Securities and Exchange Commission of Pakistan
Enforcement and Monitoring Division
7th Floor, NIC Building, Jinnah Avenue, Blue Area, Islamabad

BEFORE EXECUTIVE DIRECTOR
ENFORCEMENT AND MONITORING

In the matter of

M/S. SUNSHINE COTTON MILLS LIMITED

No. and date of show cause notice	19 (96) CF/ISS/2001 dated August 26, 2000
Date of final hearing	September, 10, 2001
Present	Mr. Saeed-Ul-Hassan, FCA.

ORDER UNDER SECTION 265 OF THE COMPANIES ORDINANCE, 1984

M/S Sunshine Cotton Mills Limited (the "Company") was incorporated in 1966 under the Companies Act, 1913 (now the Companies Ordinance, 1984). The Company made public issue of its shares and was got listed on the Karachi Stock Exchange in 1969. Subsequently, it also got listed on Lahore Stock Exchange. The main object of the Company is to manufacture and sale of cotton and polyester yarn. The manufacturing facility of the Company is located at Atta Abad, Sheikhupura and comprised of 58,088 spindles as on September 30, 1999.

2. To improve its liquidity position, the Company made several Right Issues to its shareholders during the years 1990 to 1995, the detail of subscription whereof is as under:

S #	Year	% age of right issue	Face value per share	Premium per share	Face value of subscription	Premium portion	Total amount of right subscription
			Rupees	Rupees	Rupees	Rupees	Rupees
1	1990	25	10	25	4,556,640	11,251,517	15,808,157
2	1992	25	10	15	9,255,670	13,883,505	23,139,175
3	1994	20	10	15	9,255,670	13,883,505	23,139,175
4	1995	50	10	5	22,977,250	11,488,625	34,465,875
		TOTAL			**46,045,230**	**50,507,152**	**96,552,382**

3. Inspite of the funds raised from its shareholders as detailed above, to improve its liquidity, the Company's financial position continued to deteriorate since 1994. The financial statements for the year ended September 30, 1999 also portrayed a dismal financial picture of the Company. However, no remedial measures appeared to have been taken by the management to arrest the trend of continuous losses and deteriorating financial condition of the Company. The precarious financial health of the Company necessitated a detailed look into the financial statements of the Company. The annual accounts of the Company for the years 1994-1999 were, therefore, examined.

4. The results of the Company during the aforesaid period are summarized as under:

	1999	1998	1997	1996	1995	1994
	Rupees	Rupees	Rupees	Rupees	Rupees	Rupees
Sales	119, 682,373	144,102,767	144,266,023	258,496,545	880,212,664	833,941,447
Cost of sales	150,521,064	162,450,596	178,054,170	284,589,806	899,059,918	818,042,401
Gross Profit/(Loss)	(30,838,691)	(18,347,829)	(33,788,147)	(26,093,261)	(18,847,254)	15,899,046
G. P/(G.L) to sales %	(25.77)	(12.73)	(23.42)	(10.09)	(2.14)	1.91
Financial Charges	29,029,516	13,620,705	31,221,898	26,885,233	26,859,493	17,092,483
Other income	74,115,402	2,842,575	7,773,000	1,128,539	35,824	1,129,259
Net Profit/(Loss) *	7,697,127	(38,301,339)	(70,192,023)	(76,018,888)	(72,672,869)	(28,110,054)
Earnings Per Share	0.98	(4.88)	(8.94)	(9.68)	(9.26)	(5.06)
Current Ratio	0.10	0.18	0.26	0.46	0.62	0.94
Debt equity ratio	Negative	Negative	Negative	55:45	32:68	29:71
No. of Spindle installed	58,088	58,088	58,088	58,088	58,088	58,088
No. of Spindles worked	19,470	20,230	13,008	17,336	56,082	51,438

Actual rated capacity	10,671,346	10,671,346	10,671,346	10,671,346	10,671,346	10,671,346
Actual production	1,930,884	2,029,633	1,298,702	2,291,043	7,084,778	7,836,030
Production efficiency	**18.09**	**19.02**	**12.17**	**21.47**	**66.39**	**73.43**
No. of shifts worked	**3**	**3**	**3**	**3**	**3**	**3**

- During year 1999, the company incurred a net loss of Rs. 57.275 million which was converted into profit of Rs. 7.697 million after writing back the amount of Rs. 64.972 million payable to one of its associated company, namely M/S Hassan Aftab Textile Mills Limited.

4. The sales during the last six years have dropped from Rs. 833.941 million in the year 1994 to Rs. 119.682 million in the year 1999. Except gross profit of Rs. 15.899 million earned in 1994, the Company incurred gross losses to the tune of Rs. 18.847 million in 1995, Rs. 26.093 million in 1996, Rs. 33.788 million in 1997, Rs. 18.348 million in 1998 and Rs. 30.839 million in 1999. Net loss incurred during 1994 to 1999 aggregated Rs. 342.57 million which was more than four times of its paid up capital. Production efficiency, on the basis of three shifts worked per day, during 1994 to 1999 also remained dismal being 73.43% in 1994, 66.39% in 1995, 21.47% in 1996, 12.17% in 1997, 19.02% in 1998 and 18.09% in 1999. The Company has consumed stores of Rs. 244.477 million during the years 1991 to 1999 and also incurred capital expenditure to the tune of Rs.150 million, without adding any additional capacity. Although production efficiency improved from 12.17% to 19.02% in the year 1998, yet the sales and stocks position remained at the same level. Further, there was hardly any change in short-term loans in both years, but the financial charges stood at Rs. 31.221 million in the year 1997 as compared to the year 1998, in which it stood at Rs. 13.620 million only. These inconsistencies created an apprehension about the financials of the Company. The continued decline in the performance coupled with financial inconsistencies gave apprehension as to whether its affairs are being conducted in accordance with good management policies and prudent commercial practices?

5. The auditors of the Company, M/S Saeed Methani & Co. (Formerly M/S. Hassan Rehman and Co.), Chartered Accountants, have also drawn attention of the members, without qualifying their report on annual accounts for the year ended September 30, 1999, towards the precarious financial position of the Company raising substantial doubt about its ability to continue as a going concern, in the following words:

QUOTE

"these financial statements have been prepared on a going concern basis, which is dependent on the successful outcome of matters stated in note 36, and favorable market conditions of the textile industry. The Company's accumulated loss at Rs. 186, 049,513 as at September 30, 1999 and as for that date the Company's current liabilities exceeded its current assets by Rs. 194,747,217 and its total liabilities exceeded its total assets by Rs. 54,149,719. These factors raise substantial doubt that the Company will be able to continue as a going concern"

UNQUOTE

It would be useful to reproduce the contents of note 36 for better understanding:

QUOTE

"The management of the Company is taking steps to improve the operations of the Company to cut down the losses and improve its current position. The management is confident that it will be successful in its efforts and hence the Company will be able to continue as going concern."

UNQUOTE

It is pertinent to note that the same auditors have been raising doubts in their reports, without making any qualification, about the Company's ability to continue as a going concern for the last several years. It would be interesting to reproduce the emphasis of the auditors in their reports on the annual accounts of the Company for the years 1995 to 1998:

YEAR ENDED SEPTEMBER 30, 1995

QUOTE

"these financial statements have been prepared on a going concern basis which is dependent on the successful outcome of matters stated in note 34 and favorable market conditions of the textile industry"

"Note 34: The management of the Company is taking steps to improve the operations of the Company to cut down the losses and improve its current position. The management is

confident that it will be successful in its efforts and hence the Company will be able to continue as going concern."

UNQUOTE

YEAR ENDED SEPTEMBER 30, 1996

QUOTE

"these financial statements have been prepared on a going concern basis which is dependent on the successful outcome of matters stated in note 33 and favorable market conditions of the textile industry"

"Note 33: The management of the Company is taking steps to improve the operations of the Company to cut down the losses and improve its current position. The management is confident that it will be successful in its efforts and hence the Company will be able to continue as going concern"

UNQUOTE

YEAR ENDED SEPTEMBER 30, 1997

QUOTE

"these financial statements have been prepared on a going concern basis which is dependent on the successful outcome of matters stated in note 33 and favorable market conditions of the textile industry"

"Note 33: The management of the Company is taking steps to improve the operations of the Company to cut down the losses and improve its current position. The management is confident that it will be successful in its efforts and hence the Company will be able to continue as going concern.

UNQUOTE

YEAR ENDED SEPTEMBER 30, 1998

QUOTE

"these financial statements have been prepared on a going concern basis which is dependent on the successful outcome of matters stated in note 33 and favorable market conditions of the textile industry"

"Note 33: The management of the Company is taking steps to improve the operations of the Company to cut down the losses and improve its current position. The management is confident that it will be successful in its efforts and hence the Company will be able to continue as going concern.

UNQUOTE

6. Although the performance of the company continued to deteriorate during the years 1994 to 1999, the auditors have considered it sufficient to just give a prototype emphasis note in their report to the members for the aforesaid years instead of reporting the gravity of the situation to the members who appointed them and to whom they are accountable. No specific steps were highlighted in the accounts, which could give reasonable assurance that the Company shall be able to continue as a going concern.

7. During these years when the financial condition of the Company continued to show a declining trend, the directors have kept their lips sealed and did not even bothered to inform the members of the Company about their strategy to reverse the declining trend in order to secure their investment and to retain their confidence in the management of the Company. The directors' reports for the years 1995 to 1999 did not contain any information and explanation in regard to the auditor's observation on going concern assumption in their audit reports. The directors' reports also failed to provide information about defaults in payment of debts and reasons thereof. Moreover, these reports also did not give any reasonable indication of the future prospects of profits, if any. On the operations of the Company, the directors' reports just talked that the Company had been victim of the circumstances without giving any material for the appreciation of the state of the Company's affairs by its members. The directors have attributed the losses to high rate of interest, high cost of raw material, low price of yarn and uncertain conditions of the market in all these years. The directors have failed to even give the bare minimum information in their reports as required under Section 236 of the Ordinance.

8. In nutshell, the Company, as of September 30, 1999, has accumulated losses to the tune of Rs. 186.050 million against its paid up capital of Rs. 78.511 million. Its current liabilities exceeded its current assets by 10.26 times. The manufacturing capacity was not being utilized fully. The Company was unable to meet its direct costs and was running at gross loss situation for

the last five years. The loans were not being serviced and the lenders were forcing for payments of due installments of their loans. The management could not improve the financial position even after getting additional funds from the shareholders through successive right issues at premiums. Moreover, no measures were adopted for improvement in the affairs of the Company, particularly its profitability. The shareholders were kept in dark about the affairs of the Company and the strategy being followed by the management to overcome the crisis. The above facts and figures clearly demonstrated that the financial position of the Company, *prima facie*, was such as to endanger its solvency. The Company's share of Rs. 10.00 each was being quoted on stock exchanges at around Rs. 2.50 per share, which has further decreased to Rs. 0.70 per share as on October 22, 2001 reflecting the week financial position of the company. The investors have also lost their confidence on the management, as there was no buyer of its share even at such a low price. The shareholders who have invested their hard earned money for purchase of shares of the Company at the time of its public subscription and then responded to the successive calls of the management for putting in additional funds at a high premium on the pretext of improving the liquidity and smooth running of the company, were also finding it difficult to sell their shares even at through away price. Although the low value of the share of the Company could be attributed to the recession in the stock markets, but the dismal performance of the Company is also responsible for the downward slide in its share price.

9. The aforesaid state of affairs of the Company suggested that the affairs of the Company might not been managed in accordance with prudent commercial practices. It was also apprehended that the affairs of the Company were being conducted in a manner oppressive of its members and to deprive them of a reasonable return. *Prima facie*, this was a case where the company was managed in a manner, which was unfairly prejudicial to the interest of the minority shareholders of the Company. However, before proceeding further, it was thought appropriate to look at the general conditions of the industry and to compare the performance of the Company with average competitor in the spinning sector irrespective of the quality and type of production. For this purpose, thirteen companies were selected which had also been the victim of general recession in the textile industry, high cotton prices etc. However, they have improved their performances gradually on account of managing these companies in accordance with the sound business principles and prudent commercial practices.

The outcome of the aforesaid study is as under:

Sr.#	Company	Number of Spindles		Gross Profit/(Loss)		Net Profit/(Loss)		Gross Profit /(Loss) Ratio	
(1)	(2)	(3)		(4)		(5)		(6)	
		1999	1998	1999	1998	1999	1998	1999	1998
				Rupees in million				% age	
1	Idrees Textile	27,684	27,684	105.137	39.226	5.588	(53.934)	14.706	5.878
2	Premium Textile	20,160	20,160	67.952	53.026	13.021	10.471	11.248	10.976
3	Dar-es-Salam	16,320	16,320	60.815	57.284	13.592	5.700	13.112	13.225
4	Kohat Textile	35,312	32,163	49.383	1.975	1.463	(59.582)	13.199	0.598
5	Fawad Textile	14,400	14,400	47.486	42.521	1.210	1.896	8.909	9.321
6	Shaheen Cotton	32,928	32,928	46.659	68.920	(29.302)	(45.890)	7.090	9.757
7	Shahzad Textile	30,720	30,720	45.304	47.843	(18.989)	(40.188)	7.393	7.629
8	Sajjad Textile	-	-	42.594	3.078	(0.996)	(30.069)	8.422	0.665
9	Colony Textile	59,200	52,600	40.211	21.443	2.138	(7.067)	10.170	6.242
10	Shahpur Textile	18,240	18,240	32.537	16.636	(7.115)	(42.444)	9.188	4.610
11	Sargodha Spinning	-	-	26.473	15.409	(29.777)	(76.244)	4.739	2.350
12	Nazir Cotton	44,976	44,976	12.859	2.608	(68.530)	(61.503)	4.166	0.731
13	Khursheed Spinning	14,400	14,400	(3.067)	(1.931)	(26.814)	(15.660)	(1.006)	(0.635)
14	Sunshine Cotton	58,088	58,088	(30.839)	(18.348)	7.697	(38.301)	(25.770)	(12.730)

10. A positive trend is abundantly clear from the above facts and figures and the companies hard hit by the general recession in the textile industry have started coming out of woods. The performance of the Company, however, remained unsatisfactory when compared with an average competitor in the textile sector. This state of affairs reasonably suggested that the results of the Company may not be negative just because of the general recession in the textile sector industry but there could be some other reasons including deliberate efforts on the part of the management to siphon off funds of the Company. The above stated facts led to the formation of opinion that affairs of the Company were not being managed in accordance with sound business principles and prudent commercial practices but are being conducted in a manner prejudicial to the interest of its members and to deprive them of reasonable return on their investment in the Company. A show cause notice dated August 26, 2000, therefore, was served on the Company through its Chief Executive calling upon him to show cause in writing as to why an inspector under Clause (b) of Section 265 of the Companies Ordinance, 1984 (the "Ordinance") should not be appointed to investigate into the affairs of the Company.

11. In response to the show cause notice, the Company vide letter dated September 9, 2000 requested for more time to reply, which was allowed uptill September 25, 2000. The reply of the Company was received on September 27, 2000 through its letter dated September, 26, 2000. The

Company attributed its poor performance to the high rate of electricity, consumable stores, staff salaries and cost of raw material. It was also submitted that all the industries including textile sector companies have been badly affected due to the aforesaid factors. The Company also tried to justify its negative results by comparing the same with the results of M/S Zahoor Textile Mills Limited, M/S J .A. Textile Mills Limited and M/S Khurshid Spinning Mills Limited. The paid-up Capital of these companies respectively are Rs. 746.68 million, Rs. 126.00 million and Rs. 131.74 million where as accumulated losses as of September 30, 1999 were Rs. 1,064.62 million, Rs. 268.64 million, Rs. 269.50 million respectively. The current liabilities of these companies exceeded their current assets by 3.1, 5.39 and 1.75 times respectively. It was further contended that the directors and the associated undertakings of the Company have provided huge interest free loans to the Company. Moreover, the directors have written down huge funds in favour of the Company. It was also submitted that the appointment of inspectors would discourage the efforts of the directors of the Company.

12. The Company's reply was examined, it was, however, noted that M/S Zahoor Textile Mills Limited is a composite unit comprising mainly weaving project of 150 looms and a spinning unit of 47,880 spindles. As such its comparison with the Company is not justifiable. The operational and financial performance of both M/S J. A. Textile Mills Limited and M/S Khurshid Spinning Mills Limited have been better than the Company as is evident from the following table:

S #	Description	Sunshine Cotton		J.A.Textile		Khurshid Textile		Zahoor Textile	
		1999	1998	1999	1998	1999	1998	1999	1998
1	Gross Profit/(Loss)	(30.839)	(18.348)	(30.097)	(5.581)	(3.067)	(1.931)	(11.237)	(25.790)
2	Net Profit/(Loss)	(57.275)	(38.301)	(76.798)	(67.848)	(26.814)	(15.660)	* 783.816	(162.532)
3	Earning per share	(0.98)	(4.88)	(6.1)	(6.9)	(2.04)	(1.19)	10.50	(2.13)
4	Current ratio	0.10	0.18	0.19	0.28	0.57	0.48	0.32	0.15
5	Debt equity ratio	Negative	Negative	Negative	Negative	Negative	Negative	Negative	Negative
6	Spindles installed	58,088	58,088	15,.360	15,360	14,400	14,400	47,880	69,000
7	Spindles worked	19,470	20,230	8,160	8,160	14,400	14,400	47,880	69,000
8	Actual rated capacity (20/ s)	10,671,346	10,671,346	4,572,258	4,572,258	4,235,000	4,235,000	32,992,313	47,545,313
9	Actual production (20/ s)	3,075,351	3,471,480	2,316,340	3,949,677	4,670,000	5,691,000	15,980,235	34,909,671
10	Production efficiency	29%	33%	51%	86%	110%	134%	48%	73%

* This includes effect of Rs. 860 million as an extraordinary item.

As regard to the high electricity cost, WAPDA, the supplier of electricity, is charging the same rates from all its commercial consumers. The argument of high rate of consumable stores is also not correct as the consumption of stores has decreased substantially from Rs. 49.666 million in 1994 to Rs. 3.884 million in 1999. Regarding staff salaries, no detail has been provided to substantiate that it has affected the performance of the Company. The plea of high cost of raw material also appears incorrect and misleading because of the reason that the Company is using Polyester as its major raw material whose prices have dropped from 1997 to 1999, however, the Company still incurred gross loss even in these years. The arguments of the Company were, therefore without any strength. Instead of explaining their own case, the Company has tried to justify its poor performance by comparing with only those companies whose performance was also not satisfactory.

13. In order to give the Company an opportunity of being heard and of making representation, a hearing in the case was fixed on October 10, 2000 which at the request of the Company was adjourned to October 18, 2000 on which date Mr. Saeed-ul-Hassan, FCA, one of the partners of the Company's auditors appeared on behalf of the Company and requested for one week adjournment. The case was therefore, fixed on October, 25, 2000 which was again adjourned and re-fixed on November 11, 2000. However, on the said date a request of the company was received for further adjournment. The case was, therefore, re-fixed on November 22, 2000 on which date Mr. Saeed-ul-Hassan, FCA appeared and furnished a written reply with the request to fix the hearing afresh after examination of the said reply. Summary of the Company's reply is as under:

- The Company manufactures synthetic yarn and its main raw material is viscose and polyester. The Company could not import raw material in last several years due to non-availability of L/C limits from Habib Bank Limited and has to procure raw material available locally which was expensive by Rs. 10 per LB for polyester and Rs. 5 per LB for viscose. During the years 1997, 1998 and 1999, the Company has suffered losses of Rs. 21.918 million, Rs. 24.784 million and Rs. 24.513 million respectively on account of high price of the raw material purchased from the local market.

- Banks are treating the Company as defaulter because its associated Company namely M/S Sunshine Jute Mills Limited has defaulted in repayment of loans. Banks imposed additional conditions to repay the liabilities of the said associated company, which adversely affected the business of the Company.

- Factory is not working at its full capacity due to shortage of working capital.

- The Company has been the victim of prevailing economic conditions in the textile sector, devaluation of the rupee, and the crisis in the international market as the main reasons for heavy losses.

- The Company also requested the Chairman SBP's Committee for revival of sick units for settlement of the liabilities of the Company by offering sale of fixed assets of the directors

- The Chief Executive and working directors were not getting any remuneration from the Company for the last three years.

- The directors and one of the associated company have provided interest free loans of Rs. 23.5 million to the Company.

- Liability of one of the associated Company was written back to the tune of Rs. 64.972 million.

- The management of the Company has reduced running expenses and overheads of the Company.

14. While commenting on the current situation, the reply further stated that there was a Court case pending between the Company and Habib Bank Limited for the renewal of L/C facilities and the provision of running finance. It was also stated that in the absence of these facilities, it would not be possible to turn around the Company. It was further submitted that the result for the year

ended September 30, 2000 would definitely show improvement as compared to the result of previous year. It was also requested that the management may be given another six months till May 2001 to make efforts for the renewal of financing from HBL and for positive improvement in the results in line with the general trend in the textile industry . The Company, however, failed to clarify the inconsistencies relating to gross profits, administrative and selling expenses, operating and net profits as were noticed from the working results of the Company relating to its half yearly accounts for the period ended March 31, 1998, March 31, 1999 and March 31, 2000 and annual accounts for the year ended September 30, 1998 and September 30, 1999.

15. The reply of the Company was examined and it was observed that the Company has admitted that it could not operate profitably unless Habib Bank Limited provide requisite finance facilities. This was an admission that the Company is at the verge of financial collapse and its financial position was such as to endanger its solvency. *Prima facie*, the very existence of the Company was in danger and the interest of the minority shareholders was at stake. The Company's argument that it has suffered losses due to local purchase of raw material is not well founded because the major portion of the polyester demand of the country is met through local production and a very small percentage of total consumption is imported in the country. Had the option of imported raw material so viable and profitable, then all other consumers would also have imported polyester rather than procuring the same from local sources. Moreover, in the case of local procurement no working capital is required, whereas, in the case of imports there is a minimum lead-time during which the prices could change to the disadvantage of the Company. This argument of the Company is, therefore, incorrect and misleading. Other arguments of the Company just talked about general economic conditions and difficulties with banks, which considered the Company defaulter because of the default of associated companies. As regards the support provided by the associated companies, I do not find any force in this argument because it was not reflective of any improvement in the financials of the Company. Keeping in view the worsening financials of the Company and to discuss the remedial measures adopted by the management, a hearing in this case was fixed on January 8, 2001, which at the request of the learned counsel was adjourned to January 17, 2001 and then to February 6, 2001, on which date the learned counsel appeared and filed a written reply stating that there is a healthy trend of the

operations of the Company and highlighted that productivity of the Company has been increased and expenses of Company has been reduced. The following points were particularly mentioned

- A positive contribution of Rs. 1,255,480 towards earnings.

- Manufacturing expenses reduced by Rs. 853,565 admin expenses by Rs. 1,645,286 and selling expenses by Rs.123,753.

- In manufacturing all items of expenses, with the exception of electricity, registered a reduction, including salaries & wages, repair & maintenance, and stores consumption.

- In administrative expenses almost all items registered a reduction adding up to a substantial figure of Rs.1,645,286.

- Despite increased selling activity, selling expenses also showed reduction of Rs.123,753. This was mainly due to elimination of advertisement and cutting back of unnecessary entertainment.

It was also stated that the main area from where Company can get profits is the restructuring/ sanction of finances from HBL and a favourable decision is expected from the bank within next eight weeks i.e. in the first week of April, 2001. The improvement did not speak of any major change except minor reduction in expenses. In view of the commitment of the Company's counsel that the results for the year ending on September 30, 2000 would be in line with the healthy trend in the industry, the management was given time to show improved performance.

16. The audited annual accounts for the year ended September 30, 2000 received from the Company again revealed that the performance of the Company has further deteriorated. The accumulated losses increased to Rs.210.794 million from Rs. 186.050 million in 1999 and the current liabilities of the Company exceeded its current assets by almost 12 times. The Company has not been able to get requisite funding from the financial institutions for its profitable

operations. The auditors have again drawn attention of the members of the Company towards preparation of accounts on going concern basis which was dependent on the successful negotiations with the banks for deferment of immediate liabilities and re-structuring of the long and short term loans and generation of sufficient liquid resources to fulfill its financial obligations. This has raised substantial doubt as to the Company's ability to continue as a going concern. The following irregularities and illegalities were particularly noted in the aforesaid accounts:

- No provision for deferred tax liability amounting to Rs. 28.961 million made in the accounts as required by International Accounting Standard 12.

- No provision for employees retirement benefits has been made as required by IAS 19.

- Provisions of mark-up on loans of HBL, IDBP and lease liabilities were not made. Even these liabilities were neither quantified as required under IAS 10 nor any disclosure was made in the directors' report raising doubt as to whether the accounts give a true and fair view ?.

- Statement of holding Company's interest in the subsidiaries as required under Section 237 was not annexed to the accounts.

- The directors report was silent regarding qualification of auditors, default in payment of debts and future prospects of the Company.

- The Company has disposed of 30,066 spindles comprising more than 50% of its machinery in violation of the provisions of Section 196 (2) of the Ordinance.

- The sizeable assets of the Company were sold to International Textile Association and Zain International. The disposal did not result into any cash flows. Instead creditors adjustments were made as stated in note 28 to the accounts.

17. Inspite of getting sufficient time to improve results, the management has not only failed to negotiate with its bankers but also could not arrest the trend of deteriorating financial position of

the Company. The above stated irregularities further gave strength to the apprehension that the management was lingering on this issue on flimsy grounds instead of successfully putting an end to the worsening situation with a concrete strategy to rebuild the Company. Instead, it appeared that the management has started selling assets and was not interested to revive the project.

18. It would be beneficial to look at the general trend in the textile industry during the year 2000. The financial data for the companies selected for comparison, while issuing show cause notice, is as under:

Sr.#	Name of the Company	Gross Profit/(Loss)		Net Profit/(Loss)	
		2000	1999	2000	1999
		Rupees in million			
1	Idrees Textile	203.418	105.137	75.446	5.588
2	Premium Textile	119.865	67.952	41.942	13.021
3	Dar-es-Salam	147.401	60.815	82.454	13.592
4	Kohat Textile	116.571	49.383	64.880	1.463
5	Fawad Textile	98.681	47.486	33.266	1.210
6	Shaheen Cotton	112.948	46.659	34.315	(29.302)
7	Shahzad Textile	151.836	45.304	41.669	(18.989)
8	Sajjad Textile	99.345	42.594	51.206	(0.996)
9	Colony Textile	184.535	40.211	147.731	2.138
10	Shahpur Textile	72.480	32.537	24.589	(7.115)
11	Sargodha Spinning	151.488	26.473	102.607	(29.777)
12	Nazir Cotton	79.520	12.859	24.170	(68.530)
13	Khursheed Spinning	49.247	(3.067)	18.783	(26.814)
14	Zahoor Textile	65.366	(11.237)	(210.238)	783.816
15	J.A.Textile	45.329	(30.097)	11.022	(76.798)
16	Sunshine Cotton Mills	(18.239)	(30.839)	(24.744)	7.697

The textile industry has returned to huge profitability during the year 2000 and information collected from All Pakistan Textile Mills Association shows that most of its members have shown positive results during year 2000.

19. The above stated facts and figures clearly establish that the performance of the Company is not in line with the general trend in the textile industry. Moreover, the aforesaid irregularities also

bring home the fact about management's non-serious attitude towards the Company. They have raised funds from the shareholders and now are not paying any heed to the issues raised by the Commission to protect the interest of minority shareholders of the Company.

20. In order to provide another opportunity and to elaborate and explain their point of view, the hearing was again fixed on May 30, 2001, on which date Mr. Saqib Rahman Qureshi appeared on behalf of the Company. All the issues raised in the notice and the Company's poor performance during the year was also discussed particularly the illegalities and irregularities in the accounts also came under discussion. The learned counsel could not respond to the queries and attributed the poor performance merely due to the non-availability of finance facilities from the financial institutions. He also stated that negotiations with HBL were still in progress and it would take at least three more months to get a favorable decision from the bank. The learned counsel also requested for more time for making the unit viable. He also contended that the appointment of inspectors may give bad signal to the lenders with whom the management is in negotiation for re-structuring. It was also requested to give a last opportunity to present the case.

21. A final opportunity of hearing was provided on August 1, 2001 which again was adjourned and then finally the case was heard on September 10, 2001 on which date, the learned counsel appeared and repeated the same arguments as were advanced in written replies and verbal statements in previous hearings. No concrete proposal was presented for the viability of the project. Also no reason was given for the irregularities noticed in the accounts for the period 1994 to 2000. Instead more time was demanded without any valid reason. The learned counsel for the Company has not controverted the issues raised in the show cause notice and the successive hearings.

22. I have given careful consideration to the explanations furnished by the Company in several hearings but none of them are tenable. The results of the Company when compared with other similar units were found unsatisfactory. In facts the results and performance has been below average. The Company has committed irregularities. Its management has disposed of sizeable assets (30,066 spindles) without approval of the shareholders and even did not mention a word about this transaction in the directors' report. Several companies were facing heavy losses during

last years but from the year 1999 onwards there have been total turn around as shown in the comparison given in para 18, which gives strength to the apprehension that the Company was not being managed in accordance with sound business principles.

23. The upshot of the above discussion and finding is that the aforesaid circumstances reasonably suggest that the continuous losses for several years and that to getting funds from the shareholders at high premium, particularly when the direct cost was not even recovered, suggest that there could be other reasons for the poor performance of the Company. Minority shareholders are the only medium which could genuinely contribute towards economic growth through their savings if those are channelized for productive purposes giving them reasonable returns and assuring the safety of their investments. The minority shareholders to whom the directors owe fiduciary obligations are without any return since the year 1994. In the circumstances, it is the responsibility of the Commission to ascertain factual position through competent inspector(s) whose report can bring to light as to whether the affairs of the Company were managed in conformity with the accepted principles and standards of good and efficient management. If the inspector holds that the sponsors / directors were not responsible for the current state of affairs of the Company, the report will be helpful to them rather than detrimental to their interests. The Commission can protect the interest of the investors only through timely initiating of a fact-finding exercise. The Company's arguments revolve around non-availability of working capital from banks. I am not impressed by the arguments of the company's counsel for the simple reason that they have obtained sufficient funds through right shares at very high premium and still they were unable to overcome liquidity crunch. On the question that the appointment of inspectors would discourage the efforts of the directors, I am not convinced because if the reputation of the directors of the Company is kept in view, then on the basis of such apprehension no step could be taken even against directors who have committed defaults. It is just an investigation to reach the truth of the matter. It is not a judgment because it is only after the conclusion of the investigation that the Commission could take any action and that too after providing opportunity to the persons responsible for default. The Company was given adequate time to show improvement, however, its performance continues to deteriorate with no chance for its revival. The Company could not provide any tangible material / evidence in support of its contention that the performance of the company would improve in future. The right issue was not utilized for the purposes it was meant

for, instead the Company had utilized those funds in creating capital assets. It can safely be termed as an act of mismanagement of the affairs of the Company.

24. Securities and Exchange Commission of Pakistan has been established under the Securities and Commission of Pakistan Act, 1997 for the beneficial regulation of the capital markets, superintendence and control of the Corporate entities and for matters connected therewith and incidental thereto. It is also one of its functions to conduct *sue moto* investigations into affairs of the companies, through competent inspectors(s) if in its opinion there are circumstances suggesting one or more of the matters given in sub-clauses (i) to (iv) of Clause (b) of Section 265 of the Ordinance. The Commission is further empowered to prosecute a company or persons found guilty as a consequence of such investigations. The power of investigation available to the Commission to act as a safeguard to protect the interest of the shareholders, creditors and other persons interested in public companies. It would also be pertinent to discuss here the spirit of Section 265. It is not possible for the minority shareholders to act jointly to protect their interest. Moreover, they are not able to collect evidence where management is acting prejudicial to their interest to bring the same before the appropriate forums for appropriate action. It was because of this difficulty that the legislators have enacted Section 265 to prevent the managements of companies from acting in a manner prejudicial to the interest of the minority shareholders. The provisions of this Section give powers to initiate a fact-finding exercise to reach at the truth of the matter.

25. In view of matters stated above, I am convinced that the circumstances falls under Sub-clauses (iii), (vi) and (vii) of Clause (b) of Section 265 of the Ordinance and that substantial and worthwhile basis exist to form an opinion warranting investigation into affairs of the Company. These circumstances suggest that the affairs of the Company have been so conducted and managed as to deprive the members thereof of a reasonable return. Moreover, the affairs of the company, *prime facie,* do not appear to have been managed in accordance with sound business principles and prudent commercial practices. Besides, the financial position of the Company is such as to endanger its solvency.

26. For the forgoing reasons, I, acting in the public interest and in exercise of the powers conferred on me under clause (b) of Section 265 of the Ordinance, hereby appoint Mr. Zabta Ali Mehar, FCA, of M/S Z. A. Mehar & Co. Chartered Accountants, Room 301, 302, Qadri Chambers, 5-Mcleod Road, Lahore, to act as inspectors to investigate into the affairs of M/S Sunshine Cotton Mills Limited to bring into light the true facts about affairs of the Company. He will be paid a remuneration of Rs. 200,000 (Rupees two hundred thousand only) to be paid by the Company.

27. Without in anyway limiting the scope of investigation, the inspector shall conduct investigation on all aspects of the operations of the Company and shall, after scrutiny of the entire record and books of accounts, furnish report, *inter alia,* on the following matters:

a) Reasons of heavy losses specially gross loss in the years 1995 to 2000. Whether these losses were due to mismanagement imprudent policies or some other reasons.

b) Whether funds raised through right issues were utilized in the manner as undertaken.

c) Whether or not the Company has kept proper records as required by Section 230 of the Ordinance.

d) Misappropriation and misapplications of funds and assets of the Company. Whether the disposal of fixed assets (30,066 spindles) was undertaken in accordance with the relevant provisions of the Ordinance, proceeds were adequate and why proceeds were adjusted against liabilities instead of taking cash to improve the liquidity position.

e) Diversion of funds to unauthorized objects.

f) Investigation of Sales / revenues of the Company with particular reference to a sales model based upon market prices and prices disclosed by the comparable units.

g) Investigation of Expenditures incurred by the Company with particular reference to the following:

- Expenditures versus sales /revenues/production
- Energy consumption versus capacity utilization

- Expenses of the Company versus expenses of the comparable companies
- Expenditure analysis in terms of:

    1. Organization
    2. Personal
    3. Production
    4. Selling overheads
    5. Financial charges

h) Whether or not adequate system of internal controls has existed as to prevent misappropriation and misapplication of Company's assets and resources.

i) Reasons for the failure of the Company in context to:
   - Over capitalization
   - Bad management practices
   - Leakage of sales
   - Over spending in expenditures
   - Assessment of capital expenditures of the company in respect of Company's requirements.
   - Excessive borrowings and its linkage with:
       1. Receivables
       2. Stocks
       3. Quality control
       4. Pricing
       5. Others

j) Determination of any false and incorrect statement in directors' report.

k) Compliance with statutory requirements in the operation of the Company.

l) To report any lapses or other delinquency detected during the course of investigation.

m) Whether transactions with associated undertakings were at arm's length.

n) In-efficiencies in production.

o) In-out record of the Company particularly relating to sales and purchases.

p) Statutory books including particularly minutes books of Board and general body meetings.

q) To suggest future course of action in the interest of the shareholders of the Company.

28. The inspector shall submit his report alongwith supporting documents to the Commission within sixty days from the date of this order.

29. The inspector, for the purpose of his investigation, shall have the same powers as are vested in a Court under the Code of Civil procedure, 1908 while trying a suit in respect of the matters enumerated under Section 266 of the Ordinance and every proceeding before the inspector shall be deemed to be judicial proceeding within the meaning of Section 193 and 228 of the Pakistan Penal Code, 1860. Any contravention or non-compliance with any orders, direction or requirement of the inspectors shall entail the consequences under the Code of Civil Procedure, 1908 and Pakistan Penal Code, 1860.

30. It shall be the duty of all the officers, employees and agents and other persons having dealing with the Company to provide all assistance to the inspector in connection with the investigation, and any default whereof shall be punishable under Section 268 of the Ordinance.

Rashid Sadiq
Executive Director (Enforcement & Monitoring)

Announced
October 23, 2001
ISLAMABAD