The Pakistan Credit Rating Agency Limited

Rating Report

Liberty Mills Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
10-Jul-2020	A+	A1	Stable	Maintain	-
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 strong business profile of the Company emanating from value added textile business and topped up with non-core recurring income from investments. This diversity in revenue stream insulates the Company's profitability to an extent. by providing a significant cushion. 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 holding company structure of the entity strengthens its profile with investment book constituting ~75% of the equity base. Strategic holding in IPP – Liberty Power Tech – has reaped strong dividends, though showing decline recently due to ongoing liquidity issues in the power sector because of circular debt. Over the years, the Company has built a sizable trading portfolio, which exposes it to market risk exhibited by recent volatility in the stock market. Amidst COVID-19 outbreak and subsequent lockdown, the Company had to shutdown its operations in line with the provincial Government's directive. Thus, the overall production was impacted due to the circumstances and margins were low. However, the Company continued to produce bedsheets for its hospital clients. Operations have been completely restored as majority of sales are export oriented. The recent currency devaluation is expected to be beneficial for the Company's performance. The Company's financial risk profile remains strong, characterized by moderate leveraging and in turn, strong debt-servicing ability. The Company has borrowed ~91% of loans, mainly short-term in nature, at concessionary rates from SBP. This keeps financing costs low and insulates the Company from interest rate risk. There is uncertainty due to the outbreak of COVID-19 pandemic. This has impacted the entire textile chain as demand contracts due to shutdown in domestic and global markets and tough economic conditions. However, recent easing in lockdown in local and export markets and improvement in exports provide comfort to the rating. Rating also incorporate strong sponsor support augmented by supplementary investment portfolio.
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 (iii) Pharmaceutical projects and (iv) Hydro Power projects

The ratings are dependent on sustaining business performance amidst prevailing tough conditions. Meanwhile, continued utilization of beefed-up capacities is considered critical. Meanwhile, improvement in governance framework will be favorable for the ratings. Going forward, increase in business size, continuation of dividend/other income stream will be important.

Disclosure

Name of Rated Entity	Liberty Mills Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-19),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria | Rating Modifier(Jun-19)
Related Research	Sector Study | Composite(Nov-19)
Rating Analysts	Bakhtawar Abid | bakhtawar.abid@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 though 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 pharmaceutical sectors. The sponsors have shown a willingness and ability to support the Company in times of need.

Governance

Board Structure The Board of Directors comprises seven 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 a 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, 2019.

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 Textile exports of the country dropped by ~8% for 11MFY20 to stand at ~USD 11.6bln as compared to ~USD 12.6bln in 11MFY19 due to slowdown in demand for textile products internationally, instigated by Covid-19 led lockdowns in major export destinations. Going forward, prevailing uncertainty in the dynamics of textile sector due to Covid-19 outbreak globally, lifting of lockdowns in most countries, contraction in local and international demand is expected to affect the entire textile value chain. Locally, textile sector will find comfort in relief measures introduced by State Bank of Pakistan such as, deferment of loan payments for one year, low interest rates and salary refinance scheme.

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 Liberty Mills' revenue is dominated by exports (9MFY20: ~93%) and witnessed a growth of ~19% YoY PKR 24bln (9MFY19: PKR 20bln) mainly on the back of significant currency devaluation during the period as well as more focus towards home textile products, a higher value-added segment. The Company's sales mix remains tilted towards Processing revenue (~60%) followed by Home Textile–40%. Sales are moderately diversified in different geographical regions. while the concentration of revenue from the top ten customers' is significantly high, portraying concentration risk.

Margins The Company's gross margin has shown a decrease of ~2% in 9MFY19 (9MFY20: ~15%, 9MFY19: ~17%) mainly due to the increase in raw material (fabric) prices. The same has been translated into the deterioration of operating margin which decreased to ~9% (9MFY19: ~12%). Net margin also showed YoY decline (9MFY19: ~8%, 9MFY19: ~10%) on the back of higher finance cost. Meanwhile, no dividend was received from associate concern, Liberty Power Tech, due to persisting liquidity issues of the power sector. Net profit in 9MFY20 almost remained stagnant, amounting to ~PKR 1.946bln (9MFY19 PKR 1.977bln).

Sustainability Due to COVID-19 outbreak and subsequent lockdown, the Company's operations remained shut for few days but resumed partial operations afterwards. The Company being an export-oriented entity was impacted as its demand from export destinations have gone down. Consequently, the Company was not operating at optimal capacity. However, the Company also produces bedsheets for hospitals in home textile division, which has improved and supported overall business profile of the Company. Complete resumption of operations and demand remains to be seen. The Company's strong financial health remain key in order to withstand impact of lower demand. Going forward, recent currency devaluation is also expected to provide support to profitability especially in absence of investment income from associated companies.

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. The Company's net cash cycle has increased YoY (9MFY20: 155 days, 9MFY19: 120 days) which is backed by the increased inventory. Meanwhile, the Company also have a negative borrowing cushion at trade assets level -4% is mainly due to increased short term borrowing over the period. However, at the total asset level, the Company has ample room to borrow (9MFY20: 42%, 9MFY19: 47%).

Coverages The Company free cashflow improved by 18% YoY (9MFY20: PKR ~2.2bln, 9MFY19: PKR ~1.9bln) on the back of improved profitability. However, due to higher short term borrowing and increase in interest rates, finance cost increased (9MFY20: PKR 387mln, 9MFY19: 220mln). Consequently, the Company's coverages deteriorated though remained very strong (Interest coverage: 9MFY20: 7.9x, 9MFY19: 12.1x; Debt coverage: 9MFY20: 5.9x, 9MFY19:7.8x).

Capitalization Liberty Mills maintains a moderately leveraged capital structure while leveraging has increased YoY (9MFY20: ~49%, 9MFY19: ~41%). This was mainly owing to higher short-term borrowing (9MFY20: ~PKR 16.5bln, 9MFY19: ~PKR 9.5bln) to finance higher inventory needs while some borrowing has also been done to invest trading portfolio. Major portion of borrowings 93% has been availed at the SBP's concessionary rates. Going forward, with no major expansion plans in sight, leveraging is expected to sustain around the same level.

PKR mln

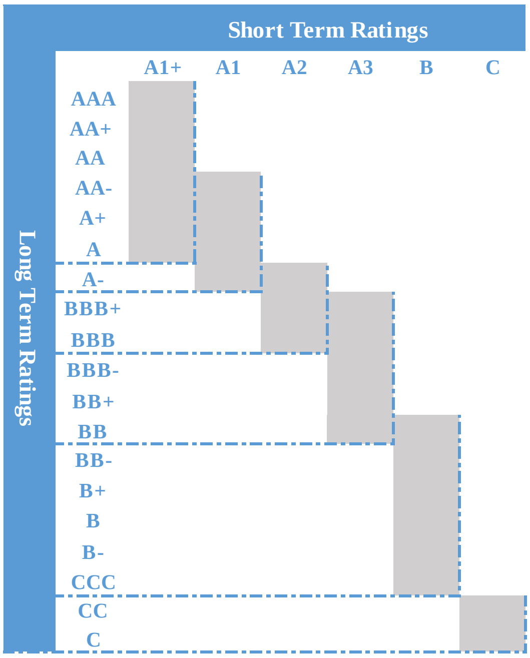
Liberty Mills Limited Textile Composite	Mar-20 9M	Jun-19 12M	Jun-18 12M	Jun-17 12M
A BALANCE SHEET				
1 Non-Current Assets	6,391	5,394	4,550	4,232
2 Investments	11,938	8,052	6,078	5,177
3 Related Party Exposure	3,816	1,937	1,447	2,027
4 Current Assets	21,662	19,082	12,258	8,217
a Inventories	*11,708*	*9,301*	*6,139*	*4,055*
b Trade Receivables	*5,264*	*6,037*	*3,376*	*2,267*
5 Total Assets	43,807	34,465	24,333	19,653
6 Current Liabilities	5,111	3,120	2,416	1,446
a Trade Payables	*3,332*	*2,045*	*1,808*	*860*
7 Borrowings	18,572	13,501	7,702	5,635
8 Related Party Exposure	367	225	-	-
9 Non-Current Liabilities	-	-	-	-
10 Net Assets	19,757	17,618	14,215	12,572
11 Shareholders' Equity	19,757	17,618	14,215	12,572
B INCOME STATEMENT				
1 Sales	23,741	26,358	16,137	15,358
a Cost of Good Sold	*(20,271)*	*(21,517)*	*(13,874)*	*(13,229)*
2 Gross Profit	3,471	4,841	2,263	2,129
a Operating Expenses	(1,275)	(1,695)	(1,121)	(1,106)
3 Operating Profit	2,195	3,146	1,143	1,023
a Non Operating Income	*542*	*937*	*918*	*3,424*
4 Profit or (Loss) before Interest and Tax	2,737	4,083	2,061	4,448
a Total Finance Cost	*(387)*	*(342)*	*(179)*	*(142)*
b Taxation	*(405)*	*(333)*	*(230)*	*(523)*
6 Net Income Or (Loss)	1,946	3,408	1,652	3,783
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*2,239*	*4,322*	*1,655*	*893*
b Net Cash from Operating Activities before Working Capital Changes	*1,852*	*4,323*	*1,933*	*3,835*
c Changes in Working Capital	*(1,904)*	*(5,893)*	*(1,868)*	*(864)*
1 Net Cash provided by Operating Activities	(51)	(1,570)	65	2,970
2 Net Cash (Used in) or Available From Investing Activities	(5,975)	(3,675)	(1,444)	(3,128)
3 Net Cash (Used in) or Available From Financing Activities	5,070	6,025	2,066	318
4 Net Cash generated or (Used) during the period	(956)	780	688	160
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	20.1%	63.3%	5.1%	2.0%
b Gross Profit Margin	14.6%	18.4%	14.0%	13.9%
c Net Profit Margin	8.2%	12.9%	10.2%	24.6%
d Cash Conversion Efficiency (EBITDA/Sales)	11.1%	17.7%	11.4%	9.3%
e Return on Equity (ROE)	13.9%	21.4%	12.3%	35.4%
2 Working Capital Management				
a Gross Working Capital (Average Days)	186	172	179	169
b Net Working Capital (Average Days)	155	145	149	148
c Current Ratio (Total Current Assets/Total Current Liabilities)	4.2	6.1	5.1	5.7
3 Coverages				
a EBITDA / Finance Cost	9.3	18.5	13.2	12.4
b FCFO / Finance Cost+CMLTB+Excess STB	5.9	11.3	6.4	4.6
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.9	0.5	0.8	1.5
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	48.9%	43.8%	35.1%	31.0%
b Short-Term Borrowings / Total Borrowings	0.9	0.8	0.8	0.8
c Average Borrowing Rate	2.3%	2.4%	2.1%	2.1%

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	
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
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.
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.
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.
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+ 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.
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.

Short Term Ratings	
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.



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 surveill the opinion due to lack of requisite information.

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

Regulatory and Supplementary Disclosure

(Credit Rating Companies Regulations,2016)

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)

Independence & Conflict of interest

(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)

Proprietary Information