The Pakistan Credit Rating Agency Limited

Rating Report

Masood Spinning Mills Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
12-May-2020	BBB+	A2	Stable	Initial	YES

Rating Rationale and Key Rating Drivers

Masood Spinning Mills Limited (‘Masood Spinning’ or ‘The Company’) is a private limited company. The Company is part of Mahmood Group, one of the premier textile conglomerates in the country. The Company is engaged in manufacturing of variety of yarn. The ratings reflect strong growth in revenues witnessed in recent years on the back of currency devaluation (revenue predominantly comprises exports) and continuous BMR. The Company's margins have improved recently though remained below par when compared with peers. Recent outbreak of COVID-19 has impacted the business profile of the Company like all export oriented spinning units. Capacity utilization is low as orders are deferred by buyers. Financial risk of the Company remains stretched given high leveraging and adequate core debt service coverages. Some relief will come from recent rate cut of 425bps and other SBP measures but cashflows are expected to remain under duress. The Company's association with Mahmood Group and vast experience of sponsors remain important rating factors.
The Rating Watch signifies the prevailing uncertainty due to the outbreak of COVID-19 pandemic. This has impacted the entire textile chain due to the lockdown in Pakistan and major export destinations of the sector. The demand is expected to contract while the eventual resumption of operations and recovery of the sector remains uncertain. The Company's operations and orders have suffered consequently. The Government and SBP have announced several initiatives to provide support. PACRA is closely monitoring the situation and will take rating action accordingly.

The ratings are dependent on the Company’s ability to sustain its operations in prevailing conditions. The management is cognizant of these challenges and working on this front. Meanwhile prudent working capital management and generating sustainable cashflows from core operations are important. Significant deterioration in business profile due to prolonged downturn leading to deterioration in coverages and/or margins will impact the ratings.

Disclosure	
Name of Rated Entity	Masood Spinning Mills 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 | Spinning(Sep-19)
Rating Analysts	Muhammad Hassan | muhammad.hassan@pacra.com | +92-42-35869504

Profile

Legal Structure Masood Spinning Mills Limited ('Masood Spinning' or 'The Company') is a private limited concern. The Company has been operating since June 2000.
Background The Company is a part of Mahmood Group which started operations in 1935 and has since evolved into a diversified business empire. Masood Spinning Mills Limited was incorporated in 2000.
Operations The Company has three production units. Unit 1 and Unit 2 are located in Kabirwala in Khanewal district near the Company's head office in Multan. Unit 3 is located in Phool Nagar in Kasur district. All three units have a collective capacity of ~82,272 spindles. The Company's total electricity requirement stands at ~10.5 M.W which is met through captive generation capacity. Additionally, the Company also has a backup line from LESCO and MEPCO to meet unforeseen energy needs.

Ownership

Ownership Structure Masood Spinning is 100% owned by Mehmood Group directly, through individuals and associated companies. Ownership is equally divided between four sons of Khawaja M. Masood (Late).
Stability The group has a clearly defined shareholding pattern among four brothers. Clarity among brothers with regards to operations of the group companies bodes well with stability of the Group and Masood Spinning. However, documentation of succession plan would bring further clarity to stability of ownership.
Business Acumen All four brothers are equipped with well-rounded experience in textile industry. Each has over forty years of experience in running the businesses of the group. Third generation of sponsors is already actively involved in running the operations of different group companies and possesses relevant knowledge and capabilities.
Financial Strength Mahmood Group maintains a strong financial profile with an equity base of ~PKR ~21bln at end-Dec19, as well as, well diversified businesses through its multiple group companies. The Company drives comfort from sponsors ability and willingness to support it, in case the need arises.

Governance

Board Structure Oversight of the Company lies with a seven-member board, which includes both the Chairman and the CEO.
Members' Profile Mr. Khawaja Muhammad Iqbal – Chairman, has over four decades of textile experience. He has held key positions in various local corporate bodies of Pakistan. Other directors' expertise in various stages of textile value-chain leads to a good skill mix of their individual competencies.
Board Effectiveness Board meetings have full attendance of directors, boding well for the board's effectiveness. Meanwhile, minutes are recorded properly, although, there is still some room for improvement. There are two sub-committees in place: Audit Committee and Human Resource Committee.
Financial Transparency Deloitte Yousuf Adil Chartered Accountants are the external auditors of the Company. The auditor is listed in Category "A" of the State Bank's panel of auditors. They have expressed an unqualified opinion on the financial statements of the company for the year ended June 30th, 2019.

Management

Organizational Structure The Company essentially operates in two distinct divisions before delegating strategic decisions to one overseeing body. At this highest level, departments are as follows: (i) Audit (ii) Taxation (iii) HR and Admin (iv) IT and ERP (v) Export and Import, (vi) Purchase & Production, (vii) Corporate affairs. (viii) Marketing and (ix) Finance.
Management Team The Company CEO – Mr. Khawaja M. Younus – has over three decades of experience in the textile sector. He also sits on the board of various group companies. Mr. Younus is supported by a team of seasoned professionals. Mr. Anees s/o Mr. Khawaja Muhammad Younus and Mr. Meher s/o Mr. Khawaja Muhammad Ilyas look after day to day operations of Kabirwala (unit 1 & 2) and Phool Nagar (unit 3) facilities respectively.
Effectiveness Division of duties among the management is clearly defined. While there are no formal management committees, the Company maintains adequate IT infrastructure and related controls for smooth running of operations.
MIS Masood Spinning Mills Limited implemented an Oracle based ERP solution – Oracle EBS – in 2008 with multiple operational modules.
Control Environment The Company is following latest quality assurance standards for production and trade of yarn. On an operational level, samples of cotton and yarn are tested for quality under laboratories of each unit.

Business Risk

Industry Dynamics Textile exports of the country grew by ~5% for 9MFY20 to stand at ~USD 10.4bln as compared to ~USD 9.9bln in 9MFY19, backed by the devaluation of the rupee, bailout package from the government and GSP Plus Scheme of the EU. This growth was led mainly by the value-added segment. Going forward, removal of zero-rated status, prevailing uncertainty in the dynamics of textile sector due to Covid-19 outbreak globally, prolonged nationwide lockdown, contraction in local and international demand is expected to affect the entire textile value chain.
Relative Position Overall, Mahmood Group has a strong presence in the country's textile sector, while Masood Spinning Mills Limited with 82,272 spindles is also adequately positioned.
Revenues During FY19, Masood Spinning's topline grew by ~25% to PKR 14,853mln (FY18: PKR 11,867mln) mainly due to better yarn prices in the local market and higher share of exports in the sales mix, which benefited from devaluation of local currency. At PKR 10,966mln (FY18: PKR 7,241mln), exports made up ~74% (FY18: ~61%) of total sales. The trend of increase in topline continued in 1HFY20 as well, with the Company posting revenue of PKR 7,735mln (1HFY19: PKR 6,304mln), an increase of ~23% period-on-period.
Margins During FY19, the Company's gross margin increased to 7.3% (FY18: 6.4%) and operating margin to 5.3% (FY18: 3.9%) on the back of currency devaluation and better yarn prices in the local market. The Company recorded a net profit of PKR 161mln (FY18: PKR 57mln) depicting a significant increase YoY, despite finance cost rising by ~53% to PKR 877mln (FY18: PKR 574mln) on the back of higher interest rates. As a result, net profit margin increased to 1.1% (FY18: 0.5%). Gross margin further increased to 9.3% and operating margin to 6.7% in 1HFY20. However, the Company's net profit decreased to PKR 56mln during 1HFY20 (1HFY19: PKR 99mln) compared to the same period last year because of higher finance cost (1HFY20: PKR 391mln, 1HFY19: PKR 275mln).
Sustainability Masood Spinning had shut down its operations as per government directive for some time. However, since the government has eased the lockdown the Company has started to partially resume its operations. However, full resumption of operations and recovery in sales of the Company remains unclear. The eventual easing and opening up of domestic and global lockdowns are important in this regard, although its timeline is not certain. The Company has opted to avail SBP initiatives to seek support in the short-term which will provide much-needed comfort to the cashflows.

Financial Risk

Working Capital During FY19, the Company's net working capital cycle days decreased to 119days (FY18: 143days) due to shorter trade receivable days. Short-term borrowings (STB) slightly decreased by ~4% to PKR 6,464mln (FY18: PKR 6,765mln). In line with this trend, short term trade leverage improved to -24% (FY18: -31%) due to some increase in net trade assets and a decrease in STB. However, at -24, negative room to borrow showed an asset-liability mismatch. During 1HFY20, net working cycle increased to 125days in 1HFY20 (1HFY19: 156days) while STB decreased to PKR 6,152mln (1HFY19: PKR 7,241mln). Short-term trade leverage improved significantly on the back of higher net trade assets and lower STB, completely eliminating asset-liability mismatch.
Coverages During FY19, Masood Spinning's free cash flows (FCFO) grew by ~51% to PKR 1,357mln (FY18: PKR 948mln). Despite increase in FCFO, the Company's interest coverage ratio slightly decreased to 1.7x (FY18: 1.8x) and debt coverage ratio to 1.0x (FY18: 1.1x) due to higher finance cost. FCFO in 1HFY20 increased to PKR 611mln (1HFY19: PKR 421mln) but interest coverage ratio remained stagnant at 1.6x (1HFY19: 1.6x) while debt coverage ratio declined to 1.3x (1HFY19: 1.5x) due to increase in CMLTD.
Capitalization At end-Jun19, the Company had a highly leveraged capital structure with a leveraging ratio of ~75% (FY18: ~80%). Leveraging ratio decreased YoY as total borrowings declined to PKR 8,257mln (FY18: PKR 8,704mln). Majority portion of debt comprised STB (78%) and out of total borrowing 22% borrowing is from SBP at concessionary rates. Leveraging ratio almost remained stagnant at ~74% in 1HFY20 mainly because impact decrease in short borrowings in the period was offset by increase in long term borrowings availed to fund CAPEX.

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Financial Summary
PKR mln

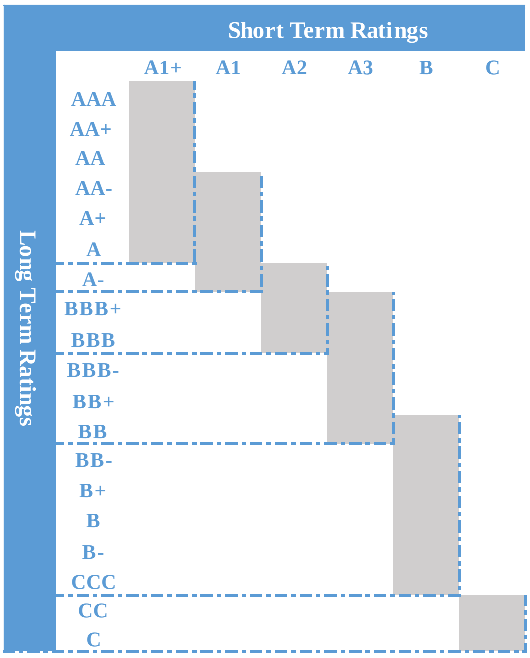
Masood Spinning Mills Limited Spinning	Dec-19 6M	Jun-19 12M	Jun-18 12M	Jun-17 12M
A BALANCE SHEET				
1 Non-Current Assets	3,840	3,982	3,490	2,976
2 Investments	884	1,424	2,068	2,014
3 Related Party Exposure	283	283	190	190
4 Current Assets	7,658	5,981	5,756	5,160
a Inventories	*3,819*	*4,172*	*3,614*	*2,674*
b Trade Receivables	*2,304*	*828*	*1,312*	*1,865*
5 Total Assets	12,664	11,671	11,504	10,339
6 Current Liabilities	1,489	612	481	632
a Trade Payables	*399*	*129*	*80*	*102*
7 Borrowings	8,317	8,257	8,704	7,526
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	-	-	-	-
10 Net Assets	2,858	2,801	2,320	2,181
11 Shareholders' Equity	2,858	2,801	2,320	2,181
B INCOME STATEMENT				
1 Sales	7,735	14,853	11,867	9,181
a Cost of Good Sold	*(7,014)*	*(13,770)*	*(11,104)*	*(8,831)*
2 Gross Profit	722	1,083	763	350
a Operating Expenses	(202)	(295)	(302)	(237)
3 Operating Profit	520	788	461	112
a Non Operating Income	*5*	*114*	*221*	*478*
4 Profit or (Loss) before Interest and Tax	525	902	681	590
a Total Finance Cost	*(391)*	*(877)*	*(574)*	*(420)*
b Taxation	*(77)*	*136*	*(51)*	*(86)*
6 Net Income Or (Loss)	56	161	57	84
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*611*	*1,357*	*948*	*403*
b Net Cash from Operating Activities before Working Capital Changes	*433*	*536*	*389*	*25*
c Changes in Working Capital	*(949)*	*(232)*	*(702)*	*(1,507)*
1 Net Cash provided by Operating Activities	(516)	304	(313)	(1,482)
2 Net Cash (Used in) or Available From Investing Activities	519	146	(853)	276
3 Net Cash (Used in) or Available From Financing Activities	60	(446)	1,178	1,193
4 Net Cash generated or (Used) during the period	63	4	12	(14)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	4.2%	25.2%	29.3%	12.2%
b Gross Profit Margin	9.3%	7.3%	6.4%	3.8%
c Net Profit Margin	0.7%	1.1%	0.5%	0.9%
d Cash Conversion Efficiency (EBITDA/Sales)	8.9%	9.9%	9.1%	5.5%
e Return on Equity (ROE)	4.0%	6.3%	2.5%	3.8%
2 Working Capital Management				
a Gross Working Capital (Average Days)	131	122	146	165
b Net Working Capital (Average Days)	125	119	143	161
c Current Ratio (Total Current Assets/Total Current Liabilities)	5.1	9.8	12.0	8.2
3 Coverages				
a EBITDA / Finance Cost	1.8	1.7	2.0	1.2
b FCFO / Finance Cost+CMLTB+Excess STB	1.3	1.1	1.1	0.6
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	4.6	3.5	4.7	-94.3
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	74.4%	74.7%	79.0%	77.5%
b Short-Term Borrowings / Total Borrowings	0.7	0.8	0.8	0.8
c Average Borrowing Rate	9.1%	10.0%	6.6%	5.5%

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.

Regulatory and Supplementary Disclosure

(Credit Rating Companies Regulations,2016)

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