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
02-Aug-2024	A-	A2	Stable	Maintain	-
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 ratings reflect the presence of Mekotex (Pvt). Limited (“MPL” or “the Company”) in the competitive textile landscape. This stems from the strong business profile and financial strength of the sponsors. It is the flagship Company of Mekotex Group. The group is considered a textile powerhouse with a long history of operations in the respective industry. The product slate of the Company primarily vests into Yarn, Fabric, and Garments. In segment-wise business contribution, Weaving is the foremost segment. A major chunk of revenue is derived from the local sales. While the exports are deftly channeled through the corporate entities of KAM International and KAM Apparel. The top clients of the Company are stable and well-established entities. During 9MFY24, the Company’s topline exhibited a dip at PKR 20.8bln (9MFY23: PKR 22.6bln) attributable to low demand and consumption trends in the local industry. The margins dipped minutely on the back of expensive raw material procurement and elevated energy cost. The management has planned the installation of a solar project as an alternate energy source. This project will be financed through the shareholder’s equity. The Company’s reliance on STBs has magnified the finance cost. This has largely diluted the profitability matrix of the Company (9MFY24: PKR 106mln; 9MFY23: PKR 284mln). The Company's financial risk profile is considered adequate with stretched working capital management depicting the industry norm. The Company's working capital requirements are primarily met through short-term borrowings (STB). The improvement in cash flows and coverages remains essential. The Company has maintained a leveraged capital structure. The Company is in the process of taking over the business which was being done under the umbrella of KAM International. This will enhance the topline of Mekotex. The size of the textile industry in Pakistan is estimated to be USD 8.1bln, ~3.0% of the total GDP as of FY23. The composite & garment segment in the textile sector has a contribution of USD 5.6bln mainly dominated by knitwear, readymade garments, bedwear, and towels followed by USD 2.7bln from spinning and USD 2.2bln from weaving. The escalation in energy tariffs & finance costs, PKR devaluation, and ensuring the availability of optimum quality raw materials are prime challenges specific to the industry to assess the international market and stay price-wise competitive.

The ratings depend on sustainable growth in the top line while improving the profitability matrix at an optimal level. The sufficient generation of cash flows and improvement in coverages remain critical. Adherence to the debt matrix at an adequate level is a prerequisite for assigned ratings.

Disclosure

Name of Rated Entity	Mekotex (Pvt.) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Correlation Between Long-term & Short-term Rating Scales(Jul-23),Methodology | Rating Modifiers(Apr-24),Methodology | Corporate Rating(Jul-23)
Related Research	Sector Study | Composite and Garments(Dec-23)
Rating Analysts	Tasveeb Idrees | Tasveeb.Idrees@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 Greige fabric and has established a digital printing unit that is operational at an optimal capacity. 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 the local market. As a group, the business has also invested in power, water supply, and home textiles. Recently, the group has been focusing on the value-addition segment.

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 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 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 an RO (river osmosis) plant in Karachi.

Ownership

Ownership Structure The Company is fully owned by the Majeed family. Mr. Khalid Majeed and Mr. Riyan Ashraf 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. The sponsors possess 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, 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 sponsoring family. The sponsors are receptive and intend to further strengthen the governance framework for all companies.

Members' Profile The board members bring with them diversified experience and knowledge of the respective industry at local and international levels which assists in providing useful insight for the development of an effective business strategy.

Board Effectiveness There are no formal board committees to assist the board on different matters. However, the financial information and financial decisions are presented in Excel sheets and communicated to finance as such after the sponsors have agreed upon.

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, 2023. This firm is QCR-rated by ICAP and is classified in Category 'A' as per the panel of auditors maintained by the State Bank of Pakistan.

Management

Organizational Structure The Company is segregated into seven key departments. The heads of all these departments qualify as "strategic managers" and report directly to the BoD. 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. The Company has a technical director who reports to the CEO directly.

Management Team The Company places high importance on professional 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 Company's 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. The Company also has an internal audit function in place.

Business Risk

Industry Dynamics . The size of the textile industry in Pakistan is estimated to be USD 8.1bln, ~3.0% of the total GDP as of FY23. The composite & garment segment in the textile sector has a contribution of ~ USD 5.6bln mainly dominated by knitwear, readymade garments, bedwear, and towels followed by USD 2.7bln from spinning and USD 2.2bln from weaving. The escalation in energy tariffs & finance costs, PKR devaluation, and ensuring the availability of optimum quality raw materials are prime challenges specific to the industry to assess the international market and stay price-wise competitive.

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 mid-tier player in the country's denim industry.

Revenues A significant portion of the revenue is generated from the local. While the remaining portion of the revenue comes from the export sales. During FY23, the Company's top line reflected a healthy increase clocking at PKR 29.0bln (FY22: PKR 26.9bln) up by 7.7% YoY. The local sales constituted 83.6% of the total revenue recorded at PKR 27.9bln (FY22: PKR 26.7bln) indicating a growth of 4.2% on a YoY basis. During 9MFY24, the Company's topline exhibited a dip to stand at PKR 20.8bln (9MFY23: PKR 22.6bln).

Margins During FY23, the Company's gross profit margin and operating inched down to 10.3% (FY22: 11.1%) and 7.3% (FY22: 8.2%). This is driven by the higher cost of production which is in line with the industry trend. The finance cost increased manifold reported at PKR 2.7bln (FY22: PKR 1.5bln) on the back of higher interest rates. The Company secured a net profitability of PKR 287mln (FY22: PKR 676mln). Hence, the Company's net profit margin clocked at 1.0% (FY22: 2.5%). During 9MFY24, the Company's gross margin inched down YoY to stand at 15.3% (9MFY23: 16.9%) primarily due to expensive raw material procurement and elevated energy costs.

Sustainability The group has ventured into the value-addition segment and enjoying good responses from export destinations. The management intends to operate in the international domain through a gradual consolidation with KAM International which strengthens the sustainability profile. Further, the management has planned the installation of a ~7 Mega Watt solar project to curb the adverse impact of elevated energy cost.

Financial Risk

Working Capital The Company's working capital requirements are a function of inventory and receivables. As of end-Jun23, the gross working capital cycle of the Company was slightly stretched to 144 days (end-Jun22: 141 days) to maintain optimum inventory levels. As of end-Mar24, the Company's gross working capital cycle improved to 138 days.

Coverages As of end-Jun23, the Company's free cashflows from operations (FCFO) were reported at PKR 2.8bln (end-Jun22: PKR 2.7bln). However, the coverages of the Company remained in a moderate range. As of end-Mar24, the interest coverage and core operating coverage clocked at 0.2x.

Capitalization The Company has a moderately leveraged capital structure. The total borrowings demonstrated an upward trend and clocked at PKR 15.3bln (end-Jun22: PKR 14.7bln). Due to higher working capital requirements, the short-term borrowings reflected a sizeable increase at PKR 11.3bln (end-Jun22: PKR 9.5bln). As of end-Mar24, the management reduced its borrowing book reported at PKR 11.3bln. This led to a decline in the Company's total leveraging recorded at 51.0%.

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Mekotex (Pvt.) Ltd.	Mar-24	Jun-23	Jun-22	Jun-21
Textile - Composite	9M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	11,275	12,190	12,377	9,894
2 Investments	107	963	51	51
3 Related Party Exposure	-	-	-	-
4 Current Assets	13,170	14,891	14,754	11,668
a Inventories	*6,382*	*8,434*	*8,998*	*5,613*
b Trade Receivables	*3,516*	*2,635*	*2,910*	*3,373*
5 Total Assets	24,553	28,043	27,181	21,614
6 Current Liabilities	2,176	3,684	3,526	1,930
a Trade Payables	*1,548*	*2,600*	*2,443*	*1,074*
7 Borrowings	11,383	15,303	14,767	11,481
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	61	46	61	66
10 Net Assets	10,933	9,011	8,827	8,136
11 Shareholders' Equity	10,933	9,011	8,827	8,136
B INCOME STATEMENT				
1 Sales	20,833	29,066	26,967	18,704
a Cost of Good Sold	*(17,654)*	*(26,083)*	*(23,966)*	*(16,562)*
2 Gross Profit	3,179	2,983	3,001	2,143
a Operating Expenses	(919)	(855)	(791)	(562)
3 Operating Profit	2,260	2,128	2,209	1,581
a Non Operating Income or (Expense)	-	*649*	*(31)*	*(34)*
4 Profit or (Loss) before Interest and Tax	2,260	2,777	2,179	1,547
a Total Finance Cost	*(1,894)*	*(2,718)*	*(1,533)*	*(951)*
b Taxation	*(260)*	*228*	*31*	*(159)*
6 Net Income Or (Loss)	106	287	676	437
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*366*	*2,875*	*2,736*	*2,329*
b Net Cash from Operating Activities before Working Ca	*366*	*157*	*1,203*	*1,378*
c Changes in Working Capital	-	*210*	*(1,103)*	*(1,449)*
1 Net Cash provided by Operating Activities	366	368	101	(71)
2 Net Cash (Used in) or Available From Investing Activi	-	(598)	(3,173)	(1,133)
3 Net Cash (Used in) or Available From Financing Activ	-	232	3,311	1,170
4 Net Cash generated or (Used) during the period	366	3	238	(35)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	-4.4%	7.8%	44.2%	28.3%
b Gross Profit Margin	15.3%	10.3%	11.1%	11.5%
c Net Profit Margin	0.5%	1.0%	2.5%	2.3%
d Cash Conversion Efficiency (FCFO adjusted for Worki	1.8%	10.6%	6.1%	4.7%
*e Return on Equity [Net Profit Margin * Asset Turnover*	1.4%	3.2%	8.0%	5.7%
2 Working Capital Management				
a Gross Working Capital (Average Days)	138	144	141	161
b Net Working Capital (Average Days)	111	113	118	143
c Current Ratio (Current Assets / Current Liabilities)	6.1	4.0	4.2	6.0
3 Coverages				
a EBITDA / Finance Cost	0.2	1.3	2.2	2.7
b FCFO / Finance Cost+CMLTB+Excess STB	0.2	0.9	1.1	1.3
c Debt Payback (Total Borrowings+Excess STB) / (FCF	-1.7	13.4	4.0	3.0
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' E	51.0%	62.9%	62.6%	58.5%
b Interest or Markup Payable (Days)	45.9	73.5	0.0	0.0
c Entity Average Borrowing Rate	16.7%	16.6%	10.2%	8.0%

Credit Rating

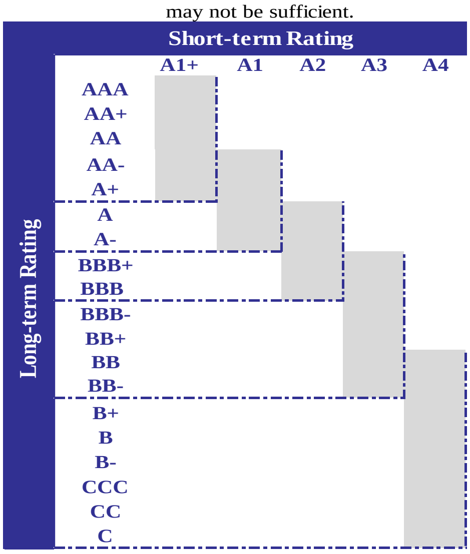
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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+ 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