



The Pakistan Credit Rating Agency Limited

## Rating Report

### Mahmood Textile Mills Limited

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#### Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
28-Dec-2018	A-	A2	Stable	Maintain	-
28-May-2018	A-	A2	Stable	Maintain	-
15-Aug-2017	A-	A2	Stable	Initial	-

#### Rating Rationale and Key Rating Drivers

The ratings reflect adequate business profile of Mahmood Textile – the flagship entity of Mahmood Group. Business operations comprise a spinning segment and two weaving units. Continuous BMR activities have led the company to witness decent growth in topline in recent years, furthered in the current year due to installation of a new weaving unit. Due to recent devaluation of rupee, the company has managed to improve gross margins; however, high expenses have kept operating margins thin. The company has a sizable investment portfolio which is managed at Group level. Although the company has invested in blue-chip stocks, high market risk exposes the company to volatile returns and valuations, mitigated to some extent through diversification in investment mix. Recent volatility in the stock market, however, diminished portfolio performance and impacted the overall profitability. The concern magnifies as these investments are partially financed through short-term borrowings. Financial risk of the company remains stretched given tight borrowing capacity and core debt service coverages. Free cashflows have shown improvement. This provided relief to the risk profile of the company; sustainability of the same is important amidst rising interest rates. Association with Mahmood Group bodes well for the company.

The ratings are dependent upon stability of business margins, prudent management of investment portfolio and financial profile. Better debt management, especially short-term borrowings, and improvement in core coverages is critical. Significant losses in investment portfolio, leading to lower profitability, and/or deterioration in coverages will impact the ratings negatively.

#### Disclosure

<b>Name of Rated Entity</b>	Mahmood Textile Mills Limited
<b>Type of Relationship</b>	Solicited
<b>Purpose of the Rating</b>	Entity Rating
<b>Applicable Criteria</b>	Methodology   Corporate Ratings(Jun-18),Methodology   Criteria   Rating Modifier(Jun-18),Methodology   Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
<b>Related Research</b>	Sector Study   Textile(Oct-18)
<b>Rating Analysts</b>	Muhammad Hassan   muhammad.hassan@pacra.com   +92-42-35869504

## Profile

**Legal Structure** Mahmood Textile Mills Limited (Mahmood Textile) is a listed, public limited concern incorporated in 1970.

**Background** The company is part of the Mahmood Group, which was originally established in 1935 by entering the tannery business. The group has now evolved into a diversified business empire with Mahmood Textile as the Group's flagship company.

**Operations** Mahmood Textile is primarily engaged in the production and sale of yarn and greige fabric, as well as generation of electricity for its plants. Its production facilities are located in Muzaffargarh, Dera Ghazi Khan and Industrial Estate, Multan with 109,008 spindles and 196 looms. The company's energy requirement of ~19MW is met completely by captive power generation capacity of ~22MW.

## Ownership

**Ownership Structure** Mahmood Group – sponsor – owns ~39% of the company. However, cumulatively, Mahmood Group owns over 90% via group companies, directors as well as distant relatives who comprise most of the general public.

**Stability** Presently, there is no group holding company or formal succession plan. Presence of the same will improve the stability of the company.

**Business Acumen** With over eight decades of experience, the sponsors have expertise in diversified sectors including cotton growing, textile, tanneries, real estate, and food.

**Financial Strength** Mahmood Group maintains an adequate financial profile with an equity base of PKR ~18bln with group companies as well as exposure in stock market, which enhances its financial profile aided by dividends and capital gains. The sponsors have shown willingness and ability to support the business if the need arises.

## Governance

**Board Structure** Oversight of the company lies with a seven-member Board, chaired by Mr. Khawaja Muhammad Masood. Six board members are sponsors, with only one independent director. This raises concern on lack of challenge posed to management decision, thus hampering effective governance.

**Members' Profile** Mr. Masood – Chairman – is the founder of Mahmood Group, having more than five decades of textile experience and has been a key position holder in various local corporate bodies of Pakistan. The board members possess diversified knowledge and experience which leads to a good skill mix of their individual competencies.

**Board Effectiveness** In line with best corporate governance practices, there are two sub-committees in place to assist the Board on relevant matters: Audit and Human Resource. Attendance of directors in meetings remains high, boding well for the board's effectiveness.

**Financial Transparency** M/s Shinewing Hameed Chaudhri & Co. Chartered Accountants are the external auditors of the company, listed in Category "B" of the State Bank's panel of auditors. The auditor expressed an unqualified opinion on the financial statements of the company for the year ended June 30th, 2018. There is also an internal audit function in place to ensure effective oversight, with the Head of Internal Audit reporting directly to the Board Audit Committee.

## Management

**Organizational Structure** The organizational structure of Mahmood Textile is divided into various functional departments reporting to the CEO and CFO.

**Management Team** Company CEO – Mr. Khawaja M. Iqbal – has been associated with the company for over four decades and also sits on the board of various group companies. Mr. Iqbal is supported by a team of seasoned professionals, most of whom have been associated with the company for a reasonably long period of time.

**Effectiveness** Adequate IT infrastructure and related controls are maintained. There is preparation of regular reports regarding the company's receivables and payables position, purchases and procurement, audit report, etc, to be submitted to higher management.

**MIS** The company has deployed Oracle based ERP with daily and monthly MIS to ensure timely availability of information for effective decision making.

**Control Environment** Mahmood Textile is accredited with international certifications for compliance including ISO 9001. The company adheres to latest quality assurance standards for fabric production and trade in addition to employment of quality control procedures.

## Business Risk

**Industry Dynamics** Textile exports of the country grew by ~9% for FY18 backed by devaluation of the rupee, bailout package from the government and GSP Plus Scheme of the EU. This growth was led mainly by the value added segment, including knitwear, home textile and ready-made garments. However, rising cost of utilities and the issue of outstanding refunds kept industry liquidity strained. Going forward, exports are expected to remain strong on account of devalued currency.

**Relative Position** Mahmood Textile contributed ~8% to the country's yarn exports of FY18 while its share in fabric export revenue amounted to ~1.2%. Overall, Mahmood Group has a strong presence in the country's textile sector while, on a standalone basis, Mahmood Textile is adequately positioned.

**Revenues** During FY18, Mahmood Textile's topline amounted to ~PKR 18bln (up ~15% YoY). The company's topline predominantly comprises yarn sales (FY18: ~77%, FY17: 79%) followed by greige fabric. Total sales have remained tilted towards export market traditionally (83%) with high customer concentration, since China alone constitutes ~32% of the topline. During the first quarter of FY19, revenue amounted to ~PKR 5.4bln, a ~27% YoY increase resulting from currency devaluation.

**Margins** The company's business margins improved slightly YoY (Gross – FY18: ~7.1%, FY17: ~6.4%; Operating – FY18: 2.7%, 3MFY18: 2.2%) owing to recent BMR activities, installation of new weaving unit and currency devaluation. Income received from investments amounted to ~PKR 294mln during the year. However, 58% higher finance cost coupled with ~PKR 285mln loss on revaluation of trading portfolio led to a sharp fall in net profitability. As a result, net profit stood at ~PKR 225mln (FY17: ~PKR 317mln). Profitability picked up in 3MFY19 led by growth in revenue owing to impact of currency devaluation, bringing net profit for the period to ~PKR 173mln (3MFY18: ~PKR 32mln).

**Sustainability** During FY18, BMR amounting to ~PKR 460mln was made in spinning units against LTFF loans. Additionally, a new weaving unit comprising 96 state-of-the-art looms was installed at Industrial Estate, Multan for a total cost of ~PKR 1,865 on this unit. This is expected to improve the performance and margins of the company, going forward. Furthermore, the company also plans to offload its trading portfolio in the medium term onto the books of a group holding company.

## Financial Risk

**Working Capital** Mahmood Textile's working capital needs emanate from financing inventories and trade receivables for which the company relies on internal cash flows as well as short term borrowings. Due to inventory accumulation foreseeing the rupee devaluation, working capital needs increased during the period, reflecting in higher net cash cycle (FY18: 117 days, FY17: 107 days). The company also borrows to finance a portion of its short-term investments. Resultantly, borrowings are in excess of requirements at trade assets level, boding negatively in terms of borrowing capacity.

**Coverages** Free cash flows grew ~38% during FY18. However, due to surging finance costs, core debt coverage remained stagnant at 0.7x, which is considered inadequate. While coverages showed improvement in 3MFY19 to stand at 1.8x owing to increased profitability, going forward, they may become strained if leveraging increases any further.

**Capitalization** At end-Jun18, the company had a highly leveraged capital structure, with a leveraging ratio of ~72%. Borrowings swelled to ~PKR 11.7bln (Jun17: ~PKR 7.9bln) with majority portion comprising STBs to finance working capital requirement and trading portfolio in addition to availing LTFF of ~PKR 1,151mln for installation of new weaving unit and BMR activities. At end-Sep18, total debt stood at ~PKR 13bln. Going forward, leveraging is expected to improve with the elimination of the trading book and no plans of additional borrowing.



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## Mahmood Textile Mills Limited

BALANCE SHEET	30-Sep-18	30-Jun-18	30-Jun-17	Financial Summary
	3MFY19	FY18	FY17	30-Jun-16
				FY16
<b>Non-Current Assets</b>	<b>5,726</b>	<b>5,603</b>	<b>3,206</b>	<b>2,934</b>
<b>Investments (Incl. Associates)</b>	<b>4,978</b>	<b>4,675</b>	<b>4,594</b>	<b>2,748</b>
Equity	4,978	4,675	4,594	2,748
Debt Instruments	-	-	-	-
<b>Current Assets</b>	<b>9,037</b>	<b>7,927</b>	<b>6,569</b>	<b>5,014</b>
Inventory	4,567	4,223	3,336	2,543
Trade Receivables	1,711	2,225	2,212	1,319
Others	2,759	1,479	1,021	1,152
<b>Total Assets</b>	<b>19,741</b>	<b>18,206</b>	<b>14,369</b>	<b>10,696</b>
<b>Debt</b>	<b>13,162</b>	<b>11,935</b>	<b>8,174</b>	<b>5,080</b>
Short-Term	10,636	9,639	7,030	4,090
Long-Term (Incl. Current Maturity of Long-Term Debt)	2,526	2,296	1,144	990
Other short-term liabilities	1,702	1,566	1,412	1,151
Other long-term liabilities	-	-	-	-
<b>Shareholders' Equity</b>	<b>4,877</b>	<b>4,704</b>	<b>4,783</b>	<b>4,466</b>
<b>Total Liabilities &amp; Equity</b>	<b>19,741</b>	<b>18,206</b>	<b>14,369</b>	<b>10,696</b>
<b>INCOME STATEMENT</b>				
<b>Turnover</b>	<b>5,443</b>	<b>18,154</b>	<b>15,748</b>	<b>13,664</b>
Gross Profit	707	1,280	1,006	1,097
Net Other Income	5	543	589	(55)
Financial Charges	(256)	(743)	(471)	(416)
<b>Net Income</b>	<b>173</b>	<b>225</b>	<b>317</b>	<b>(56)</b>
<b>Cashflow Statement</b>				
Free Cashflow from Operations (FCFO)	570	694	504	660
Net Cash changes in Working Capital	(933)	(1,325)	(1,667)	256
Net Cash from Operating Activities	(612)	(829)	(2,512)	748
Net Cash from Investing Activities	(559)	(2,778)	(595)	(227)
Net Cash from Financing Activities	1,227	3,626	3,095	(512)
<b>Ratio Analysis</b>				
<b>Performance</b>				
Turnover Growth	26.7%	15.3%	15.3%	-0.7%
Gross Margin	13.0%	7.1%	6.4%	8.0%
Net Margin	3.2%	1.2%	2.0%	-0.4%
ROE	28.4%	5.2%	7.6%	-1.2%
<b>Coverages</b>				
Interest Coverage (FCFO/Gross Interest)	2.2	0.9	1.1	1.6
Core: (FCFO/Gross Interest+CMLTD+Uncovered Total STB)	1.1	0.3	0.7	0.9
Total: (TCF) / (Gross Interest+CMLTD+Uncovered Total STB)	1.1	0.6	-0.5	1.3
Debt Payback (Total LT Debt Including Uncovered Total STBs) / (FCFO- Gross Interest)	10.5	-68.8	35.0	4.1
<b>Liquidity</b>				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	82.3	117.3	106.7	112.4
<b>Capital Structure</b> (Total Debt/Total Debt+Equity)	73.0%	71.7%	63.1%	53.2%

Mahmood Textile Mills Limited

December 2018

## 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	
<b>AAA</b>	<b>Highest credit quality.</b> Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	<b>A1+</b>	The highest capacity for timely repayment.
<b>AA+</b> <b>AA</b> <b>AA-</b>	<b>Very high credit quality.</b> 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.	<b>A1</b>	A strong capacity for timely repayment.
<b>A+</b> <b>A</b> <b>A-</b>	<b>High credit quality.</b> 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.	<b>A2</b>	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
<b>BBB+</b> <b>BBB</b> <b>BBB-</b>	<b>Good credit quality.</b> 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.	<b>A3</b>	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
<b>BB+</b> <b>BB</b> <b>BB-</b>	<b>Moderate risk.</b> 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>	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
<b>B+</b> <b>B</b> <b>B-</b>	<b>High credit risk.</b> 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>C</b>	An inadequate capacity to ensure timely repayment.
<b>CCC</b> <b>CC</b> <b>C</b>	<b>Very high credit risk.</b> 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.		
<b>D</b>	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.

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- 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

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- (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)

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(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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