Before Dr. Sajid Qureshi, Executive Director (CL)

In the matter of

M/S Hajara Textile Mills Limited

Under Rule (5) of the Companies (Issue of Capital) Rules, 1996 read with Section 476 of the Companies Ordinance, 1984)

Number and date of notice	No. EMD/CO.233/73/2002 dated January 03, 2006
Date of hearing	March 01, 2006
Present	Mr. A. Hameed Chaudhry, Consultant Mr. Sa'adat A. Chaudhry , Director
Date	March 03, 2006

ORDER

This order shall dispose of the show cause proceedings initiated against Hajara Textile Mills Limited (the "Company") under the provisions of Rule 5 of the Companies (Issue of Capital) Rules, 1996 (the "Rules") read with Section 476 of the Companies Ordinance, 1984 (the "Ordinance").

2. The Company was incorporated as a public company limited by shares in the year 1979. The shares of the Company are listed on the Karachi and Lahore Stock Exchanges. The paid up capital of the Company is Rs.137.500 million divided into 13.750 million ordinary shares of Rs.10 each. The Company is principally engaged in the manufacture and sale of all types of textile yarn. Its manufacturing facilities are located at Jhamke Macheke, District Sheikhpura. The Company has 721 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 period ended June 30, 2005, directors, their spouses and minor children hold 31% 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. Mr. Mohammad Asif, Chairman
2. Mr. Noor Elahi, Chief Executive
3. Mr.Shahid Usman, Director
4. Mr. Najib Usman, Director
5. Mr. Javed Usman, Director
6. Mr. Ahmed Elahi, Director
7. Mr. Shahid Aziz, (NIT) Director

3. Brief facts of the case are that the annual accounts of the Company for the year-ended June 30, 2005 stated that subsequent to the balance sheet date company offered 100% right shares, all of which were taken up by the directors and as a result directors loan amounting to Rs. 68.75 million was converted into equity. For ease of reference the relevant notes to the accounts are reproduced below:

> "*Note 6.5*
>
> *Loan amounting to Rs. 68.75 million has been converted into share capital against the right issue offered by the Company, subsequent to the period end. The repayment terms of the remaining amount have not yet been settled."*

> *"Note 35*
>
> *On November 08, 2004 the Board of Directors passed a resolution to issue 6.875 million right shares at the rate of 100% (1:1) out of the un-issued capital of the Company at par to the existing shareholders of the Company. The right issue is needed for extensive BMR plan to improve the quality of the products. The Company obtained the approval for right issue from Lahore Stock Exchange and Karachi Stock Exchange on May 25, 2005 and May 05, 2005 wherein the last date of payment/acceptance of right issue was August 05, 2005. No payment has been received from public in Company's bank account in this respect. However, the directors have taken up issue by themselves."*

It was also disclosed that the purchasing of right shares by the directors was on account of underwriting of right shares as they were underwriters to the right issue. The appointment of directors as underwriter is in violation of the Balloters, Transfer Agents and Underwriters Rules, 2001.

4. It was also noticed that the circular sent to the members along with the notice offering new shares pursuant to the requirements of Section 86 (3) dated June 13, 2005

stated that the main projects/objects for which the additional funds were required were as follows:

> *"The generation of Funds through right issue will be utilized to meet the fund requirement for suggested additions in fixed assets i.e. 18 spinning ring frames and gas power generation plant to improve efficiency of existing machines."*

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

> *"The funds generated through the proposed right issue will give financial strength to the company and will be highly beneficial for future profitability of the company."*

In line with the above stated purposes the funds realized through issue of right shares were proposed to be utilized in the following manner:

		Rs. In million
Proceeds from Right Issue		**68.750**
Utilization of Proceeds from Right Issue		
Power Generation Plant	30.000	
18 Spinning Ring Frames	38.000	**68.750**

5. However, the financial statements for the quarter ended September 30, 2005 do not show any material additions in the fixed assets ensuing the right issue. In fact the cash flow statement for the said quarter discloses repayment of directors' loan and bank liabilities. Furthermore, as a result of right issue the directors managed to convert their long stuck loans into equity and caused dilution of ordinary shareholders' equity who were not given any information in this regard.

6. The above observations raised concerns about the state of affairs of the Company and therefore a Show Cause Notice (the "Notice") was issued to the Chief Executive and directors of the Company on January 03, 2006 asking them to explain why penalty as provided under Companies (Issue of Capital) Rules, 1996 and Section 492 of the Ordinance may not be imposed on the Chief Executive Officer and the directors of the Company.

7. The company replied to the notice vide its letter dated January 17, 2006, and made the following submissions:

- The agreement was made between the company and its directors because no financial institution or bank was willing to underwrite the issue at par since the company's shares were being traded below par for last several years. So to fulfill the requirement to Sub-rule (v) of Rule 5 of the Companies (Issue of Capital Rules), 1996 the directors entered into an underwriting agreement with the Company.

- The Commission had not raised any objection when the underwriting agreement between the company and its directors was submitted to it prior to the right issue vide letter dated December 24, 2004.The same underwriting agreement was submitted to the Karachi & Lahore Stock Exchanges while seeking approval for the right issue and no objection was raised by them.

- The directors fulfilled their underwriting commitments and subscribed against their own and all un-subscribed portion from their own sources.

- As a result of right issue the share capital increased by Rs. 68.75 M and during the same period directors' loan increased from Rs. 77.376 million to Rs. 102.025 million.

9. In order to give an opportunity to the management of the Company to clarify their position, a hearing was fixed on February 28, 2006, which was adjourned at the request of the Company and was re-fixed on March 01, 2006.

10. On the date of hearing Mr. A. Hameed Chaudhry, Consultant and Mr. Sa'adat A. Chaudhry, Director Finance appeared on behalf of the Chief Executive and directors of the Company. During the hearing, submissions made in the written reply were reiterated and in addition the following arguments were made both verbally and in writing:

- The proceeds from the issuance of right shares were utilized in the following manner:

		Rs. In million
Proceeds from Right Issue		**68.750**
Utilization of Proceeds from Right Issue		
Captive Power Generation	30.000	
Part settlement of short term finance	32.927	
Addiitions of Plant & Machinery	2.661	**65.288**

- The Directors have injected substantial amount into the company over and above subscribing for the right issue and did not use the funds generated from right issue to repay the directors loan. The outstanding amount of loan from directors at no point of time fell below the level given in the projection given at the time of right issue. It is only because of loan from directors that the company has successfully rescheduled/repaid its loans towards financial institutions. Repayment of Directors' loan, if any, was temporary and funds were again loaned to the company. The directors loan position from September 30, 2004 to February 20, 2006 is as follows:

	Rs. In million
Directors' Loan as at 30-06-2004	77.376
Addition from 01-07-2004 to 30-06-2005	47.175
	124.551
Issue of Right Shares	(68.750)
	55.801
Addition from 01-07-2005 to 31-12-2005 to settle overdue amount due to NBP	46.224
Payment to UBL	68.400
Directors' Loan as at 20-02-2006	170.425

- In addition it was also submitted that the directors intend to introduce further loan of Rs. 35.00 Million to pay off Saudi Pak Commercial Bank Ltd.

- Issuance of right issue was necessary for improving the debt equity ratio and current ratio of the company so that the company could obtain financing for BMR and working capital. Company was faced by a tough situation since it did not meet the prudential regulations of the State Bank of Pakistan and had defaulted on loan commitments.

- Since none of the shareholders subscribed the right issue therefore they were not defrauded due to the alleged misstatement neither did they suffer any loss.

- The Directors are earnestly trying to safeguard their own investment as well as protect the outside shareholders, which is supported by the major amount introduced as directors' loan.

8. The submissions of the directors were neither substantiated from event and actual financial results of the Company. During examination of information disclosed in the historical financial statements of the Company, following facts were revealed:

- The funds as result of issue of right share were available in August 2005, therefore, the cash flow as at Sep 30, 2005 depicts its utilization. The said accounts reveal that the proceeds of the right issue were not fully utilized for the purposes disclosed in the financial projections submitted to the shareholders at the time of approval of right issue; instead these appeared to have been partially utilized for repayment of directors' loan. The cash flow statement appended to the aforesaid accounts portray the following utilization of right issue funds:

		Rs. In million
Proceeds from Right Issue		**68.750**
Utilization of Proceeds from Right Issue		
Directors Loan repaid	(40.402)	
Bank Loans repaid	(23.723)	
Fixed Capital expenditure	(1.507)	
Used in operations	(2.115)	**(67.747)**

- The fixed capital expenditure and funding sources utilized for the purpose was as follows:

Fixed Capital Expenditure and Funding Sources					
		Additions in Fixed Assets Financed through			
Year	Addition in Fixed Assets	Directors loan	funds generated from operations	Bank Borrowing	Right Issue
2003	6.269	15.972	(30.875)	19.358	
2004	50.229	22.413	(21.188)	57.583	
2005	73.355	47.175	29.282	(6.185)	
Qtr Sep 2005	1.507	(40.402)	(2.115)	(23.723)	68.750
	131.360	**45.158**	**(24.896)**	**47.033**	**68.750**

- It was noticed that over the years total additions to fixed assets amounting to Rs. 131.360 million were made, out of which Rs.129.853 million were made prior to the right issue and these were financed by a mix of directors' loan, and bank borrowings. Thus through the right issue the directors managed to convert their long stuck loans into equity and caused dilution of ordinary shareholders' equity.

- The circular sent to the members along with the notice offering new shares pursuant to the requirements of Section 86 (3) did not mention about the planned conversion/repayment of loan against the right issue. Thus the facts appeared to have been misrepresented before the shareholders.

- It has also been observed that actual financial results of the company are not in line with the projections given at the time of right issue. This is evident from the fact that against the projected EPS of Rs. 4.21 for the year 2005 the actual results for the period ended June 30, 2005 show loss per share of Rs. 1.94. Even the results post right issue cannot be compared with those projected by the Company. The projected EPS in the year 2006 is Rs. 6.76 whereas the actual results of half year ended Dec 31, 2005 show loss per share of Rs. 0.86. The fortunes of the company are not expected to turn in the next 6 months so much so that it can report a substantial profit as has been projected. This creates doubts over the authenticity of the information given by the company to the shareholders at the time of the right issue.

13. I have considered the facts of the case and observed that the Directors, while agreeing to act in the capacity of underwriters, are expected to have full knowledge of all

relevant statutes. Therefore, I reprimand the Directors to remain careful in future while complying with the statute. Further, the circular communicating right offer to the shareholders filed with the Registrar and shareholders pursuant to Section 86 (3) of the Ordinance did not disclose the actual intentions of the Directors that the right issue proceeds would be utilized towards conversion of directors' loan into equity. The fundamental information regarding capital expenditure, conversion directors' loan, and operating results provided in the projections for the offer of the right issue were thus incorrect and material facts were omitted. However, it is also evident that the directors are committed to support the company, are trying to revive its fortunes and have a major stake in the company both in terms of equity and loan.

14. In view of the above, it is evident that the Company gave incorrect information in the circular letter and the projections related to the right issue, however, in view of the directors' commitment for revival of the company I, taking a lenient view impose a fine of Rs. 20,000 on each of the following Directors and Chief Executive instead of imposing maximum penalty of Rs.100,000 as prescribed by Section 492 of the Ordinance,:

1. Mr. Mohammad Asif, Chairman
2. Mr. Noor Elahi, Chief Executive
3. Mr.Shahid Usman, Director
4. Mr. Najib Usman, Director
5. Mr. Javed Usman, Director
6. Mr. Ahmed Elahi, Director

15. Since, the concerns of the Commission regarding the Company's authenticity of the information provided in the financial projections remain unresolved, the Chief Executive Officer and Directors are directed under provisions of Section 473 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:

i) Revised financial projections for the next five years
ii) Business plan to bring the Company out of current situation of losses.

16. The Chief Executive and Directors of the Company are hereby directed to deposit

the aforesaid fine totaling to Rs.120,000 (Rupees One hundred twenty thousands only) in the designated bank account maintained in the name of Securities and Exchange Commission of Pakistan with Habib Bank Limited within thirty days from the receipt of this Order and furnish receipted vouchers or pay by a DD/pay order issued in the name of Commission for information and record, failing which proceedings under the Land Revenue Act,1967 will be initiated which may result in the attachment and sale of movable and immovable property. It may also be noted that the said penalties are imposed on the Chief Executive and other Directors in their personal capacity who are required to pay the said amount from their personal resources.

Dr. Sajid Quershi
Executive Director (CL)

Announced:
March 03, 2006
ISLAMABAD