



The Pakistan Credit Rating Agency Limited

Rating Report

Mekotex (Pvt.) Limited

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Rating History					
Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
04-Feb-2019	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings highlight the company's strong business prospects reflected by growing revenues and profitability. The ratings incorporate strong business acumen of the sponsors, making Mekotex group a vertically integrated textile unit, and recent initiatives to strengthen the governance framework. The company is a composite unit of textile from ginning to printing and has diversified from denim to greige fabric. Margins remain inline with good players in the market. The company has adequately invested in BMR and expansion projects to remain competitive and ensuring technological upgrades. This has helped in capturing growing demand in the local market, while export markets are pitched through group businesses - Kam International and Kam Apparel. The financial risk profile is relatively stretched, reflected by adequate coverages since cash flows from recent expansion are yet to fully materialize. Comfort is drawn from sponsors commitment and support, demonstrated in the form of interest-free loan mechanism. The financial matrix is expected to remain well managed. Annual turnover of the group exceeds USD 160mln per annum.

Ratings are dependent upon sustenance of topline growth, capitalizing on ongoing BMR and expansion initiatives, and conversion in profitability. This, in turn, should benefit in better debt service coverage ratios. 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 Ratings(Jun-18),Methodology Criteria Rating Modifier(Jun-18),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
Related Research	Sector Study Textile(Oct-18)
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Profile

Legal Structure Mekotex (Pvt.) Limited is a private limited concern incorporated in 1991.

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 and exporters of the country. Mekotex, the flagship company of the group, 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 between different family members.

Operations Mekotex is a fully integrated textile unit involved in ginning, spinning, weaving and printing of denim and greige fabric. The company operates with 4 ginners, 44000 spindles and 450 looms with production facilities located at Lodhran (ginning), Kotri (spinning) and Karachi (weaving), while its head office resides in Karachi. It is also self-sufficient in power production and water supply.

Ownership

Ownership Structure The company is fully owned by the families of 3 brothers: Mr. Khalid Majeed, Mr. Ashraf Majeed, and Mr. Shoaib Majeed. In the near future, Mr. Ashraf Majeed plans to transfer half of his share to his son Mr. Rayyan.

Stability There is absence of a shareholding agreement and formal succession plan between the brothers which poses a risk to the stability of the business.

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 While textile operations of the group are segregated into three businesses – Mekotex, KAM International (Home Textile), Kam International (Apparel), the group has diversified itself into energy and real estate projects, generating a stable stream of income. Annual turnover of the group exceeds ~USD 160mln per annum. The sponsors have demonstrated willingness and ability to support the business in the past, through substantial interest free director loans.

Governance

Board Structure The overall control of the board vests in a 3-member Board of Directors, all sponsors. There are no independent directors on the board, reflecting poor governance framework of the company.

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

Board Effectiveness At Mekotex, there are no formal Board meetings or a system to record the Board meeting minutes; financial information financial decisions are communicated to management after all members have agreed. There are no board committees and there is great degree of centralized control of the CEO over the operations.

Financial Transparency The company's external auditors are M. Saleem Associates. The auditors are QCR passed by ICAP; however, are not on the State bank of Pakistan's panel of auditors. The auditors expressed an unqualified opinion on the financial statements for the period ended 30th June, 2018.

Management

Organizational Structure The Company is segregated into 7 key departments, with the heads of all departments qualifying as "strategic managers" and reporting directly to the Board of Directors.

Management Team Overall management control is in the hands of eldest brother, Mr. Khalid Majeed as the CEO of the company, while the rest of the brothers oversee specified functions. Mekotex places high importance on experience and no member of the strategic management group has experience of less than two decades.

Effectiveness There are no formal management committees at Mekotex. However, all department heads generate reports relevant to their department through MIS or manually which are kept updated in an timely and accurate manner.

MIS The company has deployed Oracle-based ERP. The IT system is fully integrated in the all major departments and ensures proper financial and operational control.

Control Environment The company has adequate quality control procedures in place to ensure efficiency and minimize wastage. These controls are implemented manually, unlike industrial peers. There is also an internal audit function operating in the company.

Business Risk

Industry Dynamics The global denim market is estimated to grow from ~USD 57bln to ~USD 75bln in 2021, driven by westernization in developing countries, especially India and China. Pakistan's denim sector market size hovers around 10-15% of total textile exports of Pakistan, with major markets for fabric exports including Bangladesh, Turkey and Egypt while prime markets for denim garments comprise US and Europe.

Relative Position The company has an adequate position on standalone basis and is considered a middle-tier playing in Pakistan's denim industry.

Revenues The company's top line clocked in at PKR ~10,478mln, driven by local sales, though the company is planning to increase exports in the future, particularly in Asian markets. Top ten customer's concentration is considered high at 46%. Mekotex's revenue has seen fluctuating growth rates in the past; however, the company managed to increase sales by ~27.5% during FY18 due to offering of new products like digital print and sales from new weaving unit in 2017.

Margins Rapidly increasing production costs did not allow the company's gross margin to benefit from the increased revenue (FY18: 12.4%, FY17: 13.5%). Administrative expenses during the year increased, that led to a slight deterioration in operating margins to 8.9% (FY17: 9.8%). This, complimented by 4% declined finance cost for the period led to the company's bottomline improving to ~PKR 634mln compared to ~PKR 488mln in the previous year. Despite decrease in margins, increase in revenue proved to be key driver in higher profit in FY18.

Sustainability The company has continued to expand its weaving operations and plans to open a new spinning unit at Kotri while also increasing the number of digital print machines in Karachi. The group's plan to launch Kam Apparel's is also a good one, provided the company can develop the right expertise for the ready-made garments industry.

Financial Risk

Working Capital The working capital requirements are a function of inventory and receivables. This is partially catered by availing adequate terms from creditors, while rest has to be financed via short term borrowings. The company's net cash cycle has remained stable in recent years (FY18: 124 days, FY17: 121 days) and in line with other players in the denim industry.

Coverages The company's FCFO in FY18 increased on the back of increased revenues and in turn profitability. Despite increase in cashflows, the company's coverages largely remained at the same level (FY18 : 0.7x, FY17: 0.8x) on the back of higher interest costs and increased CMLTD. However, coverages are expected to remain at adequate level going forward.

Capitalization The company's capital structure is moderately leveraged at ~52% (FY17: 47%); however, it has increased YoY to finance capex on new weaving unit. Continuous injection by sponsors in the form of interest free loan has supported the company.



The Pakistan Credit Rating Agency Limited

Mekotex Pvt. Ltd.

BALANCE SHEET	30-Jun-18	30-Jun-17	30-Jun-16
	FY18	FY17	FY16
Non-Current Assets	6,805	5,040	4,018
Current Assets	5,817	4,096	3,454
Inventory	2,046	1,669	1,582
Trade Receivables	1,989	1,384	957
Others	1,782	1,043	915
Total Assets	12,673	9,187	7,523
Debt	6,228	4,059	3,391
Short-Term	3,532	2,374	2,369
Long-Term (Incl. Current Maturity of Long-Term Debt)	2,696	1,685	1,022
Other short-term liabilities	770	544	610
Other long-term liabilities	24	37	69
Shareholders' Equity	5,652	4,547	3,452
Total Liabilities & Equity	12,673	9,187	7,523
INCOME STATEMENT			
Turnover	10,478	8,219	6,939
Gross Profit	1,297	1,110	1,082
Net Other Income	78	90	(39)
Financial Charges	(424)	(441)	(462)
Net Income	634	488	305
Cashflow Statement			
Free Cashflow from Operations (FCFO)	796	591	508
Net Cash changes in Working Capital	(1,193)	(614)	(352)
Net Cash from Operating Activities	(246)	97	156
Net Cash from Investing Activities	(2,272)	(1,401)	(1,470)
Net Cash from Financing Activities	2,639	1,275	1,319
Ratio Analysis			
Performance			
Turnover Growth	27.5%	18.4%	-4.6%
Gross Margin	12.4%	13.5%	15.6%
Net Margin	6.0%	5.9%	4.4%
ROE	12.4%	12.2%	9.6%
Coverages			
Interest Coverage (FCFO/Gross Interest)	1.9	1.3	1.1
Core: (FCFO/Gross Interest+CMLTD+Uncovered Total STB)	0.7	0.7	0.7
Total: (TCF) / (Gross Interest+CMLTD+Uncovered Total STB)	0.9	0.8	0.7
Debt Payback (Total LT Debt Including Uncovered Total STBs) / (FCFO- Gross Interest)	7.2	11.2	22.5
Liquidity			
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	110	108	107
Capital Structure (Total Debt/Total Debt+Equity)	52.4%	47.2%	49.5%

Mekotex Pvt. Ltd.

February 2019

Credit Rating Scale & Definitions

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 Ratings		Short Term Ratings	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
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.	A1	A strong capacity for timely repayment.
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.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial 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.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
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.	C	An inadequate capacity to ensure timely repayment.
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.		



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, a) some material identifiable event and/or b) deviation from expected trend. 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 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) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults, or/and f) 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.

Disclaimer: PACRA's ratings are an assessment of the credit standing of entities/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA's opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security's market price or suitability for a particular investor.

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

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- (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.
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- (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)
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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)
- (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)

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