



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
12-Jul-2019	A+	A1	Stable	Maintain	-
11-Jan-2019	A+	A1	Stable	Maintain	-
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 has historically provided a significant buffer to the bottomline. Strategic holding in IPP – Liberty Power Tech – has reaped strong dividends, though showing recent decline due to ongoing liquidity issues in the power sector resulting from stuck up receivables from GoP. Over the years, the Company has built a sizeable trading portfolio which exposes it to market risk exhibited by recent volatility in the stock market. Liberty Mills, a family-owned textile company, operates in the value-added textile segment - processing of fabric and manufacturing of madeups - which insulates it against volatility in cotton prices. 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. The currency devaluation has benefited the Company's export-oriented revenues while business margins have recently shown improvement. Meanwhile, the Company's financial risk profile remains strong, characterized by moderate leveraging, healthy cash flows, and, in turn, strong debt-servicing ability. Working capital cycle remains stretched, mainly due to increased raw material procurement foreseeing currency devaluation, the positive impact of which is visible in the bottomline. Long association of experienced management team adds comfort. Governance framework needs improvement.

Going forward, Liberty Group - the sponsor - 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) Liberty Wind Power One (Pvt.) Limited (iii) Engro PowerGen Thar (Pvt.) Limited (iv) Pharmaceutical projects and (v) Hydro Power projects.

The ratings are dependent on the management's ability to sustain its margins while improving growth in revenue. Meanwhile, continued 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	PACRA_Methodology_Corporate_FY19(Jun-19),PACRA_Criteria_LT ST Relationship_FY19(Jun-19),PACRA_Criteria_Rating Modifiers_FY19(Jun-19)
Related Research	Sector Study Textile(Oct-18)
Rating Analysts	Muhammad Hassan muhammad.hassan@pacra.com +92-42-35869504

Profile

Legal Structure Liberty Mills Limited (Liberty Mills) is an unlisted, public limited concern incorporated in 1964.

Background Liberty Mills commenced operations in 1964 as a private limited Company. Later, in 1969, its legal status was changed to a public, listed company. In Dec'13, the Company was delisted from the stock exchange.

Operations Liberty Mills is in the business of manufacturing and processing of textile fabrics and made ups. It operates in two main segments: processing (dyeing and printing) and home textile. The Company generates electricity for its in-house use through captive power generation. Its manufacturing facility is located at Sindh Industrial and Trading Estate in Karachi.

Ownership

Ownership Structure Liberty Mills is the flagship company of the Liberty Group. It is owned wholly by the Mukaty Family, mainly through family members.

Stability In the absence of a group holding company and the personal relationship that exists between the sponsors, there is no formal succession plan, which poses a threat to the stability of the Company.

Business Acumen With almost four decades of experience, the Liberty Group has expertise in textile and energy sectors of Pakistan. The sponsors carry extensive diversified industrial experience.

Financial Strength Apart from presence in textile and energy, the Group also has interests in the aluminium sector. Furthermore, it has planned investments in power and steel sectors. The sponsors have shown willingness and ability to support the Company in times of need.

Governance

Board Structure The Board of Directors comprises eight members of the Mukaty family. The Board is Chaired by Mr. Muhammad Salim Mukaty who also holds the office of CEO. Absence of independent oversight indicates need for improvement in the governance structure of the Company.

Members' Profile The Chairman, Mr. Salim Mukaty, brings with him over 50 years of experience in the local textile industry. Meanwhile, all Board members have significant industry related as well as diversified experience and have a long association with the Liberty Group.

Board Effectiveness Board meetings are conducted at regular intervals. However, documentation of discussion in meetings needs improvement. To ensure proper oversight, the Company has also formed two committees – Audit, and Human Resource & Remuneration – to assist the board on relevant matters.

Financial Transparency 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, 2018.

Management

Organizational Structure The structure of the Company is currently divided into ten functional departments, with the Head of each department reporting directly to Executive Director, Mr. Muhammad Ashraf Mukaty, who oversees daily operations.

Management Team Mr. Muhammad Ashraf – son of Mr. Mukaty – manages day to day operations and will succeed Mr. Salim Mukaty as CEO. 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 period of time.

Effectiveness Liberty Mills maintains adequate IT infrastructure and related controls. The Company has a comprehensive reporting system for the management to keep track of activities.

MIS Oracle based Enterprise Resource Planning (ERP) system has been deployed which provides an integrated view of business processes, facilitating comprehensive MIS reporting.

Control Environment Liberty has a well-trained quality control department. The Company is ISO 9001 certified. It also has an internal audit department that reports directly to the CEO, while it should report to the Audit Committee of the Board, to ensure effectiveness of the function.

Business Risk

Industry Dynamics During 11MFY19, Pakistan's textile exports largely remained stagnant (~0.1% negative growth YoY). Even though major segments including cotton cloth, knitwear, garments and bedwear displayed strong volumetric growth, a unit price dip resulting from having to share currency devaluation benefits with customers, overall slowdown in global demand on the back of the US-China trade war and intense competition from Bangladesh and Vietnam, curbed overall growth. Going forward, the removal of zero-rated status of the textile sector may pose a challenge to the liquidity of textile players.

Relative Position Liberty Mills is placed among the major value-added textile exporters of Pakistan. The Company faces competition from other large players such as Yunus Textile Mills, Kohinoor Textile Mills, Gul Ahmed and Nishat Mills.

Revenues The Company's sales have remained tilted towards exports (9MFY19: ~93%) which are moderately diversified in different geographical regions. During 9MFY19, revenues witnessed a ~24% increase compared to FY18, mainly on the back of significant currency devaluation during the period as well as more focus toward the home textile segment, a higher value-added segment. The Company's sales mix currently stands at: Processing-60% and Home Textile-40%. Concentration of revenue from top ten customers' is significantly high, portraying concentration risk.

Margins The Company's gross margin portrayed an increase of ~3% (9MFY19: ~17%, FY18: ~14%) mainly due to timely procurement of cloth inventory, resulting in inventory gains. The benefit translated into a rise in the operating margin which improved to ~12% (FY18: ~7%). Net margin, however, remained stagnant at ~10% owing to i) increase in finance cost on account of higher short-term borrowings to finance inventory and ii) no dividend received from associate concern, Liberty Power Tech, due to persisting liquidity issues of the power sector. The Company has also built a trading book over the years, investing in diversified sectors including banking and power. Net profit for the year amounted to ~PKR 1,977mln, a ~20% YoY increase driven by the robust revenue growth.

Sustainability Regular BMR activities, ongoing capex in the processing segment and continued dividend income from strategic investments is expected to support the Company's bottomline. The Company is in the process of setting up a ~1.3MW solar power plant for captive power generation. The plant has been financed through availing SBP's long-term financing facility, incurring an estimated cost of ~PKR 94mln. This is expected to bring significant cost efficiencies, going forward, and will favorably impact the Company's margins.

Financial Risk

Working Capital Liberty Mills' working capital needs emanate from financing its inventory of cloth and dyes & chemicals along with managing its trade receivables. In 9MFY19, inventories and receivables as a percentage of sales increased to 66% (FY18: 61%) as the Company purchased a significant amount of inventory of cloth and dyeing chemical, foreseeing the rupee devaluation. A corresponding increase in payables led to a decrease in overall net cash cycle to 120 days (FY18: 149 days). The Company maintains an adequate borrowing cushion at trade assets level.

Coverages During 9MFY19, a ~44% surge in operating cashflows due to high profitability resulted in strong improvement in interest coverage (9MFY19: 14.6x, FY18: 11.9x) and core debt coverage (9MFY19: 9.x, FY18: 6.4x).

Capitalization Liberty Mills maintains a moderately leveraged capital structure (9MFY19: ~41%, FY19: ~35%). Short-term borrowing witnessed a steep increase (9MFY19: ~PKR 9.6bln, FY18: ~PKR 6.4bln) to finance higher inventory needs. Major portion of debt continues to be dominated by short-term borrowing (~86%). Meanwhile, borrowings are predominantly made at concessionary rates offered by the SBP, providing protection in rising interest rate environment.



The Pakistan Credit Rating Agency Limited

Financial Summary

PKR mln

Liberty Mills Limited Textile Composite	Mar-19 9M	Jun-18 12M	Jun-17 12M	Jun-16 12M
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A BALANCE SHEET

1 Non-Current Assets	4,954	4,550	4,232	4,106
2 Investments	8,501	6,078	5,177	2,199
3 Related Party Exposure	1,447	1,447	2,027	1,447
4 Current Assets	15,286	12,258	8,217	7,589
<i>a Inventories</i>	8,442	6,139	4,055	3,579
<i>b Trade Receivables</i>	4,330	3,376	2,267	2,097
5 Total Assets	30,188	24,333	19,653	15,341
6 Current Liabilities	3,043	2,416	1,446	1,240
<i>a Trade Payables</i>	2,950	1,808	860	926
7 Borrowings	11,126	7,702	5,635	5,317
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	-	-	-	-
10 Net Assets	16,019	14,215	12,572	8,784
11 Shareholders' Equity	16,019	14,215	12,572	8,784

B INCOME STATEMENT

1 Sales	19,989	16,137	15,358	15,055
<i>a Cost of Good Sold</i>	(16,650)	(13,874)	(13,229)	(12,393)
2 Gross Profit	3,339	2,263	2,129	2,662
<i>a Operating Expenses</i>	(962)	(1,121)	(1,106)	(945)
3 Operating Profit	2,378	1,143	1,023	1,717
<i>a Non Operating Income</i>	57	918	3,424	519
4 Profit or (Loss) before Interest and Tax	2,434	2,061	4,448	2,236
<i>a Total Finance Cost</i>	(220)	(179)	(142)	(161)
<i>b Taxation</i>	(237)	(230)	(523)	(185)
6 Net Income Or (Loss)	1,977	1,652	3,783	1,890

C CASH FLOW STATEMENT

<i>a Free Cash Flows from Operations (FCFO)</i>	1,984	1,655	893	1,789
<i>b Net Cash from Operating Activities before Working Capital Changes</i>	1,868	1,933	3,835	2,132
<i>c Changes in Working Capital</i>	(3,372)	(1,868)	(864)	(530)
1 Net Cash provided by Operating Activities	(1,503)	65	2,970	1,602
2 Net Cash (Used in) or Available From Investing Activities	(2,837)	(1,444)	(3,128)	(2,629)
3 Net Cash (Used in) or Available From Financing Activities	3,426	2,066	318	934
4 Net Cash generated or (Used) during the period	(914)	688	160	(93)

D RATIO ANALYSIS

1 Performance				
<i>a Sales Growth (for the period)</i>	65.2%	5.1%	2.0%	0.8%
<i>b Gross Profit Margin</i>	16.7%	14.0%	13.9%	17.7%
<i>c Net Profit Margin</i>	9.9%	10.2%	24.6%	12.6%
<i>d Cash Conversion Efficiency (EBITDA/Sales)</i>	11.3%	11.4%	9.3%	14.6%
<i>e Return on Equity (ROE)</i>	17.4%	12.3%	35.4%	24.1%
2 Working Capital Management				
<i>a Gross Working Capital (Average Days)</i>	153	179	143	137
<i>b Net Working Capital (Average Days)</i>	120	149	121	113
<i>c Current Ratio (Total Current Assets/Total Current Liabilities)</i>	5.0	5.1	5.7	6.1
3 Coverages				
<i>a EBITDA / Finance Cost</i>	13.8	13.2	12.4	18.2
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	7.8	6.4	4.6	14.8
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>	0.6	0.8	1.5	0.6
4 Capital Structure (Total Debt/Total Debt+Equity)				
<i>a Total Borrowings / Total Borrowings+Equity</i>	41.0%	35.1%	31.0%	37.7%
<i>b Short-Term Borrowings / Total Borrowings</i>	86%	84%	79%	82%
<i>c Average Borrowing Rate</i>	2.3%	2.1%	2.1%	2.5%

Credit Rating Scale & Definitions

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; 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.
AA+ AA 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.	A1	A strong capacity for timely repayment.
A+ A 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.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
BBB+ BBB 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 and in economic conditions are more likely to impair this capacity.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
BB+ BB 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.	B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
B+ B 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.	C	An inadequate capacity to ensure timely repayment.
CCC CC C	Very high credit risk. Substantial 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.		
D	Obligations are currently in default.		



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/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’.

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. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

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, the 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, e) the entity/issuer defaults, or/and f) PACRA finds it impractical to surveil the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Disclaimer: PACRA's ratings are an assessment of the credit standing of entities/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA's opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security's market price or suitability for a particular investor.

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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