RATING REPORT

M.K. Sons (Pvt.) Limited

REPORT DATE:
March 05, 2021

RATING ANALYSTS:
Maham Qasim
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RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A-	A-2	A-	A-2
Rating Date	*March 05, 2021*		*April 27, 2020*	
Rating Outlook	Stable		Rating Watch Negative	

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 and garments.

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-Oct'20: Rs. 2.9b; end-FY20: Rs. 2.7b;end-FY19: Rs.2.5b; end-FY18: Rs. 2.0b

Assets: end-Oct'20: Rs. 9.7b; end-FY20: Rs. 8.9b;end-FY19: Rs. 7.6b; end-FY18: Rs. 6.4b

Profit After Tax: Oct'20: Rs. 134.6m; end-FY20: Rs. 214.3; FY19: Rs. 323.6m; FY18: Rs. 182.3m

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 enhancement of margins and comfortable debt service coverages. Further, owing to reduction in benchmark rates, the financing cost for the company has reduced, reflecting positively on the bottom line. Given improvement in the company's operational performance owing to pandemic led boom in textile sector during the period under review, the outlook assigned to MKSL's ratings has been revised to 'Stable'. Even though concerns of a 2nd wave of Covid-19 remain elevated, VIS expects the order book for the industry to remain strong in the ongoing year, subsiding business risk concerns. However, the ratings remain sensitive to relatively high leverage indicators. The ratings are 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 post ongoing pandemic.

Local Textile Sector performance during COVID-19: The coronavirus pandemic led to 3% drop in global trade volumes in the 1QCY20 according to United Nations conference on Trade and Development forecasts. Industries whose operations were more globalized (particularly those who relied on Chinese inputs for production) were highly exposed to initial supply side disruptions. However, given most of the textile companies in Pakistan are heavily reliant on local cotton produce; the supply side risk were largely curtailed. In addition, the lockdown in China at the initial stage turned advantageous as the orders got shifted to Pakistan. Prior to onslaught of the pandemic, the European buyers were attracted by repetitive rupee weakening since 4QFY18, as unit prices fell only for Pakistan in 9MFY20 vis-à-vis its competitors. The price effect was further enforced by duty-free/quota free access under the GSP Plus agreement. Bangladesh and Pakistan have been able to increase their exports to the bloc as they enjoy preferential trade treatment within EU. Moreover, US-China trade war with USA applying additional tariffs on Chinese apparel imports since Sep'19 has aided low cost suppliers including Pakistan in capturing the untapped share. So after global onslaught of corona virus European and American retailers, the two main destination markets for this sector, cancelled their orders causing serious concerns in many sourcing countries. With only a few buyers honoring their import commitments with local manufactures, exports declined during April'20. Exports of readymade garments dipped by 69% in April'20 compared to same month ln the preceding year.

The country's textile industry has scaled up production to pre-Covid level of full-capacity as a significant improvement in containment of the pandemic in the country led the world buyers to partially divert their orders to domestic manufacturers. The growth in production is backed by a big jump in the import of basic raw materials – cotton and man-made yarn – after the recent heavy rainfall and pest attack damaged notable portion of cotton crops in the fields to a multi-year low. Secondly, the industry recovered on a fast pace with the government's support in the shape of rationalizing energy price to a regional competitive level, the same included continued supply of raw material and subsidized financing for the expansion of production and setting up new units. Further, the textile exports have also largely recovered from the Covid-19 pandemic shocks and are still growing both in terms of their quantity and dollar value. The textile shipments have surged by 3.8% to $4.8 billion between July and October from $4.6bn in the corresponding period last year. The rise in the textile and clothing group has been slightly faster than the 0.6% growth in the overall export. The export recovery is most prominent in the knitwear, home textiles and denim segments.

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 three-fifths of the export sales. The customers of the company include renowned international brands. 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.

Topline largely stagnant during FY20; the same along with profitability indicators picked pace during the ongoing year: With the onslaught of corona virus, the company fell short of its projected target of Rs. 11.9b for FY20 primarily with the complete halt to order placement, reception of shipments and delay in payments from the export originating countries. Further, order processing at MKSL was also disrupted by lockdown imposed in Apr'20 to curtail the spread of the pandemic. However, despite the unprecedented situation the company was able to contain its topline with slight increase from last year to Rs. 10.0b (FY19: Rs. 9.7b) during FY20; the increase was manifested in higher average retail prices of final products owing to deprecation of rupee in terms of other currencies. As per the management, the company had to close the last quarter of FY20 on a loss with nominal sales revenue generated; the same hampered the absorption of fixed overheads including salary expense and order processing charges therefore the margin declined slightly to 13.4% during FY20 as compared to 13.7% in the preceding year. The distribution expense was recorded higher at Rs. 455.7m (FY19: Rs. 367.8m) during FY20 owing to increase in selling commission and freight cost; both are correlated with higher value sales along with currency depreciation leading to increased cost. Further, administrative expenses increased on a timeline basis owing to inflationary pressure, leading to annual salary adjustments. The other expenses stood lower at Rs. 36.7m (FY19: Rs. 72.9m) on account of reduced exchange loss coupled with no bad debts written off during FY20; the bad debts recorded for FY19 amounted to Rs. 12.3m. In the backdrop of increasing average benchmark interest rates coupled with higher utilization of short-term borrowings, finance cost of the company increased to 268.3m (FY19:Rs. 229.2m) during FY20. Subsequently, with decline in margins along with increase in operating and financial expense, MKSL reported a bottom line of Rs. 214.3m as compared to Rs. 323.5m in the preceding year.

The declining trend in quantum sales was rescued during the ongoing year with the company's operations back at full capacity. MKSL's topline was recorded higher at Rs. 4.3b at end-Oct'20 owing to a combined impact of increase in export quantum coupled with higher prices in line with positive momentum in demand of home textile products. The increased demand of domestic products is underpinned by capitalizing of marketing gap as production units in competing countries are not operating at full potential owing to COVID-19 related lockdowns. In addition, the power subsidy announced by the government for the sector has made the prices even more competitive globally, therefore positively resulted in the offtake of local products. Subsequently, with increase in retail prices and no major increase in input cost the margins improved to 15.0% during the first four months of FY21. The operating expenses were recorded higher at Rs. 373.4m till

Oct'20 with increase largely manifested in distribution cost; however the same if annualized is largely in sync with increase in scale of operations. On the other hand, the finance cost was rationalized owing to sharp dip in benchmark interest rates despite increase in total borrowings of the company during the period under review. As a result of positive trajectory of revenues, improved margins and curtailment of interest expense, MKSL reported healthy profit of Rs. 134.6m during the first four months of FY21. As per the management, the company reaped a revenue of around Rs.6.7b at end-HY21. Going forward, the management projects to close FY21 with a topline of Rs.12.7b and profit of Rs. 396.0m. The company in on track of meeting the projected target with orders of USD $25m in the pipeline.

Strong liquidity profile as evident from healthy cash flows in relation to outstanding obligations and sound 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 reduced margins and lower profitability, Funds from Operations (FFO) declined and were recorded lower at Rs. 467.1m (FY19: Rs. 687.9m) during FY20. However, with the improvement in scale of operations during the ongoing year, FFO amounted to Rs. 295.1m during the first four months of FY21. Although, there has been an increase in the long-term and short-term borrowings during the ongoing year, FFO in terms of outstanding obligations was adequate. Similarly, debt service coverage remained sizeable during the period under review. Going forward, cash flows are expected to improve on account of increase in sales supported by incremental revenue from full scale operations of new denim unit which came online in June'20 with a delay of almost six months due to COVID-19 implications. During HY21, the denim unit has contributed 270m to the topline; the management expects to close FY21 with denim unit contribution of around Rs. 600m. Further, stock in trade increased by end-Oct'20 in which 35% and 40% pertained to raw material and work-in process inventory respectively for meeting production orders received. In addition, trade receivables also stood higher at end-Oct'20 on account of sales growth. The aging of receivables is considered satisfactory since less than 1% of the total export receivables were due for more than three months. The imported raw materials include yarn, fabric, dyes, chemicals and packaging material. The current ratio is maintained at 1.0x over the last three years.

Moderately leveraged capital structure: The equity base of the company has steadily strengthened on the back of profit retention. MKSL procured long-term debt amounting to Rs. 113m during FY20 under SBP refinance scheme for payment of salaries and wages at subsidized rate of borrowing during June'20. The loan is repayable in eight quarterly installments in two and half years including grace period of six months stating from July'20. The markup is charged at subsidized SBP rate i.e. 0% plus 1.5% per annum. Further, the company obtained a long-term loan amounting to Rs. 396.0m to finance denim unit and machinery in different tranches for seven years with a two year grace period. It is secured against 1st exclusive charge of Rs. 475.0m over imported machinery and is to paid in twenty equal quarterly installments. Markup is charged at SBP rate plus 1% per annum. Further, for all the other existing long-term facilities banks have deferred the loan installments for the period of one year under SBP directive as a relief to the company during COVID-19 pandemic. Subsequently, total debt levels of the company have also increased on account of higher utilization of short-term credit facilities to meet increased working capital requirements during FY20. Given higher borrowings carried on the balance sheet, gearing and leverage indicators have witnessed an increasing trend on a timeline basis. Moreover, for expansion of denim plant, MKSL plans to obtain a long-term facility of Rs. 400.0m from SBP during FY22; hence leverage indicators are projected to increase slightly on timeline basis.

M.K. Sons (Pvt.) Limited (Rs. in million)				Annexure I
BALANCE SHEET	**June 30, 2018**	**June 30, 2019**	**June 30, 2020**	**Oct 31, 2020**
Non-Current Assets	2,485.9	2,627.1	3,230.3	3,148.0
Stock-in-Trade	2,262.6	2,835.0	3,444.7	3,404.6
Trade Debts	587.3	975.3	708.7	1,395.1
Cash & Bank Balances	72.0	120.4	84.0	67.4
Total Assets	6,414.2	7,613.2	8,935.1	9,684.7
Trade and Other Payables	894.3	1,105.2	1,247.9	1,287.0
Short Term Borrowings	2,662.0	3,447.0	3,869.4	4,145.7
Long Term Borrowings	747.8	610.5	944.1	1,243.9
Total Liabilities	4,414.0	5,143.4	6,191.7	6,796.7
Paid Up Capital	100.0	500.0	500.0	500.0
Core Equity/Total Equity	2,000.3	2,69.7	2,743.4	2,888.0
INCOME STATEMENT	**June 30, 2018**	**June 30, 2019**	**June 30, 2020**	**Oct 31, 2020**
Net Sales	7,112.5	9,746.9	9,983.1	4,347.2
Gross Profit	915.4	1,333.8	1,337.5	651.2
Operating Profit	431.9	745.1	624.2	277.8
Profit Before Tax	215.8	443.2	321.2	193.7
Profit After Tax	182.3	323.6	214.3	134.6
FFO	429.8	687.9	467.1	295.1
RATIO ANALYSIS	**June 30, 2018**	**June 30, 2019**	**June 30, 2020**	**Oct 31, 2020**
Gross Margin (%)	12.9	13.7	13.4	15.0
Net Working Capital	86.5	309.2	486.3	863.3
Current Ratio (x)	1.02	1.07	1.09	1.15
FFO to Total Debt (x)	0.13	0.18	0.10	0.16
FFO to Long Term Debt (x)	0.57	1.13	0.49	0.71
Debt Service Coverage Ratio (x)	1.50	1.91	1.54	3.67
ROAA (%)	2.9	4.6	2.6	4.3
ROAE (%)	9.6	14.5	8.2	14.3
Gearing (x)	1.63	1.59	1.75	1.87
Debt Leverage (x)	2.21	2.08	2.26	2.35
Stock+ Trade debts/ Short-term Borrowings (x)	1.07	1.15	1.07	1.16

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				
05-03-2021	A-1	A-2	Stable	Maintain
27-04-2020	A-	A-2	Rating Watch Negative	Maintain
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	2-Feb-2021