



The Pakistan Credit Rating Agency Limited

PROSPERITY WEAVING MILLS LIMITED

| | NEW [DEC-16] | PREVIOUS [DEC-15] |
|----------------|-----------------|----------------------|
| Entity | | |
| Long Term | A- | A- |
| Short Term | A2 | A2 |
| Outlook | Negative | Negative |

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DECEMBER 2016

Profile & Ownership

- Incorporated in Nov 1991, Prosperity Weaving is listed on Pakistan Stock Exchange
- Operating with 276 air-jet looms at end-Jun16; installed capacity of 58mln sq. meters p.a.
- Nagina Group, through group companies and individuals, holds 88% stake in the company

Governance & Management

- Eight-member board dominated by sponsoring family: seven Nagina Group affiliates, including CEO, and one independent director; six non-executives
- Experience of directors mostly limited to Nagina Group
- In Sep16, after the demise of Mr. Shaikh Enam Ellahi, his elder son, Mr. Shahzada Ellahi Shaikh, assumed the role of Chairman
- The CEO, Mr. Shaukat Ellahi Sheikh, is a seasoned professional with over 25 years of experience in textile sector
- Lack of segregation of governance and management as control of the latter vests with sponsoring family; absence of challenge to management's decisions

Operational Risk

- Oracle based ERP system implemented; comprehensive MIS reporting
- Daily management meetings to identify and resolve bottlenecks
- Production re-profiling, leading to productivity gains and cost efficiencies

Business Risk

- Local:export mix (FY16: 50:50); expected to skew towards local in medium-term
- Continuous declining trend in revenues over recent years; during FY16, topline declined (10%) to PKR 5.2bln, whereby a rise in local sales (7%) was partially countered by a sharp decline in exports (23%)
- A more than proportionate fall in cost of sales increased gross margins (FY16: 6.9%, FY15: 5.5%); drop in costs led by efficiency gains from BMR in FY15
- Increase in pre-tax profitability for the period (FY16: PKR 72mln, FY15: PKR 31mln). Net margin, however, remained constricted (FY16: 0.8%, FY15: 1.0%)
- Break-even achieved in 1QFY17, after net loss in the same period last year; positive trend in rates and volumes in the domestic market, while export market remains challenging
- High customers' concentration in domestic (59%) and export (81%) markets, though local concentration been falling in recent years
- Build-up of investment book; board-approved limit increased to PKR 500mln. Exposure to capital market (end-Sep16: PKR 156mln, end-Jun15: nil), though prone to market risk, is mitigated via investment in blue-chip stocks. Meanwhile, while long-term investment strategy remains conservative
- Undergoing BMR (100% debt-financed) of ~PKR 700mln to install 112 new wider-width looms with ongoing production re-profiling. Going forward, focus on enhancing cost efficiency, while tapping diversified final product

Financial Risk

- Stretched financial profile of the company; weakened in recent years
- Working capital needs increased during FY16 and 1QFY17. The company managed its working capital requirements via a mix of internal generation and short-term borrowing (STB), though utilization of STB increased (end-Sep16: PKR 380mln, end-Sep15: PKR 311mln)
- Net cash cycle remained stable (end-Sep16: 42days) and is considered efficient when compared with peers
- Higher operating cashflows in FY16 on the back of better performance
- At end-Sep16, debt coverage barely stays to 1.0x (end-Jun16: 1.3x, end-Jun15: 1.2x) due to a relatively greater amount of debt payments falling due next year. The company maintains a cushion in the form of unutilized STB lines, to meet urgent needs of funding
- Leveraged capital structure (end-Sep16: 63%); expected to remain range-bound

RATING RATIONALE

The ratings reflect Prosperity Weaving's adequately maintained business profile despite suppressed domestic textile sector fundamentals. The company's revenues have taken a consistent hit in recent years mainly due to price decline both in exports and local segments. However, support from efficiency gains – a factor of production technology upgradation – has augmented core margins. Prosperity maintains a reasonably diversified geographical presence. Prosperity Weaving intends to gradually build a sizable investment portfolio; though conservatively investing in blue chip stocks, market risk remains. Financial risk remained stretched owing to (i) additional debt for regular BMR, and (ii) limited improvement in operating cashflows impacting the company's debt servicing ability, in turn, coverages. However, the assigned ratings derive comfort from the company's liquid investments, ability to manage financial risk, and its association with Nagina Group.

KEY RATING DRIVERS

The ratings continue to have 'Negative Outlook' signifying pressure on financial risk profile. The ratings may be impacted in the absence of incremental cashflows vis-à-vis debt accumulation further deteriorating the financial profile.



Prosperity Weaving Mills Limited

| BALANCE SHEET | 30-Sep-16 1QFY17 | 30-Jun-16 FY16 | 30-Sep-15 1QFY16 | 30-Jun-15 FY15 | 30-Jun-14 FY14 |
|--|---------------------|-------------------|---------------------|-------------------|-------------------|
| Non-Current Assets | 1,766 | 1,763 | 1,865 | 1,913 | 1,411 |
| Investments (incl. Associates) | 156 | 120 | 36 | 86 | - |
| Equity | 156 | 120 | 36 | - | - |
| Debt Securities (incl. income funds) | - | - | - | 86 | - |
| Current Assets | 1,095 | 1,058 | 1,054 | 790 | 888 |
| Inventory | 446 | 297 | 508 | 344 | 388 |
| Trade Receivables | 256 | 283 | 231 | 173 | 245 |
| Others | 393 | 477 | 315 | 273 | 255 |
| Total Assets | 3,017 | 2,941 | 2,955 | 2,789 | 2,299 |
| Debt | 1,621 | 1,570 | 1,655 | 1,466 | 1,025 |
| Short-term | 380 | 297 | 311 | 106 | 307 |
| Long-term (incl. Current Maturity of Long-Term debt) | 1,242 | 1,274 | 1,345 | 1,360 | 718 |
| Other Short-term Liabilities | 343 | 321 | 339 | 318 | 236 |
| Other Long-term Liabilities | 95 | 93 | 58 | 56 | 75 |
| Shareholder's Equity | 957 | 957 | 903 | 949 | 963 |
| Total Liabilities & Equity | 3,017 | 2,941 | 2,955 | 2,789 | 2,299 |

INCOME STATEMENT

| | | | | | |
|-------------------|--------------|--------------|--------------|--------------|--------------|
| Turnover | 1,167 | 5,211 | 1,138 | 5,811 | 6,347 |
| Gross Profit | 67 | 360 | 33 | 319 | 481 |
| Other Income | (3) | (9) | (2) | (2) | (17) |
| Financial Charges | (27) | (111) | (30) | (107) | (61) |
| Net Income | 1 | 40 | (39) | 61 | 182 |

Cashflow Statement

| | | | | | |
|--------------------------------------|------|-------|-------|-------|-------|
| Free Cashflow from Operations (FCFO) | 66 | 343 | 33 | 240 | 333 |
| Net Cash changes in Working Capital | (86) | (116) | (216) | 200 | 32 |
| Net Cash from Operating Activities | (47) | 114 | (215) | 344 | 307 |
| Net Cash from Investing Activities | (86) | (79) | 44 | (719) | (655) |
| Net Cash from Financing Activities | 51 | 77 | 189 | 349 | 312 |
| Net Cash generated during the period | (81) | 112 | 18 | (25) | (36) |

Ratio Analysis

| | | | | | |
|--|-------|--------|--------|-------|-------|
| Performance | | | | | |
| Turnover Growth | 2.6% | -10.3% | -20.6% | -8.4% | -3.8% |
| Gross Margin | 5.8% | 6.9% | 2.9% | 5.5% | 7.6% |
| Net Margin | 0.1% | 0.8% | -3.5% | 1.0% | 2.9% |
| ROE | 0.4% | 4.2% | -17.9% | 7.0% | 21.4% |
| Coverages | | | | | |
| Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB) | 1.0 | 1.3 | 0.6 | 1.2 | 2.2 |
| Interest Coverage (x) (FCFO/Gross Interest) | 2.5 | 3.1 | 1.1 | 2.2 | 5.5 |
| Debt Payback (Total LT Debt Including UnCovered Total STBs) / (FCFO- Gross Interest) | 7.9 | 5.5 | 105.0 | 10.3 | 2.6 |
| Liquidity | | | | | |
| Net Cash Cycle (Inventory Days + Receivable Days - Payable Days) | 42 | 43 | 44 | 43 | 42 |
| Capital Structure (Total Debt/Total Debt+Equity) | 62.9% | 62.1% | 64.7% | 60.7% | 51.6% |



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 | | SHORT 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. | 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- | 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: The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. |
| 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. | C: An inadequate capacity to ensure timely repayment. |
| 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. | |

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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Rated Entity

Name of Issuer

Sector

Type of Relationship

Purpose of the Rating

Rating History

Prosperity Weaving Mills Limited
Textile
Solicited
Independent Risk Assessment

| Dissemination Date | Long Term | Short Term | Outlook |
|--------------------|-----------|------------|----------|
| 29-Dec-16 | A- | A2 | Negative |
| 29-Dec-15 | A- | A2 | Negative |
| 29-Dec-14 | A- | A2 | Stable |
| 20-Mar-14 | A- | A2 | Stable |
| 10-Jan-13 | A- | A2 | Stable |

Related Criteria and Research

Specific Methodology:

Research:

Rating Analysts

Corporate Rating Methodology
Textile Sector Overview - 2016

| | |
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Rating Team Statement

Rating Procedure

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