RATING REPORT

M.K. Sons (Pvt.) Limited

REPORT DATE:
April 22, 2022

RATING ANALYSTS:
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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 Outlook	*Stable*		*Stable*	
Rating Action	Reaffirmed		Maintained	
Rating Date	*April 22, 2022*		*March 05, 2021*	

COMPANY INFORMATION	
Incorporated in 1987	External auditors: Kreston Hyder Bhimji & Co. Chartered Accountants
Private Limited Company	Chairman/CEO: Mr. Javed Akhtar
Key Shareholders (with stake 5% or more):	
Mr. Javed Akhtar – 34.0%% Mr. Mohammad Babar – 30.0% Ms. Fareeha Javed – 16.0% Mr. Mohammad Erkan – 10.0% Mr. Mohammad Aneeq – 10.0%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Corporates (August 2021)
https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

M.K. Sons (Pvt.) Limited

OVERVIEW OF THE INSTITUTION

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

Tier-1 Equity: end-7MFY22: Rs. 3.54b; end-FY21: Rs. 3.20b; end-FY20: Rs. Rs. 2.74b.

Assets: end-7MFY22: Rs. 15.75b; end-FY21: Rs. 13.63b; end-FY20: Rs 8.94b.

Net Profit: 7MFY22: Rs. 342m; FY21: Rs. 456m; FY20: Rs. 214m.

RATING RATIONALE

The ratings assigned to MKSL take into account the company's presence in export oriented value-added textile segment, growth in revenue combined with steady improvement in profitability over the review period, and reasonable experience of management team in the relevant industry. Ratings also incorporate moderate financial risk profile as reflected in improved margins and adequate debt service coverages. Liquidity profile is supported by internal cash flows generation and satisfactory cash conversion cycle. However, the ratings remain sensitive to elevated leverage indicators due to increased utilization of short-term borrowings for working capital requirements and mobilization of long-term loans to fund the capex. Going forward, the ratings are dependent on realization of revenue targets, maintenance of margins and debt servicing coverages, and rationalization of leverage indicators.

Product and client portfolio: Product portfolio primarily includes home textile, processed fabric, denim garments, and grey fabric. Textile made-ups, including home textile products sets, is the main revenue driver for the company, constituting around 65% of the export sales, followed by processed fabric 27%, and denim garments 6%. The customer base has remained largely the same during the period under review and mainly comprised renowned international brands. The company has longstanding 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.

Production capacities: The company has four production units namely weaving, processing, stitching, and denim garments. With no change in installed capacity, utilization of weaving units has remained largely stable over the review period. Production capacities of fabric processing and denim garments units were enhanced to 58.2m meters (FY21: 56.4m meters) and 3.6m pieces (FY21: 1.8m pieces) respectively, for a capex of Rs. 321m (FY21: Rs. 109m) during HY22. Capacity utilization of denim unit remained on the lower side despite some improvement; the management expects the same to improve further, going forward, on account of increasing orders. Going forward, the company plans to double the denim capacity and install 30-35 new air jet looms for an estimated capex of Rs. 1.2b – Rs. 1.4b that will be funded through a mix of debt and equity.

Sales and profitability: Net sales of the company increased to Rs. 14.0b (FY20: Rs. 10.0b) during FY21, driven largely by higher exports. Exports remained the major revenue driver and accounted for 88% (FY20: 78%) of overall revenue mix during the year. Increase in export revenue to Rs. 12.7b (FY20: Rs. 8.1b) during FY21 was mainly led by higher volumetric sales of made-ups and denim garments as well as favorable prices for the key product categories. Revenue from services to exports decreased slightly to Rs. 1.1b (FY20: Rs. 1.2b) while local sales decreased to Rs. 518m (FY20: Rs. 1.0b) due to focus on exports during FY21. Going forward, the company is targeting revenue of Rs. 18.5b during FY22, with growth mainly emanating from higher volumes of made-ups, processed fabric, and denim garments coupled with improvement in selling price.

Cost of sales increased at a slightly lower pace to Rs. 12.0b (FY20: Rs. 8.6b) during FY21, due to increased production levels and input cost inflation. Raw material and related items remained the major cost drivers accounting for three-fourth of overall production cost, followed by salaries & wages, conversion & processing charges, and fuel & power. Raw materials mainly comprise yarn and fabric sources from the local market, while imports represent a small portion. Gross profit was reported higher at Rs. 2.1b (FY20: Rs. 1.3b) due to a combination of higher sales and improvement in gross margin to 14.8% (FY20: 13.4%) as the company was able to fully pass the impact of input cost escalation onto customers during FY21.

In line with higher export volumes, selling & distribution expenses increased to Rs. 802m (FY20: Rs. 456m) primarily on account of higher selling commission, notable increase in sea & air freight due to global shortage of shipping containers, and clearing & forwarding expenses during the year. Administrative expenses also increased to Rs. 320m (FY20: Rs. 258m) owing to increase in staff salaries & benefits. Increase in other operating expenses was mainly led by higher workers' profit participation fund and exchange loss of Rs. 18m (FY20: Rs. 7m). Despite reduction in benchmark rates, the company incurred higher financial charges of Rs. 293m (FY20: Rs. 268m) on account of higher utilization of bank borrowings to support business growth. Accounting for tax expense, the company's net profit more than doubled to Rs. 456m (FY20: Rs. 214m) which translated into improved net margin of 3.2% (FY20: 2.1%) during FY21.

The company is targeting revenue of Rs. 18.5b for the ongoing year, out of which Rs. 10.4b has already been realized during 7MFY22. Gross profit has been reported at Rs. 1.6b due to higher sales and further improvement in gross margin to 15.4% as the company was able to pass the impact of sizeable increase in yarn and fabric costs onto customers during 9MFY22. In line with the increasing exports, distribution expenses were recorded higher at Rs. 708m vis-à-vis corresponding period of last year. Financial charges remain high at Rs. 226m owing to increase utilization of short-term borrowings. Net profit is projected at around Rs. 600m, out of which Rs. 342m has already been realized during 7MFY22.

Liquidity: Liquidity profile of the company is considered adequate and is supported by internal cash flows generation. In line with the profits, the company generated higher funds from operations (FFO) amounting to Rs. 909m (FY20: Rs. 467m) during FY21. FFO generation amounted to Rs. 506m during 7MFY22. The company's capacity to meet its financial obligations is considered adequate, as reflected in debt service coverage ratio (DSCR) of 3.18x (FY20: 1.54x) and FFO-to-total debt ratio of 0.14x during FY21. The decrease in DSCR to 1.33x during 7MFY22 was mainly due to early settlement of one of the long-term loan facilities. Current ratio remained largely stable at 1.10x. Inventory and receivables provide adequate coverage against short-term borrowings as reflected in 1.18x (FY21: 1.15x) at end-7MFY22.

While cash conversion cycle is considered is satisfactory, the same has increased steadily to 129 days (FY21: 123 days) over the review period due to increase in receivable days. In the absolute terms, trade receivables increased to Rs. 1.9b (FY21: Rs. 1.2b) on account of rupee depreciation and increase in shipping lines transit time due to global shortage of shipping containers. However, the credit risk emanating from the same is considered low as receivables are secured by L/Cs. Given the company has an integrated unit and operating 4-moth production cycle, inventory days remained largely stable at 141 days (FY21: 144 days) during the period. Increase tax refund due from govt. to Rs. 1.5b (FY21: Rs. 1.4b) is due to inventory purchases; as per the management, the company is receiving refunds on a regular basis.

Capitalization: Paid up capital of the company remained unchanged at Rs. 500m. Tier-1 equity accumulated to Rs. 3.5b (FY21: Rs. 3.2b) with the retention of profits of during 7MFY22 and also includes interest-free sponsor loan of Rs. 202m (FY21: Rs. 202m). Revaluation surplus amounted to Rs. 1.9b (FY21: Rs. 1.9b). Total liabilities stood higher at Rs. 10.3b (FY21: Rs. 8.5b) at end-7MFY22, mainly due to increase in trade & other payables to Rs. 2.1b (FY21: Rs. 1.7b) and short-term borrowings to Rs. 6.6b (FY21: Rs. 5.1b) to fund the increased working capital requirements due to denim unit. With the scheduled repayments, outstanding balance of long-term loans inclusive of current maturity declined to Rs. 1.3b (FY21: Rs. 1.4b) by end-7MFY22. Resultantly, gearing and leverage ratios increased further to 2.23x (FY21: 2.05x) and 2.90x (FY21: 2.65x) by end-7MFY22. Given the company has a capex plan of Rs. 1.2b to Rs. 1.4b going forward, that will be funded through a mix of debt and equity, leverage indicators are expected to remain higher, going forward.

M.K. Sons (Pvt.) Limited Annexure I

FINANCIAL SUMMARY (*amounts in PKR millions*)			
BALANCE SHEET	**FY20**	**FY21**	**7MFY22**
Non-Current Assets	3,230	5,527	5,592
Stores, Spares, and Loose Tools	422	543	642
Stock-in-Trade	3,445	4,721	5,835
Trade Receivables	709	1,190	1,941
Tax Refund Due from Govt.	961	1,471	1,517
Advances & Deposits	84	123	163
Cash & Bank Balance	84	54	59
Total Assets	**8,935**	**13,629**	**15,749**
Trade and Other Payables	1,248	1,703	2,147
Short-Term Borrowings	3,869	5,128	6,611
Long-Term Borrowings *(Inc. current matur)*	944	1,437	1,283
Other Liabilities	130	223	227
Total Liabilities	6,192	8,492	10,269
Tier-1 Equity	**2,743**	**3,200**	**3,543**
Paid up Capital	**500**	**500**	**500**
INCOME STATEMENT	**FY20**	**FY21**	**7MFY22**
Net Sales	9,983	14,044	10,414
Gross Profit	1,337	2,081	1,606
Profit Before Tax	321	614	446
Profit After Tax	214	456	342
FFO	467	909	506
RATIO ANALYSIS	**FY20**	**FY21**	**7MFY22**
Gross Margin (%)	13.4	14.8	15.4
Net Margin (%)	2.1	3.2	3.3
Current Ratio	1.09	1.10	1.10
Net Working Capital	486	741	955
FFO to Long-Term Debt	0.49	0.63	0.68*
FFO to Total Debt	0.10	0.14	0.11*
Debt Servicing Coverage Ratio (x)	1.54	3.18	1.33
Gearing (x)	1.75	2.05	2.23
Debt Leverage (x)	2.26	2.65	2.90
Inventory + Receivable/Short-term Borrowings (x)	1.07	1.15	1.18

**Annualized*

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	Annexure III
Name of Rated Entity	M.K. Sons (Pvt.) Limited
Sector	Textile
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings
Rating History	

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
22-04-2022	A-	A-2	Stable	Reaffirmed
05-03-2021	A-	A-2	Stable	Maintained
27-04-2020	A-	A-2	Rating Watch Negative	Maintained
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 Meeting Conducted

Name	Designation	Date
Mr. Rehman Iqbal	Deputy GM Finance	March 24, 2022