



The Pakistan Credit Rating Agency Limited

Rating Report

Mahmood Textile Mills Limited

Report Contents

1. Rating Analysis
2. Financial Information
3. Rating Scale
4. Regulatory and Supplementary Disclosure

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
28-Jun-2019	A-	A2	Stable	Maintain	-
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 finance cost 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 may impact the ratings negatively.

Disclosure

Name of Rated Entity	Mahmood Textile Mills 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 Mahmood Textile Mills Limited (The Company) is a public listed concern, incorporated in 1970. The Company is listed on Pakistan Stock Exchange.

Background The Company is a part of 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. Its production facilities are located in Muzaffargarh, DG Khan and Multan. The Company has 109,008 spindles and 196 looms. The Company's energy requirement of ~19MW is completely met by capacity of ~22MW. Furthermore, the Company has a line from MEPCO as backup.

Ownership

Ownership Structure Cumulatively, sponsors own over 90% of shareholding through group companies, directors as well as distant relatives. Therefore, ~1% of the Company stock is free-float.

Stability The Group has no holding Company. Third generation of the sponsor family is actively involved in the operations of the Company but no formal succession plan has been announced. Documentation or formation of family office will bode well with stability and succession of ownership.

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 a considerable equity base through Group companies and stock market investments. Investments enhance the Group's financial profile through dividends and capital gains but also expose the Group to financial risk. 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. During the year Khawaja Muhammad Masood - Chairman of the board passed away. Consequently there is a casual vacancy on the board which is yet to be filled. Currently, five board members are from the sponsor families, with only one independent director. This raises concern on the lack of challenge posed to management decisions, thus hampering effective governance.

Members' Profile Board has yet to appoint Chairman of the board because of demise of the Chairman Khawaja Muhammad Masood. Currently, Mr. Iqbal has assumed charge of Chairman however, no official statement or decision has been made. Mr. Iqbal having more than four decades of textile experience and has been a key position holder in various local corporate bodies of Pakistan. Overall, 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. Meanwhile, minutes have room for improvement.

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 and for the period ended Dec 31st, 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 departments reporting to the CEO and CFO. The departments are as follows: (i) Audit (ii) Taxation (iii) HR and Admin (iv) IT and ERP (v) Export and (vi) Finance.

Management Team The 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% in FY18, backed by devaluation of the rupee, bailout package from the government and GSP Plus Scheme of the EU. During 9MFY19, however, exports stagnated. Even though major segments including cotton cloth, knitwear, garments and bedwear displayed strong quantitative growth, industry players needed to share the benefit of the currency depreciation with their buyers which resulted in a unit price dip across all major categories, curbing overall growth. This, coupled with cotton yarn displaying double-digit quantitative decline on account of the US-China trade war as well as strong domestic demand for yarn, resulted in overall increase in exports of only ~0.1% YoY. Going forward, withdrawal of textile's zero rated status and further devaluation of currency will impact industry's overall performance.

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. The Company continued to maintain its share in the local Textile industry during 9MFY19.

Revenues During 9MFY19, Mahmood Textile's topline amounted to ~PKR 17.3mln growing by ~35% compared to same period last year, on the back of recently completed BMR and currency devaluation. The Company's topline predominately comprises of yarn sales followed by greige fabric. Total sales have remained tilted towards export market due to established overseas customer base and currency devaluation.

Margins During 9MFY19, Mahmood Textile's gross margin improved to ~11.6% (9MFY19: ~7.4%) and operating margin to ~7.5% (9MFY18: ~3.3%) due to currency devaluation and better yarn and fabric prices in the market.

Sustainability The Company went through a major BMR that included upgradation of existing spindles and addition of a new weaving unit comprising of 96 looms. This improved performance and margins of the Company. Going forward, the Company also plans to offload its trading portfolio in the medium term onto the books of a holding company, which will limit its exposure to stock market fluctuation and make more capital available to be used in core business activity.

Financial Risk

Working Capital The Company's working capital cycle decreased slightly during 9MFY19 to 124 days (9MFY18: 127 days) due to lower receivable days. 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. STB are also used to fund short term investments, effectively creating negative room for further borrowing.

Coverages Free cash flows (FCFO) grew massively in 9MFY19 to ~PKR 1,623mln (9MFY18: ~PKR 317mln) factor of improved profits from operations. Despite exponential rise in finance cost, debt (9MFY19: 1.9x, 9MFY18: 0.8x) and interest coverage ratios (9MFY19: 1.4x, 9MFY18: 0.5x), though remained adequate.

Capitalization During 9MFY19, the Company's capital structure remained highly leveraged at 78.2% (9MFY18: 70%). During 9MGY19, short term borrowings increased to ~PKR 13.3bln showing growth of ~39% since same period last year (9MFY18: ~PKR 9.6bln). Meanwhile, Long term borrowing increased by 59% to ~PKR 3bln (9MFY18: 1.9bln). Increase in STB was due to the financing of long term investment in Orient power. Going forward, leveraging is expected to improve with the elimination of the trading book.



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

1 Non-Current Assets	5,586	5,603	3,206	2,934
2 Investments	1,839	4,675	4,594	2,748
3 Related Party Exposure	2,171	-	-	-
4 Current Assets	13,903	7,927	6,569	5,014
a Inventories	6,715	4,223	3,336	2,543
b Trade Receivables	3,090	2,225	2,212	1,319
5 Total Assets	23,499	18,206	14,369	10,696
6 Current Liabilities	1,952	1,561	1,380	1,029
a Trade Payables	263	219	113	89
7 Borrowings	16,841	11,935	8,174	5,080
8 Related Party Exposure	6	5	30	122
9 Non-Current Liabilities	-	-	-	-
10 Net Assets	4,700	4,704	4,785	4,466
11 Shareholders' Equity	4,700	4,704	4,785	4,466

B INCOME STATEMENT

1 Sales	17,365	18,154	15,748	13,664
a Cost of Good Sold	(15,344)	(16,874)	(14,742)	(12,566)
2 Gross Profit	2,021	1,280	1,006	1,097
a Operating Expenses	(712)	(794)	(657)	(623)
3 Operating Profit	1,309	487	349	474
a Non Operating Income	(94)	543	589	(55)
4 Profit or (Loss) before Interest and Tax	1,215	1,030	939	419
a Total Finance Cost	(1,020)	(743)	(471)	(416)
b Taxation	(155)	(63)	(150)	(59)
6 Net Income Or (Loss)	39	225	317	(56)

C CASH FLOW STATEMENT

a Free Cash Flows from Operations (FCFO)	1,623	694	504	660
b Net Cash from Operating Activities before Working Capital Changes	754	495	(845)	492
c Changes in Working Capital	(4,704)	(1,325)	(1,667)	256
1 Net Cash provided by Operating Activities	(3,949)	(829)	(2,512)	748
2 Net Cash (Used in) or Available From Investing Activities	(915)	(2,778)	(595)	(227)
3 Net Cash (Used in) or Available From Financing Activities	4,869	3,626	3,095	(512)
4 Net Cash generated or (Used) during the period	4	19	(12)	10

D RATIO ANALYSIS

1 Performance				
a Sales Growth (for the period)	27.5%	15.3%	15.3%	-0.7%
b Gross Profit Margin	11.6%	7.1%	6.4%	8.0%
c Net Profit Margin	0.2%	1.2%	2.0%	-0.4%
d Cash Conversion Efficiency (EBITDA/Sales)	10.1%	4.9%	4.2%	5.8%
e Return on Equity (ROE)	1.1%	4.7%	6.9%	-1.3%
2 Working Capital Management				
a Gross Working Capital (Average Days)	128	121	109	88
b Net Working Capital (Average Days)	124	117	107	86
c Current Ratio (Total Current Assets/Total Current Liabilities)	7.1	5.1	4.8	4.9
3 Coverages				
a EBITDA / Finance Cost	2.1	1.3	1.7	2.2
b FCFO / Finance Cost+CMLTB+Excess STB	1.4	0.8	0.7	1.0
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	3.3	68.0	10.4	3.7
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Short-Term Borrowings / Total Borrowings	78.2%	71.7%	63.2%	53.8%
b Interest or Markup Payable (Days)	0.8	0.8	0.9	0.8
c Average Borrowing Rate	7.8%	6.6%	5.8%	7.0%

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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(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.
- (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)

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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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