The Pakistan Credit Rating Agency Limited

LIBERTY MILLS LIMITED

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

REPORT CONTENTS

JUNE 2016

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 and energy sectors
- Group has planned investment in Power and Aluminum sectors

Governance

- Eight board comprises four directors from sponsoring family, three executive members, and a non-executive director (NED)
- 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 - son of Mr. Mukaty - oversees the 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 to meet energy requirements (~11MW)

Performance

- Export oriented company; sales mix is dominated by Processing segment, followed by Home Textile segment
- Top ten customers' revenue is considered high, thus concentration risk
- In FY15, the revenues increased significantly by ~23% on YoY basis – a factor of higher sales volume in processed fabric segment
- Gross (FY15: 17.5%, FY14: 14.9%) and operating (FY15: 11.4%, FY14: 9.1%) margins increased on YoY basis. Robust profitability (up ~40% on YoY basis)
- Dividend income from subsidiary – Liberty Power Tech Limited – continued to augment the bottom-line
- Suring 1HFY16, topline grew (~6%) on YoY basis. Net profit increased by ~20% on YoY basis
- Strategic investment in power sector is likely to be strengthened in medium term

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. Resultantly, net working capital days have improved (1HFY16: 97days, FY15: 107days, FY14: 122days)
- Strong coverages (end-Jun15: interest coverage: 9.0x; debt service coverage: 3.9x); expected to remain healthy in medium term
- Moderately leveraged capital structure (end-Dec15: ~29%); no major capex 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 strong business margins. Liberty, with an export market orientation, focuses on its established niche of quality-conscious institutional buyers; garnering healthy margins. Although this has led to customer concentrations, longevity of relationship in addition to sustained quality helps manage the risk. This has helped the company to sustain its performance despite deterioration in local textile sector fundamentals. The company's performance is augmented by recurring dividend stream from investment in an IPP - Liberty Power Tech. Liberty's borrowings are primarily a function of its working capital need, whereas it has limited long-term debt. This has yielded a strong financial risk profile also supported by healthy cashflows, in turn, debt service coverages. While the company's CAPEX plan reflects its conservative growth strategy, the leveraging is expected to remain moderate. Working capital cycle is relatively stretched, though in line with peers. Any improvement will bring efficiency gains. Long associated and experienced management team adds comfort; however, governance framework needs improvement. Going forward, the sponsors - Liberty Group - intend to expand in power sector while setting up holding company structure in the medium term.

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, continuation of dividend/other income stream vis-a-vis strengthening of governance framework will have positive implication on ratings.

PKR mln

Liberty Mills Limited

BALANCE SHEET	31-Dec-15	30-Jun-15	30-Jun-14	30-Jun-13
	2QFY16	Annual	Annual	Annual
Non-Current Assets	**1,201**	**3,890**	**2,570**	**2,280**
Investments (Incl. associates)	**2,292**	**1,683**	**1,447**	**1,572**
Equity	1,992	1,683	1,447	1,447
Debt	300	-	0	125
Current Assets	**6,594**	**7,284**	**6,130**	**5,450**
Inventory	3,064	3,757	3,376	3,184
Trade Receivables	2,120	1,829	1,628	1,509
Others	1,409	1,699	1,126	757
Total Assets	**10,087**	**12,857**	**10,148**	**9,303**
Debt	**3,258**	**4,384**	**3,686**	**4,392**
Short-term	2,606	3,407	3,308	3,967
Long-term (Inlc. Current Maturity of long-term debt)	652	977	378	426
Other shortterm liabilities	1,512	1,361	1,148	884
Other Longterm Liabilities	2	214	173	130
Shareholder's Equity	**7,989**	**6,899**	**5,141**	**3,896**
Total Liabilities & Equity	**12,760**	**12,857**	**10,148**	**9,303**
INCOME STATEMENT				
Turnover	**8,039**	**14,938**	**12,181**	**10,923**
Gross Profit	1,615	2,613	1,819	1,521
Net Other Income	45	417	617	360
Financial Charges	(116)	(247)	(326)	(359)
Net Income	**1,090**	**1,758**	**1,252**	**873**
Cashflow Statement				
Free Cashflow from Operations (FCFO)	1,178	1,706	1,309	1,930
Net Cash changes in Working Capital	(483)	(489)	(212)	(1,408)
Net Cash from Operating Activities	598	1,498	1,255	148
Net Cash from InvestingActivities	(593)	(1,812)	(515)	(683)
Net Cash from Financing Activities	(325)	599	(48)	(229)
Ratio Analysis				
Performance				
Turnover Growth	6.4%	22.6%	11.5%	4.6%
Gross Margin	20.1%	17.5%	14.9%	13.9%
Net Margin	13.6%	11.8%	10.3%	8.0%
ROE	24.0%	28.5%	25.4%	22.4%
Coverages				
Interest Coverage (FCFO/Gross Interest)	10.2	6.9	4.0	5.4
Core: (FCFO/Gross Interest+CMLTD+Uncovered Total STB)	8.5	3.0	3.5	4.4
Total: (TCF) / (Gross Interest+CMLTD+Uncovered Total STB)	8.6	3.9	4.8	4.4
Debt Payback (Total LT Debt Including UnCovered Total STBs) / (FCFO- Gross Interest)	0.3	0.7	0.4	0.3
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	98	107	122	134
Capital Structure (Total Debt/Total Debt+Equity)	29.0%	38.9%	41.8%	53.0%

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.

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	Short Term	Outlook	Action
14-Jun-16	A+	A1	Stable	-

Related Criteria and Research

Rating Methodology: Corporate Rating Methodology

Sector Research: Textile Sector - Viewpoint | Sep-15

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Rating Team Statement

Rating Procedure

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