The Pakistan Credit Rating Agency Limited

Rating Report

Prosperity Weaving Mills Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-Jun-2018	A-	A2	Stable	Maintain	-
28-Dec-2017	A-	A2	Stable	Maintain	-
15-Jun-2017	A-	A2	Negative	Maintain	-
29-Dec-2016	A-	A2	Negative	Maintain	-
29-Dec-2015	A-	A2	Negative	Maintain	-

Rating Rationale and Key Rating Drivers

The ratings reflects Prosperity Weaving Mills Limited's improving business profile in harmonization with better textile industry dynamics in recent times. The company's revenues have taken a hit in previous years mainly due to price decline both in exports and local segments. Lately, revenues have started to pick up, benefiting from local demand. Recent re-imposition of custom duty & sales tax on cotton imports in FY19 budget, coupled with exclusion of tax rebate on yarn and greig fabric may put pressure on margin, if not modified. Leveraging has increased owing to debt-driven expansion. Meanwhile, support from core business margins is dependent upon efficiency gains via technology upgrades. Prosperity Weaving Mills intends to gradually build a sizable investment portfolio. This exposes the company to market risk as exhibited by recent volatility in stock exchange. Any significant decline in investments leading to losses, and eventually equity erosion, will impact the financial profile of the company. The management's ability to manage this risk is critical. However, the assigned ratings derive comfort from Prosperity Weaving Mills association with Nagina Group.

The ratings are dependent upon sustained market position of the company. Moreover, the company's ability to generate cash flows to fulfill its increasing financial obligations is critical. At the same time, prudent management of investment portfolio is important.

Disclosure

Name of Rated Entity	Prosperity Weaving Mills Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating Methodology(Jul-17),Methodology | Correlation between long-term and short-term rating scale(Jun-17),Methodology | Criteria Modifiers(Jun-17)
Related Research	Sector Study | Textile(Oct-17)
Rating Analysts	Muhammad Hassan | muhammad.hassan@pacra.com | +92-42-35869504

Prosperity Weaving Mills Ltd Profile	
Incorporated	Nov 1991
Major business lines	Production and sale of denim and non-denim garments.
Legal status	Public limited, listed.
Capacity	324 looms

Industry Snapshot

- During 9MFY18, total textile exports of Pakistan stood at USD ~ 12bln, a 13% YoY growth. Cotton yarn contributes 31% to exports in volume terms.
- High cost of doing business as compared to other countries like Bangladesh, India and Vietnam.
- Re-imposition of custom duty & sales tax on cotton imports in FY 19 budget, coupled with exclusion of tax rebate on yarn and greig fabric may put pressure on the industry margins, if not modified.

Ownership

- Prosperity Weaving Mills Ltd incorporated in 1991 as a public limited company in Pakistan under the Nagina Group (NG).
- NG, through Directors (53.6%) and its group companies Ellahi International (Pvt) Ltd (20.3%) and AHR (Pvt) Ltd (9.1%), retains the majority stake (84%). The remaining shareholdings (16%) rests with General public, Joint Stock companies and Foreign investors.
- Nagina Group – one of the oldest small-sized textile houses in Pakistan – comprises three listed public limited companies – and six private limited companies, all engaged in various aspects of Textile value chain.

Governance

- The nine member board, is dominated by Sponsoring family; eight NG affiliates, including CEO, and one independent director. Six non-executive directors on the board.
- Lack of segregation of governance and management as control of the latter vests with sponsoring family. However, the board is compliant with Code of Corporate governance with non-executive director as Chairman of board. HR and Audit committees exists at board level.

Management

- Mr. Raza Ellahi Shaikh – CEO of the company, associated with the company for almost a decade. Supported by an experienced management team that has extensive exposure in textile sector.
- Mr. Muhammad Ahmed, Company's CFO, has been associated with the company since 2007.

System & Controls

- Prosperity Weaving Mills deploys oracle based Enterprise Resource Planning (ERP) system that provides comprehensive MIS reporting.
- Daily management meeting to identify and resolve bottlenecks, ensuring smooth and sound operations.
- Recent BMR and upgradation in production process leading to productivity gains and cost-efficiencies.

Business Risk

- Sales mix (local: export) has shifted from export centric 9MFY18 (25% declined by ~60%) to domestic market in recent years, due to better local prices. Asian Region account for 88% of total exports (including Hong Kong).
- During 9MFY18, topline Increased by ~10% to PKR 4.47bln as compared to corresponding period last year basis. The rise in local sales offsets the impact of declining exports, as the local market demand surges.
- The Gross margin (9MFY18: 5.3%, 9MFY17: 5.3%) remained same and operating margin (9MFY18: 2.6%, 9MFY17: 2.4%) slightly improved due to batter pricing and relatively lower input cost. However, margins are on lower side when compared to peers.
- Increased finance cost (43% higher YoY) due to increased short-term borrowing, kept profitability at ~PKR 21mln in 9MFY18 same as previous corresponding period.
- Investment portfolio (Mar 18: PKR 442mln) now comprising 49% of equity, exposes the company to significant market risk. Decline in investment value due to stock volatility will impact the company's profitability. The management's ability to manage this risk and keeping exposure in acceptable limits is critical.

Financial Risk

- Stretched financial profile of the company; with leveraging increased to ~74% at 9MFY18 (9MFY17: 72%), owing to higher short-term borrowings (STB).
- Working capital requirement, a function of inventory and receivables, are met through a mix of internal cash generation and short-term borrowing. The company's working capital needs escalate during the year due to higher trade receivables and inventory days (9MFY18: 60days, 9MFY17: 42days).
- The debt service coverages remain adequate, with slightly improved cash flows. The company maintains a cushion in the form of unutilized STB lines to meet urgent need of funding.
- Any significant decline in investments leading to losses, and eventually equity erosion, may impact the financial profile of the company.

Prosperity Weaving Mills Limited

BALANCE SHEET	31-Mar-18	30-Jun-17	30-Jun-16	30-Jun-15
	9MFY18	FY17	FY16	FY15
Non-Current Assets	**2,142**	**2,273**	**1,763**	**1,913**
Investments (incl. Associates)	**465**	**549**	**120**	**86**
Equity	465	549	120	-
Debt Securities (incl. income funds)	-	-	-	86
Current Assets	**1,581**	**1,476**	**1,058**	**790**
Inventory	521	386	297	344
Trade Receivables	527	632	283	173
Others	533	458	477	273
Total Assets	**4,188**	**4,299**	**2,941**	**2,789**
Debt/Borrowings	**2,726**	**2,787**	**1,570**	**1,466**
Short-Term	1,058	969	297	106
Long-Term (incl. Current Maturity of Long-Term Debt)	1,668	1,819	1,274	1,360
Other Short-Term Liabilities	378	437	321	318
Other Long-Term Liabilities	121	107	93	56
Shareholder's Equity	**963**	**968**	**957**	**949**
Total Liabilities & Equity	**4,188**	**4,299**	**2,941**	**2,789**

INCOME STATEMENT				
Turnover	**4,465**	**5,820**	**5,211**	**5,811**
Gross Profit	236	303	360	319
Other Income	10	25	(9)	(2)
Financial Charges	(106)	(102)	(111)	(107)
Net Income	**21**	**56**	**40**	**61**

Cash Flow Statement				
Free Cash Flows from Operations (FCFO)	267	311	343	240
Net Cash changes in Working Capital	(132)	(379)	(116)	200
Net Cash from Operating Activities	35	(149)	114	344
Net Cash from InvestingActivities	79	(1,139)	(79)	(719)
Net Cash from Financing Activities	(98)	1,185	77	349
Net Cash generated during the period	16	(103)	112	(25)

Ratio Analysis				
Performance				
Turnover Growth (v.s same period last year)	10.3%	11.7%	-10.3%	-8.4%
Gross Margin	5.3%	5.2%	6.9%	5.5%
Net Margin	0.5%	1.0%	0.8%	1.0%
ROE	2.1%	5.8%	4.2%	6.4%
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	60	45	42	41
Leveraging (Total Debt/Total Debt+Equity)*	73.9%	74.2%	62.1%	60.7%

**Total Debt = Long-Term Debt + Short-Term Debt*

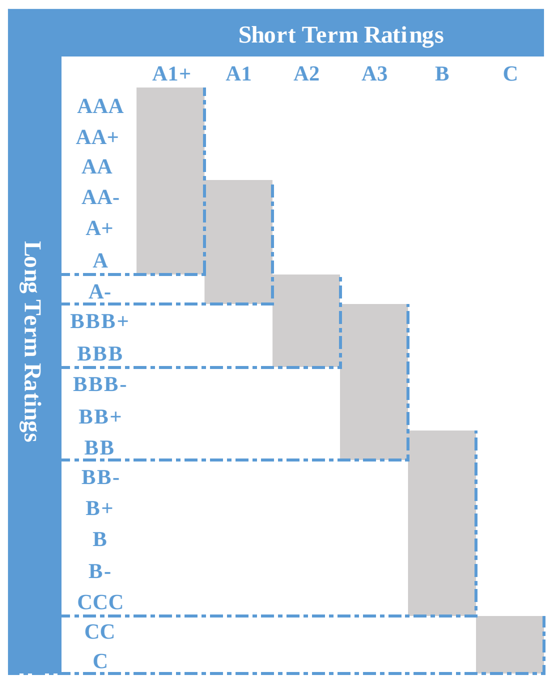
Rating Scale

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.

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)
(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.
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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)

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)
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