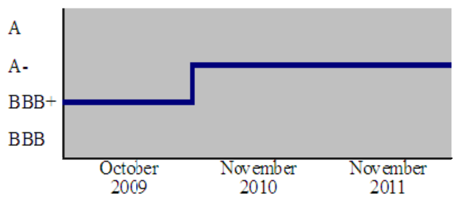
RATINGS (NOVEMBER 2011)

PROSPERITY WEAVING MILLS LIMITED

ENTITY	NEW	PREVIOUS
Long Term	A-	A-
Short Term	A2	A2

PWML L.T. ENTITY RATING HISTORY



FINANCIAL DATA

PKR (MLN)

	Jun-11	Jun-10
Total Assets	1,576	1,513.8
Equity	585.2	502.0
Net Turnover	5,952.1	4,070.2
Gross Margin (%)	8.2	9.8
Net Income	138.6	127.3
EBITDA	431	374.1
ROE (%)	25.5	27.9
EBITDA Interest Cover (X)	3.6	3.2
Total Debt/Total Debt + Equity (%)	56	61

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RATING RATIONALE & KEY DRIVERS

- The ratings reflect PWML's sustained position in its key markets emanating from long standing business relationships, quality production process and effective control environment. Globally textile demand is undergoing rationalization due to fragile economic environment and changing consumption centres. However, Prosperity is enhancing export focus with intentions to capture relatively untapped segments, while having major export markets in Asia. Financial risk is expected to remain manageable on account of a low leveraged capital structure and efficient working capital management.
- The ratings are dependent on the management's ability to sustain its competitive position in its key markets. Meanwhile, any adverse changes in the socio-economic environment impacting the company's margins and putting its cash-flows and coverages under significant pressure would have negative implications for the ratings.

ASSESSMENT

- The country's textile sector experienced significant growth in the recent period, primarily attributed to improved exports (FY11: USD 13.8bln, up 35% YoY). This had limited volumetric expansions and was mainly driven by hike in prices, as the cost of basic raw material – cotton – observed a rising trend in the wake of supply constraints. Since the last quarter of FY11, the prices came under pressure, largely owing to piling up of inventories due to excessive buying, pending concerns over revival in the world economy, and better prospects of cotton crop. This led the sector to book inventory losses and face pressure on incremental gross margin. However, despite reduction in prices, the demand has yet to pick up with no let up in factors leading to current prices, these are expected to remain under pressure.
- PWML had an agreement to sell excess electricity to LESCO (~2.6MW) after catering for its own internal power requirements (5.5MW). However, the agreement with LESCO for sale of surplus electricity had expired on Dec 31, 2010, though supply continued till March 31, 2011 due to the temporary extension being made in the agreement. The company's sales mix (excluding electricity) comprised 57% exports and 43% local in FY11.
- During FY11, PWML experienced substantial upturn in its turnover. This was mainly attributed to the hike in selling price due to general rising trend in the textile industry and partly because of change towards high value fabric construction. This enabled the company to register record profitability in 9MFY11. However, in the last quarter, the company suffered inventory losses due to a sharp revision in the prices of raw material. Consequently, the company's annual gross margin went down, impacting net profit margin as well. There was no change in the PWML's operating expenses as a percentage of turnover. During 1QFY12, with continuing pressure on product pricing, PWML observed a substantial dip in the gross margin (1QFY12: 6%; 1QFY11: 10%). This reduced the company's bottom-line as well. The future performance would depend on the stability in the yarn pricing and the company's ability to manage its order book in favour of optimal capacity utilization.
- Going forward, PWML would continue to strengthen its position in its key market. Meanwhile, it would enhance the proportion of mixed fabric in its product portfolio. PWML has added 16 air-jet looms, which are expected to increase the annual production by 1.8mln meters. The machines are operational since April 2011. However, despite capacity enhancement, the company's profitability may be volatile owing to macroeconomic challenges prevailing in the local and international markets.
- PWML finances its working capital with a combination of short term borrowing, commercial credit and internal cash flows. Consequently, there is less reliance on short term bank lines; hence room to borrow from banking system. The company's coverages have moved in line with the trend in profitability. By end-Jun11, free cash flow have fallen less than immediately maturing obligations. For this, the company may reprofile its long term debt (amount due in FY12: PKR 230mln) or utilize the cushion in short term borrowing especially if operating profitability remains under pressure.
- In FY11, PWML made a capex of 113mln (FY10: 13mln), for BMR and capacity expansion (addition of 16 air jet looms). In this regard, PWML has acquired a loan of PKR 140mln. The repayment of the loans is spread over six years, (including a grace periods of one year), commencing from September 2012. Currently the pricing is at 6MK +200bps; however, upon SBP's approval, 50% of the loan facility may be converted to low rate LTFF.

PROFILE

- Prosperity Weaving Mills Limited (PWML),incorporated in November 1991, is primarily engaged in production of apparel and home furnishing greige fabric and dyed yarn fabric of various widths and contractions (capacity: 340 air jet looms). The company is listed on Karachi and Lahore Stock Exchanges. PWML is majority owned by Nagina Group (NG), through key sponsoring individuals (57%) and group companies (30%). NG, also operating in the spinning business, has a collective capacity of 100,956 spindles.
- PWML's board of directors, comprising seven members including the Managing Director (MD), is dominated by key sponsoring individuals. The company's MD, Mr. Shaukat Ellahi Shaikh, is a graduate of Columbia University and has been associated with PWML since its inception.