The Pakistan Credit Rating Agency Limited

# Rating Report

# Matracon Pakistan (Pvt.) Limited

**Report Contents**



**Rating History**

| Dissemination Date | Long Term Rating | Short Term Rating | Outlook | Action | Rating Watch |
|---|---|---|---|---|---|
| 29-Apr-2021 | BBB | A2 | Stable | Initial | - |

## Rating Rationale and Key Rating Drivers

Matracon Pakistan holds experience in construction industry of Pakistan for over two decades. Matracon has delivered multiple, public and government projects of which the completion spanned a number of years. Matracon embarks upon large infrastructure projects in collaboration with different international JV partners including Chinese and Japanese, which in their own right are established institutions. Matracon was originally focused on roads construction and drainage systems, but recently the Company is focusing on designing buildings. Construction industry's prospects seems to be promising in terms of increasing PSDP funding and civil works related to CPEC and otherwise all around the country. Matracon reported adequate profit margins in FY20, though in 1HFY21, the management has reported higher net profits. The trends towards the full year is yet to be seen. The business pipeline reflects fewer projects, though the management is hopeful of gaining new projects based upon current picked up pace in construction sector however the tussle in margins still remain critical. This is owing to the number of construction players and tougher competition. The business funding needs has been met by non-funded lines of banks and JV partner's guarantees. Equity base of the Company is adequate especially when compared with the non-funded obligations assumed by the Company.

The ratings are dependent on the sustainability of the business and its financial structure; sustaining a steady revenue stream and financial risk profile. Financial metrics need to be upheld as well. Strengthening of projects pipeline is also essential for the ratings. Any prolonged downturn in subdued business volume can have a detrimental effect on the rating. Improvement in governance and control environment is also important and needs to be strengthened.

| Disclosure | |
|---|---|
| **Name of Rated Entity** | Matracon Pakistan (Pvt.) Limited |
| **Type of Relationship** | Solicited |
| **Purpose of the Rating** | Entity Rating |
| **Applicable Criteria** | Methodology \| Corporate Ratings(Jun-20),Methodology \| Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria \| Rating Modifier(Jun-20) |
| **Related Research** | Sector Study \| Construction(Mar-21) |
| **Rating Analysts** | Anam Waqas Ghayour \| anam.waqas@pacra.com \| +92-42-35869504 |

## Profile

**Legal Structure** Matracon Pakistan Pvt. Ltd. (hereinafter referred to as ‘‘the Company’’ or ‘‘Matracon’’) is a Pvt Limited Company (unquoted) incorporated in 2006.

**Background** Mr. Abdul Qadir established Matracon as a sole proprietorship in 1995 in Quetta with an ambitious plan after having entrepreneurial experience of years. Later the initial business in Quetta was closed and a new office was established under the name of ‘Matracon Pakistan, which in 2006 converted to Pvt. Limited Company.

**Operations** Matracon Pakistan Pvt. Ltd. is registered with the Pakistan Engineering Council (PEC) and holds the C-A (no limit) license. Different license codes range from C-6 to C-A based on the contract value allowed to undertake, within a specific contract band. The Company is capable of handlings projects related to constructing drainage system, civil construction, roads, and provision of construction-related services on a contract basis.

## Ownership

**Ownership Structure** Matracon Pakistan Pvt. Ltd is mainly owned and managed by Mr. Muhammad Abdul Qadir, with an ownership stake of 99.9% while the remaining 0.1% shares are owned by Mr. Muhammad Ayub.

**Stability** Matracon is majority-owned by M.Qadir but it needs to have formal succession planning in order to ensure that future prospects are taken care of in the hour of need.

**Business Acumen** The business acumen of sponsors is considered adequate.

**Financial Strength** Matracon is the prime asset of the sponsor. He owns another building in his personal name through which rental income is generated.

## Governance

**Board Structure** Matracon has a two-member board. The affairs of the company are directly managed by the owners. Hence, there is no board per se. The governance structure hence would require improvement.

**Members’ Profile** The CEO - Mr. Muhammad Abdul Qadir, is the founding member, has over ~26 years of evolving expertise. Only one board member has the relevant industry experience however, both members have been associated with the Board since the company’s incorporation.

**Board Effectiveness** The Company conducts board meetings on a quarterly basis and the minutes are not available. Board committees are not properly formed and there is the single position of CEO and chairperson of the board that represents the structure that requires improvement.

**Financial Transparency** M/s. Zahid Jamil & Co Chartered Accountants, categorized in ‘B category’ on a panel of auditors maintained by the State Bank of Pakistan, is the external auditor of the company. The auditor has expressed an unqualified opinion on Matracon Pakistan Pvt. Ltd.’s financial statements for the year ended June 30th, 2020.

## Management

**Organizational Structure** Matracon is working with six key functions namely (i) Finance, (ii) Marketing, (iii) Admin & HR, (iv) IT (v)Engineering,(vi) Procurement, reporting to the MD. Each division is working with the whole team including technical staff & senior managers reporting to their respective GMs.

**Management Team** Mr. Muhammad Abdul Qadir – the CEO and the Director of M/s Gammon Pakistan Limited, is the execution lead who oversees the business and all the matters pertaining to local clients. The CEO is supported by a team consists of seasoned experienced professionals. The Company is in process of hiring a Chartered Account as CFO.

**Effectiveness** Since the company has a lean and structured organizational structure with the sponsors looking after the day-to-day operations, Matracon needs to have formal management committees in place which can monitor performance and assure adherence to the policies and procedures.

**MIS** Matracon is currently using customized accounting software from 'Intuit' Quickbooks Enterprise Solutions for its bookkeeping and accounting needs.

**Control Environment** The Company adheres to strict quality control standards as it is certified under ISO 9001:2005 which is also the need of the construction industry.

## Business Risk

**Industry Dynamics** The construction sector share in GDP for FY19-20 recorded an uptick of 2.85% from the previous year (FY18-19: 2.82%). This status quo contribution is on account of the economic slowdown which was experienced due to the globally declared pandemic - Covid19. There are a number of other factors that have been slowing growth, including GoP insignificant increase in the PSDP funding, growing inflation, and interest rates. However now the Govt. has taken major infrastructure projects under the Naya Lahore scheme and Naya Pakistan Housing Scheme which will kick the economic activity along with CPEC near completion and there will be a lot more clarity on the economy's direction in the upcoming fiscal years.

**Relative Position** Out of the 10,000+ firms registered with Pakistan Engineering Council as Constructors / Operators, only ~100 (1%) hold the prestigious CA category (no limit) license. Matracon Pakistan Pvt. Ltd., holding the CA category license caters to the needs of the niche market.

**Revenues** Matracon, in recent years, has witnessed a consistent increase in its revenues, primarily due to the nature and size of the contracts initiated in a given year. During 1HFY21, the entity’s revenues witnessed a ~49% increase on a period basis. (FY20: 6.5bln; FY19: PKR 4.3bln; FY18: PKR 3.6bln), while in 1HFY21 turnover was about PKR 4.9bln. The Company has reported a significant growth in revenues which is contrary to the industry trend as there was a halt in infrastructural activities experienced due to the COVID-19 pandemic in FY20. The construction sector is subject to a cyclical hike in sales during the months of Mar-Jun which were severely impacted on account of country-wide lockdown; however, the company managed to make timely collections from projects.

**Margins** During 1HFY21, along with the topline saw a humble growth, a proportionate inflationary impact in the cost of sales contributed to narrow down gross margins (1HFY21: 17%; FY20: 16%; FY19: 15%). The operating margin stayed in line with the gross margin trend on the back of prudent management of overhead expenses (1HFY21: 10%; FY20: 9%; FY19: 8.6%). With the absence of finance charges on account of non-interest-bearing financing arrangement from directors, the Company managed to report profits for the period (1HFY21: PKR 162mln; FY20: PKR 97mln; FY19: 51mln).

**Sustainability** The Company’s management furnished reliable budgets and forecasts which reflects the strategy of the management and viability of the design path to reach the goal. After the pandemic, the revival of the industry is expected on the back of Govt. planned massive infrastructural projects which will further strengthen the Matracon Pak’s revenues in upcoming periods.

## Financial Risk

**Working Capital** For working capital needs, which is a function of inventory and receivables, a company relies on both internal robust and sustained cash flow stream. Over the period, the company has reported an increasing tendency in reported operational cashflows (EBITDA- 1HFY21: PKR 573mln; FY20: PKR 542mln, FY19: PKR 466mln). On account of better cash flow management and increased revenue from ongoing projects, the company’s net cash cycle is portraying a strong position (1HFY21 22days; FY20 34days; FY19: 45days).

**Coverages** Matracon Pakistan Pvt. Ltd acquired interest-bearing financing facilities - neither on long term nor short-term basis. The company has demonstrated remarkable growth in its operating cash flows over the period as demonstrated in the adjacent graphical presentation. During 1HFY21, Company’s operating cash flows (FCFO) increased to PKR 233mln (FY20: PKR 251mln; FY19: 143mln), on the back of a strong cash-flow stream and no cost on financing, the company has the strength to explore capital markets in order to expand its operations. While current ratio stood at 1.8x on account of a higher proportion of holding cash during the period (FY20: 1.7; FY19: 1.9; FY18: 1.5).

**Capitalization** The Company had a declining leveraged capital structure as compared to the previous year with a debt to debt plus equity ratio of (FY20: 10%; FY19: 16%; FY18: 18%). The major portion of debt comprises loans from directors which is a non-interest bearing arrangement. The company has also maintained non-funded obligations of PKR 9bln.

The Pakistan Credit Rating Agency Limited

*Financial Summary*
*PKR mln*

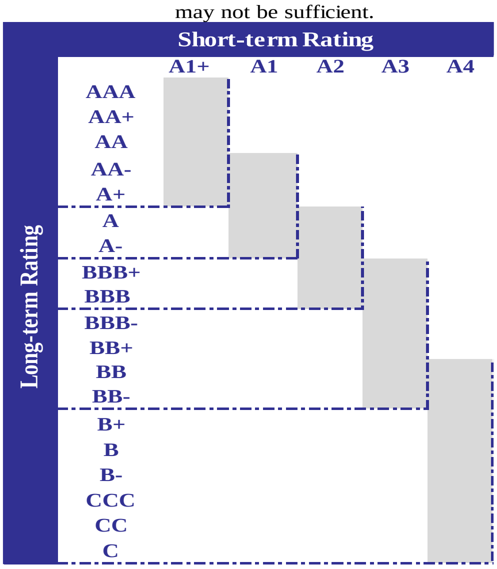
| Matracon Pakistan Pvt Ltd. | Dec-20 | Jun-20 | Jun-19 | Jun-18 | Jun-17 |
|---|---|---|---|---|---|
| Construction | 6M | 12M | 12M | 12M | 12M |
| **A BALANCE SHEET** | | | | | |
| 1 Non-Current Assets | 1,816 | 1,834 | 1,401 | 932 | 903 |
| 2 Investments | 526 | 526 | 1,060 | 1,060 | 1,060 |
| 3 Related Party Exposure | - | - | - | - | - |
| 4 Current Assets | 2,784 | 3,230 | 2,084 | 1,270 | 1,011 |
| *a Inventories* | *882* | *802* | *801* | *521* | *385* |
| *b Trade Receivables* | *561* | *510* | *427* | *191* | *159* |
| **5 Total Assets** | 5,126 | 5,590 | 4,545 | 3,263 | 2,975 |
| 6 Current Liabilities | 1,572 | 1,852 | 1,091 | 830 | 571 |
| *a Trade Payables* | *751* | *830* | *492* | *394* | *277* |
| 7 Borrowings | - | - | - | - | - |
| 8 Related Party Exposure | 340 | 340 | 370 | 494 | 528 |
| 9 Non-Current Liabilities | 1,405 | 1,767 | 1,549 | 455 | 474 |
| **10 Net Assets** | 1,810 | 1,632 | 1,535 | 1,484 | 1,401 |
| **11 Shareholders' Equity** | 1,810 | 1,632 | 1,535 | 1,484 | 1,401 |
| **B INCOME STATEMENT** | | | | | |
| **1 Sales** | 4,859 | 6,546 | 4,300 | 3,605 | 3,231 |
| *a Cost of Good Sold* | *(4,027)* | *(5,502)* | *(3,654)* | *(3,049)* | *(2,720)* |
| **2 Gross Profit** | 832 | 1,044 | 646 | 556 | 511 |
| *a Operating Expenses* | (339) | (467) | (276) | (229) | (215) |
| **3 Operating Profit** | 493 | 577 | 370 | 327 | 296 |
| *a Non Operating Income or (Expense)* | *10* | *12* | *3* | *9* | *4* |
| **4 Profit or (Loss) before Interest and Tax** | 502 | 588 | 373 | 336 | 300 |
| *a Total Finance Cost* | - | - | - | - | - |
| *b Taxation* | *(340)* | *(491)* | *(323)* | *(252)* | *(226)* |
| **6 Net Income Or (Loss)** | 162 | 97 | 51 | 84 | 74 |
| **C CASH FLOW STATEMENT** | | | | | |
| *a Free Cash Flows from Operations (FCFO)* | *233* | *251* | *143* | *110* | *98* |
| *b Net Cash from Operating Activities before Working Capital Changes* | *233* | *251* | *143* | *110* | *98* |
| *c Changes in Working Capital* | *(526)* | *215* | *(435)* | *18* | *(1)* |
| **1 Net Cash provided by Operating Activities** | (293) | 466 | (292) | 129 | 97 |
| **2 Net Cash (Used in) or Available From Investing Activities** | (38) | (53) | (561) | (56) | (51) |
| **3 Net Cash (Used in) or Available From Financing Activities** | (362) | 187 | 970 | (54) | (42) |
| **4 Net Cash generated or (Used) during the period** | (692) | 600 | 117 | 19 | 3 |
| **D RATIO ANALYSIS** | | | | | |
| **1 Performance** | | | | | |
| *a Sales Growth (for the period)* | 48.5% | 52.2% | 19.3% | 11.6% | -- |
| *b Gross Profit Margin* | 17.1% | 15.9% | 15.0% | 15.4% | 15.8% |
| *c Net Profit Margin* | 3.3% | 1.5% | 1.2% | 2.3% | 2.3% |
| *d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)* | -6.0% | 7.1% | -6.8% | 3.6% | 3.0% |
| *e Return on Equity [ Net Profit Margin * Asset Turnover * (Total Assets/Sha* | 17.1% | 6.6% | 3.8% | 5.9% | 5.3% |
| **2 Working Capital Management** | | | | | |
| *a Gross Working Capital (Average Days)* | 52 | 71 | 82 | 64 | 18 |
| *b Net Working Capital (Average Days)* | 22 | 34 | 45 | 30 | -13 |
| *c Current Ratio (Current Assets / Current Liabilities)* | 1.8 | 1.7 | 1.9 | 1.5 | 1.8 |
| **3 Coverages** | | | | | |
| *a EBITDA / Finance Cost* | N/A | N/A | N/A | N/A | N/A |
| *b FCFO / Finance Cost+CMLTB+Excess STB* | N/A | N/A | N/A | N/A | N/A |
| *c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)* | 0.7 | 1.2 | 2.3 | 4.2 | 5.1 |
| **4 Capital Structure** | | | | | |
| *a Total Borrowings / (Total Borrowings+Shareholders' Equity)* | 14.5% | 15.8% | 18.0% | 23.7% | 26.1% |
| *b Interest or Markup Payable (Days)* | N/A | N/A | N/A | N/A | N/A |
| *c Entity Average Borrowing Rate* | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |

## Credit Rating

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 Rating | |
|---|---|
| **Scale** | **Definition** |
| AAA | **Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments |
| AA+<br>AA<br>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+<br>A<br>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+<br>BBB<br>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+<br>BB<br>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+<br>B<br>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<br>CC<br>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 Rating | |
|---|---|
| **Scale** | **Definition** |
| 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 |
| A4 | The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient. |




**The correlation shown is indicative and, in certain cases, may not hold.*

**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 some material identifiable event with indeterminable rating implications. 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 rating 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) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) 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.

**Surveillance.** Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

**Note.** This scale is applicable to the following methodology(s):

**Entities**
a) Broker Entity Rating
b) Corporate Rating
c) Financial Institution Rating
d) Holding Company Rating
e) Independent Power Producer Rating
f) Microfinance Institution Rating
g) Non-Banking Finance Companies (NBFCs) Rating

**Instruments**
a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk Rating

## 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**