servicing ability. Working capital cycle is stretched, though in line with peers; any improvement will bring efficiency. Long association of experienced management team adds comfort. However, governance framework needs improvement.

Going forward, Liberty Group - the sponsors - intends to expand its industrial footing with a diversification philosophy. A number of medium and long term projects are underway at group-level including (i) Pakistan Aluminum Beverage Cans Limited (PABC) (ii) Noor Solar Energy (Pvt.) Limited (iii) Engro PowerGen Thar (Pvt.) Limited (iv) Steel Plant (v) Pharmaceutical company

The ratings are dependent on the management's ability to sustain its margins while improving growth in revenue. Meanwhile, utilization of beefed-up capacities is considered important. Going forward, increase in business size, continuation of dividend/other income stream vis-à-vis solidification of governance framework will have positive implications on ratings.

Disclosure

Name of Rated Entity	Liberty Mills Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Corporate Rating Methodology(Jul-2017), Methodology Correlation between long-term and short-term rating scale(Jun-2017), Methodology Criteria Modifiers(Jun-2017)
Related Research	Sector Study Textile(Oct-2017)
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The Pakistan Credit Rating Agency Limited

LIBERTY MILLS LIMITED - PROFILE		INDUSTRY SNAPSHOT
Incorporated	1964	<p>During FY17, total textile exports stood at USD ~ 12,453mln.</p> <p>Cotton yarn contributes (10%), cotton cloth (17%), home textile (29%), while garments contributes (38%).</p> <p>Pakistan's exported value added products of ~9bln in FY17.</p> <p>Bailout package from government along with devaluation in currency is expected to boost otherwise diminishing exports of textile sector</p>
Major business lines	Processing and Home Textile	
Legal status	Private Company	
Head office	Karachi	
Capacity	90mln Linear meters	
Plant Location	Sindh Industrial and Trading Estate in Karachi	

OWNERSHIP

- The company is majority (~100%) owned by Mukaty family.
- The Group heritage starts from M/s Noor Mohammad Haji Mohammad & Sons, established by father of Mr. Salim Mukaty in 1908 in the subcontinent with the Head Office in Bombay and branches in Calcutta, Chennai, and Rangoon.
- Currently, Liberty Group has interests in textile and energy sectors of Pakistan.
- Going forward, a number of medium and long term projects are underway at group-level including (i) Pakistan Aluminum Beverage Cans Limited (PABC) (ii) Noor Solar Energy (Pvt.) Limited (iii) Engro PowerGen Thar (Pvt.) Limited (iv) Steel Plant

GOVERNANCE

- Eight-member board comprises four directors from sponsoring family, three executive members, and one non-executive director.
- No segregation in the role of Chairman & CEO; position held by Mr. Salim Mukaty – the founding member
- Need for improvement in governance structure to bring independent oversight and guidance to management strategy.
- Board members have significant industry experience and have a long association with Liberty. BoD meetings are conducted at regular intervals. However, documentation of discussion in meetings needs improvement.
- M/s, Kreston Hyder Bhimji & Co. Chartered Accountants, is the external auditor of the company. They are classified by the State Bank of Pakistan in "Category A" on its panel of auditors. The auditor gave an unqualified opinion on the company's financial statements for the year ended June 30, 2017.

MANAGEMENT

- Executive Director Mr. Muhammad Ashraf S. Mukaty - son of Mr. Salim Mukaty - oversees company operations. Mr. Ashraf is supported by a team of experienced professionals. Most of the senior management has been associated with the company for a reasonably long time.
- The organizational structure of the company is well-defined and proper hierarchy is in place. Head count of the company at Jun17 was 2,000.
- Liberty deploys oracle based Enterprise Resource Planning (ERP) system; it provides an integrated view of business processes.
- The company maintains a comprehensive MIS reporting system for the management to keep track of activities. The company's MIS comprises range of reports including cash position, receivable position, payable position, production, inventory status reports etc.

BUSINESS RISK

- Export-oriented company (92% of sales); sales mix is dominated by Processing segment, followed by Home Textile segment
- Sales are moderately diversified in different geographical regions. The top three exporting countries in FY17 include USA (~52% of export revenues), followed by Germany (~12%), and United Kingdom (~11%).
- Long-term working relationships with top brands including Polo Ralph Lauren, GAP, The Children's Place, etc. At the same time, concentration of revenue from top ten customers', is high, portraying concentration risk.
- During FY17, revenues increased by ~2% on YoY to PKR ~15,358mln (FY16: PKR 15,055mln). This is mainly attributable to the increase in export sales segment - stood at PKR 14,137mln (FY16: PKR 13,935mln). However, a plunge in the revenue growth is observed owing to intense competition in the region.
- During FY17, cost of production increased by higher proportion (7%) than revenues mainly due to increase in cost of raw material - ~65% of the revenue (FY16: ~62%), resulting in contraction of margins; gross (FY17: ~14%, FY16: ~18%) and operating (FY17: 6.7%, FY16: 11.4%).
- Going forward, revenue growth and margins are expected to improve owing to prudent procurement of raw material.
- Recurring non-core income constitutes a significant part of company's bottom line. Herein, hefty dividend income from subsidiary – Liberty Power Tech Limited, continues to yield predominant proportion (FY17: PKR 2,966mln; FY16: PKR 506mln).
- During 1HFY18, topline of the company increased by ~5% to PKR 7,823mln. Cost of sales has increased by proportion (~7%) than revenues attributing to hike in the cost of raw material [Percentage of Revenue: 1HFY18: ~68%, 1HFY17: ~63%]. Ensuing gross margin of the company declined (1HFY18: ~14%, 1HFY17: ~16%). Accounting for taxation, net profit of the company stood at PKR 525mln (1HFY17: PKR 785mln). Dividend income from Liberty Power Tech is expected to receive in 2HFY18.
- Liberty generates electricity for its in-house use through captive power plants (natural gas: 8.6MW, HSD: 2MW), which are sufficient to meet total energy requirements (5.2MW).

FINANCIAL RISK

- Working capital requirements, a function of its receivables and inventory, are met through a mix of internal generation and short term borrowings. Inventory and receivables as a percentage of sales continued to decrease in recent years resulting in better net working capital days (1HFY18: 139days, FY17: 142days).
- Interest coverage (FY17: 6.3x, FY16: 11.1x) and debt coverage (FY17: 4.0x, FY16: 11.1x) have declined YoY owing to reduction in FCFO (FY17: 893mln, FY16: 1,789)
- Moderately leveraged capital structure (end-Dec17: ~32%, end-Jun17: ~31%) - no major expansion is expected in the medium term.
- Investment book constitutes ~60% of Liberty's equity base at end-Dec17; predominantly comprises strategic investments in Liberty Power Tech Limited and Engro PowerGen Thar (Pvt.) Limited.



Liberty Mills Limited

PKR mln

BALANCE SHEET	30-Dec-17	30-Jun-17	30-Jun-16	30-Jun-15
	6M	FY17	FY16	FY15
Non-Current Assets	4,265	4,232	4,106	3,890
Investments (Incl. Associates & Subsidiaries)	7,886	6,624	3,646	1,683
Equity	7,886	6,624	3,146	1,683
Debt Securities	-	-	500	-
Current Assets	8,904	8,797	7,589	7,284
Inventory	4,281	4,055	3,579	3,757
Trade Receivables	2,228	2,267	2,097	1,829
Others	2,395	2,474	1,913	1,699
Total Assets	21,055	19,653	15,341	12,857
Debt	6,189	5,635	5,317	4,384
Short-Term	4,958	4,477	4,365	3,407
Long-Term (Incl. Current Maturity of Long-Term Debt)	1,231	1,158	953	977
Other Short-Term Liabilities	1,775	1,446	1,240	1,361
Other Long-Term Liabilities	-	-	-	214
Shareholder's Equity	13,091	12,572	8,784	6,899
Total Liabilities & Equity	21,055	19,653	15,341	12,857

INCOME STATEMENT

Turnover	7,823	15,358	15,055	14,938
Gross Profit	1,096	2,129	2,662	2,613
Net Other Income	(18)	3,424	519	417
Financial Charges	(87)	(142)	(161)	(247)
Net Income	526	3,783	1,890	1,758

Cash Flow Statement

Free Cash Flow from Operations (FCFO)	737	893	1,789	1,706
Net Cash changes in Working Capital	600	(864)	(530)	(489)
Net Cash from Operating Activities	1,314	2,970	1,602	1,498
Net Cash from Investing Activities	(1,857)	(3,128)	(2,629)	(1,812)
Net Cash from Financing Activities	409	318	934	698

Ratio Analysis

Performance				
Turnover Growth	4.9%	2.0%	0.8%	22.6%
Gross Margin	14.0%	13.9%	17.7%	17.5%
Operating Margin	9.1%	6.7%	11.4%	11.4%
Net Margin	6.7%	24.6%	12.6%	11.8%
ROE	8.3%	33.7%	23.4%	28.5%
Coverages				
Interest Coverage (FCFO/Gross Interest)	8.4	6.3	11.1	6.9
Core: (FCFO/Gross Interest+CMLTD+Uncovered Total STB)	5.8	4.0	11.1	3.0
Total: (TCF) / (Gross Interest+CMLTD+Uncovered Total STB)	6.3	17.7	14.4	3.9
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	139	142	129	126
Capital Structure (Total Debt/Total Debt+Equity)	32.1%	31.0%	37.7%	38.9%



ENTITY CREDIT RATING SCALE & DEFINITIONS

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity; 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		SHORT TERM RATINGS	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments.	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.	
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.		
AA	Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.		
AA-			
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.		
A			
A-			
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 or economic conditions are more likely to impair this capacity.		
BBB			
BBB-			
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.		
BB			
BB-			
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.		
B			
B-			
CCC	Very high 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.		
CC			
C			
D	Obligations are currently in default.		
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. Rating Watch may carry designation – Positive (rating may be raised, negative (lowered), or developing (direction is unclear). A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled.	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 or 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'.	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, a suspended 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, or e) the entity/issuer defaults.
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Rating Team Statements

(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) Conflict of Interest

- i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
- ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
- iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term “family members” shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions

- (3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
- (4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
- (5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business

- (6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
- (7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
- (8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
- (9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
- (10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
- (11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

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- (12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA’s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
- (13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers’ associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
- (14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
- (15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
- (16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst’s area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
- (17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review

- (18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
- (19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
- (20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
- (21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)

Probability of Default

(22) PACRA’s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA’s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA’s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)

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