The Pakistan Credit Rating Agency Limited

Rating Report

M.A. Aleem Khan and Sons (Pvt.) Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
27-Aug-2019	BBB+	A2	Stable	Maintain	-
28-Feb-2019	BBB+	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

M. A. Aleem Khan & Sons (Pvt) Limited (MAAKSONS) has been in the construction industry for many decades. The company has three generations of the sponsoring family in the business and has two main offices – Lahore and Islamabad. The sponsors have a very good understanding of the business. The reporting and functional responsibilities are clearly demarcated. The company has delivered multiple projects. MAAKSONS has a no limit contract license. Construction business is dependent on award of contract works. Given the slowdown in the economic activity, maintaining a continued healthy business pipeline would be a challenge. Alternatively, the company has a portfolio of properties. The envisaged strategy is to develop these properties to ensure revenue sustainability in the future. Properties are diverse and furnish different propositions to translate them into revenue streams. Although top-line for FY19 was robust, the latest numbers reflect a somewhat sustainable trend-line. FY18 numbers were exceptionally well due to a few big ticket projects which were completed. The company has a mix of funded and non-funded banking lines to facilitate its business. The control environment may be strengthened by harnessing the audit quality and adopting quarterly accounts. The company has a defined strategy of building assets, required for its operations as well as investment purpose, through surplus cash. Occasionally, funded facilities are also utilized to finance acquisition.

The ratings are dependent on sustaining a steady revenue stream and financial risk profile. Any prolonged downturn in subdued business activity can negatively affect profitability. Good corporate governance practice is considered essential.

Disclosure

Name of Rated Entity	M.A. Aleem Khan and Sons (Pvt.) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	PACRA_Methodology_Corporate_FY19(Jun-19),PACRA_Crtieria_LT ST Relationship_FY19(Jun-19),PACRA_Criteria_Rating Modifiers_FY19(Jun-19)
Related Research	Sector Study | Construction(Mar-19)
Rating Analysts	Muhammad Obaid | muhammad.obaid@pacra.com | +92-42-35869504

Profile

Legal Structure M Aleem Khan & Sons (MAAKSONS) was officially registered as a Private Limited Company in 1984 but has been in business since 1951.

Background The Company commenced its business in 1951 with Public Works Development Authority and Irrigation Department thus successfully completing various projects of water management and irrigation systems. MAAKSONS scope of work comprises of construction of Roads and Highways, Bridges & Structures, Residential and Commercial Buildings, Canals and Tunnels, etc. Its consolidated turnover for the last 4 years is in excess of PKR 12 billion.

Operations Presently the Company holds “no limit” C-A license from Pakistan Engineering Council. Different license codes range from C-6 to C-A based on the contract value allowed to undertake within that contract band. Significant projects to its credit are Signal Free Corridor on Islamabad Highway and in DHA Lahore, Metro Lahore, 29 storey Telecom Tower Islamabad, Gulberg Green, 3x210 Thermal Power Station Muzaffargarh, Chashma Canal, etc. to name a few.

Ownership

Ownership Structure Mr. M. Aleem Khan, the founder of the company is identified as the man at the last mile and is entrusted with the oversight of the entire business.

Stability MAAKSONS is entirely a family owned business where the third generation has also joined in the recent years. The hierarchy has clear lines of authority terminating at the MD. His two sons and grandsons look after their respective areas. The two sons of M Nadeem Khan, Shehzer Khan and Shahnawaz Khan took over the ownership from their mother and aunt in 2016.

Business Acumen The sponsoring family has been in the construction industry for over four decades with the MD having 60+ years of rich industry experience. The sponsors have a thorough understanding of the business as they are all actively involved in the running of the day to day affairs.

Financial Strength MAAKSONS has an adequate financial profile. The entity has a few subsidiaries, namely, MAAKCRETE, MAAK Asphalt, and MAAK Gas which have the main purpose of serving the parent organization. They are trying to diversifiy their business somewhat by entering the agriculture and dairy industry and also own MAAK Agro and MAAK Farms.

Governance

Board Structure The overall control of the company vests in three senior directors; MD and his two sons. Out of the 9 shareholders, seven male members of the family are executive directors whereas the two daughters-in-law of Mr M Aleem Khan are silent partners. There is no independent director on the board, hence the governance structure needs improvement.

Members’ Profile Three of the board members carry extensive experience of the construction industry, while the other board members are relatively new in the Industry. The two sons of M Aleem Khan, M Waseem Khan and M Nadeem Khan joined the business in 1980s and have more than four decades of experience.

Board Effectiveness The Board members are actively involved in the planning and execution of the business projects and overseeing the operations on a regular basis.

Financial Transparency An independent director on the Board would ensure effective, transparent and independent oversight of the company’s operations. The governance model is weak and needs improvement in order to comply with the corporate governance model. The company is in the practice of forming quarterly accounts. M/s. Kamran & Co. Chartered Accountants is the external auditor of the company and has expressed an unqualified audit opinion on the financial statements for the year ended June 30th, 2018

Management

Organizational Structure The company operations are divided into two regions, Islamabad and Lahore, which operate independently under the oversight of MD/Chairman M A Aleem Khan. Company head office is in Lahore while in Islamabad is the regional office. Business pertaining to Lahore region is under the management of M Waseem Khan and his two sons.

Management Team MAAKSONS has a team of experienced and competent professionals who have been with the entity over a long period of time.

Effectiveness Functions of the management are clear and well-defined to effectively achieve its underlying goals and objectives. System of internal control is in place, although continuous review of these controls by an internal audit department would ensure further effectiveness of the management.

MIS MAAKSONS is currently using Axiom ERP System for generating daily reports in order to track project specific progress. It is a web based system which is accessible to all the staff working on project and generates reports on supplier, procurement, and inventory etc.

Control Environment MAAKSONS adheres to strict quality control standards as it is the need of the construction industry. The company maintains a comprehensive MIS reporting system for the management to keep track of its different project sites and activities.

Business Risk

Industry Dynamics Construction sector’s share in GDP in FY18 was 2.82% against a share of 2.74% last year. This sector has witnessed a growth of ~9% against a growth of ~10% last year, as many CPEC related projects were ongoing during 2016-17. For FY19 the Federal Government has allocated PKR ~800 bln under PSDP spending, and considering 70% utilization history, there is a major cut in the expected construction activity which doesn’t bode very well for the economy. Although if / when PMs’ ambitious plan to build 5 million houses goes through it would provide a major impetus to the debilitating construction industry.

Relative Position Out of the 10,000+ firms registered with Pakistan Engineering Council as Constructors / Operators, only ~100 (1%), including MAAKSONS, hold the prestigious CA category (no limit) license which enables them to be on the pre-qualifying list of approved constructors.

Revenues During FY18 Signal Free Corridor in DHA Lahore which had a 9 month deadline added a significant jump in the revenues. For 6MFY19, revenue stands at PKR 1,568mln (FY18: 5,300mln; FY17: PKR 3,220mln; FY16: PKR 2,930mln; FY15: PKR 1,229mln), although there are more projects in pipeline which would add to the topline in the remaining 6 months.

Margins Like other companies in the construction industry, MAAKSONS has also experienced an erratic and less predictable topline primarily due to project based contractual nature of revenue. Short term borrowing increased by PKR 554mln at the end of 6MFY19. MAAKSONS posted a meager net profit of PKR 86.5mln for the 6MFY19 but the management is expecting major upcoming projects in the remaining 6 months.

Sustainability Given the slowdown in the economic activity, maintaining a continued healthy business pipeline would be a challenge. Although FY18 depicted robust results, the latest numbers reflect squeeze.

Financial Risk

Working Capital For working capital needs, which is a function of inventory and receivables, a company relies on both internal cash flows as well as short term borrowing (STB). MAAKSONS working capital management is good with improving negative net working capital days (FY18: -104 days, FY17: -23 days). During FY18, MAAKSONS added 330mln in STBs resulting in short-term total leverage of the company (room to borrow) reducing to 18% (FY17: 23%).

Coverages During 6MFY19, MAAKSONS free cash flows (FCFO), amounted to ~182PKR mln (FY18: PKR 516mln; FY17: PKR 375mln). Core debt coverage ratio has reduced considerably during the period and would deteriorate further if additional business isn’t realized in the remaining period (6MFY19: 2.4x, FY18: 3.2x, FY17: 3.4x). The company is utilizing 96% from its borrowing limit of PKR 750mln.

Capitalization At end-6MFY19, the company had a slightly leveraged capital structure, with a debt to debt plus equity ratio of 15.6% (FY18: 17%, FY17: 22%, FY16: 18%). Long term borrowings have reduced to PKR 117mln during the period (FY18: PKR 143mln, FY17: PKR 167mln) largely in response to slower business and retiring long term leases. Major portion of debt comprises STB.

M. A. Aleem Khan & Sons (Pvt) Ltd

BALANCE SHEET	31-Dec-18	30-Jun-18	30-Jun-17	30-Jun-16
	1H-FY19	Annual	Annual	Annual
Non-Current Assets	**1,807**	**1,841**	**1,462**	**1,450**
Investments (Incl. Associates)	**-**	**-**	**-**	**-**
Equity	-	-	-	-
Debt Securities	-	-	-	-
Investment Property	860	451	497	-
Current Assets	**2,630**	**3,356**	**2,741**	**2,716**
Inventory	-	-	-	-
Trade Receivables	742	544	318	269
Others	1,889	2,811	2,422	2,447
Total Assets	**5,297**	**5,648**	**4,700**	**4,166**
Debt	**1,072**	**545**	**690**	**481**
Short-Term	972	401	523	403
Long-term (Incl. Current Maturity of Long-Term Debt)	100	143	167	79
Other Short-Term Liabilities	1,387	2,352	1,595	1,536
Other Long-Term Liabilities	-	-	-	-
Shareholder's Equity	**2,838**	**2,752**	**2,415**	**2,149**
Total Liabilities & Equity	**5,297**	**5,648**	**4,700**	**4,166**
INCOME STATEMENT				
Turnover	**1,568**	**5,300**	**3,220**	**2,930**
Gross Profit	306	901	643	581
Other Income	(1)	2	0	1
Financial Charges	(46)	(55)	(44)	(31)
Net Income	**87**	**337**	**266**	**256**
Cashflow Statement				
EBITDA	293	861	576	526
Free Cashflow from Operations (FCFO)	182	516	375	323
Net Cash changes in Working Capital	(467)	132	(7)	(16)
Net Cash from Operating Activities	(313)	592	326	280
Net Cash from InvestingActivities	(456)	(337)	(339)	(396)
Net Cash from Financing Activities	510	(230)	(3)	314
Net Cash Generated during the period	(259)	25	(16)	199
Ratio Analysis				
Performance				
Turnover Growth (same period last year)	-70.4%	64.6%	9.9%	138.5%
Gross Margin	19.5%	17.0%	20.0%	19.8%
Net Margin	5.5%	6.4%	8.3%	8.7%
ROE	12.0%	13.0%	11.7%	12.7%
Coverages				
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Unco	26.1	3.2	3.4	5.2
Interest Coverage (x) (FCFO/Gross Interest)	26.1	9.3	8.5	10.5
Debt Payback (Years) (Total Lt.Debt (excluding Covered Short T	0.0	0.3	0.5	0.3
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Day	-38	-39	-21	-8
Capital Structure (Total Debt/Total Debt+Equity)	18%	17%	22%	18%

Credit Rating Scale & Definitions

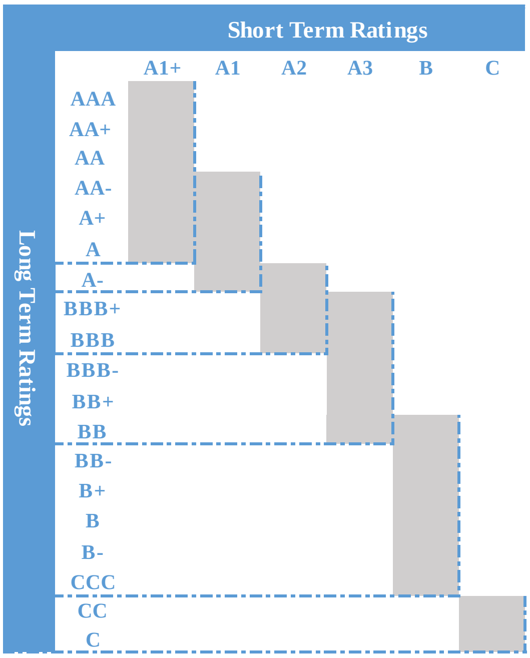
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings

AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk “CCC” Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. “CC” Rating indicates that default of some kind appears probable. “C” Ratings signal imminent default.
D	Obligations are currently in default.

Short Term Ratings

A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
C	An inadequate capacity to ensure timely repayment.



Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. ‘Stable’ outlook means a rating is not likely to change. ‘Positive’ means it may be raised. ‘Negative’ means it may be lowered. Where the trends have conflicting elements, the outlook may be described as ‘Developing’.

Rating Watch Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Disclaimer: PACRA's ratings are an assessment of the credit standing of entities/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA's opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security’s market price or suitability for a particular investor.

Regulatory and Supplementary Disclosure

(Credit Rating Companies Regulations,2016)

Rating Team Statements

(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**

i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions

(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business

(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest

(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review

(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)

Probability of Default

(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)

Proprietary Information