The Pakistan Credit Rating Agency Limited

MAHMOOD TEXTILE MILLS LIMITED

ENTITY RATINGS

RATING REPORT

	INITIAL [AUG-17]
Entity	
Long Term	A-
Short Term	A2
Outlook	Stable

REPORT CONTENTS

AUGUST 2017

Profile & Ownership

- Incorporated in 1970, Mahmood Textile – family-owned business – is listed on PSX. It is principally engaged in production and sale of yarn and grey fabric
- Operating with 107,760 spindles and 100 looms at end-Jun17; installed capacity of ~41mln kgs and ~23mln sq. meters p.a., respectively
- Mahmood Group (MG) cumulatively holds majority (~90%) stake via individuals and companies
- MG has interests in textile, ginning, leather, food, real estate, and power sectors; FY16 combined topline: PKR ~35bln

Governance & Management

- Seven-member board dominated by sponsor family: six family members, including CEO, and one independent director
- Mr. Khawaja M. Masood - founder of MG - is Chairman, and Mr. Khawaja M. Iqbal is CEO. Both have more than four decades of textile experience
- First-tier management's responsibilities are structured at both group-level and company-level; senior family members are responsible for group's core functions in addition to being company CEOs. Group's finance, marketing and fixed asset procurement functions are also headed at group level by professionals.
- Lack of segregation between governance and management as control of the latter vests with sponsors; absence of challenge to management

Operational Risk

- Plants, 5 spinning and 1 weaving, located in Muzaffargarh, Dera Ghazi Khan; capacity utilization levels of ~92% and ~93%, respectively. Energy requirements (~17MW) met via captive generation capacities (~19MW)
- Oracle-based ERP system implemented with different operational modules; daily and monthly MIS reporting to senior management

Business Risk

- Topline constitutes spinning (~81%) and weaving (~19%) segments
- Local:export mix, traditionally export-oriented, tilted towards a balance recently
- High customer and geographic concentration risk; though at par with peers
- During 9MFY17, the company's topline increased to ~PKR 12bln (up ~13% YoY), supported by volumes as well as rates. Margins improved (gross: 9MFY17: 8.1%, 9MFY16: 7.1%; operating: 9MFY17: 3.8%, 9MFY16: 2.7%) due to cost efficiencies. Though gross margin is at par, operating margin remains lower as compared to that peers.
- As a business, the group takes exposure in stock market, and overall profitability has proved to be largely a function of dividends and capital gains; high exposure to market risk. At end-Mar17, the company's investment portfolio comprises equity stakes in group companies (fair value: PKR 799mln) and other corporates (fair value: PKR 3,114mln).
- During 9MFY17, the company generated dividend income (~PKR 144mln) and capital gains (~PKR 240mln) from trading book.
- Net income jumped YoY to PKR 488mln (9MFY16: PKR 33mln) owing to higher aggregate return on investments during the period (9MFY17: PKR 384mln, 9MFY16: PKR 198mln).
- Going forward, the company plans to compress and cap the size of its investment portfolio, thus limiting the balance sheet's exposure to market risk.

Financial Risk

- Stretched financial risk profile of the company
- Inventory and receivables increased YoY as a percentage of sales (Mar17: 36%, Jun16: 28%) depicting higher working capital needs. Net working capital days (Mar17: 110days, Jun16: 107days); this seasonal increase is in line with peers.
- Relative to working capital needs, the company has high STBs (Mar17: PKR ~8bln) in order to finance a portion of its short-term investments.
- With support from improved cash flows and lower finance costs, core debt coverage improved during the period (Mar17: 1.2x, Jun16: 0.9x).
- Leveraged capital structure (Mar17: 65%); ST leveraging of 56%

RATING RATIONALE

The ratings reflect adequate business profile of Mahmood Textile – flagship entity of Mahmood Group. The company operates in spinning and weaving segments. In recent years, in line with industry trends, revenues of the company witnessed declining trend led by fall in exports. The company managed to improve its margins – both gross and operating; however, high expenses resulted in lower operating margin. Overall profitability is a function of performance of the company's large trading portfolio which is managed at group-level. Although the company is invested in blue-chip stocks, high market risk exposes the company to volatile returns and valuations. This concern magnifies as these investments are partially financed through short-term borrowings. Additionally, financial risk remains stretched given tight borrowing capacity and core debt service coverages. The company has recently shown improvement in its operational performance, which was further beefed-up by dividend income. This provided relief to the risk profile of the company; sustainability of the same is important. Association with Mahmood Group, and the board's vast experience bodes well for the company.

KEY RATING DRIVERS

The ratings are dependent on stability of business margins, and overall risk profile and returns of the investment portfolio. Uplifting of financial risk profile via improved core coverages would be ratings positive. Meanwhile, materialization of benefits for the textile sector, announced by the state, would improve performance.

INDUSTRY

GoP notified its Textile Package in FY17, which included measures such as export rebates, and duty-free import of cotton and textile machinery. While higher export rebates on textile products should support all export-oriented players in terms of liquidity, disbursements of the same have been slow, adding to large sums of sales tax refunds already due from GoP. Moreover, as a result of duty-free cotton, improvement in cost of production was expected. However, an industry-wide margin squeeze has been witnessed primarily on the back of higher energy and labor costs. Going forward, the Free Trade Agreement (FTA) between Pakistan and Turkey, if materialized, should bode well for the industry.

PKR mln

Mahmood Textile Mills Limited

BALANCE SHEET	31-Mar-17	30-Jun-16	30-Jun-15	30-Jun-14
	9MFY16	Annual	Annual	Annual
Non-Current Assets	**3,165**	**2,934**	**3,052**	**3,047**
Investments (Incl. Associates)	**3,912**	**2,748**	**3,025**	**1,978**
Equity	3,912	2,748	3,025	1,978
Debt Instruments	-	-	-	-
Current Assets	**7,654**	**5,014**	**5,412**	**4,097**
Inventory	3,423	2,543	3,403	2,668
Trade Receivables	2,140	1,319	1,343	605
Others	2,091	1,152	666	824
Total Assets	**14,732**	**10,696**	**11,488**	**9,122**
Debt	**9,008**	**5,080**	**5,442**	**3,788**
Short-Term	7,817	4,090	4,205	2,424
Long-Term (Incl. Current Maturity of Long-Term Debt)	1,192	990	1,236	1,364
Other short-term liabilities	770	1,151	1,262	771
Other long-term liabilities	-	-	115	115
Shareholders' Equity	**4,954**	**4,466**	**4,670**	**4,448**
Total Liabilities & Equity	**14,732**	**10,696**	**11,488**	**9,122**
INCOME STATEMENT				
Turnover	**11,584**	**13,664**	**13,759**	**15,475**
Gross Profit	938	1,097	945	1,359
Net Other Income	451	(55)	749	382
Financial Charges	(309)	(416)	(475)	(562)
Net Income	**488**	**(56)**	**371**	**472**
Cashflow Statement				
Free Cashflow from Operations (FCFO)	638	660	449	833
Net Cash changes in Working Capital	(2,935)	256	(861)	473
Net Cash from Operating Activities	(2,431)	748	(815)	732
Net Cash from InvestingActivities	(1,391)	(227)	(683)	(519)
Net Cash from Financing Activities	3,928	(512)	1,504	(218)
Ratio Analysis				
Performance				
Turnover Growth	13.1%	-0.7%	-11.1%	8.6%
Gross Margin	8.1%	8.0%	6.9%	8.8%
Net Margin	4.2%	-0.4%	2.7%	3.0%
ROE	13.8%	-1.2%	8.1%	10.6%
Coverages				
Interest Coverage (FCFO/Gross Interest)	2.1	1.6	0.9	1.5
Core: (FCFO/Gross Interest+CMLTD+Uncovered Total STB)	1.2	0.9	0.6	0.9
Total: (TCF) / (Gross Interest+CMLTD+Uncovered Total STB)	1.5	1.3	0.7	0.9
Debt Payback (Total LT Debt Including Uncovered Total STBs) / (FCFO- Gross Interest)	2.7	4.1	-48.6	5.0
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	109.9	101.1	120.0	74.4
Capital Structure (Total Debt/Total Debt+Equity)	64.5%	53.2%	53.8%	46.0%

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

Rated Entity	Mahmood Textile Mills Limited
Sector	Textile
Type of Relationship	Solicited
Purpose of the Rating	Independent Risk Assessment

Rating History

Dissemination Date	Long Term	Short Term	Outlook
08-Aug-17	A-	A2	Stable

Related Criteria and Research

Specific Methodology: Corporate Rating Methodology

Research: Textile Sector Overview - 2016

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Rating Team Statement

Rating Procedure

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Prohibition

Probability of Default (PD)

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