

Before Dr. Sajid Qureshi, Executive Director (CL)

In the matter of

M/S Mukhtar Textile Mills Limited

Rule (3) of balloters, transfer agents and underwriters rules, 2001 read with Section 22(1) (b) of the Securities and Exchange Ordinance, 1969 and under section 86(3) read with section 492 of the Companies Ordinance, 1984 and under section 231(1) of the Companies Ordinance, 1984

Number and date of notice	No.EMD/CO.233/123/2002, October 21, 2005
Date of hearing	January 03, 2006
Present	Rana Muhammad Saleem, Chief Executive
Date	January 17, 2006

ORDER

This order shall dispose of the proceedings initiated through Show Cause Notice No. No.EMD/CO.233/123/2002 dated October 21, 2005 against Mukhtar Textile Mills Limited (the “Company”) under the provisions of Rule (3) of balloters, transfer agents and underwriters rules, 2001 read with Section 22(1) (b) of the Securities and Exchange Ordinance, 1969 and under section 86(3) read with section 492 of the Companies Ordinance, 1984 and under section 231(1) of the Companies Ordinance, 1984 (the “Ordinance”).

2. The Company was incorporated as a public company limited by shares in the year 1992. The shares of the Company are listed on all Stock Exchanges in Pakistan. The paid up capital of the Company is Rs.150 million divided into 15 million ordinary shares of Rs. 10 each. The Company is principally engaged in the manufacture and sale of yarn. Its manufacturing facilities are located at Faisalabad. The Company has 1,285 shareholders comprising individuals, investment companies, joint stock companies etc. and as per its pattern of shareholding annexed to the Directors’ Report in the accounts for the year June 30, 2005, directors, their spouses and

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Enforcement Department

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other relatives hold 65.26% of the total shareholding. This indicates that there is considerable public interest in the Company. Board of Directors of the company as per its annual report for the year ended June 30, 2005 comprises the following persons:

1.	Rana Muhammad Saleem, Chief Executive
2.	Rana Rasheed Ahmed Khan, Director
3.	Mr. Shamim Ahmed Khan, Director
4.	Mrs. Shaista Saleem, Director
5.	Miss. Nadia Saleem, Director
6.	Mr. Umer Saleem, Director
7.	Mr. Khalid Mehmood, Director

3. Brief facts of the case are that during examination of annual accounts of the Company for the year-ended September 30, 2004 it was observed that share capital of the Company was increased from Rs. 100 million in 2003 to Rs. 145 million in 2004 as a result of 45 % right issue at par on May 05, 2004 under the companies (issue of capital) rules, 1996. It was noted from the pattern of shareholding disclosed in the directors' reports for the subject years that shareholding of CEO, Director and their spouses, was as follows:

	Shares held			
	2003		2004	
Directors	Number	%	Number	%
Rana Muhammad Saleem	200,000	2.00	2,699,225	18.62
Mr. Shamim Ahmed Khan	63,000	0.63	63,000	0.43
Mrs. Shaista Saleem	1,000	0.01	751,000	5.18
Ms. Nadia Saleem	10,000	0.10	260,000	1.79
Mr. Kalid Mehmood	5,000	0.05	5,000	0.03
Mr. Umer Saleem	247,600	2.48	922,400	6.36
Rana Adnan Rashid	5,000	0.05	505,000	3.48
CEO, Directors, their spouses and minor children	531,600	5.32	5,205,625	35.89
Other relatives of directors	4,219,300	42.19	4,188,300	28.88
Financial institutions	763,500	7.63	736,400	5.08
General Public	4,485,600	44.86	4,369,675	30.15
Total	10,000,000	100	14,500,000	100

4. On inquiry and subsequent perusal of the underwriting agreement it was discovered that Mr. Rana M. Saleem, CEO, Mrs. Shaista Saleem, Miss Nadia Saleem, Mr. Umer Saleem and Mr. Adnan Rashid, directors were joint underwriters to the issue. Their shareholding increased as a result of fulfilling of their underwriting commitments which however resulted in dilution of shareholding of the minority shareholders. Moreover, the appointment of CEO as underwriter was in violation of the Balloters, Transfer Agents and Underwriters Rules, 2001 which attracted penal provisions contained in Section 22 of the Securities and Exchange Ordinance, 1969.

5. It was noticed that the circular sent to the members along with the notice offering new shares pursuant to the requirements of Section 86 (3) dated January 06, 2004 stated that the main projects/objects for which the additional funds were required were as follows:

“The funds raised through proposed right issue will be utilized to meet the funds requirements for suggested addition in fixed assets/BMR proposal to improve the efficiency of existing machinery.”

Further, as regards the expected benefits in profitability or otherwise likely to accrue from the proposed issue, following was stated:

“The funds generated through proposed right issue will give financial strength to the Company and will be highly beneficial for future profitability of the Company.”

Financial projections were specified as follows:

	2004	2005	2006
Capacity utilization	92%	94%	96%
Sales-net	338,448	365,490	387,401
Operating Profit	21,105	28,593	35,032
Financial Charges	163	79	42
Profit before tax	19,626	26,685	32,723

6. Later on from perusal of detailed financial projections prepared pursuant to Rule 5 of the Rules it was noticed that the project implementation was not completely in accordance with the financial projections. The expected profitability in post right issue period depicted in the circular filed with the registrar pursuant to Sub-section (3) of Section 86 of the Companies Ordinance, 1984 (“Ordinance”) and sent to the shareholders was not visible, which raised concerns that the Company had failed to materialize the anticipated benefits. This was evident from following facts noted from the financial results for the year 2004-2005:

- Additions to fixed assets amounting to Rs. 40 million were planned for the year 2004 and Rs. 22.537 million have been actually incurred.
- Profit before tax for the year 2004 was projected at Rs. 19.626 million in the letter of right dated May 05, 2004 and actual results for the year ended September 30, 2004 depicted just Rs. 4.112 million as profit before tax. The conditions further worsened subsequent to the year end as shown by the financial results for the half year ended on March 31, 2005 wherein the Company had suffered a loss before tax of Rs. 12.886 million against a projected profit of Rs. 26.685 million for the year 2005.
- Sales were projected at Rs. 338.448 million for the year 2004 while actual sales could reach only Rs. 277.376 million.
- Debtors increased from Rs. 22.702 million to Rs. 46.860 million compared to increase in sales of Rs. 32 million from the year 2003.

7. The above observations raised concerns about the state of affairs of the Company, a Show Cause Notice (the “Notice”) was then issued to the Chief Executive and directors of the Company on October 21, 2005 asking them to explain the violation of Balloters, Transfer Agents and Underwriters Rules, 2001 and why penalty under Section 492 of the Ordinance may not be invoked against the Company for making incorrect statements in the circular filed with the registrar pursuant to Sub-section (3) of Section 86 of the Ordinance and why an inspection in terms of provisions of Sub-section (1) of Section 231 of the Ordinance may not be initiated by the registrar or by any officer authorized by the Commission in this behalf on the basis of aforesaid paradoxical financial results.

8. The company replied to the notice vide its letter dated November 11, 2005. Wherein, following submissions were made:

- At the time of right issue the market price of the Company's shares was below par value since more than six months and in this situation no financial institution would agree to underwrite this issue at par value i.e. Rs.10/. Therefore, to meet the requirements of issue of capital rules 1996 section 5(e), the underwriting arrangement was made with directors of the company. The company has also got due approval from Lahore, Karachi and Islamabad Stock Exchanges for this right issue of Rs. 45 million at par in April 2004. Keeping in view the above mentioned circumstances, the company has requested to ignore this default and assured that they will take extra care in future.
- The projected BMR was still in progress and could not be completed up to June 30, 2005. Hence the expected benefits could not be derived. The losses are due to increase in the prices of Polyester Fiber, which constitute 81.82% of the total raw material and its financial impact comes to Rs. 22.644 million. This loss could not be compensated by corresponding increase in yarn prices. The company is trying to shift over to cotton and on completion of BMR during the current year, company will be able to do so and then better results may be expected.
- Because of slump in the yarn market, the company has to extend credit to the available customers, which resulted increase in debtors. However, the debtors have been decreased to Rs. 12.547 million as on June 30, 2005.
- Finally request has been made for withdrawal of the SCN and giving of a year's time for showing the positive effect of additional funds being invested by them in the best interest of the company. They have further assured of their efforts to improve the profitability of the company during the current and ensuing years.

9. Submissions of the Company were analyzed in detail, the Company's reasoning of failure to meet commitments made shareholders and the validity of the representations made before the various stakeholders at the time of the right issue do not hold ground. It was observed during hearing that the Company lacks appropriately structured management setup proficient with the business planning and decision making process. This has resulted in mismanagement of the proceeds of the right issue and has adversely effected the BMR. Further the representations of

the Company that price fluctuations of yarn resulted in company's failure to meet commitments with its shareholders cannot be considered as a cogent reason. The financial plan submitted at the right issue was supposed to remain valid for relevant period and any revision, duly substantiated, should have been submitted to all stakeholders.

10. The situation depicted from examination of financial statements showed that out of the total right issue proceeds of Rs. 45 million raised for BMR, only Rs. 22.470 million was utilized for it, and the balance was consumed for meeting the operating losses. Thus no resources are currently available to the Company for its planned BMR. Moreover, it was also felt that the preparation of financial projections and their submission to the regulator was not given due seriousness by the Company as a result of which the financial impact of the right issue was miscalculated. The misrepresentation before the shareholders and the regulator resulted due to the management's laxity toward the compliance with the statute.

11. In order to give an opportunity to the management of the Company to clarify their position, a hearing was fixed on January 03, 2006.

12. On the date of hearing Rana Muhammad Saleem, Chief Executive appeared on behalf of the Chief Executive and directors of the Company.

13. During the hearing, submissions made in the written reply were reiterated. Violation of the Balloters, Transfer agents and Underwriter Rules, 2001 was not discussed as the issue had already been referred to the office of Executive Director (SM) due to transfer of power of adjudication to his office. The Chief Executive Officer gave a detailed explanation of the causes of failure to achieve the projected results. He attributed the losses to the unprecedented increase in polyester and petroleum prices, due to which the expected benefits of right issue could not be materialized. As regards the lack of any visible improvement in the financial results of the Company when compared to the financial projections and benefits of right issue not being tangible, it was stated that the management foresees better results in the near future. It was also committed that detailed financial affairs with reference to the project will be submitted to the Commission.

14. I have taken into consideration the submissions, made in writing as well as those at the time of hearing of this case and have also perused the relevant documents and the applicable legal provisions. I am of the view that the management, in order to conduct the business of the company in a prudent manner, should have complete knowledge of the business environment and factors which may affect it in any manner whatsoever. The Code of Corporate governance aims at promoting such a management attitude and management while making statement of Compliance with Code's requirements is expected to be fully cognizant of that. Accordingly, any future plans for the business should be drawn with provision for all adverse circumstances. The management of listed company should also be conscious of the fact that the investment decisions of ordinary investors are effected by the information disseminated by them in the statutory document circulated to the stakeholders. It is further viewed that representations given in any public document are in effect management's undertaking. It is the responsibility of the management to ensure these undertakings are implemented in letter and spirit within the time frame specified. In case of deviation of any sort the management is duty bound to disclose the same to the stakeholders along with the effects thereof and measures taken to minimize the adverse effects, if any. In this case deviation of the financial position of the company from that presented in the projections appears to be more attributable to lack of professionalism and ill planning of the management rather than any malfeasance on their part to defraud the general public.

15. In view of the above discussion, I instead of imposing maximum penalty of Rs. 100,000 on the Chief Executive and each director as prescribed by Section 492 of the Ordinance, and ordering for inspection in terms of Section 231 thereof, hereby provide an opportunity to the management to honor its commitments and defer any action till such time the concerns of the Commission are satisfactorily answered. I hope that the directors would react positively and would ensure that the irregularities committed in the past are not repeated.

16. Since, the concerns of the Commission regarding BMR project and its effect on the Company's profitability remained unresolved, the Chief Executive Officer and Directors are directed under provisions of Section 472 of the Ordinance to provide the financial plan after carrying out due diligence within 60 days of the date of this order, with particular reference to the following:

1. BMR undertaken and planned by the Company.
2. Working capital needs originally planned and the current level.
3. Operational activities planned to bring the Company out of current situation of operational losses.

Dr. Sajid Qureshi
Commissiner (CLD)