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
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 highlight the Company's good business profile reflected by growing revenues and profitability in recent years. The ratings incorporate strong business acumen of sponsors, making Mekotex group a vertically integrated textile unit. The Company is a composite unit of textile with diversified products mainly denim & greige fabric. The Company has adequately invested in BMR and expansion projects to remain competitive through 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. Business operations comprise ginning, spinning, weaving and digital printing. During the year, Mekotex expanded and installed a new weaving unit in Kotri. Topline of the Company inclined sizably. Improved margins, in line with the positive industry dynamics, have assisted strengthening of business profile. Lower finance cost, on account of TERF and ERF obtained, has also supplemented the profitability. Consequently, the Company reported bottom-line of PKR 870mln in 9MFY22 (9MFY21: 493mln). The Company’s financial risk profile is characterized by high leveraging and good coverages. Working capital cycle improved considerably driven by lower inventory days. During 9MFY22 (Jul21-Mar22), Pakistan textile exports surged to $14.2bln (recording growth of 25%) as compared to $11.3bln in the same period last year. This is attributable to increase in demand for textile products internationally and channeling of export orders towards Pakistani market. On a YoY basis, the exports of raw cotton, cotton (carded or combed) and cotton cloth recorded notable growth. However, month on month basis, textile exports have declined by 3.5%. Going forward, the textile sector’s outlook is expected to stay good in the medium term where demand for textile products is expected to sustain.

The ratings are dependent on the Company’s ability to maintain 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),Mehtodology | Rating Modifiers(Jun-22)
Related Research	Sector Study | Composite and Garments(Dec-21)
Rating Analysts	Sehar Fatima | sehar.fatima@pacra.com | +92-42-35869504

Profile

Legal Structure Mekotex (Pvt.) Limited (Mekotex or 'the Company') is a private limited concern incorporated in 1991. The registered office of the Company is situated in Karachi, Sindh.

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 manufacturer. 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 among 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, 110,000 spindles, 641 looms, and 5 digital printing machines 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 majority shares are owned by three brothers; Ashraf Majeed (30%), Khalid Majeed (23%) and Shoaib Majeed (14%), while rest of the shareholding lies with other family members.

Stability There is absence of a shareholding agreement and formal succession plan among the family members 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 Operations of the group are segregated into three businesses – Mekotex, KAM International Home Textile & Apparel, the group has diversified itself into energy and water supply projects, generating a stable stream of income.

Governance

Board Structure The overall control of the board vests in a 5-member Board of Directors, three sponsors and two non-executive independent directors. However, the Board is still dominated by the sponsors. Induction of independent directors is a step towards strengthening of 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 board meetings. The board has not formed any committee and there is 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 end June 30, 2021. 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 seven 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 – who acts 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 The Company has no management committees in place. Management meetings are convened on "as and when required basis". The management effectiveness can be improved by formalizing the management committee.

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. The Company has obtained certification from various international accreditation organizations including Global Organic Textile Standards, Organic Exchange, Worldwide Responsible Accredited Production, etc.

Business Risk

Industry Dynamics During 9MFY22 (Jul21-Mar22), Pakistan textile exports surged to $14.2bln (recording growth of 25%) as compared to $11.3bln in the same period last year. This is attributable to increase in demand for textile products internationally and channeling of export orders towards Pakistani market. On a YoY basis, the exports of raw cotton, cotton (carded or combed) and cotton cloth recorded notable growth. However, month on month basis, textile exports have declined by 3.5%. Going forward, the textile sector's outlook is expected to stay good in the medium term where demand for textile products is expected to sustain.

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

Revenues Mekotex derives its revenue mainly from manufacturing and sale of denim and other fabrics. The Company's top-line is mainly driven by local sales with a share of 87%, while rest comes from exports. The Company's top-line clocked in at PKR 19,962mln during 9MFY22 (9MFY21: PKR 13,906mln), showing a growth of 43.5% YoY.

Margins During 9MFY22, gross profit margin of the Company increased marginally to 12.2% (9MFY21: 12.0%). Operating margin witnessed an increase to 11.0% in 9MFY22 (9MFY21: 9.1%), on the back of 37.9% decrease in operating expenses to PKR 249mln (9MFY21: PKR 401mln). The Company's PBIT increased by 32.4% and stood at PKR 1,232mln (9MFY21: PKR 1,232mln). However, due to interest friendly environment, the finance cost for the period witnessed a decline of 1.5% and was reported at PKR 536mln (9MFY21: PKR 564mln). Subsequently, net profit showed growth of 76.4% and was reported at PKR 870mln (9MFY21: PKR 493mln).

Sustainability The country has gone through three waves of COVID-19 pandemic; however, the textile sector doesn't seem to be slowing down. This is attributable to increase in demand for textile products internationally and channelling of export orders towards Pakistani market. However, the impact of price adjustment of cotton and demand pattern is yet to be accounted for.

Financial Risk

Working Capital During 9MFY22, gross working capital days of the Company decreased to 133 days (FY21: 161 days) on the back of decreased inventory to 85 days (FY21: 104 days). Net working capital days decreased and stood at 109 days (FY21: 143 days), due to increase in payable days to 24 days (FY21: 18 days). The Company's short-term borrowing increased to PKR 8,838mln (FY21: PKR 7,169mln).

Coverages The Company's free cashflows (FCFO) increased to PKR 2,329mln during FY21 (FY20: PKR 1,784mln) on the back of higher EBITDA. Meanwhile, finance cost decreased to PKR 951mln (6MFY20: PKR 1,142mln) due to relaxation in interest rates. Consequently, interest coverage ratio improved to 2.6x (FY20: 1.6x).

Capitalization Mekotex maintains a highly leveraged capital structure. During 9MFY22, the leveraging increased to 65.2% (FY21: 58.5%). Short term borrowings made up 61.2% (FY21: 62.4%) of the total borrowings.

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Financial Summary
PKR mln

Mekotex (Pvt.) Limited	Mar-22	Jun-21	Jun-20	Jun-19
Garments	9M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	11,522	9,894	9,795	8,301
2 Investments	-	0	0	0
3 Related Party Exposure	51	51	51	51
4 Current Assets	13,052	11,668	9,743	7,969
a Inventories	*6,813*	*5,613*	*5,076*	*3,367*
b Trade Receivables	*3,584*	*3,373*	*2,443*	*2,652*
5 Total Assets	24,625	21,614	19,588	16,321
6 Current Liabilities	2,404	1,930	1,530	1,133
a Trade Payables	*2,404*	*1,074*	*746*	*643*
7 Borrowings	14,447	11,481	10,848	8,316
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	66	66	47	33
10 Net Assets	7,709	8,136	7,164	6,839
11 Shareholders' Equity	7,709	8,136	7,164	6,839
B INCOME STATEMENT				
1 Sales	19,962	18,704	14,573	13,020
a Cost of Good Sold	*(17,522)*	*(16,562)*	*(12,940)*	*(11,401)*
2 Gross Profit	2,440	2,143	1,633	1,619
a Operating Expenses	(249)	(562)	(467)	(405)
3 Operating Profit	2,191	1,581	1,166	1,214
a Non Operating Income or (Expense)	*(560)*	*(34)*	*33*	*95*
4 Profit or (Loss) before Interest and Tax	1,631	1,547	1,199	1,309
a Total Finance Cost	*(562)*	*(951)*	*(1,142)*	*(759)*
b Taxation	*(198)*	*(159)*	*181*	*60*
6 Net Income Or (Loss)	870	437	239	610
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*1,069*	*2,329*	*1,784*	*1,676*
b Net Cash from Operating Activities before Working Capital Changes	*1,069*	*1,378*	*642*	*1,044*
c Changes in Working Capital	-	*(1,449)*	*(1,312)*	*(1,727)*
1 Net Cash provided by Operating Activities	1,069	(71)	(670)	(683)
2 Net Cash (Used in) or Available From Investing Activities	-	(1,133)	(2,066)	(2,056)
3 Net Cash (Used in) or Available From Financing Activities	-	1,170	2,869	2,665
4 Net Cash generated or (Used) during the period	1,069	(35)	133	(73)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	42.3%	28.3%	11.9%	24.3%
b Gross Profit Margin	12.2%	11.5%	11.2%	12.4%
c Net Profit Margin	4.4%	2.3%	1.6%	4.7%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	5.4%	4.7%	3.2%	-0.4%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	14.6%	5.7%	3.4%	9.8%
2 Working Capital Management				
a Gross Working Capital (Average Days)	133	161	170	141
b Net Working Capital (Average Days)	109	143	152	125
c Current Ratio (Current Assets / Current Liabilities)	5.4	6.0	6.4	7.0
3 Coverages				
a EBITDA / Finance Cost	2.0	2.7	1.8	2.6
b FCFO / Finance Cost+CMLTB+Excess STB	1.0	1.3	1.3	1.1
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	7.9	3.0	5.5	3.3
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	65.2%	58.5%	60.2%	54.9%
b Interest or Markup Payable (Days)	0.0	0.0	0.0	0.0
c Entity Average Borrowing Rate	5.1%	8.0%	10.9%	9.0%

Credit Rating

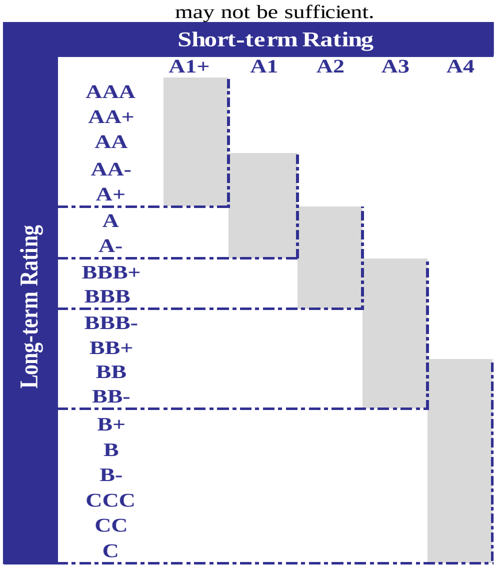
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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):

Entities

a) Broker Entity Rating
b) Corporate Rating
c) Financial Institution Rating
d) Holding Company Rating
e) Independent Power Producer Rating
f) Microfinance Institution Rating
g) Non-Banking Finance Companies (NBFCs) Rating

Instruments

a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk 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