PACRA

The Pakistan Credit Rating Agency Limited

LIBERTY MILLS LIMITED

ENTITY RATINGS

	NEW [JUN-17]	INITIAL [JUN-16]
Entity		
Long Term	A+	A+
Short Term	A1	A1
Outlook	Stable	Stable

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JUNE 2017

Profile & Ownership

- Liberty, established in 1964, is in the business of manufacturing and processing of textile fabrics (capacity: 78mln linear meters p.a.) and made ups (stitching machines: 716).
- The company is majority (~100%) owned by Mukaty family mainly through individuals.
- Liberty Group has interests in textile, energy and aluminium sectors, along with other planned investments.

Governance

- Eight-member board comprises four directors from sponsoring family, three executive members, and one non-executive director.
- No segregation in the role of Chairman & CEO; position held by Mr. Salim Mukaty – the founding member
- Need for improvement in governance structure to bring independent oversight and guidance to management strategy

Management

- Executive Director Mr. Muhammad Ashraf S. Mukaty - son of Mr. Mukaty - oversees company operations.
- Management team comprises long associated professional and experienced individuals.

Operational Risk

- Sound operational infrastructure; mainly European technology
- Deploys oracle based ERP; comprehensive MIS reporting
- ISO 9001, OE 100/OE Blended Standards, Oeko-Tex Standard 100 and SA 8000 certified
- Captive power generation (~11MW) to meet energy requirements (~5MW)

Performance

- Export-oriented company (92% of sales); sales mix is dominated by Processing segment, followed by Home Textile segment
- Long-term working relationships with top brands including Polo Ralph Lauren, GAP, The Children's Place, etc. At the same time, concentration of revenue from top ten customers', is high, portraying concentration risk.
- During 9MFY17, revenues decreased by ~7% on YoY basis to PKR 11bln. This is mainly attributable to the troublesome export market which fetched lower revenues as compared to same period last year.
- Cost of production decreased by a lower proportion than revenues, resulting in contraction of margins; gross (9MFY17: 14.6%, 9MFY16: 19.0%) and operating (9MFY17: 9.3%, 9MFY16: 14.1%).
- Hefty dividend income from subsidiary – Liberty Power Tech Limited – continues to augment bottom-line which amounted to PKR 1,463mln during the period (9MFY16: PKR 1,807mln).
- Investment book constitutes ~53% of Liberty's equity base at end-Mar17; predominantly comprises strategic investments in Liberty Power Tech Limited and Engro PowerGen Thar (Pvt.) Limited.
- Strategic investment in power sector is likely to be strengthened in the medium-term, along with other sectors.

Financial Risk

- Working capital requirements, a function of its receivables and inventory, are met through a mix of internal generation and short term borrowings.
- Inventory and receivables as a percentage of sales continued to decrease in recent years resulting in better net working capital days (FY16: 97days, FY15: 107days, FY14: 122days). Owing to seasonality effect, working capital requirements rose at end-Mar17, leading to relatively higher days.
- Very strong debt-servicing ability; expected to remain healthy in medium-term
- Moderately leveraged capital structure (end-Mar17: ~36%); no major expansion is expected in the medium term.

RATING RATIONALE

Liberty, a family-owned textile company, operates in value-added segment - processing of fabric and made-ups. While this insulates it against volatility in cotton prices, the company's resilient business profile emanates from core operations featured by business margins which, though reduced recently, remain strong despite weak local textile sector fundamentals. With an export market orientation, the company focuses on its established niche of quality-conscious institutional buyers, garnering healthy margins. Although this has led to customer concentrations, longevity of relationship with big-name clients in addition to sustained quality helps manage the risk. However, revenue growth has recently been affected on the back of increased international competition. Meanwhile, despite the announcement of export incentives by the state, materialization of the same is low. The company's bottomline is augmented by a recurring dividend stream from investment in an IPP - Liberty Power Tech. Liberty's strong financial risk profile is characterized by limited long-term debt, healthy cash flows, and, in turn, strong debt-servicing ability. Working capital cycle is stretched, though in line with peers; any improvement will bring efficiency. Long association of experienced management team adds comfort. However, governance framework needs improvement. Going forward, Liberty Group - the sponsors - intends to expand its industrial footing with a diversification philosophy. As part of the strategy, the group has recently ventured into the food beverage market partnering with an international investment group. Furthermore, increased outlay of investments in energy and other infrastructural sectors is on the cards.

KEY RATING DRIVERS

The ratings are dependent on the management's ability to sustain its overall profile. Meanwhile, utilization of lately beefed-up capacities is considered important. Going forward, increase in business size, continuation of dividend/other income stream vis-a-vis strengthening of governance framework will have positive implications on ratings.

Liberty Mills Limited (Liberty)

PKR mln

BALANCE SHEET	31-Mar-17	30-Jun-16	30-Jun-15	30-Jun-14
	FY	FY	Annual	Annual
Non-Current Assets	**4,217**	**4,106**	**3,890**	**2,570**
Investments (Incl. Associates & Subsidiaries)	**5,393**	**3,646**	**1,683**	**1,447**
Equity	4,409	3,146	1,683	1,447
Debt Securities	984	500	-	0
Current Assets	**8,329**	**7,589**	**7,284**	**6,130**
Inventory	4,424	3,579	3,757	3,376
Trade Receivables	2,315	2,097	1,829	1,628
Others	1,590	1,913	1,699	1,126
Total Assets	**17,939**	**15,341**	**12,857**	**10,148**
Debt	**5,807**	**5,317**	**4,384**	**3,686**
Short-Term	4,714	4,365	3,407	3,308
Long-Term (Incl. Current Maturity of Long-Term Debt)	1,092	953	977	378
Other Short-Term Liabilities	1,885	1,240	1,361	1,148
Other Long-Term Liabilities	-	-	214	173
Shareholder's Equity	**10,248**	**8,784**	**6,899**	**5,141**
Total Liabilities & Equity	**17,939**	**15,341**	**12,857**	**10,148**
INCOME STATEMENT				
Turnover	**11,059**	**15,055**	**14,938**	**12,181**
Gross Profit	1,615	2,662	2,613	1,819
Net Other Income	806	519	417	617
Financial Charges	(122)	(161)	(247)	(326)
Net Income	**1,463**	**1,890**	**1,758**	**1,252**
Cash Flow Statement				
Free Cash Flow from Operations (FCFO)	1,461	1,789	1,706	1,309
Net Cash changes in Working Capital	143	(530)	(489)	(212)
Net Cash from Operating Activities	1,916	1,602	1,498	1,255
Net Cash from Investing Activities	(2,188)	(2,629)	(1,812)	(515)
Net Cash from Financing Activities	140	934	698	(707)
Ratio Analysis				
Performance				
Turnover Growth	-7.3%	0.8%	22.6%	11.5%
Gross Margin	14.6%	17.7%	17.5%	14.9%
Operating Margin	9.3%	11.4%	11.4%	9.1%
Net Margin	13.2%	12.6%	11.8%	10.3%
ROE	20.5%	23.4%	28.5%	25.4%
Coverages				
Interest Coverage (FCFO/Gross Interest)	11.9	11.1	6.9	4.0
Core: (FCFO/Gross Interest+CMLTD+Uncovered Total STB)	11.9	11.1	3.0	3.5
Total: (TCF) / (Gross Interest+CMLTD+Uncovered Total STB)	15.5	14.4	3.9	4.8
Debt Payback (Total LT Debt Including UnCovered Total STBs) / (FCFO- Gross Interest)	0.6	0.6	0.7	0.4
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	125	120	117	122
Capital Structure (Total Debt/Total Debt+Equity)	36.2%	37.7%	38.9%	41.8%

The Pakistan Credit Rating Agency Limited

STANDARD 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. This capacity is highly unlikely to be adversely affected by foreseeable events.
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-	**Speculative.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic change over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**Highly speculative.** Significant 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	**High default 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.

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. Rating Watch may carry designation – Positive (rating may be raised, negative (lowered), or developing (direction is unclear). A watch should be resolved with in foreseeable future, but may continue if underlying circumstances are not settled.

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'.

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, or e) the entity/issuer defaults.

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Regulatory and Supplementary Disclosure

Name of Issuer	Liberty Mills Limited
Sector	Textile
Type of Relationship	Solicited
Purpose of the Rating	Independent Risk Assessment

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action
12-Jun-17	A+	A1	Stable	Maintain
14-Jun-16	A+	A1	Stable	Initial

Related Criteria and Research

Rating Methodology	Corporate Rating Methodology
Sector Research	Textile Sector Overview - 2016

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Rating Team Statement

Rating Procedure

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