

RATINGS (JANUARY 2012)

HUSSAIN MILLS LIMITED (HML)

ENTITY	INITIAL
Long Term	A-
Short Term	A2

FINANCIAL DATA

PKR (MLN)

	Jun-11	Jun-10
Total Assets	9,434.1	8,265.0
Equity	3,850.7	3,139.0
Net Turnover	13,976.8	8,695.5
Gross Margin (%)	11.6	18.3
Net Income	575.7	432.9
EBITDA	1,383.4	1,431.8
ROE (%)	15.9	14.6
EBITDA Interest Cover (X)	2.7	2.5
Total Debt/Total Debt+Equity (%)	53.9	57.3

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PROFILE

- Hussain Mills Limited, incorporated in 1980, commenced its operations in the same year. The company is engaged in the manufacturing of different varieties of yarn and fabric. The installed capacities of the company are 93,720 spindles and 210 looms. The major shareholders of the company are Hussain Group (HG), Fatima Enterprises Limited (FEL), and Fazal Group (FaG), holding 53%, 42% and 5%, respectively; while the management control of the company lies with HG. All the three groups belong to the same family descending from Mr. Fazal-ur-Rehman. Textile is their basic forte with prime focus on spinning and weaving.
- HML has a seven member board including the CEO - Mr. Mohammad Ismail, a long serving employee of the company. The Chairman of the board is Mr. Sheikh Umar Farooq, who is the founder of Hussain Group. The management of the company lies with the Chairman and his son - Mr. Hussain Ahmad Fazal, also a director on the board. The top management is assisted by a team of experienced professionals.

RATING RATIONALE & KEY DRIVERS

- The ratings reflect strength in the business model of the company, which aims at quality and diversity of product basket, sustainable customer relationships, and efficient production process. This has helped company in achieving relatively better and stable core margins. The organizational structure is designed to segregate key roles in order to ensure due focus and responsibility. HML has an advanced technology infrastructure, though manufacturing module is yet to come and some key MIS is not system generated. The company is primarily driven by the key sponsors – chairman and family. Although this is a feature of most family owned enterprises, upholding of good governance standards remain critical. The financial risk profile of the company, considering director's interest free loan as quasi equity, is expected to remain manageable.
- The ratings are dependent on the continued competitiveness of the company in its key markets, which may be subject to volatility due to ongoing economic crisis in Europe, a key market for HML. Meanwhile, any material deterioration in the company's margins or adverse drop in operational cash flows, emanating from business risk, would have negative implication for the ratings.

ASSESSMENT

- The performance of the textile industry is varying inline with changing demand pattern. This in turn reflects the key players' view on the outlook of the world economy and expected customer behaviour down the retail chain. Because of its subjective nature, speculation also plays a role in influencing supply/demand dynamics, in turn, pricing. Nevertheless, there is a dominant portion of intrinsic demand, given critical importance of textiles and related products for people at large. Apart from seasonal cum cyclical spikes, the growth is mainly a function of increase in world population and changing world demographics including distribution of wealth. The local operating environment is, however, another bottleneck to deal with. The acute energy crisis, high inflation, precarious security situation, fiscal and economic imbalances continue to pose a challenge.
- HML, being cognizant of the benefits of diversification and size, has been increasing its capacity in both spinning and weaving segment over the last few years. This has not only helped the company in attaining significant volumetric growth, but has yielded higher profits. During FY11, HML experienced sizable upturn in its turnover. This was because of the dual impact of merger of HML's subsidiary into the company and rising product prices in the international market. However, due to increased raw material pricing and inventory write-down in the latter half of the year, its gross margin could not hold. This also dragged down the operating margin despite reduction in the operating expenses as a percentage of sales. Nevertheless, finance cost reduced despite increase in quantum of borrowing. This was made possible due to higher utilization of low cost dollar based financing in the wake of relatively stable exchange parity. Furthermore, utilization of deferred tax benefit recognised on account of amalgamation with a wholly owned subsidiary of the company helped HML in registering historic bottomline.
- During 1QFY12, HML registered healthy profitability, also taking benefit from reduced borrowing. HML's outreach, product basket, and ability to service clients, is expected to help the company to sustain business volumes. However, topline and profit margins would decline due to reduced prices and incremental cost pressures mainly related to energy.
- Going forward, HML intends to continue taking benefit of its established foot prints in its key markets. The diversified product basket emanating from diverse production capacity would provide a shield to the company against volatility. Nevertheless, macroeconomic challenges prevailing in the local and international markets would continue to be an area of concern for the company's prospects.
- The company has an advanced technology platform and is in the process of updating Oracle E-Business Suite R12.1.3, expected to be completed by end-FY12. Moreover, the company is in the process of adapting Internal Control Management System which is outsourced to an established firm of accountants.
- The company's short term borrowings are mainly a function of its inventory requirements and receivable days. The company's inventory holding period has significantly reduced over the last few years which in turn has resulted in improved cash cycle. Working capital changes have turned to positive adjustments owing to slowdown in inventory build-up and one-off adjustment due to recent merger. The company's cash coverages have not depicted stability despite improvement and warrant a closer monitoring to maintain HML's financial portfolio.
- HML's capital structure is relatively leveraged. However, significant portion of it constitutes self-liquidating working capital borrowings, mainly acquired to finance inventory and receivables. Meanwhile, comfort can be drawn from quasi equity in the form of directors' interest free loan. Moreover, the management does not plan any major capex over the medium term. Hence, no drag on the capital structure of the company is expected.