RATING REPORT

MIMA Leather (Private) Limited

REPORT DATE:
December 03, 2018

RATING ANALYSTS:
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RATING DETAILS		
Rating Category	**Latest Rating**	**Previous Rating**
Entity	**BB+/A-3**	**BBB-/A-3**
Rating Date	*November 28, '18*	*October 9,'17*
Rating Outlook	Negative	Negative
Outlook Date	*November 28, '18*	*October 9,'17*

COMPANY INFORMATION	
Incorporated in 1972	**External auditors:** Deloitte Yousuf Adil, Chartered Accountants
Private Limited Company	**Chairman of the Board:** Mr. S. M. Saleem
Key Shareholders (with stake 10% or more):	**Chief Executive Officer:** Mr. S.M. Naseem
Mr. Shahid Hussain - 11.99%	
Mr. Farrukh Hussain Sheikh - 11.08%	
Mr. S.M. Saleem - 10.32%	
Mr. S.M. Naseem - 10.32%	

APPLICABLE METHODOLOGY(IES)
Applicable Rating Criteria: Industrial Corporates (May, 2016)
http://jcrvis.com.pk/docs/Corporate-Methodology-201605.pdf

MIMA Leather (Private) Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

OVERVIEW OF THE INSTITUTION

MIMA Leather (Private) Limited is an ISO certified company with its primary activity being leather tanning of goat and sheep skins. The factory is situated at Korangi Industrial Area, Karachi with an annual production capacity of 7m sq. feet for finished leather.

RATING RATIONALE

In operations since 1972, MIMA Leather (Private) Limited (MLPL) is part of MIMA Group of Companies. The parent group comprises MIMA Knit (socks), MIMA Apparel (clothing), Universal Leather, Hub Leather and Hub Stores (leather products and retail) with annual sales turnover of ~Rs. 3b. The sponsors have long standing experience in the leather business spanning over three decades.

MLPL is predominantly engaged in manufacturing and export of finished leather (goat and sheep) which accounted for 91% of sales in FY18. Apart from exports, the company also derives 9% of revenue from the domestic market.

Rating Drivers

High competition in the industry limits bargaining power of exporters; slowdown in European markets may impact demand outlook for leather exports. Further PKR depreciation can support revenues

Leather industry is characterized by high competition due to presence of large number of small to medium sized players. Local firms have to compete not only with other domestic players, but also with Chinese, Indian and Bangladeshi manufacturers in the overseas market. The intense competition limits ability of companies to pass volatility of raw material prices and foreign exchange loss to customers entirely while pricing products. The domestic leather prices are dependent on availability of leather in the domestic market and are subject to significant volatility. However, as the export realization is not linked to the domestic leather prices, the margins are susceptible to adverse price movements in the export and domestic markets.

In the last four fiscal years, leather exports from Pakistan have declined by ~40% owing to slowdown in demand from European countries. Moreover, a shift in leather demand has been observed from Europe to Asia (the former imported US$ 753.9m and the latter imported US$ 965.7m worth of leather in FY17). Apart from deteriorating external conditions, a difficult operating environment for tanneries in the southern region of the country vis-à-vis northern players has led to exits by smaller firms although large companies continue to operate given their scale and experience. Nevertheless, PKR depreciation against US$ (20%) and Euro (17%) in FY18 has provided support to revenues of Pakistani tanneries over the outgoing fiscal year; further depreciation may serve as a positive driver for firms' topline.

Revenue growth dragged down by weak demand from European and other markets

In FY18, net sales of the company increased by 9% to Rs. 474.7m (FY17: Rs. 437.2m; FY16: Rs. 643.6m). In volumetric terms, exports sales declined by 3% primarily on account of fall in trade volumes globally. However, 9% increase in average selling prices enabled the company to report 5% growth in export revenues. Depressed demand from Europe has shifted management's focus towards capturing sales from Eastern Asian markets including Bangladesh, Vietnam and Cambodia. Among countries from where significant increase in revenues has been witnessed are Korea (32%) and Indonesia (49%). Top five countries generated 78% (FY17: 80%) of total revenue in FY18. On the domestic front, while local selling prices declined by 18%, overall revenues increased by 49% to Rs. 22.8m (FY17: Rs. 15.3m) on account of volumetric growth. Management continues to maintain a 10% target for share of local sales in the ongoing fiscal year while focusing on untapped markets for exports.

Margins have improved but remain under pressure on account of depressed volumes

Gross margins have improved on a timeline basis to 8.09% (FY17: -1.9%; FY16: 6.6%) on the back of better selling prices and stable procurement costs. However, gross margins remain below levels observed in FY11-13 on account of depressed sales volumes. Current margins remain insufficient to cover the operating expenses of the company as a result of which the company reported a sizeable loss before tax of Rs. 63.06m (FY17: Profit of Rs. 14.4m; FY16: Loss of Rs. 62.7m). Major components of operating expenses comprise distribution (38.8m), administrative (Rs. 31.5m) and finance cost (Rs. 30.8m). In order to curtail expenses, management is taking various measures. Going forward, profitability is expected to remain under pressure given subdued demand of leather products and volatility in export selling prices. Hence, achieving projected sales volumes, reduction in borrowings levels to reduce finance cost and rationalization of expenses is considered important in terms of profitability.

Inventory and receivables remain sufficient to cover short term borrowings taken up by the company

Inventory carried on balance sheet stands on the higher side and represented more than one year of sales at end-FY18. In line with plans, the company has reduced inventory on a timeline basis by ~5-7% every year. Fresh procurement of raw material has also reduced by 9% in volumetric terms. The management remains focused on aggressively selling its stock-in-trade and not carrying any major purchases. Borrowings (FY18: Rs. 500.2m; FY17: Rs. 555.6m; FY16: Rs. 544.3m) are utilized to fund inventory carried on the balance sheet and are entirely short term in nature. Stock-in-trade represented 157% (FY17: 167%; FY16: 183%) of borrowings at end-FY18. The management aims to trim down its credit exposure in line with expectations of higher cash sales to new export markets of Eastern Asia. Majority of receivables are due within one year.

Liquidity profile of the company has weakened on a timeline basis with negative cash flows & an increase in cash conversion cycle

Liquidity position remains weak on account of negative cash flows and stretched working capital cycle. Funds from Operations (FFO) was reported negative on account of losses incurred during FY18. Negative cash flows were majorly funded through better working capital management with decline in stock-in-trade, stores and spares and increase in payables.

Equity base declining on account of losses while a leveraged capital structure is a constraint on capitalization indicators

Consistent losses have resulted in equity attrition on timeline basis to Rs. 227.6m (FY17: Rs. 276.3m; FY16: Rs. 269.1m) as at end-FY18 (adjusting for loan from directors). Despite a mere dip in short term borrowings, leverage indicators remain on the higher side with gearing and debt leverage reported at 2.78x (FY17: 2.01x; FY16: 2.02x) and 3.79x (FY17: 3.19x; FY16: 3.56x). In order to improve liquidity profile, reduce leverage indicators and expand borrowing capacity, the management plans to inject equity of Rs. 100m by end-FY19.

MIMA Leather (Private) Limited — Appendix I

FINANCIAL SUMMARY			*(amounts in PKR millions)*
BALANCE SHEET	**30-Jun-18**	**30-Jun-17**	**30-Jun-16**
Non-current Assets	72.03	72.6	77.3
Stores Spares & Loose Tools	22.8	30.3	34.8
Stock-in-trade	885.3	928.3	993.8
Trade Debts	37.34	36.8	26.8
Short Term Loans & Advances	48.42	57.2	65.4
Cash & Bank Balances	3.87	8.5	6.6
Total Assets	1,093.06	1,157.0	1,227.1
Short-term borrowings	500.2	555.6	544.3
Trade Payables	283.40	245.2	317.8
Total Liabilities	929.52	925.6	1,005.5
Total Equity	227.6	276.3	269.1
INCOME STATEMENT	**30-Jun-18**	**30-Jun-17**	**30-Jun-16**
Net Sales	474.7	437.2	643.6
Cost of Sales	436.2	445.5	601.2
Gross Profit	38.4	(8.4)	42.4
Distribution Expenses	38.8	37.3	46.6
Administrative Expenses	31.6	28.5	25.0
Other Income	0.34	117.2	(0.0)
Finance Cost	30.8	28.7	33.5
Profit before Tax	(63.06)	14.4	(62.7)
Taxation	4.9	4.5	7.7
Profit/(Loss) After Tax	(68)	9.9	(70.4)
RATIOS & KEY NUMBERS	**30-Jun-18**	**30-Jun-17**	**30-Jun-16**
Gross Margin (%)	8.09%	-1.9%	6.6%
PBT Margin (%)	-13.2%	3.3%	-9.7%
Net Margin (%)	-14.3%	2.3%	-10.9%
Current Ratio (x)	1.19	1.26	1.24
Net Working Capital	159.9	222.6	222.3
Working Capital Cycle	566	583.3	416.9
Gearing (x)	2.78	2.01	2.02
Debt Leverage (x)	3.79	3.19	3.56
FFO	(18.6)	(115.1)	(64.0)
FFO/Total Debt (x)	(0.031)	(0.18)	(0.10)
Debt Servicing Coverage (x)			
ROAA (%)	-6.04%	0.8%	-5.4%
ROAE (%)	-34.45%	4.4%	-25.4%

ISSUE/ISSUER RATING SCALE & DEFINITIONS — Appendix II

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: JCR-VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.jcrvis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details. www.jcrvis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES — Appendix III

Name of Rated Entity	MIMA Leather (Private) Limited
Sector	Tanneries and Leather Products
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	See table below
Instrument Structure	N/A
Statement by the Rating Team	JCR-VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
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Rating History

Rating Date	Current Rating	Rating Outlook	Rating Action
RATING TYPE: ENTITY			
28/11/2018	BB+/A-3	Negative	Downgrade
10/09/2017	BBB-/A-3	Negative	Downgrade
06/03/2016	BBB/A-3	Stable	Reaffirmed
05/04/2015	BBB/A-3	Stable	Reaffirmed
04/09/2014	BBB/A-3	Stable	Reaffirmed
04/08/2013	BBB/A-3	Stable	Reaffirmed
02/13/2012	BBB/A-3	Stable	Reaffirmed