



The Pakistan Credit Rating Agency Limited

Rating Report

Masood Fabrics 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	
30-Jun-2018	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect adequate business profile of Masood Fabrics Limited and its association with Mahmood Group. The company is principally engaged in the manufacture of yarn and griegie fabric, primarily catering to the home textile market. The company has built a significant investment portfolio that is managed at the group level. The company witnessed growth in its topline and margins. However, net margins from core business operations remains low due to high expenses. Overall profitability of the company remains a function of income from the large investment portfolio, in shape of dividends and capital gains/losses. Although the company is invested in blue-chip scrips, high market risk exposes the company to volatile returns and valuations. This concern is magnified as the investments are partially financed through short-term borrowings. Liquidating investments in a down market remains a concern. Free Cashflows have recently shown improvement, resulting in better coverages. However, financial profile of the company remains stretched given highly leveraged capital structure and limited borrowing capacity. Board's vast experience and association with Mahmood Group bodes well for the company.

The ratings are dependent on the company's ability to improve financial profile by reducing leveraging through successfully divesting certain scrips. The management is working on this front and timely materialization of these initiatives is critical. Additionally, maintaining margins and improving profitability from core operations is important

Disclosure

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

Profile

Legal Structure Masood Fabrics Limited was incorporated on May 12, 1998, as a public limited company.

Background Masood Fabrics is a venture of Mahmood Group, which was originally established in 1935, initially entering the tannery business. Now the group has presence in complete cotton chain (growing to finished products), tanneries, real estate, and food.

Operations It is primarily engaged in the manufacture and sale of greige fabric and yarn. The company also carries a significant investment portfolio and participates in equity market. Masood Fabrics installed 14,400 new spindles in its spinning department. Currently, the spindles and the looms both, are operating at 99% capacity respectively. The company has a combined power generation of 10,900 KW/h through captive generators, 5,400 KW/h in the spinning unit and 5,000 KW/h in the weaving unit.

Ownership

Ownership Structure The Khawaja family comprises Mr. Khawaja Muhammad Masood – the father and chairperson for all group companies, his four sons and three daughters. 97% of the company is owned directly by the Khawaja family and 3% is owned indirectly through group companies.

Stability However, documentation of succession plan would bring clarity for practical purposes. A formal family council with defined roles and responsibilities would ensure future sustainability of the group. A detailed break-up of the shareholding pattern can be found in the table above.

Business Acumen The Chairman along with four sons form the core cabinet, which is the main decision making body for finalizing the future strategy of the group. The group's core functions are divided between each of the four brothers, as follows: (i) Finance & Cotton procurement – Mr. Khawaja M. Iqbal (ii) Technical and Operations – Mr. Khawaja M. Younus, (iii) Cotton ginning division and Internal controls – Mr. Khawaja M. Ilyas, and (iv) Investments, New ventures and Expansion – Mr. Khawaja M. Jalal-ud-din Roomi.

Financial Strength Mahmood Group maintains very strong financial profile with an equity base of PKR ~16bln at end-Jun17 and substantial investments in equities and property. This indicates sponsors' ability to provide support if need arises.

Governance

Board Structure Masood Fabrics board comprises seven members, including the Chairman - Mr. Khawaja Muhammad Masood, and Chief Executive Officer (CEO) - Khawaja Muhammad Ilyas. The company's board comprises all sponsor-family members, Chairman Mr. Masood however provides requisite challenge and effective oversight to the management of the company.

Members' Profile The board has vast knowledge and experience of entire textile chain. The directors' expertise of various stages of the textile value-chain leads to a good skill mix. Mr. Masood, is the founder of Mahmood Group, has more than five decades of textile experience. Mr. Ilyas, the CEO, has more than three decades of textile experience.

Board Effectiveness Total number of meeting held during the year were four, which were attended by all of the members. High attendance bodes well for board effectiveness. However, there is room for improvement in recording minutes and establishing best governance practices.

Financial Transparency M/s Deloitte Yousof Adil & Co. Chartered Accountants, who are categorized in category A by the SBP and have a satisfactory QCR rating by ICAP, are the external auditors of the company. They have expressed an unqualified opinion on the financial statements of the company for the year ended June 30, 2018.

Management

Organizational Structure The top management control is held by sponsors, middle tier is taken care by experienced management team. The organizational structure of the company is divided into various departments with reporting to the CEO and BOD. Both the executive directors and GM Audit report directly to the BOD, while the rest report to the CEO.

Management Team Mr. Khawaja Muhammad Ilyas, the CEO of the company, has relevant experience of more than 35 years in the industry. However, the company is looked after by Mr. Jalaluddin Roomi, who is the brother of Mr. Ilyas and carries vast experience in leading different government, semi-government and public limited companies. Currently he is also on the board of Arif Habib Corporation and Shakarganj ltd.

Effectiveness Board meetings are held formally and separately for all group companies, and are chaired by Mr. Khawaja Muhammad Masood. Meeting minutes are captured formally, but however there is room for improvement.

MIS The company's MIS is generated on a monthly and daily basis, for both the spinning and the weaving units separately. Various reports are collected and submitted to higher management regarding monthly operations, finished goods, cotton reconciliation report, yield report and raw materials report.

Control Environment The group continuously updates its technology infrastructure in all its manufacturing and support functions, while adapting to new technology, processes to ensure quality and cost effectiveness. The company deploys Oracle as ERP solution since 2014. The group is currently operating Oracle R12, which has been customized from KPMG Taseer Hadi & Co. Chartered Accountants.

Business Risk

Industry Dynamics The substantial devaluation of Pakistani Rupee (a total of ~23% since November, 2017) brought major benefits to textile players, particularly those who are export-oriented. Many players, including foreseeing the devaluation, procured large amounts of inventory beforehand and thus were able to gain advantage of lower costs. Interest rate hiked during the period, negatively impacting the profitability of companies which are highly leveraged. Cotton prices increased significantly during FY18 by PKR 2,000-PKR 3,000 posing a challenge to inventory management.

Relative Position With 32,640 spindles and 244 looms Mahmood Fabrics is able to land in the middle tier of textile industry. Overall as a group Mahmood group has presence in complete cotton chain, cumulatively the group owns ~300,000 spindles and 850 looms and can qualify as one of the biggest textile manufacturing groups in Pakistan.

Revenues The majority of the sales revenue for the company comes from export sales, which account for ~90% of total sales revenue. However, during FY18 export sales witnessed an increase of ~33%. Bulk of the export sales come from the export of fabric, which accounts for 73% of total export sales and 65% of total sales. During FY18, Masood Fabrics grew its top line by ~30% bringing the value of sales up to ~PKR 9bln.

Margins The cost of goods sold of the company increased to PKR 8,150mln (FY17: PKR ~6,640) recording an increase of ~23%. The major chunk of the cost comes from the raw materials consumed which make up 75% of the cost of goods sold. Gross margin of the company improved to 11.2% (FY17: 6.5%). On the other hand, net profit margin of the company reduced to 3.7% (FY17: 5.3%), main reason behind this reduction was increase in administrative, distribution and finance cost.

Sustainability During the year, the Company has installed new 14,400 spindles. The Company has incurred capital expenditure of PKR 1330mln for Balancing, Modernization and Replacement (BMR) of production facilities during the year.

Financial Risk

Working Capital Working capital requirements increase by 128% in FY18 because of massive prudent procurement of raw materials, as inventory levels increased to PKR 3,170mln (FY17: PKR 1,254mln). Stocking of inventory also increased the net working capital days to 118 days (FY17: 92 days, FY16: 92 days). average raw material held days also increased to 84 days (FY17: 58 days, FY16: 56 days). As compared to FY17 Masood Fabrics is moving in a larger working capital circle in FY18.

Coverages FCFO of Masood Fabrics more than doubled to the amount of PKR 712mln (FY17: PKR 314mln) because of increased profitability from its core operations. The interest coverage and the total coverage both stood at 1.2x (FY17: 0.8). Coverages might deteriorate further with interest rate hikes.

Capitalization The capital structure of the company is highly leveraged because of increased short-term and long-term borrowings. In FY18 leveraging was recorded at ~73% (FY17: 62%).



Masood Fabrics Limited

PKR mln

BALANCE SHEET	Jun-18	Jun-17	Jun-16
	FY	FY	FY
Non-Current Assets	4,653	2,678	2,293
Investments (incl. Associates)	5,099	4,972	3,596
Equity	5,099	4,972	3,596
Current Assets	5,519	2,361	1,771
Inventory	3,170	1,254	973
Trade Receivables	1,529	814	533
Others	820	293	265
Total Assets	15,271	10,011	7,660
Debt	10,547	5,672	3,900
Short-term	8,356	4,501	2,907
Long-term (incl. Current Maturity of Long-Term debt)	2,190	1,171	993
Other Short-term Liabilities	791	631	462
Other Long-term Liabilities	0	166	59
Shareholder's Equity	3,934	3,543	3,239
Total Liabilities & Equity	15,271	10,011	7,660

INCOME STATEMENT

Turnover	9,179	7,104	6,848
Gross Profit	1,029	463	623
Other Income	(39)	824	(307)
Financial Charges	(576)	(377)	(345)
Net Income	341	379	(169)

Cashflow Statement

Free Cashflow from Operations (FCFO)	712	314	532
Net Cash changes in Working Capital	(2,636)	(518)	628
Net Cash from Operating Activities	(2,252)	(414)	967
Net Cash from Investing Activities	(2,621)	(1,360)	(560)
Net Cash from Financing Activities	4,875	1,772	(403)
Net Cash generated during the period	2	(2)	3

Ratio Analysis

Performance			
Turnover Growth	29.2%	3.7%	-3.2%
Gross Margin	11.2%	6.5%	9.1%
Net Margin	3.7%	5.3%	-2.5%
ROE	8.7%	10.7%	-5.2%
Coverages			
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB)	0.9	0.6	1.1
Interest Coverage (x) (FCFO/Gross Interest)	1.2	0.8	1.5
Debt Payback (Total LT Debt Including UnCovered Total STBs) / (FCFO- Gross Interest)	16.4	-18.6	5.3
Liquidity			
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	157	92	92
Capital Structure (Total Debt/Total Debt+Equity)	72.8%	61.6%	54.6%

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.

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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

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- (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)
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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.
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- (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)

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- (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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