The Pakistan Credit Rating Agency Limited

Rating Report

Mekotex (Pvt.) Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
04-Aug-2023	A-	A2	Stable	Maintain	-
05-Aug-2022	A-	A2	Stable	Maintain	-
06-Aug-2021	A-	A2	Stable	Maintain	-
05-Aug-2020	A-	A2	Negative	Maintain	Yes
06-Aug-2019	A-	A2	Stable	Maintain	-
04-Feb-2019	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The Company's ratings underscore its robust business profile, exemplified by a trajectory of ascending revenues and profitability in recent years. These ratings factor in the strong business acumen of its sponsors, establishing Mekotex Group as a vertically integrated textile powerhouse. The Company functions as a composite unit within the textile sector. Through prudent investment in Business Modernization and Reinvestment (BMR) initiatives and expansion endeavors, Mekotex Group has fortified its competitive edge through cutting-edge technological upgrades. This strategic approach has facilitated the capture of burgeoning local market demand, while exports are deftly channeled through the corporate entities of KAM International and KAM Apparel. The operational spectrum encompasses ginning, spinning, weaving, and digital printing. Recently, the group has ventured into the value-addition segment and enjoying good responses 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. However, heightened finance costs have exerted downward pressure on profitability, leading to a reported bottom line of PKR 284mln in 9MFY23, a decline compared to PKR 870mln recorded in 9MFY22. The financial risk landscape reflects elevated total borrowings (larger contribution from short-term borrowings) with sustained coverage over the last few years. An extended working capital cycle reflects the processes undertaken to manufacture the end product. The strategy is to survive through the challenging times and sustain the business volumes.

The ratings are dependent on the Company’s ability to maintain a strong business profile and optimal capacity utilization. Meanwhile, careful management of financial obligations is imperative. Improvement in reporting mechanism and governance framework would be critical for the ratings.

Disclosure

Name of Rated Entity	Mekotex (Pvt.) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating(Jun-22),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jun-22),Methodology | Rating Modifiers(Jun-22)
Related Research	Sector Study | Composite and Garments(Dec-22)
Rating Analysts	Sehar Fatima | sehar.fatima@pacra.com | +92-42-35869504

Profile

Legal Structure Mekotex Pvt. Limited was incorporated in 1991 as a composite denim producer in the textile industry. The company has since evolved to produce Greig fabric and has established a digital printing unit that is operational at optimal capacity (90.9%). Initially, the company was set up with a view to export denim, however, has made inroads into the local market and the bulk of business now is derived from local customers. As a group, the business has also invested in power, water supply, and home textiles. Recently, the group is focusing on value addition segment as well.

Background The foundation of the Mekotex group was laid by Mr. Abdul Majid Qasim (late) in 1979 and has since evolved to become one of the leading denim manufacturers. Mekotex, the group's flagship company, was pioneered by Mr. Abdul Majid's sons: Mr. Ebrahim Qasim and his elder brother, Mr. Abdul Majeed. Mr. Ebrahim Qasim exited the company in 2001 after the family decided to split the family wealth among different family members.

Operations The Company has operational facilities at Lodhran (ginning), Kotri (spinning), and Karachi (weaving). The company's head office is at Deh Landhi, Karachi. The company owns 110K spindles, 450 looms, and 5 digital printing machines to support its operations. The company is self-sufficient in power production with a total capacity of 29MW. The company uses natural gas as fuel for its power generation. The company is also self-sufficient in terms of water supply and has installed RO (river osmosis) plant in Karachi.

Ownership

Ownership Structure The Company is fully owned by the families of three brothers: Mr. Khalid Majeed, Mr. Ashraf Majeed, and Mr. Shoaib Majeed. Mr. Khalid Majeed and Mr. Ashraf Majeed own 36% shares each, while 28% shares are held by Mr. Shoaib Majeed.

Stability There is an absence of a shareholding agreement and formal succession plan among the family members which poses a risk to the stability of the business. However, the engagement of the second generation in distinct areas of business is adding comfort.

Business Acumen With over three decades of experience, the group carries expertise in textile, energy and power. Its sponsors also have diversified industrial experience.

Financial Strength The textile operations of the group are segregated into three businesses – Mekotex, KAM International (Home Textile), and KAM International (Apparel), the group has diversified itself into energy and water supply projects, generating a stable stream of income. The sponsors have demonstrated willingness and ability to support the business in the past, through substantial interest-free director loans and new equity injections.

Governance

Board Structure The overall control of the board vests in a five-member Board of Directors, three sponsors, and two non-executive independent directors. However, the Board is still dominated by the sponsors. The induction of independent directors is a step toward strengthening the company's governance framework. Sponsors are receptive and intend to further strengthen the governance framework for all companies.

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 Mekotex, 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 Crowe Hussain Chaudhury & Co 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 external audit process for FY23 is underway and shall be finalized soon. The firm is QCR rated by ICAP and is classified in Category 'A' 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: 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. There is also a technical director who reports to the CEO directly.

Management Team Mekotex places high importance on experience and no member of the strategic management group has experience of less than two decades.

Effectiveness The Company has no management committees in place. Management meetings are convened on an "as and when required basis".

MIS The Company's operating environment depends upon an IT Infrastructure supported by an in-house implemented Oracle-based ERP. The IT system is fully integrated into all major departments. The system for reporting has been designed as per the requirements of the board of directors.

Control Environment The Company has adequate quality control procedures in place to ensure efficiency and minimize wastage. There is also an internal audit function operating in the Company.

Business Risk

Industry Dynamics During 7MFY23, the textile exports were valued at $10.08bln compared to $10.93bln, reflecting an 8% decline YoY – the declining trend has been recorded in the last few months. The decline in exports is driven by attrition in the demand pattern of export avenues.

Relative Position With 110,000 spindles, 450 looms, and 5 digital printing machines, the Company has an adequate position on a standalone basis and is considered a middle-tier player in Pakistan's denim industry.

Revenues The Company's top line clocked in at PKR 26,967mln during FY22 (FY21: PKR 18,704mln), depicting a growth of 44.1% YoY. The growth emanated from increased export and local sales volume due to better capacity utilization, as the weaving unit is working at ~75% capacity, spinning at ~85%, processing at ~65%, ginning at ~27%, and digital printing at ~90%. Revenue in 9MFY23 was recorded at PKR 22,652mln, depicting an increase of 13.4% from the corresponding previous period (9MFY22: PKR 19,962mln).

Margins In FY22, the company's gross profit margin decreased to 11.1% (FY21: 11.5%). Operating margin clocked at 8.2% in FY22 (FY21: 8.5%), with operating expenses increasing by 40.7% to PKR 791mln (FY21: PKR 562mln). PBIT enhanced to PKR 2,179mln (FY21: PKR 1,547mln). Hence, Net profit grew to PKR 676mln (FY21: PKR 437mln), with a net profit margin of 2.5% (FY21: PKR 2.3%). In 9MFY23, the gross and operating margins strengthened whereas the net margin inched down to 1.3% (PKR 284mln).

Sustainability The Company has achieved diversification over the years in areas of digital printing, home textile, and value addition segments. This has assisted the Company in strengthening its footprint in local as well as export destinations. The group has ventured into the value-addition segment and enjoying good responses from export destinations. A marketing strategy is devised to further enhance the current product's penetration in international markets. The strategy for Mekotex is to survive through the challenging times and sustain the business volumes.

Financial Risk

Working Capital During 9MFY23, the gross working capital days of the Company inched up to 150 days (FY22: 141 days). Net working capital days also increased to 124 days (FY21: 118 days), due to an increase in inventory days to 106 days (FY22: 99 days). Short-term trade leverage has dropped whereas total leverage has remained largely same.

Coverages The Company's free cashflows (FCFO) increased to PKR 2,736mln during FY22 (FY21: PKR 2,329mln). Meanwhile, finance costs increased to PKR 1,533mln (FY21: PKR 951mln) due to an increase in borrowings. Consequently, the interest coverage ratio inched down to 1.9x (FY21: 2.6x). During 9MFY23, interest and core coverage ratio were calculated at 2.1x and 1.9x respectively.

Capitalization Mekotex maintains a highly leveraged capital structure. During FY22, the leveraging increased to 62.6% (FY21: 58.5%). Short-term borrowings made up 64.6% (FY21: 62.4%) of the total borrowings. Total borrowings further increased to PKR 16,236mln in 9MFY23 (9MFY22: PKR 14,447mln) where as the equity base has recorded strengthening, over the years, to PKR 9.2bln as of end-Mar23 (end-Jun22: PKR 8.8bln).

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Financial Summary
PKR mln

Mekotex (Pvt.) Ltd.	Mar-23	Jun-22	Jun-21	Jun-20
Textile - Composite	9M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	11,870	12,377	9,894	9,795
2 Investments	-	0	0	0
3 Related Party Exposure	51	51	51	51
4 Current Assets	16,432	14,754	11,668	9,743
a Inventories	*8,601*	*8,998*	*5,613*	*5,076*
b Trade Receivables	*4,358*	*2,910*	*3,373*	*2,443*
5 Total Assets	28,353	27,181	21,614	19,588
6 Current Liabilities	2,824	3,526	1,930	1,530
a Trade Payables	*1,919*	*2,443*	*1,074*	*746*
7 Borrowings	16,236	14,767	11,481	10,848
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	61	61	66	47
10 Net Assets	9,233	8,827	8,136	7,164
11 Shareholders' Equity	9,233	8,827	8,136	7,164
B INCOME STATEMENT				
1 Sales	22,652	26,967	18,704	14,573
a Cost of Good Sold	*(18,829)*	*(23,966)*	*(16,562)*	*(12,940)*
2 Gross Profit	3,822	3,001	2,143	1,633
a Operating Expenses	(1,260)	(791)	(562)	(467)
3 Operating Profit	2,562	2,209	1,581	1,166
a Non Operating Income or (Expense)	-	*(31)*	*(34)*	*33*
4 Profit or (Loss) before Interest and Tax	2,562	2,179	1,547	1,199
a Total Finance Cost	*(1,996)*	*(1,533)*	*(951)*	*(1,142)*
b Taxation	*(283)*	*31*	*(159)*	*181*
6 Net Income Or (Loss)	284	676	437	239
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*3,932*	*2,736*	*2,329*	*1,784*
b Net Cash from Operating Activities before Working Ca	*3,932*	*1,203*	*1,378*	*642*
c Changes in Working Capital	-	*(1,103)*	*(1,449)*	*(1,312)*
1 Net Cash provided by Operating Activities	3,932	101	(71)	(670)
2 Net Cash (Used in) or Available From Investing Activi	-	(3,173)	(1,133)	(2,066)
3 Net Cash (Used in) or Available From Financing Activ	-	3,311	1,170	2,869
4 Net Cash generated or (Used) during the period	3,932	238	(35)	133
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	12.0%	44.2%	28.3%	11.9%
b Gross Profit Margin	16.9%	11.1%	11.5%	11.2%
c Net Profit Margin	1.3%	2.5%	2.3%	1.6%
d Cash Conversion Efficiency (FCFO adjusted for Worki	17.4%	6.1%	4.7%	3.2%
*e Return on Equity [Net Profit Margin * Asset Turnover*	4.2%	8.0%	5.7%	3.4%
2 Working Capital Management				
a Gross Working Capital (Average Days)	150	141	161	226
b Net Working Capital (Average Days)	124	118	143	209
c Current Ratio (Current Assets / Current Liabilities)	5.8	4.2	6.0	6.4
3 Coverages				
a EBITDA / Finance Cost	2.1	2.2	2.7	1.8
b FCFO / Finance Cost+CMLTB+Excess STB	1.9	1.1	1.3	1.3
c Debt Payback (Total Borrowings+Excess STB) / (FCF	1.6	4.0	3.0	5.5
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' E	63.7%	62.6%	58.5%	60.2%
b Interest or Markup Payable (Days)	0.0	0.0	0.0	0.0
c Entity Average Borrowing Rate	16.3%	10.2%	8.0%	10.9%

Credit Rating

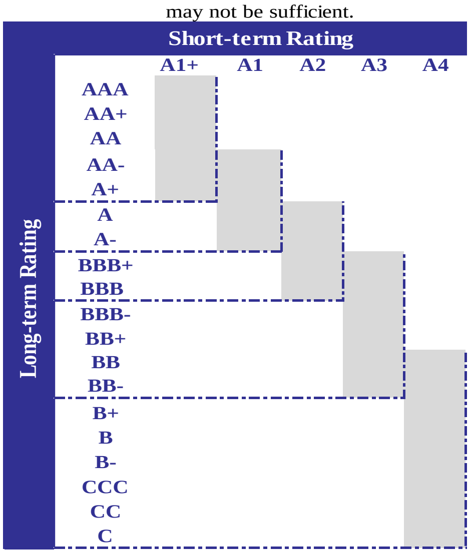
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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 | 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