The Pakistan Credit Rating Agency Limited

Rating Report

Meko Denim Mills (Pvt.) Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
26-Dec-2023	BBB+	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The Company's ratings underscore its strong business profile, exemplified by a trajectory of ascending revenues and profitability in its initial phase of operations. These ratings factor in the strong business acumen of its sponsors, establishing the group as a vertically integrated textile powerhouse. The Company functions as a composite denim unit within the textile sector. Through prudent investment in Business Modernization and Reinvestment (BMR) initiatives and expansion endeavors, Meko Denim has fortified its competitive advantage by implementing advanced technological upgrades and pursuing diversification strategies. This strategic approach has facilitated the capture of the burgeoning international market’s garments and fabric demand as well as local yarn demand, while exports are also deftly channeled through the group corporate entities of KAM International and KAM Apparel. The operational spectrum encompasses ginning, spinning, weaving, and processing. Recently, the company has ventured into the value-addition segment by adding a garment segment unit and is enjoying a good response from export destinations. A marketing strategy is devised to further enhance the current product’s penetration in international markets. The Company has witnessed a substantial upswing in top-line revenue, supported by enhanced gross profit and operating margins, thereby bolstering its overall business standing, leading to a reported bottom line of PKR 220mln in 3MFY24, a 47% surge compared to PKR 150mln recorded in FY23. The financial risk landscape reflects a less leveraged capital structure with healthy interest coverages. The strategy is to build and grow prudently through the initial phase of operations, with a focus on realizing the full potential in the forthcoming years.

The ratings are dependent on the Company’s ability to establish a strong business profile and optimal capacity utilization. Improvement in the management and reporting mechanism and governance framework would be critical for the ratings.

Disclosure

Name of Rated Entity	Meko Denim Mills (Pvt.) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating(Jul-23),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jul-23),Methodology | Rating Modifiers(Apr-23)
Related Research	Sector Study | Composite and Garments(Dec-23)
Rating Analysts	Uswa Sikandar | uswa.sikandar@pacra.com | +92-42-35869504

Profile

Legal Structure Established in 2021, Meko Denim Pvt Ltd operates as a comprehensive denim producer, separating from Mekotex Pvt Ltd to utilize its denim capacity. Engaging in spinning, weaving, dyeing, printing, and processing, the company expanded with a stitching unit in Site Area Karachi, producing around 70,000 pieces monthly. While focused on denim exports, it also sells yarn locally. The company is part of a larger group with investments in power, water supply, and home textiles.

Background Founded in 1979 by Mr. Abdul Majid Qasim, Meko Denim Group, led by sons Mr. Abdul Majeed, Mr. Khalid Majeed, Mr. Shoaib Majeed, and late Mr. Ashraf Majeed, transformed into a major denim manufacturer. Operations are managed by the family, with Mr. Shoaib overseeing denim, Mr. Khalid leading spinning, and Mr. Rayan managing the dying, printing, and processing section previously overseen by the late Mr. Ashraf.

Operations Meko Denim, based in Karachi with key facilities in Landhi, Kotri, and Site Area, is contemplating relocating its head office from Landhi to Kotri. The company operates with significant infrastructure, including 44K spindles, 234 looms, 2000 rotors, and 200 stitching machines, supporting its comprehensive operations. Currently, it relies on a 7MW gas-powered turbine for energy, with plans to shift towards renewable energy in the future.

Ownership

Ownership Structure Ownership of the company is vested in the family of Mr. Shoaib and Mr. Khalid Majeed. Mr. Shoaib Majeed holds the majority stake, owning 55% of the shares, while Mr. Khalid Majeed possesses a 25% share. Additionally, Mrs. Kiran Bano, the wife of Mr. Shoaib, holds a 20% share in the company.

Stability Meko Denim Pvt. Ltd. exhibits stability in its business operations. Bolstered by a comprehensive approach to denim production and strategic expansion into diverse sectors, the company has secured a solid position in Pakistan's denim industry. The family-centric ownership structure, led by Mr. Shoaib Majeed, ensures continuity and a hands-on approach.

Business Acumen CEO Mr. Shoaib Majeed, a Business Administration graduate, oversees various roles within the family business. Mr. Khalid Majeed, with an MBA, serves as Managing Director, managing expansions, marketing, HR, and more.

Financial Strength The group's businesses, including Meko Denim, generate income from textiles, energy, and water supply projects. Annual turnover exceeds USD 60 million, supported by interest-free loans and equity injections.

Governance

Board Structure Controlled by a 5-member Board of Directors, the company is working on strengthening its governance framework by introducing independent directors.

Members' Profile The Board members have diversified experience and knowledge of the textile industry at local and international levels which assists in providing useful insight into developing strategy.

Board Effectiveness At Meko Denim there are no formal board meetings or a system to record the board minutes, however, financial information and financial decisions are presented in Excel sheets and communicated to finance as such after all brothers have agreed upon. There are no board committees and a great degree of centralized control of the CEO over the operations.

Financial Transparency Reanda Haroon Zakaria & Company Chartered Accountants, are the external auditors of the Company. They gave an unqualified opinion on financial statements for the year ending on June 30, 2022. The firm is QCR-rated by ICAP and is classified in Category 'B' in the panel of auditors maintained by SBP.

Management

Organizational Structure The Company is segregated into 7 key departments. The heads of all these departments qualify as "strategic managers" and report directly to the board of directors. The key departments include the back office and finance, while the business operations include: Marketing, Processing, Spinning, Weaving, Power, and Ginning. In addition to this, the company has managers for HR and administration who report to the head of finance.

Management Team Strategic managers, each with two decades of experience, contribute to the company's success. CFO Mr. Rehan Memon, an ACCA-certified professional, oversees financial intricacies and talent development.

Effectiveness The Company has no management committees in place. Management meetings are convened on an "as and when required basis". The management effectiveness can be improved by formalizing the management committee.

MIS Relying on an Oracle-based ERP system, the company ensures financial and operational control, focusing on individual business segment performance.

Control Environment Adequate control environment with in-house and international sales teams, manual quality control, and appropriate HSE infrastructure.

Business Risk

Industry Dynamics During FY23, textile exports were valued at $16.5 billion compared to $19.33 billion, reflecting a dip of 15% YoY – the declining trend has been witnessed by the start of FY23. The exports tumbled attributable to high energy costs, shortage of cotton, and uncertainty in the foreign exchange rate. The suppressed demand pattern exhibited by export avenues was also a challenge. During FY23, value-added products such as knitwear, bedwear, towels, and ready-made garments witnessed a decline of 13% YoY. The basic textiles including raw cotton, cotton yarn, and cotton cloth posted a drop of 21% YoY. During the month of June 2023, cotton yarn exports increased by 7% MoM. The value-added exports reported a volumetric increase of 16% on a MoM basis. Knitwear and readymade garments witnessed an incline at 18% and 19% respectively. During the month of July 2023, textile exports were valued at $2 billion compared to $2.3 billion, reflecting a slump of 12.6% on a MoM basis. Further analysis reveals an overall decline of 8.6% YoY.

Relative Position With 44K spindles, 234 looms, 2000 rotors, and 200 stitching machines, the Company has an adequate position on a standalone basis and is considered a middle-tier player in Pakistan's denim industry.

Revenues Predominantly export-oriented, Meko Denim's revenue reached PKR 1,034mln in FY23, marking a significant growth of 474% compared to FY22. The projected top-line for FY24 is estimated at PKR 17,994mln.

Margins In FY23, Meko Denim saw a decline in gross profit margin to 19.8% (from 22.6% in FY22), further dropping to 11.6% in 3MFY23. Operating margin, resilient at 19.1% in FY23 (up from 17.4% in FY22), dipped to 9.9% in 3MFY24. PBIT surged 441% in FY23 to PKR 157mln, growing 70.7% in 3MFY24 to PKR 268mln. Finance costs rose from PKR 29mln in FY23 to PKR 45mln in 3MFY24. Net profit grew significantly to PKR 150mln in FY23 and PKR 220mln in 1QFY24. However, the net profit margin declined from 16.2% in FY22 to 14.5% in FY23 and further to 5.7% in 3MFY24.

Sustainability In FY23, the country witnessed a 15% decline in exports, primarily attributed to factors such as elevated energy costs, a shortage of cotton, and uncertainty in foreign exchange rates. However, the export scenario is currently undergoing a positive shift, with a projected surge in demand for textile products globally. This positive momentum is further bolstered by the redirection of export orders towards the Pakistani market.

Financial Risk

Working Capital In FY23, the Company's gross working capital days were 69, showcasing an efficient working capital management strategy. This trend continued in 3MFY24, with a reduction to 49 days. The net working capital days were recorded at 21 days. The Company's short-term borrowing increased to PKR 293mln in FY23, compared to PKR 208mln in FY22.

Coverages The Company demonstrated a positive FCFO of PKR 157mln during FY23, reflecting its ability to generate cash after meeting operational expenses and capital expenditures. In 1QFY24, FCFO increased to PKR 268mln, indicating sustained financial health. However, it's noteworthy that finance costs rose from PKR 29mln in FY23 to PKR 45mln in 3MFY24. Despite this increase, the interest coverage ratio remained healthy, reaching 6x in FY23 and 5.4x in 3MFY24.

Capitalization Meko Denim maintains a deliberate and conservative capital structure, avoiding significant borrowings in the initial operational phase due to high-interest rates. In FY23, the company reduced leverage to 32.3% (from 42% in FY22). Total borrowings increased by 36.9%, reaching PKR 1,304mln (FY22: PKR 952mln), with long-term borrowings constituting 62.1% (FY22: 78%). As of end-Jun'23, equity substantially grew to PKR 2,727mln (end-Jun'22: PKR 1,314mln), mainly due to an increased director's loan. Equity continued expanding, reaching PKR 4,502mln in 3MFY24.

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Financial Summary
PKR mln

Meko Denim Mills (Private) Limited	Sep-23	Jun-23	Jun-22	Jun-21
##	3M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	3,442	3,270	1,951	590
2 Investments	-	-	-	-
3 Related Party Exposure	-	-	-	141
4 Current Assets	5,699	995	442	16
a Inventories	*2,528*	*114*	*128*	-
b Trade Receivables	*1,365*	*120*	*30*	-
5 Total Assets	9,141	4,265	2,393	747
6 Current Liabilities	2,904	234	127	0
a Trade Payables	*2,173*	*175*	*95*	-
7 Borrowings	1,735	1,304	952	-
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	-	-	-	-
10 Net Assets	4,502	2,727	1,314	747
11 Shareholders' Equity	4,502	2,727	1,314	747
B INCOME STATEMENT				
1 Sales	3,836	1,034	180	-
a Cost of Good Sold	*(3,392)*	*(829)*	*(139)*	-
2 Gross Profit	444	205	41	-
a Operating Expenses	(62)	(8)	(9)	(9)
3 Operating Profit	382	198	31	(9)
a Non Operating Income or (Expense)	*(69)*	*(12)*	*4*	*0*
4 Profit or (Loss) before Interest and Tax	313	186	35	(9)
a Total Finance Cost	*(45)*	*(29)*	*(6)*	*(0)*
b Taxation	*(48)*	*(7)*	*(0)*	*(0)*
6 Net Income Or (Loss)	220	150	29	(9)
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*268*	*157*	*(146)*	*(15)*
b Net Cash from Operating Activities before Working Capital Changes	*268*	*157*	*(152)*	*(15)*
c Changes in Working Capital	-	-	*(95)*	*0*
1 Net Cash provided by Operating Activities	268	157	(246)	(14)
2 Net Cash (Used in) or Available From Investing Activities	-	-	(1,364)	(600)
3 Net Cash (Used in) or Available From Financing Activities	-	-	1,631	615
4 Net Cash generated or (Used) during the period	268	157	21	0
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	1383.5%	476.0%	--	N/A
b Gross Profit Margin	11.6%	19.8%	22.6%	N/A
c Net Profit Margin	5.7%	14.5%	16.2%	N/A
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	7.0%	15.2%	-133.8%	N/A
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	24.3%	7.4%	2.8%	N/A
2 Working Capital Management				
a Gross Working Capital (Average Days)	49	69	322	N/A
b Net Working Capital (Average Days)	21	21	128	N/A
c Current Ratio (Current Assets / Current Liabilities)	2.0	4.2	3.5	145.5
3 Coverages				
a EBITDA / Finance Cost	6.0	5.4	56.8	N/A
b FCFO / Finance Cost+CMLTB+Excess STB	3.5	0.7	-219.5	N/A
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	1.1	7.9	-5.1	0.0
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	27.8%	32.3%	42.0%	0.0%
b Interest or Markup Payable (Days)	0.0	0.0	0.0	N/A
c Entity Average Borrowing Rate	11.8%	2.6%	0.1%	--

Credit Rating

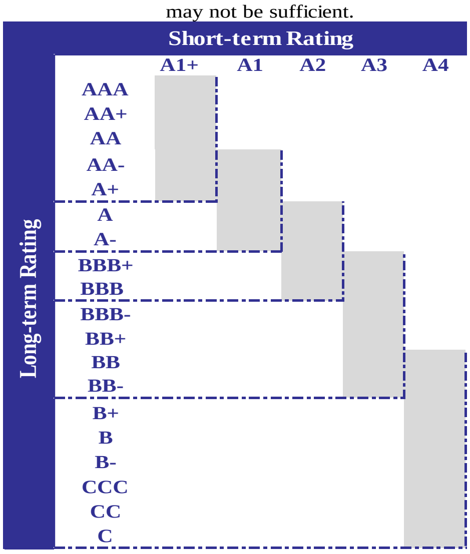
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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+ 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 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):

a) Broker Entity Rating
b) Corporate Rating
c) Debt Instrument Rating
d) Financial Institution Rating
e) Holding Company Rating
f) Independent Power Producer Rating
g) Microfinance Institution Rating
h) Non-Banking Finance Companies 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 | Clause 11-(A)(p).
(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 | 17-(a)
(19) PACRA reviews all the outstanding ratings periodically, on annual basis; Provided that public dissemination of annual review and, in an instance of change in rating will be made; | Chapter III | 17-(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 | 17-(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 | 17-(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 | 14-3(f)(vii)

Proprietary Information