

Before Javed K. Siddiqui, Executive Director (CL)

In the matter of
Service Fabrics Limited
Under Section 265 of the Companies Ordinance, 1984

Number and date of notice	EMD/233/231/2002-3833 December 24, 2004
Date of hearing	April 20, 2005
Present	<i>On Behalf of the Company:</i> Mr. Ralph Nazirullah Company Secretary
Date of Order	May 20, 2005

Order

This order shall dispose off the proceedings initiated through Show Cause Notice No. EMD/233/231/2002-3833 dated December 24, 2004 against Service Fabrics Limited (herein after referred to as the “Company”) under the provisions of Section 265 of the Companies Ordinance, 1984 (herein after referred to as the “Ordinance”).

2. The Company was incorporated in 1987 as a public limited company under the Ordinance. The Company is listed on Karachi and Lahore Stock Exchanges. The principle business of the Company as per its Memorandum of Association is manufacturing and sale of fabrics. The paid up capital of the Company as per its last filed annual accounts for the year ended September 30, 2002 is Rs. 157.548 million divided into 15,754,800 ordinary shares of Rs.10 each.



3. The background of the case is that while examining the financial statements of the Company for the year ended September 30, 2002, it was observed that the accumulated losses of the Company stood at Rs. 923.053 million resulting into negative equity of Rs. 765.505 million and its current liabilities exceeded its current assets by almost 7 times, which shows that the Company's capital has been completely eroded by its losses, hence the financial position of the Company was such as to endanger its solvency. The auditors of the Company have expressed an adverse opinion on the financial statements for the year ended September 30, 2002 including their doubts on the validity of the going concern assumption. They were also unable to get information required on ongoing recovery proceeding initiated by M/s. Habib Bank Limited ("HBL"), which has claimed outstanding amount under the consent decree amounting to Rs. 694 million and liquidated damages @ 20% per annum. The auditors have also given adverse audit report for the year ended September 30, 2001 on the similar facts as mentioned above. The audited financial statements for the year ended September 30, 2003 have not been filed with the Commission. The Company has also made default in the filing of quarterly and half-yearly accounts from the quarter ended December 31, 2002 till December 31, 2004. The Company is also in default in timely holding of Annual General Meetings ("AGMs") since the year 2000 for which the Company was penalized accordingly. Details of delays in holding AGMs are the following:

S. No	Year	delay
i.	September 30, 2000	53 days
ii.	September 30, 2001	110 days
iii.	September 30, 2002	322 days
iv.	September 30, 2003	119 days

4. The Company has not declared any dividend since its listing in the year 1989. Furthermore, the ordinary share of the Company having par value of Rs. 10.00 each is quoted at Rs. 2.00 per share on April 15, 2005 at the Karachi Stock Exchange and the Company has been placed on defaulters' counter by the Exchange. The financial results of the Company



have so deteriorated to the extent that it has not been able to meet even its cost of production for the last several years as it is suffering consistently from gross losses.

5. In view of the above circumstances, it was apprehended that:
- The affairs of the Company are not being managed in accordance with sound business principles, prudent commercial practices and good corporate governance;
 - The affairs of the Company have been so conducted and managed as to deprive the members thereof of a reasonable return; and
 - The financial condition of the Company is such as to endanger its solvency.
6. In view of the above, a show cause notice under Section 265 of the Ordinance dated December 24, 2004 was issued to the Company. In response to the show-cause notice, the Company's Counsel vide his letter dated March 1, 2005 replied the following:

“(i) On 20-12-2003, the Company was successfully able to negotiate settlement of its liabilities with Habib Bank Ltd. This settlement resulted in the consent decree amount of Rs. 693.935 million being reduced to Rs. 125.000 million. This is a major success that the Company has achieved. Presently, the Company is in the process of making arrangements for the full discharge of the settled amount owed to HBL. Further sensitive negotiations are at present underway and any interference by the SECP is likely to jeopardize the success of these negotiations.

(ii) The audited financial statement for the year ended September 30, 2003 will be forwarded to the Commission within the course of the coming week. The Commission may kindly examine the contents of this statement before proceeding any further.

(iii) the difficulties that the Company has faced in the past have been similar to those experienced by a large number of other similarly placed textile units. There is no reason whatsoever to presume that the losses suffered by the Company during the lean period suffered by the entire textile industry was the result of any deliberate act on the part of the management. The inability of the Company, on account of causes beyond its control, to achieve profitability and declare dividends is no reason for any action under Section 265 of the Companies Ordinance, 1984.”



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7. In order to provide an opportunity of hearing, the matter was fixed for hearing on April 20, 2005 on which date Mr. Ralph Nazirullah, Company Secretary appeared on behalf of the Company and besides verbal arguments submitted written explanation to the show cause notice. The Company Secretary informed that their long-standing matter of debt settlement with HBL has now been settled, under Circular No. 29 dated October 15, 2002 issued by the State Bank of Pakistan (“SBP”), which will be fully settled by December 2006. He further informed and requested that the management is expected to regularize all its affairs and are eager to revive the unit within next year including filing of its accounts, holding of AGM, profitability, and payouts etc.

8. I have considered all the relevant facts and position of law and have also perused the documents placed before me. It has also been observed that in the past also, a Show Cause Notice under Section 265 of the Ordinance was served on the Company on August 19, 2000 for appointment of Inspectors on certain grounds stated therein. The aforesaid proceedings were deferred on the Company’s request for allowing two years’ time for its revival and assurance by the Company that performance would improve resulting in reasonable returns to the members in future. The Company had also assured to commence payment of dividend to its shareholders in future years. However, it has been noticed that the Company’s state of affairs has not improved since then, despite a lapse of almost five years, rather they have deteriorated further as detailed below:

(Rs. In thousands)

	1999	2000	2001	2002	2003	2004
Equity	157,548	157,548	157,548	157,548	Accounts not filed	Accounts not filed
Net loss for the year	159,071	122,586	103,828	57,929		
Accumulated losses	638,709	761,295	865,124	923,053		
Current Assets	191,962	111,099	51,364	69,571		
Current Liabilities	340,838	378,490	413,369	481,190		



9. The Company has not been able to file its annual audited accounts for the second consecutive year ended September 30, 2004 nor did it hold the AGM for the said year. The Company Secretary, while arguing his case before me, committed that the accounts for the year ended September 30, 2003 will be filed within coming weeks. However, these also have not been filed till writing of this order. The Company was not able to present any sound reasoning for the continuous deteriorating financial position. The Directors, in their, Report on the accounts for the year ended September 30, 2002 have mentioned that the Company is in a turnaround position and situation will improve gradually in due course of time. However, no evidences have been produced to substantiate that the situation has started to improve.

10. The continuous decline in the performance and financial position of the Company give rise to apprehension that the affairs of the Company are not being conducted in accordance with sound business principles, prudent commercial practices and good corporate governance and are being conducted in a manner oppressive to its members and to deprive them of the reasonable return on their investment. In view of the aforesaid discussion it is clear that the performance of the Company has been far from satisfactory. The interests of the shareholders have been jeopardized as they have not been paid any dividend since the Company was listed on stock exchanges in 1989 and its share is being traded at Rs. 2.00 (Rs. 10 par value) in stock exchanges on April 15, 2005. In view of the aforesaid discussion, it is clear that the interest of the shareholders have been seriously jeopardized. 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 are being managed in conformity with the accepted and sound business principles, prudent commercial practices, and good corporate governance. This fact can only be unearthed by initiating of a fact-finding exercise through appointment of competent inspectors.

11. I, therefore, in exercise of the powers conferred on me under Section 265 of the Ordinance appoint Ford Rhodes Sidat Hyder & Co., Chartered Accountants, Mall View Building, 4-Bank Square, Lahore, which is a practicing chartered accountant firm, to act as



Inspector on a remuneration of Rs. 250,000 (Rupees two hundred fifty thousand only) including out of pocket expenses, which would be paid in terms of the provisions of Section 277 of the Ordinance.

12. Without limiting the scope of investigation, the inspector shall conduct investigation on all aspects of the operations of the Company and shall, after scrutiny of all the records and books of accounts, furnish a report, *inter alia* covering the period of two years from the period April 1, 2003 to March 31, 2005 on the following matters:

- a. Whether or not affairs of the Company are being managed in accordance with sound business principles, prudent commercial practices and good corporate governance
- b. Reasons of heavy losses sustained by the Company. Whether these losses were due to operational inefficiencies, mismanagement, imprudent policies or any other reasons.
- c. Whether the management has made any effort to overcome losses and revive the Company.
- d. Diversion of funds to associates/subsidiaries without proper legal procedure and/or for unauthorized business.
- e. Whether or not financial and operational state of affairs of the Company are in line with other comparable units in the industry.
- f. Detailed investigation of the transactions with the associated undertakings as to whether the same were "arms length" transactions.
- g. Whether or not adequate system of internal controls existed and implemented so as to prevent misappropriation and misapplication of Company's assets and resources.
- h. Determination of any false and incorrect statement in the Directors' Report.
- i. Report any lapses or other delinquency detected during the course of investigation.



- j. Statutory books including particularly minutes books of the Board and general body meetings.
- k. To suggest future course of action in the interest of the shareholders of the Company.

13. The inspector shall submit his report along with supporting documents to the Commission, highlighting violations of the relevant provisions of the Ordinance, within sixty days from the date of this order.

14. 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.

15. 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.

Javed K. Siddiqui
Executive Director (CL)