The Pakistan Credit Rating Agency Limited

Rating Report

Maksons Textile (Pvt.) Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
18-Sep-2019	BBB-	A3	Stable	Maintain	-
19-Mar-2019	BBB-	A3	Stable	Maintain	-
19-Sep-2018	BBB-	A3	Stable	Maintain	-
22-Mar-2018	BBB-	A3	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect modest business profile of Maksons Textile (Private) Limited (the Company), depicted by its niche market operations and adequate margins. Lately, margins have come under pressure as cost of imported raw material increased without commensurate rise in the Company's products in export market. This also led to contraction in top line and put pressure on the Company's profitability in FY19. The ratings incorporate the Company's experienced management team along with effective control environment. The country's textile industry remained stagnated during FY19, despite ~34% currency devaluation and incentives introduced by the government to promote exports. With planned BMR activities in the short-term, the Company is expected to bring efficiencies and growth, going forward. The Company has a relatively stretched financial risk profile, characterized by moderate leveraging and depressed coverages. Although the leveraging decreased during FY19 on account of lower short-term borrowings, coverages came under pressure due to depressed cash flows. The ratings account for financial strength of the Company's sponsors - AL-Tariq Group - having strong presence in engineering and trading segments.

The ratings are dependent on improving margins, in turn, profitability and ensuing cash flows. Rationalization of top ten client concentration remains critical. Meanwhile, maintaining moderately leveraged capital structure and adequate coverages is important. Any significant deterioration in profits and/or coverages will have a negative impact on ratings.

Disclosure

Name of Rated Entity	Maksons Textile (Pvt.) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	PACRA_Methodology_Corporate_FY19(Jun-19),PACRA_Crtieria_LT ST Relationship_FY19(Jun-19),PACRA_Criteria_Rating Modifiers_FY19(Jun-19)
Related Research	Sector Study | Weaving(Sep-19)
Rating Analysts	Ateeb Riaz | ateeb.riaz@pacra.com | +92-42-35869504

Profile

Legal Structure Maksons Textile (Private) Limited (Maksons) is a private limited company incorporated in May, 2000.

Background Maksons is a venture of a group of four family members who are shareholders of Al-Tariq Group. Using the expertise of textile engineers and their own engineering knowledge and experience, the group decided to incorporate Maksons.

Operations Maksons is a modern weaving unit that manufactures greige fabric used for home textile and outsources the processing for the finished goods. The mill presently has an installed capacity of 114 weaving looms including AIRJET & SULZER looms. The Company is also self-sufficient in power generation with captive power plant capacity of 4MW.

Ownership

Ownership Structure Shareholding of the Company is held by four individuals equally, while profit sharing ratio has been agreed to be distributed between five individuals. The fifth individual, Mr. Muhammad Khalid, is given share of profits against management services.

Stability There is no formal succession plan which poses a threat to the stability of the Company. Documenting an understanding between the sponsors would improve the ownership structure of the Company.

Business Acumen In addition to textile, the group has interests in energy, power, construction and trading. The sponsors of the Company carry extensive industrial experience and are actively involved in its daily operations.

Financial Strength Al-Tariq Group has strong presence in engineering sector. Furthermore, the sponsors have shown willingness and ability to support the Company in the past. In addition to cash injection in the form of capital, the group supports the Company from time to time in the form of loans.

Governance

Board Structure The Company’s BoD comprises four members, all are sponsors. The position of the Chairman is held by Mr. Abdul Quddoos whereas Mr. Khalid Majeed is the CEO of the company. There are no independent directors on the board.

Members’ Profile Board members have extensive knowledge and experience of the textile industry.

Board Effectiveness Board meetings are held regularly on monthly basis in which discussion on various aspects is recorded in minutes and decision or action is referred to the Chairman. Meanwhile, no subcommittees are in place to assist the Board.

Financial Transparency iThe Company has changed its external auditors from Rahim Jan & Company (Non-QCR rated) to Grant Thornton Anjum Asim Shahid Rehman & Co., Chartered Accountants for FY19. The previous auditors have expressed unqualified opinion on the financial statements of the Company for the year ended June 30, 2018. The current auditors are both QCR rated by Institute of Chartered Accountants of Pakistan and are on Category 'A' panel of auditors maintained by SBP. This transition is expected to improve the financial transparency and quality of reporting. The audit for FY19 is in process.

Management

Organizational Structure The company has a lean organizational structure with managers of four functional departments reporting directly to the Director – Mr. Muhammad Khalid.

Management Team All operational activities including asset management and procurement are overseen by Mr. Muhammad Khalid – Director. He is assisted by a management team with extensive industrial experience and reasonably long association with the Company.

Effectiveness Management has formed two committees, namely, i) Management Committee, and ii) Finance Committee. Management committee, headed by the CEO, is the apex committee and its meetings are held on a weekly basis to pro-actively address operational issues, if any. Finance Committee also meets on a weekly basis to discuss and resolve all issues relating to Finance.

MIS The Company has recently shifted to Oracle ERP from web based ERP solution. The transition is in process and it is expected that management will fully migrate to Oracle ERP in the short-term, resulting in improved information flow.

Control Environment The management has established a strong control environment in the Company through submission of weekly MIS reports on liquidity and production position of the Company. The quality control department ensures the quality of its products throughout the production process. In addition, management has established an internal audit function, which regularly conducts audit programs and submits its monthly internal audit report to the top management.

Business Risk

Industry Dynamics The export performance of Pakistan’s textile industry remained stagnated during FY19, despite ~34% currency devaluation and incentives introduced by the government to promote exports. While the current deficit has shown improvement, overall exports showed lackluster performance with the textile sector displaying negative YoY growth of ~1% in dollar terms. Even though leading textile categories including ready-made garments, knitwear and cotton cloth displayed double-digit volumetric growth, the hit to unit prices on account of exporters having to share the benefit of the currency depreciation with buyers in the extremely competitive international market, curbed overall growth. The withdrawal of zero rating status may cause liquidity crunch for the companies with majority exports. This, along with restriction on sales to unregistered person has resulted in a slowdown in textile’s operations, in local market.

Relative Position Maksons has modest presence in textile industry with relatively low installed capacity. The Company caters to niche market in textile industry providing textile solutions in the form of semi-finished and finished fabrics.

Revenues Maksons is engaged in the manufacture and sale of fabrics, with most of its revenue derived through exports (FY19: ~85%, FY18: ~95%) majorly to Europe. Meanwhile, local sales are derived from two sources: sale of fabric and weaving conversion income. The top line of the Company declined by ~20% in FY19 and clocked in ~PKR 1,273mln, as export revenue shrank. Although the Company's exports remained same in volumetric terms, the Company fetched lower prices in dollar terms due to high competition.

Margins The Company's gross margin declined during FY19 and stood at ~9% (FY18: ~13.5%). Although the Company has historically maintained its gross profit margin in the range of ~12-14%, the gross margin declined due to higher cost of raw materials and decrease (in dollar terms) in end-product price. The operating expenses also increased during the period which resulted in net operating loss of ~PKR 70mln in FY19 (FY18: PKR 78mln Profit). However, the bottom-line of the Company clocked at PKR 169mln during FY19 (FY18: PKR 41mln) due to one time provision income amounting to ~PKR 295mln of a related party. Otherwise, the Company would have incurred a net loss during FY19.

Sustainability Going forward, Maksons is planning to replace 48 old SULZER looms with modern AIRJET looms to increase the production capacity. Currently, all looms are operating at their full capacity. Revival of margins and increase in top line remains important.

Financial Risk

Working Capital Working capital is a function of inventory and trade receivables and is financed partly via in house generated cash flows and mainly from short-term borrowings. The cash cycle has increased significantly in FY19 (Gross- FY19: 146 days, FY18: 100 days, Net- FY19: 113 days, FY18: 77 days). Although working capital requirements decreased during FY19, the cash cycle increased mainly due to significant decline in top line. The Company's reliance on short-term borrowings has decreased during FY19 and clocked in at ~PKR 211mln (FY18: ~PKR 310mln). Net trade assets of the Company stood at PKR 422mln during FY19 (FY18: PKR 454mln), showing adequate room for further borrowings.

Coverages The free cash flows (FCFO) of the Company declined significantly during FY19 on the backdrop of negative operating margins. The FCFO clocked in at ~PKR 17mln during FY19 (FY18: PKR 157mln). This, coupled with higher finance cost, led to depressed coverages. The interest coverage ratio dropped to 0.4x during FY19 (FY18: 4.4x) and the debt coverage ratio decreased to just 0.2x (FY18: 1.4x).

Capitalization The Company has moderately leveraged capital structure. The leveraging stood at ~55% during FY18 (FY18: ~75%). The decrease in leveraging is attributable to lower short-term and long-term borrowings. Short-term borrowings comprise ~39% of total borrowings. The leveraging of the Company is expected to decrease further as the Company intends to pay-off its long-term debt, going forward.

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Maksons Textile (Private) Limited	Jun-19	Jun-18	Jun-17
Weaving	12M	12M	12M
A BALANCE SHEET			
1 Non-Current Assets	524	612	617
2 Investments	-	-	-
3 Related Party Exposure	-	-	-
4 Current Assets	620	649	406
a Inventories	*253*	*324*	*258*
b Trade Receivables	*241*	*203*	*85*
5 Total Assets	1,144	1,260	1,022
6 Current Liabilities	144	110	109
a Trade Payables	*130*	*100*	*104*
7 Borrowings	471	642	585
8 Related Party Exposure	73	222	82
9 Non-Current Liabilities	-	-	1
10 Net Assets	455	286	245
11 Shareholders' Equity	455	286	245
B INCOME STATEMENT			
1 Sales	1,273	1,588	1,312
a Cost of Good Sold	*(1,157)*	*(1,372)*	*(1,127)*
2 Gross Profit	116	216	185
a Operating Expenses	(186)	(137)	(121)
3 Operating Profit	(70)	78	64
a Non Operating Income	*298*	*7*	*(2)*
4 Profit or (Loss) before Interest and Tax	228	86	62
a Total Finance Cost	*(47)*	*(43)*	*(26)*
b Taxation	*(11)*	*(2)*	*(13)*
6 Net Income Or (Loss)	170	41	22
C CASH FLOW STATEMENT			
a Free Cash Flows from Operations (FCFO)	*17*	*157*	*146*
b Net Cash from Operating Activities before Working Capital Changes	*(30)*	*114*	*119*
c Changes in Working Capital	*(16)*	*(254)*	*(89)*
1 Net Cash provided by Operating Activities	(46)	(140)	30
2 Net Cash (Used in) or Available From Investing Activities	-	(69)	(319)
3 Net Cash (Used in) or Available From Financing Activities	49	208	286
4 Net Cash generated or (Used) during the period	3	(1)	(3)
D RATIO ANALYSIS			
1 Performance			
a Sales Growth (for the period)	-19.8%	21.1%	2.4%
b Gross Profit Margin	9.1%	13.6%	14.1%
c Net Profit Margin	13.3%	2.6%	1.7%
d Cash Conversion Efficiency (EBITDA/Sales)	2.2%	10.9%	12.1%
e Return on Equity (ROE)	45.7%	15.5%	9.5%
2 Working Capital Management			
a Gross Working Capital (Average Days)	146	100	78
b Net Working Capital (Average Days)	113	77	55
c Current Ratio (Total Current Assets/Total Current Liabilities)	4.3	5.9	3.7
3 Coverages			
a EBITDA / Finance Cost	0.7	4.6	6.0
b FCFO / Finance Cost+CMLTB+Excess STB	0.2	1.4	1.5
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	-13.8	4.6	3.6
4 Capital Structure (Total Debt/Total Debt+Equity)			
a Total Borrowings / Total Borrowings+Equity	54.5%	75.1%	73.1%
b Short-Term Borrowings / Total Borrowings	0.4	0.4	0.4
c Average Borrowing Rate	5.8%	4.9%	4.9%

Credit Rating Scale & Definitions

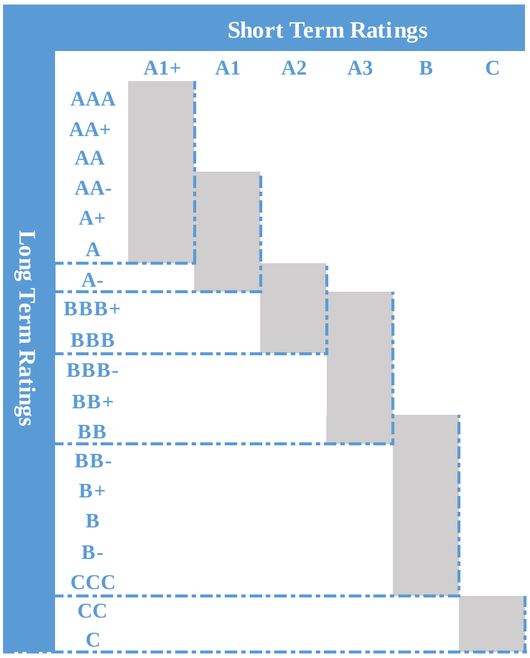
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings

Rating	Definition
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

Rating	Definition
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

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