



The Pakistan Credit Rating Agency Limited

Rating Report

Zahir Khan & Brothers

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
02-Feb-2022	A	A2	Stable	Maintain	-
10-Mar-2021	A	A2	Stable	Maintain	-
10-Mar-2020	A	A2	Stable	Maintain	-
30-Aug-2019	A	A2	Stable	Maintain	-
01-Mar-2019	A	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect Zahir Khan & Brothers' (ZKB) financial & business strength. ZKB is known for undertaking large infrastructure projects in collaboration with different JV partners. ZKB is led by Zahir Khan and family - a name well known in the construction industry. Over the years, ZKB has delivered huge projects, of which the completion spanned a number of years. ZKB has experience of decades that brings expertise in understanding of business dynamics and various risks prevalent in this business. The company faced a period of low contracting activity partly due to muted growth in the construction industry and later on due to outbreak of Covid-19. However, the pipeline of current and upcoming projects is quite healthy now and future flow of business is expected to improve as the Company has managed to acquire a large project in the roads construction segment on BOT basis. ZKB has booked net profit of PKR 359 mln in 3MFY22 (FY21: PKR 902 mln; FY20: PKR 3,996 mln; FY19: PKR 2,992 mln). The business funding needs have historically been met by non-funded lines of banks and supplier credit but the company has recently procured short term borrowing lines to support working capital requirements.

The ratings are dependent on the upcoming big projects undertaken by management for sustainability of the business and financial structure of ZKB. Governance and corporate structure is evolving to be complied with best practices and improved financial transparency. Although management has expressed its mandate to corporatize its structure. Financial metrics need to be upheld as well.

Disclosure

Name of Rated Entity	Zahir Khan & Brothers
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Corporate Rating(Jun-21),Criteria Correlation Between Long-term & Short-term Rating Scales(Jun-21),Criteria Rating Modifiers(Jun-21)
Related Research	Sector Study Construction(Mar-21)
Rating Analysts	Uswa Sikandar uswa.sikandar@pacra.com +92-42-35869504

Profile

Legal Structure Zahir Khan & Brothers (ZKB) is a Partnership Firm established in 1970.

Background ZKB, as an industry leader in construction, currently nurtures projects that span across such diverse segments as transportation, power, road mapping, oil and gas pipeline constructions, irrigation and water supply, utilities, and urban infrastructure, all of which impact the nation of Pakistan. With a large number of projects, ZKB's portfolio has covered the entire spectrum of construction work in every corner of the country. The firm's head office is based in Islamabad.

Operations ZKB is registered with the Pakistan Engineering Council (PEC) and holds the 'CA' class with a 'NO LIMIT', license. It has a huge range of construction equipment such as pavers, power curber, asphalt plants, bitumen distributors, transit mixers, rotary drilling machines, gantry cranes, straddle carriers, milling machines, etc. The firm has permanent staff employees and additional labor is temporarily hired according to the requirement of projects.

Ownership

Ownership Structure ZKB is registered as a Partnership firm and owned by 4 Partners. Mr. Zahir Khan owns 51%, Mr. Mohabbat Khan owns 41%, Mr. Suleman and Mr. Samiullah hold 4% each respectively.

Stability ZKB is majority-owned by Mr. Zahir Khan but it needs to have formal succession planning in order to ensure future prospects are taken care of in the hour of need.

Business Acumen The key founder CEO of ZKB, Mr. Zahir Khan with deep hands-on knowledge has extensive construction industry experience of nearly 4 decades.

Financial Strength ZKB is entirely equity-financed and if the future need arises, the sponsors stand by to support them as they have a sound financial profile.

Governance

Board Structure The overall control of the firm vests in the 04 partners. Apart from the CEO, three partners have executive roles. The governance structure has room for improvement as currently, ZKB is still a partnership concern.

Members' Profile All the board members are experienced individuals. Three of them carry around ten years' experience of the construction industry. Mr Zahir Khan, CEO, and the founding member of ZKB, has nearly four decades of experience in construction sector. He is the person behind the success of the firm leading with his visionary leadership.

Board Effectiveness There is as such no board committee. All partners also have management positions in the company which inhabits the room for impartial oversight and strong governance.

Financial Transparency M/s. RSM Avais Hyder Liaquat Nauman Chartered Accountants, is the external auditor of the firm. The auditors have expressed an unqualified audit opinion on the financial statements of Zahir Khan & Brothers for the year ended June 30, 2021.

Management

Organizational Structure : A simplified organizational structure exists in ZKB. Operations are segregated into six broad departments, (i) Bidding, (ii) Information Technology, (iii) Contract Management, (iv) Construction, (v) Admin & HR, and (vi) Finance. Clear lines of responsibility are defined for each department.

Management Team Mr Zahir Khan (CEO) is involved in key decisions of the firm specifically pertaining to bidding for the contracts from the government. Execution is being carried out by project managers under supervision of the Director (Technical Services) & COO, Mr Mohabbat Khan, who is a business man and has 14 years of experience in the construction sector. He is supported by an able core management team having ample experience.

Effectiveness With the support of a qualified and experienced team of professionals, ZKB is building up the business strengths and increasing its foot print across Pakistan. Functions of the management are clear and well-defined to effectively achieve its underlying goals and objectives. The system of internal control is in place and has been effectively implemented.

MIS ZKB is currently using SARAP (ERP/oracle) software customized for the construction industry. The software keeps track of receivables, payables, general ledger, accounts, etc.

Control Environment ZKB follows a balanced and environment-friendly growth strategy in all their operations and has adopted sustainable growth principles that emphasize diminishing the environmental harm to a minimum & upholding social stakeholder and social values.

Business Risk

Industry Dynamics The construction sector contributed almost PKR-794bln to the Gross Domestic Product (GDP) of Pakistan in FY20 (FY19: PKR-734bln), registering a growth of ~8.1% YoY basis. The major demand driver for the construction sector is the Public Sector Development Programme (PSDP) expenditure followed by Private Investments. Majority of the construction revenue is from government contracts ranging from building of Infrastructure to Highways, Offices and Airports. The budgeted size of PSDP allocation for FY21 is PKR~1,324bln (FY20: PKR~1,155bln). With the increased allocation coupled with other initiatives, the outcome looks encouraging. PSDP expenditure is highly correlated to construction sector activity.

Relative Position Out of the 10,000+ firms registered with Pakistan Engineering Council as Constructors / Operators, only ~100 (1%), including ZKB, hold the prestigious CA category (no limit) license which enables them to be on the pre-qualifying list of approved constructors. ZKB is one of Pakistan's leading construction companies with over 4 decades of invaluable experience and has expertise in executing large and complex infrastructure projects.

Revenues During 1QFY22, the entity's top line was recorded at PKR 3.2 billion (FY21: PKR 13.7 billion; FY20: PKR 12.2 billion; FY19: PKR 22.8 billion). Revenues witnessed a significant dip in recent periods in response to the overall slowdown in economic activity due to change in government and the devastating impacts of the Covid-19 pandemic. However going forward, company expects an increase in its billing on the back of some mega projects that have been awarded to the company.

Margins The gross margins of the entity showed a slight improvement and stood at 21.7% (FY21: 17.4%; FY20: 17%; FY19: 22.3%). Further support from operating margins of 18.8% (FY21: 14.8%; FY20: 14.7%; FY19: 22.1%) positively supported the bottom line. Hence, the firm's net profit clocked at PKR359mln during 1QFY22 (FY21: PKR 902mln; FY20: PKR 3996mln; FY19: PKR 2,992mln).

Sustainability ZKB's management envisages sustainable footing in the market by planning to move to a private limited company structure instead of a partnership in the near future and will continue to work for a sustainable future with more efficient and successful projects with technical competency, experience, quality, speed, high technology, creativity, and corporate responsibility. New projects in the pipeline stand to lift the topline as the firm's eyes geographical diversity in its business stream

Financial Risk

Working Capital For working capital needs, which are a function of inventory and receivables, and payables. ZKB's trade payable days stretched to 124 (average days), therefore networking capital days showed a negative value of (38) days during the 1QFY22, in line with the previous years' trend (Net Working Capital days; FY21: (84) days; FY20: (119)days; FY19: (70)days). Furthermore, ZKB has recently included short-term borrowing into the processes, however, while considering the strength of the company's internal cashflows there's a sizable cushion for future borrowings.

Coverages In 1QFY22, ZKB's operating cash flows (FCFO) marked at PKR 599mln (FY21: PKR 2034mln; FY20: PKR 1,630mln; FY19: 4,857mln) on account of gross profit incurred PKR 694mln. The firm has not procured long-term debt so far and has been funding the business through its equity, so going forward if circumstances demand ZKB has enough room to procure debt to further fuel its already robust growth. However, ZKB has induced short-term borrowing to finance working capital requirements, therefore, the reported status of short-term borrowing is PKR 724 mln in 1QFY22 (FY21: PKR 724mln; FY20: PKR 1155mln).

Capitalization During 1QFY22, the leverage structure of the firm is 1.4% (FY21: 1.4%; FY20: 0.20%). Historically, ZKB has had no reliance on long term debt for its business requirement, however, management has incorporated short-term borrowing into the capital mix. The firm has non funded credit facility mainly in the form of bank guarantees given to project owners. These borrowings are secured against tangible collateral in the form of a mortgage over residential/commercial properties in the name of sponsors



Zahir Khan & Brothers Construction	Sep-21 3M	Jun-21 12M	Jun-20 12M	Jun-19 12M
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A BALANCE SHEET

1 Non-Current Assets	18,321	18,582	19,217	39,702
2 Investments	33,355	33,107	32,795	-
3 Related Party Exposure	818	962	769	553
4 Current Assets	13,474	16,061	17,725	20,887
<i>a Inventories</i>	1,199	845	1,205	2,066
<i>b Trade Receivables</i>	1,651	2,385	2,824	7,416
5 Total Assets	65,968	68,712	70,507	61,142
6 Current Liabilities	8,093	11,175	13,757	15,646
<i>a Trade Payables</i>	3,585	5,132	8,434	13,029
7 Borrowings	724	724	115	-
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	4,586	4,606	4,643	486
10 Net Assets	52,566	52,207	51,993	45,010
11 Shareholders' Equity	52,565	52,207	51,993	45,010

B INCOME STATEMENT

1 Sales	3,204	13,702	12,221	22,827
<i>a Cost of Good Sold</i>	(2,510)	(11,315)	(10,135)	(17,736)
2 Gross Profit	694	2,387	2,086	5,091
<i>a Operating Expenses</i>	(93)	(357)	(291)	(405)
3 Operating Profit	601	2,030	1,795	4,686
<i>a Non Operating Income or (Expense)</i>	5	117	4,993	92
4 Profit or (Loss) before Interest and Tax	606	2,147	6,788	4,777
<i>a Total Finance Cost</i>	(44)	(240)	(121)	(73)
<i>b Taxation</i>	(204)	(1,005)	(2,671)	(1,712)
6 Net Income Or (Loss)	359	902	3,996	2,992

C CASH FLOW STATEMENT

<i>a Free Cash Flows from Operations (FCFO)</i>	599	2,034	1,630	4,857
<i>b Net Cash from Operating Activities before Working Capital Changes</i>	599	2,034	1,630	4,784
<i>c Changes in Working Capital</i>	(1,368)	(1,521)	(342)	(2,300)
1 Net Cash provided by Operating Activities	(769)	513	1,288	2,485
2 Net Cash (Used in) or Available From Investing Activities	(248)	(845)	(161)	7,720
3 Net Cash (Used in) or Available From Financing Activities	(251)	1,157	(1,652)	(10,620)
4 Net Cash generated or (Used) during the period	(1,269)	826	(525)	(415)

D RATIO ANALYSIS

1 Performance				
<i>a Sales Growth (for the period)</i>	-6.5%	12.1%	-46.5%	-43.4%
<i>b Gross Profit Margin</i>	21.7%	17.4%	17.1%	22.3%
<i>c Net Profit Margin</i>	11.2%	6.6%	32.7%	13.1%
<i>d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)</i>	-24.0%	3.7%	10.5%	11.2%
<i>e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sl</i>	2.7%	1.7%	8.2%	6.5%
2 Working Capital Management				
<i>a Gross Working Capital (Average Days)</i>	87	97	202	190
<i>b Net Working Capital (Average Days)</i>	-38	-84	-119	-70
<i>c Current Ratio (Current Assets / Current Liabilities)</i>	1.7	1.4	1.3	1.3
3 Coverages				
<i>a EBITDA / Finance Cost</i>	28.1	16.2	22.5	76.3
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	20.4	10.7	15.1	66.4
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>	0.0	0.0	0.0	0.0
4 Capital Structure				
<i>a Total Borrowings / (Total Borrowings+Shareholders' Equity)</i>	1.4%	1.4%	0.2%	0.0%
<i>b Interest or Markup Payable (Days)</i>	0.0	0.0	0.0	0.0
<i>c Entity Average Borrowing Rate</i>	20.7%	52.2%	93.6%	n/a

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.

Scale	Long-term Rating Definition
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
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.
AA-	
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.
A-	
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.
BBB-	
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.
BB	
BB-	
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.
B-	
CCC	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.
CC	
C	
D	Obligations are currently in default.

Scale	Short-term Rating 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 conditions.
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 surveil 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):

<p>Entities</p> <ul style="list-style-type: none"> 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 	<p>Instruments</p> <ul style="list-style-type: none"> a) Basel III Compliant Debt Instrument Rating b) Debt Instrument Rating c) Sukuk Rating
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(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

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- (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.
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- (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)
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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)

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