



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
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. Recovery from the impact of COVID-19 pandemic resulted in subdued profits at the end of FY20. However, after the initial drawback of the pandemic, the Company bounced back by posting enhanced profitability during 9MFY21 as compared to FY20. Lower finance cost has also supplemented the profitability. Improved margins, in line with the positive industry dynamics, have assisted strengthening of business profile. The Company's financial risk profile is characterized by high leveraging and good coverages. Going forward, the textile sector's outlook is expected to stay stable in the medium term where the demand for textile products is expected to increase. The probability of little attrition in demand remains on the horizon attributable to the outbreak of COVID-19 variants. The country's textile group exports have witnessed 9.06% growth during the first nine months (July-March) 2020-21 and remained at \$11.35bln compared to \$10.4bln during the same period last year. The removal of 'Rating Watch' signifies the Company overcoming challenges faced by the COVID-19 outbreak. The entire textile chain had been impacted due to the initial lockdowns across the globe. However, with support from the Government and SBP's several initiatives to provide aid, recent figures represent record numbers for the textile sector.

The ratings are dependent on the Company's ability to maintain strong business profile and optimal capacity utilization amidst current circumstances. Meanwhile, careful management of financial obligations during and after the pandemic 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-21),Criteria Correlation Between Long-term & Short-term Rating Scales(Jun-21),Criteria Rating Modifiers(Jun-21)
Related Research	Sector Study Garments(Dec-20)
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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, 450 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, 2020. 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 Textile exports of the country recorded a double digit increase of ~23% for FY21 to stand at USD 15.4bln as compared to USD 12.5bln in FY20 due to increase in demand for textile products internationally, led by good recovery around the globe post pandemic. Going forward, the textile sector's outlook is expected to stay stable in the medium term where the demand for textile products is expected to increase. The probability of little attrition in demand remains on horizon attributable to outbreak of COVID-19 variants. In the local market, textile sector has recorded strong performance.

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 13,906mln during 9MFY21 (9MFY20: PKR 12,255mln), showing a growth of 13% YoY. The growth emanated from increased yarn sales volume at better prices after recent capacity enhancement, as the new spinning unit is capable of producing finer quality yarn which attracts premium prices. Denim segment also witnessed growth in terms of both volume and rate.

Margins During 9MFY21, gross profit margin of the Company decreased marginally to 12.0% (9MFY20: 12.4%), owing to increased cost of sales to PKR 12,239mln (9MFY20: PKR 10,730mln), representing a rise of 14%. Operating margin witnessed a decline to 9.1% in 9MFY21 (9MFY20: 10.3%), on the back of 53% increase in operating expenses to PKR 401mln (9MFY20: PKR 263mln). The Company's other income witnessed a major decline as a meagre profit on scrap sales amounted to PKR 2.7mln, whereas, during 9MFY20, major portion of other income was from dividend, which amounted to PKR 110.7mln. The Company's PBIT suffered due to this reason as the reported figure was 3% lower than last year. However, due to interest friendly environment, the finance cost for the period witnessed a decline of 9%. Subsequently, net profit showed slight growth of 2%, despite net profit margin declining to 3.5% (9MFY20: PKR 4.0%).

Sustainability The country has gone through three waves of COVID-19 pandemic, however the textile sector doesn't seem to be slowing down. On the contrary, recent figures represent record numbers for the textile sector. In face of the 4th wave and increasing vaccine rates, the threat to the sector is minimal and no such disruption is expected.

Financial Risk

Working Capital During 6MFY21, gross working capital days of the Company increased to 172 days (FY20: 170 days) on the back of increased inventory to 114 days (FY20: 106 days). Net working capital days showed no change as it stood at 152 days (FY20: 152 days), due to increase in payable days to 21days (FY20: 17days). The Company's short term trade leverage significantly declined to -7.0% during 6MFY21 (FY20: -3.5%) due to increase in short term borrowing to PKR 8.656mln (FY20: PKR 7.119mln), leaving the Company with excess borrowing.

Coverages The Company's free cashflows (FCFO) increased to PKR 2,236mln during 6MFY21 (6MFY20: PKR 1,614mln) on the back of higher EBITDA. Meanwhile, finance cost decreased to PKR 415mln (6MFY20: PKR 503mln) due to relaxation in interest rates. Consequently, interest coverage ratio improved to 5.6x (FY20: 1.6x).

Capitalization Mekotex maintains a highly leveraged capital structure. During 6MFY21, the leveraging increased to 62.5% (FY20: 60.2%). Short term borrowings made up 70% (FY20: 66%) of the total borrowings. Sponsors have injected the money in the past in order to maintain the leveraging. Going forward, taking on additional debt to finance expansion projects may increase leveraging further.



Mekotex (Pvt.) Limited Garments	Dec-20 6M	Jun-20 12M	Jun-19 12M	Jun-18 12M
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A BALANCE SHEET

1 Non-Current Assets	9,571	9,795	8,301	6,805
2 Investments	-	0	0	-
3 Related Party Exposure	51	51	51	51
4 Current Assets	11,497	9,743	7,969	5,817
<i>a Inventories</i>	5,925	5,076	3,367	2,046
<i>b Trade Receivables</i>	3,226	2,443	2,652	1,989
5 Total Assets	21,119	19,588	16,321	12,673
6 Current Liabilities	1,259	1,530	1,133	770
<i>a Trade Payables</i>	1,259	746	643	467
7 Borrowings	12,381	10,848	8,316	6,228
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	47	47	33	23
10 Net Assets	7,431	7,164	6,839	5,652
11 Shareholders' Equity	7,431	7,164	6,839	5,652

B INCOME STATEMENT

1 Sales	8,831	14,573	13,020	10,478
<i>a Cost of Good Sold</i>	(7,610)	(12,940)	(11,401)	(9,180)
2 Gross Profit	1,221	1,633	1,619	1,297
<i>a Operating Expenses</i>	(217)	(467)	(405)	(369)
3 Operating Profit	1,004	1,166	1,214	928
<i>a Non Operating Income or (Expense)</i>	(66)	33	95	78
4 Profit or (Loss) before Interest and Tax	938	1,199	1,309	1,006
<i>a Total Finance Cost</i>	(415)	(1,142)	(759)	(424)
<i>b Taxation</i>	(132)	181	60	52
6 Net Income Or (Loss)	391	239	610	634

C CASH FLOW STATEMENT

<i>a Free Cash Flows from Operations (FCFO)</i>	2,236	1,784	1,676	1,220
<i>b Net Cash from Operating Activities before Working Capital Changes</i>	1,821	642	1,044	946
<i>c Changes in Working Capital</i>	(1,205)	(1,312)	(1,727)	(1,193)
1 Net Cash provided by Operating Activities	616	(670)	(683)	(246)
2 Net Cash (Used in) or Available From Investing Activities	(1,747)	(2,066)	(2,056)	(2,272)
3 Net Cash (Used in) or Available From Financing Activities	1,553	2,869	2,665	2,639
4 Net Cash generated or (Used) during the period	422	133	(73)	121

D RATIO ANALYSIS

1 Performance				
<i>a Sales Growth (for the period)</i>	21.2%	11.9%	24.3%	27.5%
<i>b Gross Profit Margin</i>	13.8%	11.2%	12.4%	12.4%
<i>c Net Profit Margin</i>	4.4%	1.6%	4.7%	6.0%
<i>d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)</i>	11.7%	3.2%	-0.4%	0.3%
<i>e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sl</i>	10.7%	3.4%	9.8%	12.4%
2 Working Capital Management				
<i>a Gross Working Capital (Average Days)</i>	172	170	141	123
<i>b Net Working Capital (Average Days)</i>	152	152	125	110
<i>c Current Ratio (Current Assets / Current Liabilities)</i>	9.1	6.4	7.0	7.6
3 Coverages				
<i>a EBITDA / Finance Cost</i>	5.3	1.8	2.6	3.5
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	4.1	1.3	1.1	1.2
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>	1.0	5.5	3.3	3.3
4 Capital Structure				
<i>a Total Borrowings / (Total Borrowings+Shareholders' Equity)</i>	62.5%	60.2%	54.9%	52.4%
<i>b Interest or Markup Payable (Days)</i>	0.0	0.0	0.0	0.0
<i>c Entity Average Borrowing Rate</i>	7.3%	10.9%	9.0%	7.9%

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.

Scale	Long-term Rating Definition
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
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.
AA-	
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.
A-	
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.
BBB-	
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.
BB	
BB-	
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.
B-	
CCC	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.
CC	
C	
D	Obligations are currently in default.

Scale	Short-term Rating 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 conditions.
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 surveil 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):

<p>Entities</p> <ul style="list-style-type: none"> 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 	<p>Instruments</p> <ul style="list-style-type: none"> a) Basel III Compliant Debt Instrument Rating b) Debt Instrument Rating c) Sukuk Rating
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- 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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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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- (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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