MIMA Leather (Private) Limited

REPORT DATE:
March 9, 2020

RATING ANALYSTS:

Arsal Ayub, CFA
arsal.ayub@vis.com.pk

RATING DETAILS		
Rating Category	**Indicative Rating**	**Previous Rating**
Entity	**BB+/A-3**	**BB+/A-3**
Rating Date	*March 9, '20*	*November 28,'18*
Rating Outlook	Stable	Negative
Outlook Date	*March 9, '20*	*November 28,'18*

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 (April, 2019)
https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Corporate-Methodology-201904.pdf

MIMA Leather (Private) Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

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 12m sq. feet for finished leather.

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

MLPL is predominantly engaged in manufacturing and export of finished goat leather, which accounted for 92% of sales in FY19. Apart from exports, the company also sells in the domestic market, albeit local sales constitute roughly ~5% of the total sales.

Rating Drivers

Given an international demand weakening, Pakistan's leather export revenues continue to depict a negative trend.

The global leather industry continues to go through turmoil, given increasing significance of faux leather and the resultant softening demand for leather products. In the past 3-year period (FY17-19), the export price per square foot of tanned leather, from Pakistan, has dropped at an average of 18% per annum. Some quantitative increase in exports was witnessed in FY17 & FY18, albeit in the outgoing year, exports fell in both quantities and revenue terms.

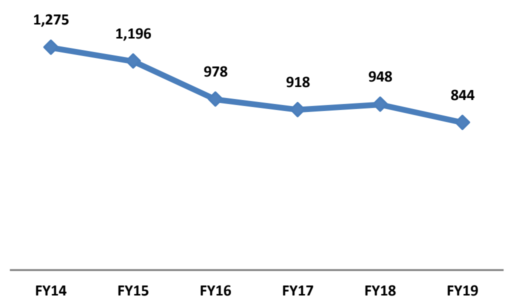

Figure 1: Export Revenues (in USD' Millions)

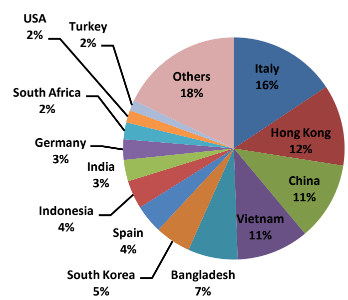

Figure 2: Country-wise Export Breakup (FY19)

Given the trends discussed above, leather exports revenues from Pakistan have consistently declined over the years, as depicted in figure 1 above. Country-wise exports are presented in figure 2, wherein it is pertinent to mention that in all major export destinations, a YoY drop in exports was observed. In terms of leather categories, exports of all categories posted a decline, except for the leather footwear segment.

Going forward, the global leather demand is expected to remain weak. However, trade policy issues between US & China, which although temporarily sorted, present opportunity for smaller-sized players like Pakistan to fill capacity. Furthermore, the outbreak of the novel coronavirus in the Hubei province of China, will certainly translate in supply-side weakening of leather products, which will present opportunity for others to fill capacity.

Mima's revenues remain lower than Rs. 500mn, well below historical highs of more than Rs. 1bn

Table 1: Category-wise Sales

	Qty (Sqft)		Rate (Rs./Sqft)		% of Revenues	
Export	**FY18**	**FY19**	**FY18**	**FY19**	**FY18**	FY19
Wet Blue	-	-	-	-		
Crust (Goat)	35,855	77,260	129.26	154.30	0.9%	2.5%
Finish (Goat)	2,908,580	2,159,514	161.75	198.99	94.5%	91.8%
Finish (Sheep)	-	2,511.00	-	225.50	0.0%	0.1%
Local						
Wet Blue (Goat)	20,000	149,250	7.50	19.12	0.0%	0.6%
Crust (Goat)	600	17,281	25.00	16.37	0.0%	0.1%
Finish (Goat)	273,221	227,011	78.62	100.98	4.3%	4.9%
Finish (Sheep)	7,511	-	154.99	-	0.2%	0.0%
Gross Sales	3,245,767	2,632,827				

Mima's net sales dropped by 5% in FY19, owing to a quantitative decrease in sales, while per unit selling price in every category, except for Crust (Goat), depicted an increase, which is mainly attributable to local currency depreciation. The share of exports in revenues dropped slightly to 94.4% (FY18: 95.4%).

Country-wise sales have remained similar prior year, with China (25%), Germany (22%), Austria (9%), Korea (8%) and Poland (7%) being the most prominent export destinations. In absolute terms, sales to each of these countries has dropped, except for Germany. Both client and country wise concentration in sales is on the higher side with top five countries generating 71% (FY18: 74%) of total revenue in FY19.

Company remains in losses, despite YoY improvement in profitability metrics

Table 2: Profitability Margins

	FY18	FY19
Gross Margin	7.2%	15.3%
Operating Margin	-7.8%	-0.6%
Net Margin	-13.2%	-7.2%

Gross margins almost doubled during the year, which can be attributed to better pricing available in the international market, in PKR terms given significant depreciation in domestic currency. The average USD/PKR exchange rate for FY19 was Rs. 136 vis-à-vis Rs. 109 for FY18. With the USD/PKR parity averaging Rs. 156 in the ongoing fiscal year, a further improvement in gross margin is likely. As per management, gross margins in H1'FY20 stood at 22%, while the topline reached Rs. 200mn.

Table 3: Operating & Finance Costs (In PKR' millions)

	FY18	FY19
Distribution Expenses	39	36
Administrative Expenses	32	35
Finance Cost	31	34

Mima's bottom line continues to suffer on account of low business volumes, which are inadequate to meet running expenses, at prior year margins. However, further improvement in margins is viewed positively. At H1'FY20 gross margin of 22%, assuming similar operating expenses, the company's business volumes will need to increase to Rs. 500mn for the company to achieve a net breakeven. As per management, the topline for H1'FY20 stood at Rs. 200mn, while product off-take has shown some uptick in Q3'FY20. All in all the management is committed to achieve the top line target of Rs. 500mn.

The sizable net cash cycle continues to be a strain on the company's liquidity

Table 4: Cash Conversion Cycle (In Days)

	FY18	FY19
Inventory Days	751	841
Debtor Days	29	28
Creditor Days	221	296
Cash Conversion Cycle	**559**	**573**

Given very long inventory turnover, the company's liquidity remains affected by the elongated working capital cycle. As a result, the company's FFO remains depressed and the company has to rely on short term borrowings for funding. As per management, the inventory can only be reduced gradually as the factory continues to operate at minimum capacity. Alternatively, a drastic reduction inventory would require factory closure and reduction in work force. On the contrary, the sizable inventory should allow the company the flexibility to meet potential bulk orders, as and when they arise.

As the company has remained in losses, the FFO has also been negative. The company has also taken loan from sponsor, the quantum of which remained unchanged as of Jun'19 (Jun'19: Rs. 66mn; Jun'18: Rs. 64mn). Given the increase in benchmark rates, the sponsors have increased their interest-free loan to the company by Rs. 100mn; subsequently sponsor loan has increased to Rs. 160mn. Going forward, the improvement in profitability metrics is expected to translate in improved liquidity, albeit it liquidity generation will be minimal, as at present the company is only targeting a net breakeven.

Table 6: Liquidity

	FY18	FY19
FFO (Rs. Millions)	-62	-42
Debt (Rs. Millions)	500	471
Current Ratio	1.3x	1.2x

Capitalization metrics have further deteriorated

The improved profitability metrics have translated in relatively slower equity erosion, albeit it has not arrested the trend. As of Jun'19, the gearing and leverage of the company stood on the higher side. Given a negative FFO, the increase in gearing and leverage is a concern. However, some comfort can be derived from the coverage of borrowings by inventory and trade debts.

As an exporting company, Mima is entitled to financing at subsidized rates. As of Jun'19, the company's debt was entirely short-term and amounted to Rs. 471mn (Jun'18: Rs. 500mn), of which Rs. 145mn was under SBP's export refinance scheme (Jun'18: Rs. 447mn). Cognizant of the increase in leverage, the sponsors have increased their interest free loan to the company to Rs. 166mn, subsequent to year–end FY20. As per management and the sponsoring directors, the loan will be retained within the company for the foreseeable future. Incorporating the additional sponsor loan on pro-rata basis gearing and leverage would reduce to 1.7x and 3.1x respectively.

Table 5: Capitalization (Figures in PKR' Millions, unless stated otherwise)

	FY18	FY19
Net Equity	**159**	**118**
- Share Capital	48	48
- General Reserve	20	20
- Share Deposit Money	143	143
- Accumulated Losses	(52)	(93)
Tier 2 Equity	**64**	**66**
- Loan from Sponsor Interest Free	64	66
Gearing (adjusted)	**2.2x**	**2.6x**
Leverage	**3.9x**	**4.8x**

MIMA Leather (Private) Limited — Appendix I

FINANCIAL SUMMARY			*(amounts in PKR millions)*
BALANCE SHEET	**30-Jun-17**	**30-Jun-18**	**30-Jun-19**
Non-current Assets	72.6	71.7	63.4
Stores Spares & Loose Tools	30.3	22.9	22.7
Stock-in-trade	928.3	885.3	871.9
Trade Debts	36.8	41.0	32.9
Short Term Loans & Advances	57.2	48.8	43.6
Cash & Bank Balances	8.5	3.9	6.9
Total Assets	1,157.0	1,093.1	1,058.7
Short-term borrowings	555.6	500.2	471.4
Trade Payables	245.2	288.0	330.9
Total Liabilities	925.6	870.0	874.8
Paid-up Capital	48.0	48.0	48.0
Total Equity	276.3	223.1	183.9
INCOME STATEMENT	**30-Jun-17**	**30-Jun-18**	**30-Jun-19**
Net Sales	437.2	474.8	450.4
Cost of Sales	445.5	437.4	381.4
Gross Profit	(8.4)	37.0	69.0
Distribution Expenses	37.3	38.8	36.5
Administrative Expenses	28.5	31.6	34.8
Other Income	117.2	0.4	0.4
Finance Cost	28.7	30.8	33.9
Profit before Tax	14.4	(67.6)	(36.5)
Taxation	4.5	4.9	4.7
Profit/(Loss) After Tax	9.9	(62.7)	(31.8
RATIOS & KEY NUMBERS	**30-Jun-17**	**30-Jun-18**	**30-Jun-19**
Gross Margin (%)	-1.9%	7.2%	15.3%
PBT Margin (%)	3.3%	-14.2%	8.1%
Net Margin (%)	2.3%	-13.2%	-7.1%
Current Ratio (x)	1.26	1.18	1.12
Net Working Capital	222.6	155.8	108.9
Working Capital Cycle	583.3	558.6	573.0
Gearing (x)	2.0	2.2	2.6
Debt Leverage (x)	3.2	3.9	4.8
FFO	(115.1)	(62.0)	(42.0)
FFO/Total Debt (x)	(0.17)	(0.12)	(0.09)
Debt Servicing Coverage (x)	NA	NA	NA
ROAA (%)	0.8%	-5.6%	-3.0%
ROAE (%)	4.4%	-32.1%	-23.0%

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 below

Rating Date	Current Rating	Rating Outlook	Rating Action
RATING TYPE: ENTITY			
03/09/2020	BB+/A-3	Stable	Maintained
11/28/2018	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

Instrument Structure	N/A
Statement by the Rating Team	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.
Probability of Default	VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.
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Due Diligence Meetings Conducted	see below

Name	Designation	Date
Mr. Imtiaz Siddique	CFO	February 27, 2020
Mr. Umer Saleem	Director	February 27, 2020