



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
27-Dec-2019	A-	A2	Stable	Maintain	-
28-Jun-2019	A-	A2	Stable	Maintain	-
28-Dec-2018	A-	A2	Stable	Maintain	-
30-Jun-2018	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect growing business profile of Masood Fabrics Limited ('Masood Fabrics' or 'The Company') emanating from growth in revenues and better margins. The profitability of the Company improved YoY due to increase in topline, despite higher finance cost. 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. 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. This concern is magnified as the investments are partially financed through short-term borrowings. 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 remained important rating factors.

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-19),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria Rating Modifier(Jun-19)
Related Research	Sector Study Composite(Nov-19)
Rating Analysts	Muhammad Hassan muhammad.hassan@pacra.com +92-42-35869504

Profile

Legal Structure Masood Fabrics Limited ('Masood Fabrics' or 'The Company') was incorporated in 1998, as a public limited company.

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

Operations The Company is primarily engaged in the manufacture and sale of greige fabric and yarn. It also carries a significant investment portfolio and participates in equity market. The Company has a combined power generation of 10.9MW through captive generators, 5.4MW is utilized in the spinning unit and 5MW in the weaving unit.

Ownership

Ownership Structure The Khawaja Family comprises Chairman for all group companies Mr. Khawaja Muhammad Iqbal – the eldest son of late Mr. Khawaja Muhammad Masood, his three brothers and three sisters. Khawaja family directly owns 97% of the Company and the remaining 3% is indirectly owned through group companies.

Stability Defined and streamlined shareholding pattern among family members along with clear succession adds strength to the structure. However, documentation of succession plan would bring clarity for practical purposes.

Business Acumen The Chairman and his three brothers 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.

Financial Strength Mahmood Group maintains very strong financial profile with a considerable equity base 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, all from the sponsor family including the Chairman - Mr. Khawaja Muhammad Iqbal, and CEO - Khawaja Muhammad Ilyas. Chairman of the board, Mr. Iqbal 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. Iqbal – Chairman – has more than four decades of experience in textile industry. He succeeded his late father Mr. Khawaja Muhammad Masood, who passed away earlier this year. Mr. Ilyas – CEO – has more than three decades of experience in textile industry.

Board Effectiveness Total number of meeting held during the year was 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.

Financial Transparency M/s Deloitte Yousuf Adil & Co. Chartered Accountants, who are categorized in category A in the SBP's panel for auditors 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 30th, 2019.

Management

Organizational Structure Top tier management control is held by sponsors while middle tier is taken care by a team of experienced professionals. 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 three decades. 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 Limited.

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

MIS Various MIS reports are generated and submitted to higher management regarding monthly operations, finished goods, cotton reconciliation report, yield report and raw material report.

Control Environment The group continuously updates its technology infrastructure in all its manufacturing and support functions, while adapting to new technology and processes to ensure quality and cost effectiveness. The group is currently operating Oracle R12.

Business Risk

Industry Dynamics Pakistan's textile exports displayed small negative YoY growth in dollar terms in FY19. While some leading textile categories displayed strong 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. Meanwhile, cotton yarn exports witnessed a sizable decline, driven by falling yarn prices as well as the US-China trade war. Removal of zero-rated status of the textile sector and sharp rise in interest rates has pressurized margins of industry players.

Relative Position With 32,640 spindles and 244 looms, Masood Fabrics is a middle tier textile company. Cumulatively, the group owns 300,000 spindles and 850 looms and is one of the biggest textile manufacturing groups in Pakistan.

Revenues During FY19, Revenue of Masood Fabrics grew by ~31% to PKR 12,000mln (FY18: PKR 9,179mln) due to expansion in spinning capacity and currency devaluation. Majority of the revenue for the Company comes from export sales, which accounted for ~84% of total sales revenue in FY19. Bulk of the export sales come from the export of fabric, which accounts for 68% of total export sales and 57% of total sales. Growth in revenue continued through 1QFY20 with revenue growing ~18% QoQ and clocked in at PKR 3,841mln (1QFY19: PKR 3,252mln).

Margins Gross margin of the company improved to 13.5% in FY19 (FY18: 11.2%) as a result of higher revenue and relatively lower cost of sales, principally energy cost. Impact of increase in revenue, combined with lower operating expenses resulted in improvement in operating margins (FY19: 10.4%, FY18: 7.7%). Currency devaluation also supported margins of the Company. However, Net margins remained stagnant (FY19: PKR 448mln, FY18: PKR 341mln) YoY as the impact of higher top line was neutralized by significant increase in finance cost. During 1QFY20, gross margin slightly decreased to 12.9% and operating margin to 9.4%. Net profit margin during 1QFY20 experienced a significant decrease and clocked in at 1.5% (1QFY19: 5%) due to higher finance cost.

Sustainability Recently, the Company installed new 14,400 spindles under BMR initiative for production facilities. Going forward, improvement in stock market will benefit the Company's financial profile.

Financial Risk

Working Capital During FY19, the Company's net working capital cycle increased to 145days (FY18: 125 days) due to high inventory procurement to meet high post expansion production needs. On the other hand, short term borrowings decreased to PKR 7,240mln (FY18: PKR 8,356mln), as the Company's trade receivable cycle improved. The Company's room to borrow came down to -28% during FY19 (FY18: -77%) which is significantly lower than last year yet shows an unfavourable asset liability mismatch. During 1QFY20 working capital cycle showed some improvement and came down to 118days (1QFY19: 126days) due to decrease in average inventory days.

Coverages During FY19, the Company experienced a significant increase in its Free Cash Flow From Operations (FY19: PKR 2,094mln, FY18: 712mln) which led to improvement in coverages. Interest coverage ratio increased to 2.2x (FY18: 1.3x) and debt coverage ratio to 1.6x (FY18: 1.0x). Coverages slightly fell during 1QFY20, with interest coverage ratio decreasing to 1.7x and debt coverage ratio to 1.2x due to higher finance cost.

Capitalization During FY19, the Company's leveraging stood at ~66% (FY18: ~73%). Most of the debt is in terms of short term borrowing, which at PKR 7,240mln made up 70% of total debt (FY18: 79%). At the end of FY19, total borrowings of the company stood at PKR 10,317mln, with a decrease of 2% compared to the same period last year (9MFY18: PKR 9,116mln).



Masood Fabrics Limited Textile	Sep-19 3M	Jun-19 12M	Jun-18 12M	Jun-17 12M
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A BALANCE SHEET

1 Non-Current Assets	4,170	4,245	4,007	2,502
2 Investments	5,430	5,831	5,745	5,148
3 Related Party Exposure	-	-	-	-
4 Current Assets	6,464	6,719	5,519	2,362
<i>a Inventories</i>	3,778	4,715	3,170	1,254
<i>b Trade Receivables</i>	1,588	898	1,529	814
5 Total Assets	16,064	16,794	15,271	10,011
6 Current Liabilities	1,290	1,050	791	631
<i>a Trade Payables</i>	564	448	336	143
7 Borrowings	9,289	10,317	10,547	5,672
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	0	0	0	166
10 Net Assets	5,485	5,427	3,934	3,543
11 Shareholders' Equity	5,485	5,427	3,934	3,543

B INCOME STATEMENT

1 Sales	3,841	12,000	9,179	7,104
<i>a Cost of Good Sold</i>	(3,346)	(10,375)	(8,150)	(6,640)
2 Gross Profit	495	1,626	1,029	463
<i>a Operating Expenses</i>	(136)	(374)	(323)	(290)
3 Operating Profit	359	1,252	706	173
<i>a Non Operating Income</i>	38	338	(39)	824
4 Profit or (Loss) before Interest and Tax	398	1,589	668	997
<i>a Total Finance Cost</i>	(301)	(1,017)	(576)	(377)
<i>b Taxation</i>	(38)	(124)	249	(242)
6 Net Income Or (Loss)	58	448	341	379

C CASH FLOW STATEMENT

<i>a Free Cash Flows from Operations (FCFO)</i>	474	2,094	712	314
<i>b Net Cash from Operating Activities before Working Capital Changes</i>	145	1,054	384	105
<i>c Changes in Working Capital</i>	435	(1,260)	(2,636)	(518)
1 Net Cash provided by Operating Activities	580	(205)	(2,252)	(414)
2 Net Cash (Used in) or Available From Investing Activities	443	442	(2,621)	(1,360)
3 Net Cash (Used in) or Available From Financing Activities	(1,028)	(230)	4,875	1,772
4 Net Cash generated or (Used) during the period	(5)	6	2	(2)

D RATIO ANALYSIS

1 Performance				
<i>a Sales Growth (for the period)</i>	28.0%	30.7%	29.2%	--
<i>b Gross Profit Margin</i>	12.9%	13.5%	11.2%	6.5%
<i>c Net Profit Margin</i>	1.5%	3.7%	3.7%	5.3%
<i>d Cash Conversion Efficiency (EBITDA/Sales)</i>	12.5%	17.0%	8.2%	5.3%
<i>e Return on Equity (ROE)</i>	4.3%	9.6%	9.1%	10.7%
2 Working Capital Management				
<i>a Gross Working Capital (Average Days)</i>	130	157	135	90
<i>b Net Working Capital (Average Days)</i>	118	145	125	83
<i>c Current Ratio (Total Current Assets/Total Current Liabilities)</i>	5.0	6.4	7.0	3.7
3 Coverages				
<i>a EBITDA / Finance Cost</i>	1.7	2.1	1.4	1.1
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	1.2	1.6	1.0	0.6
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>	4.0	2.7	13.2	-34.2
4 Capital Structure (Total Debt/Total Debt+Equity)				
<i>a Total Borrowings / Total Borrowings+Equity</i>	62.9%	65.5%	72.8%	61.6%
<i>b Short-Term Borrowings / Total Borrowings</i>	0.7	0.7	0.8	0.8
<i>c Average Borrowing Rate</i>	11.6%	9.2%	6.7%	6.1%

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)

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- (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)
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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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