RATING REPORT

M.K. Sons (Pvt.) Limited

REPORT DATE:
January 31, 2020

RATING ANALYSTS:
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RATING DETAILS		
	Initial Rating	
Rating Category	**Long-term**	**Short-term**
Entity	A-	A-2
Rating Date	*30th Dec'19*	
Rating Outlook	Stable	
Outlook Date	*30th Dec'19*	

COMPANY INFORMATION	
Incorporated in 1987	External Auditors: Kreston Hyder Bhimji & Co.
Private Limited Company	Chairman of the Board/CEO: Mr. Javed Akhtar
Key Shareholders (More than 5%):	
Mr. Javed Akhtar – 34.0%	
Mr. Mohammad Babar – 30.0%	
Ms. Fareeha Javed – 16.0%	
Mr. Mohamad Erkan – 10.0%	
Mr. Mohamad Aneeq – 10.0%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: Corporates (May 2019) https://www.vis.com.pk/kc-meth.aspx

M.K. Sons (Pvt.) Limited

OVERVIEW OF THE INSTITUTION

M.K. Sons (Pvt.) Limited (MKSL) was established in 1987 as a trading base export house. The company is involved in the weaving, processing and finishing fabric along with sale of textile madeups'.

Profile of the Chairman/CEO

Mr. Javed Akhtar serves as the Chairman of the Board and Chief Executive Officer. He has over 30 years of experience in the textile industry.

Financial Snapshot

Total Equity: end-FY19: Rs.2.3b; end-FY18: Rs. 2.0b; end-FY17: Rs.1.8b

Assets: end-FY19: Rs. 7.6b; end-FY18: Rs. 6.4b; end-FY17: Rs.6.0b

Profit After Tax: FY19: Rs. 323.6m; FY18: Rs. 182.3m; FY17: Rs. 170.7m

RATING RATIONALE

Rating Rationale

The ratings assigned to M.K. Sons (Pvt.) Limited (MKSL) take into account the company's presence in export oriented value-added textile segment, positive momentum in profitability on a timeline basis, sound liquidity and reasonable experience of management team in the relevant industry. Ratings also incorporate sound financial risk profile as manifested in sustenance of healthy margins and comfortable debt service coverages. M.K. Sons operates as a family owned business with the shareholding vested among individuals of the same family. The ratings remain constrained by overall high business risk related to inherent volatility in the textile sector coupled with relatively high leverage indicators. The ratings remain dependent on maintenance of margins, realization of projected targets, product diversification and incremental cash flow generation from recent capital expenditure coupled with evolution of sector dynamics.

Competition from regional competitors on a higher side: The significance of textile sector is exemplified by the fact that this sector contributes more than half of Pakistan's total exports. On average, textile products accounted for 59% of the country's total exports during the last three years. The demand driven price risk is largely curtailed given the demand for textile apparel in the world was recorded around US$920 billion during FY18 and it is projected to increase at a CAGR of 4.4% during the forecasted period to reach approximately US$1.2 trillion by end-FY24. In line with positive demand outlook coupled with recent rupee devaluation, the sector has significant opportunity to earn foreign exchange through textile exports; the same was somewhat capitalized during FY19 with hosiery (Rs. 285b), readymade garments (Rs. 259b) and home textile (Rs. 227m) constituting 13%, 11% and 10% respectively of the total exports of the country. However, potential revenue risk prevails on account of intense competition posed by regional competitors including India and Bangladesh in the international market. In addition, sell side risks involving sizeable energy costs shroud the actual potential of textile industry. Further, in the backdrop of increasing benchmark rates, the borrowing capacity of the local market players has been adversely impacted leading to liquidity stress. In addition, the resistance to change and inflexibility in built in the sector dynamics has hampered the capability of exporters to incorporate ever-changing consumer preferences in the product profile; the same has largely rendered exports uncompetitive in the past. In view of this, relaxation in governed policies, incentivisation of the local textile producers in terms of subsidies, conduction of trade fares and supply of uninterrupted power is likely to play a significant role in unlocking the budding potential of the segment.

Integrated manufacturing facility: The sponsors of MKSL, started textile business in 1987 as a trading base export house. Since then the company has expanded and diversified into a vertical based manufacturing and finishing operations consisting of a weaving unit, processing unit comprising of printing, dyeing and finishing along with a well-equipped stitching unit. Currently, the total headcount of the company is around 2,095. The Mill comprising Weaving, Processing, Stitching and Wadding & Quilting units for home textile products and Cutting, Stitching, Processing, Finishing and Packing units for garments which are located at 2-KM, Jaranwala Road and 33. KM Sheikhupura Road, Faisalabad and the company's head office is situated at 2 K.M. Jaranwala Road, Faisalabad, Pakistan.

The company has an aggregate weaving capacity of 59,822,972 square meters/year with 104 shuttle less looms and 120 airjet looms. The capacity utilization of the weaving unit was recorded higher at 85% (FY18: 85%) during FY19. The product range includes 100% cotton, poly cotton fabrics in plain weave, herringbone, ducks and twills. The airjet weaving set up comprise sizing machine of Karl Mayer brand from Germany and weaving machines of Toyoda Brand from Japan. Processing function at MKSL comprises fabric singeing, sizing, mercerizing, bleaching, dyeing, printing and finishing. The processing set up pertains to Osthoff (SINGEING DESIZING), Goller (BLEACHING), Riggiani (Rotary- Printing) and Monforts (Stanters & Dyeing) brands, all are of German and Italian origin. The production capacity of the bleaching unit is around 140,000 meters/day; meanwhile the total yearly installed capacity of processing unit is 52,800,000 meters. The capacity utilization of the processing unit was recorded higher at 88% during FY19 as compared to 75% in preceding year. During FY19, weft straightener machine was added to the existing product range. The dyeing capacity of the company is 40,000 meters/ day.

The Printing Range includes rotaries and digital printing with a combined printing capacity of 85,000 meters/day. The company has 2 Reggiani machines with 16 color printing options and a working width of upto 320 cm. The rotary machines are capable of doing standard design repeats of 64cm, 82cm, 91cm and 101cm. MKSL also has one Italian made digital printing machine with a maximum printing width of 330 cm. Depending on the print heads, the production output can vary, fully configured with 64 print heads the machine produces 640 running meters/hr in 310 cm width and 670 running meters/hr in 160 cm.

Moreover, quality assurance department involves strict quality control procedures with routine checkup for composition, thread count, piling, absorbency, whiteness, wet & dry washing and rubbing analysis to assure that fabric is properly inspected for relevant factors before being forwarded to the next stage of production. In order to maintain quality of processed fabrics, the company has a testing laboratory capable of performing all possible tests.

The company has a Stitching, Wadding and Quilting unit with 500 machines including kansai, barrata, hem sticth, over lock, pin tuck, blind stitch, embroidery, threading and cutters etc. In atomization, the company also has multi needle quilting machines, direct filling, auto cutting, auto pillows making and embroidery machines. Stitching unit has a capacity to cut and stitch 1.5m meters/month. The capacity utilization of this unit is indeterminable due to multi product plans involving varying processes of manufacturing and run length of order lots. During FY19, the capacity of stitching and quilting unit was enhanced on account of addition in embroidery machine.

The management has recently installed garments unit comprising of Cutting, stitching, washing & packing facilities with an aggregate capacity of 5,000 articles per day.

Performance lifted by exports: Product portfolio primarily includes home textile, processed fabric, garments and grey fabric. Textile made ups including home textile products sets is the main revenue driver for the company constituting around 57% of the export sales. The breakdown of revenue mix in export sales in terms of product portfolio is presented in the table below:

Products	FY17	FY18	FY19
Processed Fabric	35.8%	36.0%	33.7%
Made Ups	59.6%	56.0%	57.0%
Garments	1.3%	1.7%	1.9%
Greige fabric	3.3%	6.3%	7.4%

Total	100%	100%	100%

The customers of the company include renowned international brands. Despite dealing with prominent wholesale clients, the client concentration was manageable with top-10 customers representing 25% (FY18: 28%; FY17: 36%) of the total revenues during FY19. The company has long standing business relations with majority of customers; however the contracts are largely done on order basis. Europe is the main export market for MKSL constituting major share of the total export revenues followed by North America. However, company has its market share in different regions including Africa, Australia & New Zealand, Middle East & Asia.

The company has different payments terms with different buyers Exports are made on four different bases of payments including Letter Of Credit Sight (LCS), Letter Of Credit Usance (LCU) Cash against Documents (CAD) and Documents against Acceptance (DA). Credit period under LCU varies from 60-120days & under DA from 45-90days. DA portfolio has only a marginal share in receivables portfolio. For DA customers company has its policy to cover the risk either through factoring agreement or export credit insurance. On the other hand, yarn procurement from local market is done on cash while payment period for imported raw materials ranges between 10-90 days. The company's follows a lean supply chain management strategy whereby stock for three months is procured; hence working capital requirements remain within manageable limits leading to moderate operational costs. MKSL annual power requirement is around 41.9MW; the same has been arranged through various sources including 3.7MW from Water and Power Development Authority (WAPDA) and 38.2MW from the company's captive power.

Profitability indicators supported by improvement in margins: Over the last three years, sales of the company have grown at a CAGR of around 15%; moreover, the sales for FY19 were recorded 37% higher than the preceding year. The export sales remain the major revenue driver contributing around 92% to the sales mix. Net sales of the company increased during the outgoing year; the increase was a combined outcome of higher selling prices and quantity of made ups. Moreover, increased quantity sale of processed fabric also contributed to higher revenue generated during FY19. Further, the impact of higher prices along with increased contribution of high value products in the revenue mix reflected positively in the gross margins of the company that increased to 13.7% (FY18: 12.9%) during FY19. The distribution cost increased primarily as a result of higher freight expense owing to increase in cost of clearing and forwarding contracts and higher selling commission in line with increase in scale of operations. Further, administrative expenses increased on a timeline basis owing to inflationary pressure, leading to annual salary adjustments together with higher headcount reported during FY19. In the backdrop of increasing average benchmark interest rates coupled with higher average short-term borrowings finance cost of the company increased during FY19. However, the increase in operating expenses and finance cost was offset by increase in margins and positive momentum in revenues, therefore, MKSL's bottom line was recorded higher during FY19 as compared to preceding year.

Strong liquidity profile as evident from healthy cash flows in relation to outstanding obligations and adequate debt service ability: Liquidity profile of the company is considered sound in view of sizable cash flows in relation to long-term outstanding obligations and sound debt service capacity. As an outcome of higher profit before taxation, Funds from Operations (FFO) exhibited an increasing trend and were recorded at Rs. 687.9m (FY18: Rs. 429.8m) during FY19. However, owing to increase in short-term funding, the increase is FFO to total debt was marginalized; on the other hand, FFO to long-term debt and debt service coverage remained sizeable in FY19. According to the management, cash flows are expected to improve on account of increase in sales supported by incremental revenue from installation of new denim unit which is expected to come online in Jan'20 coupled with cost saving from improving operational efficiencies from investment in wadding, processing and stitching unit. While trade receivables stood higher on account of sales growth along with PKR depreciation against USD & addition of new clients in FY19, other receivables also increased on a timeline basis mainly due to opening of letter of credit facilities for servicing of export orders. The aging of receivables is considered satisfactory since less than 0.2% of the total export receivables were due for more than three months. Further, stock in trade increased slightly on a timeline basis in line with sizeable quantum of work in process inventory for meeting production orders received. The imported raw materials include yarn, fabric, dyes and packaging material. The current ratio is maintained at 1.0x over the last two years.

Conservative capital structure with gearing levels expected to improve further: The equity base of the company has steadily strengthened on the back of profit retention. MKSL procured long-term debt during FY19 to finance capex in plant and machinery of around Rs. 116m with purchase of sewing machines and gas generators. The loan is obtained for seven years including two years grace period; the loan is payable is twenty equal quarterly installments and carries a mark-up charge at SBP rate plus 1% per annum. The entire long-term funding pertains to export based long-term financing offered by apex bank at concessional rates. However, despite procurement of additional long-term borrowing during the outgoing year, the long-term debt levels declined owing to regular timely payment of contractual obligations. The markup on LTFF loans ranges between 3.0% and 4.5%. However, total debt levels of the company have increased on account of higher utilization of short-term credit facilities to meet increased working capital requirements during FY19. According to the management, the increase in short-term credit is temporary in nature, mainly pertaining to financing of work in process inventory to process orders of clients booked. Given higher short-term borrowings carried on the balance sheet, gearing and leverage indicators have witnessed an increasing trend on a timeline basis; both are relatively on a higher side than industry averages. Moreover, for set-up of denim plant entailing a capex of Rs. 800m the company obtained a long-term facility of Rs. 400.0 from SBP during the ongoing year; hence leverage indicators are projected to increase slightly by end-FY20.

Information Technology and Internal Audit function: MKSL is using SAP-based ERP software comprising five modules including Material Management, Sales and Invoicing (both export and local), Production Management and Finance & Costing. Majority of the computerized machines are integrated with ERP platform which provides real time data on production. Daily backup of data is taken; meanwhile it is stored on portable hard drives every two weeks and stored offsite. The internal audit team is comprises twelve members who conduct post and pre-audit of all the transactions.

Steady growth projected going forward with no sizable long-term funding planned to be procured: Going forward, the management projects sales to grow at a CAGR of 17.5% over the next three years with gross margins expected to be maintained around 14.0%. The profitability is projected to exhibit positive momentum on account of initiation of operations of the denim unit which is likely to contribute around Rs. 1.5b to the topline in FY21; however the contribution in the ongoing year is estimated to be marginal of around Rs. 300.0m. Demand for denim garments has a favorable outlook but cost pressures pertaining to input prices and competitive pressures on account of international expansion by major players are expected to keep pricing power and hence margins in check. Moreover, management believes that MKSL is positioned to meet change in demand patterns due to its focus on research and development. Asset base is likely to augment on the back of further capex in fixed assets; the management plans to double the capacity of denim unit in FY21 with additional capex of Rs. 450m which will be met by procurement of long-term funding and company's internal capital generation. Gearing and debt leverage are projected to decline FY20 onwards in line higher equity base and retirement of long-term debt.

M.K. Sons (Pvt.) Limited			Annexure I
BALANCE SHEET	**June 30, 2017**	**June 30, 2018**	**June 30, 2019**
Non-Current Assets	2,583.1	2,485.9	2,627.1
Stock-in-Trade	1,991.6	2,262.6	2,835.0
Trade Debts	471.2	587.3	975.3
Cash & Bank Balances	66.0	72.0	120.4
Total Assets	6,012.6	6,414.2	7,613.2
Trade and Other Payables	742.1	894.3	1,105.2
Short Term Borrowings	2,483.5	2,662.0	3,447.0
Long Term Borrowings	921.1	747.8	610.5
Total Liabilities	4,200.8	4,414.0	5,285.5
Paid Up Capital	100.0	100.0	500.0
Core Equity/Total Equity	1,811.7	2,000.3	2,327.7
INCOME STATEMENT	**June 30, 2017**	**June 30, 2018**	**June 30, 2019**
Net Sales	6,646.0	7,112.5	9,746.9
Gross Profit	827.6	915.4	1,333.8
Operating Profit	332.3	431.9	745.1
Profit Before Tax	170.7	215.8	443.2
Profit After Tax	170.7	182.3	323.6
FFO	333.0	429.8	687.9
RATIO ANALYSIS	**June 30, 2017**	**June 30, 2018**	**June 30, 2019**
Gross Margin (%)	12.5	12.9	13.7
Net Working Capital	(10.7)	86.5	167.2
Current Ratio (x)	1.00	1.02	1.03
FFO to Total Debt (x)	0.10	0.13	0.17
FFO to Long Term Debt (x)	0.36	0.57	1.13
Debt Service Coverage Ratio (x)	2.99	1.50	1.91
ROAA (%)	2.9	2.9	4.6
ROAE (%)	9.9	9.6	15.0
Gearing (x)	1.85	1.63	1.70
Debt Leverage (x)	2.32	2.21	2.27

M.K. Sons (Pvt.) Limited (Projections)			Annexure II
BALANCE SHEET	**June 30, 2020**	**June 30, 2021**	**June 30, 2022**
Non-Current Assets	3,024.0	3,202.0	3,333.0
Stock-in-Trade	3,460.6	3,790.0	4,178.8
Trade Debts	1,172.9	1,410.7	1,603.1
Cash & Bank Balances	144.4	180.5	225.7
Total Assets	9,274.9	10,359.3	11,100.9
Trade and Other Payables	1,453.0	1,575.5	1,733.7
Short Term Borrowings	4,150.9	4,317.0	4,257.3
Long Term Borrowings	818.4	971.4	852.2
Total Liabilities	6,550.7	7,012.4	6,979.7
Core Equity/Total Equity	2,724.2	3,347.0	4,121.1
INCOME STATEMENT	**June 30, 2020**	**June 30, 2021**	**June 30, 2022**
Net Sales	11,948.3	14,107.2	15,825.1
Gross Profit	1,529.7	1,951.7	2,156.3
Operating Profit	821.7	1,108.5	1,185.4
Profit Before Tax	519.2	767.1	935.7
Profit After Tax	396.5	622.7	774.2
FFO	731.1	985.7	1,083.0
RATIO ANALYSIS	**June 30, 2020**	**June 30, 2021**	**June 30, 2022**
Gross Margin (%)	12.8	13.8	13.6
Net Working Capital	397.1	1,081.0	1,799.8
Current Ratio (x)	1.07	1.18	1.29
FFO to Total Debt (x)	0.15	0.19	0.21
FFO to Long Term Debt (x)	0.89	1.01	1.27
ROAA (%)	4.7	6.3	7.2
ROAE (%)	15.7	20.5	20.7
Gearing (x)	1.80	1.59	1.24
Debt Leverage (x)	2.40	2.10	1.69

ISSUE/ISSUER RATING SCALE & DEFINITIONS Annexure II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

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: 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.vis.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.vis.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.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'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.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when 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	M.K. Sons (Pvt.) Limited				
Sector	Textile				
Type of Relationship	Solicited				
Purpose of Rating	Entity Rating				
Rating History	**Rating Date**	**Medium to Long Term**	**Short Term**	**Rating Outlook**	**Rating Action**
	RATING TYPE: ENTITY				
	30-12-2019	A-	A-2	Stable	Initial
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		**Name**	**Designation**	**Date**	
	1	Mr. Rehman Iqbal	Deputy General Manager	10-Dec-2019	