# RATING REPORT

# Metco Textile (Pvt) Ltd

**REPORT DATE:**

October 06, 2023

**RATING ANALYST:**

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| Rating Category | Latest Rating | | Previous Rating | |
|---|---|---|---|---|
| | Long-term | Short-term | Long-term | Short-term |
| **Entity** | A- | A-2 | A- | A-2 |
| ***Rating Date*** | *October 06, 2023* | | *July 04, 2022* | |
| **Rating Outlook** | Negative | | Stable | |
| **Rating Action** | Maintained | | Reaffirmed | |

| COMPANY INFORMATION | |
|---|---|
| **Incorporated in 2008** | **External auditors:** M/s M. Saleem Associates |
| **Private Limited Company** | **Chairman:** |
| **Key Shareholders (with stake 5% or more):** | **Chief Executive Officer:** Asad R. Premjee |
| Asad R. Premjee - 33.3% | |
| Miqdad Muhammad - 33.3% | |
| Others - 33.3% | |

| APPLICABLE METHODOLOGY(IES) |
|---|
| ***Applicable Rating Criteria: Corporates (May 2023)***: https://docs.vis.com.pk/docs/CorporateMethodology.pdf |

| APPLICABLE RATING SCALE(S) |
|---|
| ***VIS Issue/Issuer Rating Scale:*** https://docs.vis.com.pk/docs/VISRatingScales.pdf |

# Metco Textile (Pvt) Limited

| OVERVIEW OF THE INSTITUTION | RATING RATIONALE |
|---|---|

*Metco Textile (Private) Limited is a private limited company with equity distributed amongst family members.*

***Profile of CEO:***
*Mr. Asad Premjee is associated with the company from 1994 and possesses 16 years of textile management. business.*

**Corporate Profile**

Metco Textile (Pvt.) Limited was incorporated in 2012 and is a family-owned business primarily engaged in the spinning of yarn for the local market. It is part of the Metco Group which also includes Metco Commodities, Metco Steel and Metco Ship Breakers; however, these companies are not currently operational. The product line includes slub, lycra, and ring yarn along with spandex catering to the weaving and knitting industry. The company has three yarn manufacturing units for cloth and hosiery segment, and one for towel production. The Company's head office is located in Karachi while the manufacturing unit is situated in Nooribad with a total spindle count of about 59,840 at end-9MFY23.

**Rating Drivers:**

**Business risk profile is constrained by current weak macroeconomic environment both globally and locally as evident by demand slowdown, high interest rate situation, inflationary pressures and ongoing energy crisis. These factors pose a challenge to margins sustainability and future growth.**

The local spinning sector is highly organized, comprising of 477 small and large-scale spinning mills, making the industry competitive. During FY23, the overall textile industry faced significant challenges arising from flash flooding which inundated about a third of the country under water, destroying vast amounts of crops particularly in the Sindh, Southern Punjab and Baluchistan regions. About 45% of the total cotton crop was damaged, resulting in a significant drop in output to 4.76m bales during 9MFY23, against an annual target of 9m bales. Combined with higher input costs of fertilizers and energy, prices increased sharply to a 12-year high of Rs. 21,600/maund during March'23. Timeline price changes can be seen below:

**Table: Cotton Prices Trend (In Rs.)**

| | FY19 | FY20 | FY21 | FY22 | FY23 | 2M'FY24 |
|---|---|---|---|---|---|---|
| Per Maund | 8,770 | 8,860 | 13,000 | 17,380 | 18,500 | 19,200 |
| YoY % Change | 26% | 1% | 32% | 34% | *6.4%* | *3.8%* |

Moreover, quantum of raw cotton imports has decreased during FY23 due to import restrictions and severe currency devaluation, declining by about 13.2% YoY to 683,911 MT (FY22: 788,107 MT). Consequently, besides affecting profit margins, higher raw material prices increasing the working capital requirements have negatively affected the liquidity profile of the overall textile sector. Additionally, with supply and demand constraints, cotton yarn output has declined notably during FY23 by about 22.1% to 2.7m MT (FY22: 3.5m MT). Going forward, industry players expect cotton output to breach the 10m bales mark for FY24 due to favorable weather conditions, increase in minimum support price and governmental financial assistance to farmers for purchase of raw materials, particularly in Punjab. However, as per estimates, production is still projected to fall short of the annual target of 12.7m MT.

In terms of exports, textile proceeds have oscillated in the range of USD 22-25b during the past decade (FY11-FY21), however, in FY22 exports finally broke the threshold, coming in at USD 32.4b. Textile sector contributes nearly one-fourth to industrial value-added segment and 8.5% to the country's GDP, with an estimated market size of around Rs. 4.0tr. Barring seasonal and cyclical fluctuations, textiles sector has maintained an average share of about 60% in national exports.

**Table: Pakistan Export Statistics (in USD millions)**

| | FY20 | FY21 | FY22 | 10M'FY22 | 10M'FY23 |
|---|---|---|---|---|---|
| **PAKISTAN TOTAL EXPORTS** | 22,536 | 25,639 | 32,450 | 26,858 | 23,211 |
| **TEXTILE EXPORTS** | 12,851 | 14,492 | 18,525 | 15,174 | 14,178 |
| **PKR/USD AVERAGE RATE** | 158.0 | 160.0 | 177.5 | 174.4 | 245.4 |

*Source: SBP*

Export revenues from textile sector have noted sizeable growth over the years (FY22: $19.3b FY21: $15.4b; FY20: $12.5b; FY19: $13.6b). Knitwear, Readymade and Bed wear segments continue to contribute higher than other segments, with a cumulative contribution of more than 60% in textile exports. While the growth was primarily driven by volume (excluding knitwear and cotton yarn), higher prices also boosted exports in FY22. However, current fiscal year has been significantly impacted due to challenging global and local macroeconomic environment and 10M export proceeds (in value terms) reflect a year-on-year (YoY) decline of ~14%.

**Table: Textile Export Details (in USD millions)**

| | FY20 | FY21 | FY22 | 10M'FY22 | 10M'FY23 |
|---|---|---|---|---|---|
| **High Value-Added Segment** | **9,669** | **12,427** | **15,605** | **12,908** | **11,337** |
| - Knitwear | 2,794 | 3,815 | 5,121 | 4,218 | 3,712 |
| - Readymade Garments | 2,552 | 3,033 | 3,905 | 3,214 | 2,905 |
| - Bed wear | 2,151 | 2,772 | 3,293 | 2,727 | 2,250 |
| - Towels | 711 | 938 | 1,111 | 928 | 825 |
| - Made-up Articles | 591 | 756 | 849 | 710 | 585 |
| - Art, Silk & Synthetic Textile | 315 | 370 | 460 | 385 | 343 |
| - Others | 555 | 743 | 866 | 725 | 718 |
| **Low to medium Value-Added Segment** | **2,858** | **2,972** | **3,717** | **3,074** | **2,372** |
| - Cotton Cloth | 1,830 | 1,921 | 2,438 | 2,006 | 1,685 |
| - Cotton Yarn | 984 | 1,017 | 1,207 | 1,006 | 637 |
| - Others | 43 | 34 | 72 | 62 | 51 |
| **Total** | **12,527** | **15,399** | **19,332** | **15,982** | **13,709** |

*Source: PBS*

Global and domestic challenges, such as slowdown in export demand (primarily from North America and the EU, which has begun to materialize in Pakistan's monthly export proceeds) due to recessionary trend, industrial gas load shedding expected in the country, and rising production costs due to inflation, will weigh on the business risk profile going forward. These factors may result in competitive market pricing for exporters.

**Capacity enhancement expected to help diversify product mix; slowdown in demand reduced capacity utilization during 9MFY23**

| Spinning Capacity Utilization | | | |
|---|---|---|---|
| | FY21 | FY22 | 9MFY23 |
| **Production Capacity (mln kg)** | 15.2 | 17.4 | 15.0 |
| **Actual Production (mln kg)** | 14.9 | 16.6 | 13.1 |
| **Capacity Utilization (%)** | **98.1%** | **95.0%** | **87.2%** |

The Company's production facilities included two units with a total spindle count of 37,440 that could produce about 28,500 bags/month, utilized for the manufacture of pure cotton hosiery and weaving products. An additional third manufacturing unit came online during Feb'23 to produce CVC and PC yarn (mixed blends of cotton and polyester) which have witnessed a rising trend in demand in the local market. The total spindle count for the new unit amounts to 21,600 which can produce 16,100 bags/month. However, only 18,000 spindles came online during FY23 owing to delays in procurement of the remaining machinery. According to management, the remaining capacity commissioned production by end-July'23. **Total capex incurred till end-Mar'23 amounts Rs. 3.75b, 50% of which was funded by long-term debt and the remainder by internal capital generation.** Moreover, the Company also has 800 open-ended routers with a total capacity of 3,050 bags/month which produce relatively lower quality products from the waste of the pure cotton production units.

Albeit being on the higher side, capacity utilization witnessed a decline during 9MFY23 due to the low base effect of the incremental capacity installed in end-Feb'23 along with some slowdown in demand during 1HFY23, according to management.

**Limited growth in revenues during 9MFY23 due to subdued demand; topline expected to improve with full utilization of new manufacturing unit**

During FY22, the topline increased to Rs. 8.7b (FY21: Rs. 7.3b) despite decline in volumetric output by about 8% due to sizeable appreciation in prices by 35.5%. The Company sold exclusively to local clients, largely within the Karachi region. Export sales were not registered during the period (FY21: Rs. 217.1m) owing to decline in international demand. The product mix constituted mainly of hosiery and weaving products at 58.6% and 34.8%, respectively, while open-end yarn made the remainder. Additionally, client concentration risk remained notable as 51% of total sales emanated from the top 10 clients (FY21: 47%), with a single client generating about 15% of revenue. Improvement in client concentration over the rating horizon will be important.

Revenues reduced by 2.6% on an annualized basis to Rs. 6.4b during 9MFY23 despite prevailing higher prices as volumetric output decreased notably by 17.9% due to demand slowdown in conjunction with inflationary pressure. The product mix continued to be dominated by hosiery and weaving products at 69.5% and 17.6%, respectively. Additionally, with the new manufacturing unit coming online during

Feb'23, contribution of CVC and PC product lines to overall revenue was limited to about 3.4% and 3.5%, respectively, while the remainder pertained to open-end yarn. However, going forward, CVC and PC segment are projected to contribute about 40% to overall sales mix as capacity utilization of the new unit increases, as per management. Client concentration improved in 9MFY23 with 44% of sales emanating from the top 10 clients. The Company expanded its client base to Punjab during 9MFY23 despite high transportation charges and stiff competitive environment owing to drop in demand from its traditional client base in the Karachi region. Breakdown of product mix and client concentration can be seen below:

| | FY22 | | 9MFY23 | |
|---|---|---|---|---|
| **Product** | **Revenue (Rs. Mln)** | **Sales %** | **Revenue (Rs. Mln)** | **Sales %** |
| **Hosiery** | 5,102 | 58.6% | 4,422 | 69.5% |
| **Weaving** | 3,029 | 34.8% | 1,116 | 17.6% |
| **CVC** | - | - | 218 | 3.4% |
| **PC** | - | - | 222 | 3.5% |
| **Open End** | 571 | 6.6% | 380 | 6.0% |
| **Waste** | 2 | 0.0% | - | - |
| **Total** | **8,702** | **100.0%** | **6,359** | **100.0%** |

| FY22 | | | 9MFY23 | | |
|---|---|---|---|---|---|
| **Client** | **Rs. (mln)** | **%** | **Client** | **Rs. (mln)** | **%** |
| **PROLINE (PVT) LTD** | 1,279 | 15% | **PROLINE (PVT) LTD** | 1,248 | 20% |
| **INDIGO TEXTILE (PVT) LTD.** | 765 | 9% | **S.M.TRADERS** | 281 | 4% |
| **S.M.TRADERS** | 557 | 6% | **EASTERN GARMENTS (PVT) LTD** | 254 | 4% |
| **RAJBY TEXTILES (PVT) LTD** | 546 | 6% | **TOWELLERS LTD** | 239 | 4% |
| **KASSIM TEXTILES (PVT) LIMITED** | 305 | 4% | **ASCO INTERNATIONAL (PVT) LTD** | 204 | 3% |
| **CLASSIC GARMENTS** | 292 | 3% | **CLASSIC GARMENTS** | 199 | 3% |
| **EASTERN GARMENTS (PVT) LTD** | 230 | 3% | **SIDDIQSONS LTD** | 152 | 2% |
| **SELIMPEX INTERNATIONAL** | 163 | 2% | **NFK EXPORTS (PVT) LTD** | 104 | 2% |
| **MULTINATIONAL EXPORT BUREAU** | 139 | 2% | **RAJBY TEXTILES (PVT) LTD** | 100 | 2% |
| **AMNA ASHRAF APPAREL** | 137 | 2% | **SONIC TEXTILE INDUSTRIES (PVT) LTD** | 38 | 1% |
| **Total Top 10** | **4,414** | | **Total Top 10** | **2,820** | |
| **Total Sales** | **8,703** | | **Total Sales** | **6,359** | |
| **Top 10 Sales %** | **51%** | | **Top 10 Sales %** | **44%** | |

Going forward, the management projects significant augmentation in revenue the full utilization of the new manufacturing unit and expected rebound in demand. Additionally, export base is also projected to increase due to a minimum export sales requirement as part of the terms of the LTFF facility, according to management. Achieving projected topline will be vital from a rating's perspective.

**Thin net margins in 9MFY23 depict pressure owing to higher input costs and financing charges**

Gross margins during FY22 grew to 20% (FY21: 18.6%) largely on the account of inventory gains and increase in proportion of cheaper imported cotton to 59.5% (FY21: 44.5%) in the raw material mix. However, net margins declined to 11% (FY21: 12%) owing to sizeable increase in administration expenses to Rs. 417.7m (FY21: Rs.

139.6m) attributable to a Rs. 258.9m bad debt provision for a pending trade receivables case which is currently under litigation.

Profitability performance during 9MFY23, however, witnessed notable pressure with gross margins declining to 10% as rising raw material costs, in line with shortage of local cotton and severe currency devaluation, were not fully passed on to customers. Composition of imported cotton witnessed a decrease owing to variation in client requirements, according to management. Breakdown of cotton procurement can be seen below:

| | FY22 | | | | 9MFY23 | | | |
|---|---|---|---|---|---|---|---|---|
| **Cotton** | **Weight (kgs)** | **Rs./kg** | **Amount (Rs. Mln)** | **% (weight)** | **Weight (kgs)** | **Rs./kg** | **Amount (Rs. Mln)** | **% (weight)** |
| **Imported** | 9.5 | 386 | 3,662 | 59.5% | 5.8 | 607 | 3,517 | 53.6% |
| **Local** | 6.5 | 380 | 2,449 | 40.5% | 5.0 | 496 | 2,483 | 46.4% |
| **Total** | **15.9** | **383** | **6,110** | **100.0%** | **10.8** | **555** | **6,000** | **100.0%** |

The bottom-line was significantly strained during 9MFY23 owing to lower gross margin as well as jump in financing costs to Rs. 321.5m (FY22: Rs. 92.4m, FY21: Rs. 108m) on account of higher debt levels and policy rate hikes. Consequently, the net margin was squeezed to 1.1% in 9MFY23. Projected improvement in margins amidst current economic situation will be critical to sustain the ratings.

**Although DSCR remains sufficient to meet obligations for the next year, weakening in liquidity profile is noted.**

Funds from Operation (FFO) declined notably to Rs. 102.8m during 9MFY23 (FY22: Rs. 1.1b, FY21: Rs. 974.2m) on the account of lower profitability levels. Consequently, cash flow coverages were strained with FFO/Long-term Debt and FFO/Total Debt standing at 0.07x and 0.02x, respectively (FY22: 0.57x, 0.36x; FY21: 10.65x, 4.48x). Furthermore, debt-servicing capacity also reduced notably to 1.21x (FY22: 7.93x, 11.3x) but remained within manageable levels.

The Company's inventory levels witnessed a sizeable increase to Rs. 4.6b at end-9MFY23 (FY22: Rs. 2.3b, FY21: Rs. 1.4b) which was due to the management's decision to continue production despite slowdown in demand. Additionally, trade debts rose to Rs. 2.5b (FY22: Rs. 1.6b, FY21: Rs. 1.6b), but aging schedule remained sound with about 99.2% of receivables due within 90 days (FY22: 91.8%, FY21: 83.8%). Therefore, cash conversion cycle extended to 201 days (FY22: 123 days, FY21: 138 days) owing mainly to lower inventory and receivable turnover. Advances, deposits and loans also increased to Rs. 807.8m (FY22: Rs. 195.5m, FY21: Rs. 355.1m) owing mainly to a container deposit.

Liquidity indicators depicted pressure with current ratio and short-term borrowing coverage both decreasing to 1.35x and 1.58x, respectively (FY22: 2.27x, 4.03x; FY21: 4.49x, NA) at end-Mar'23 due to sizeable incurrence of short-term borrowings to meet extended working capital needs.

**Elevated gearing and leverage indicators due to sizeable borrowings, however, improvement projected with greater earning capacity**

The Company's equity base rose to Rs. 4.8b at end-9MFY23 (FY22: Rs. 4.5b, FY21: Rs. 3.6b) on account of profit retention. Overall debt levels, however, grew notably on a timeline basis to Rs. 6.6b (FY22: Rs. 2.9b, FY21: Rs. 217.2m) owing largely to greater short-term borrowings of Rs. 4.7b (FY22: Rs. 1.8b, FY21: Rs. 125.7m) to finance extended cash conversion cycle. Furthermore, the Company drew long-term borrowings for capital expenditure related to the new production unit, with the current level standing at Rs. 1.9b at end-March'23 (FY22: Rs. 1.8b, FY21: nil). Ratings factor in the fact that about 96.7% of long-term borrowings carry concessionary mark-up rates of up to 5.46%. Consequently, leverage and gearing both increased to 1.68x and 1.37x, respectively (FY22: 0.83x, 0.64x; FY21: 0.26x, 0.06x) at end- Mar'23, but remained within the parameters of the assigned ratings. According to management, further long-term debt was drawn during July'24 to meet the remaining capital expenditure for 3,600 spindles. Limiting capitalization indicators at levels that commensurate with the assigned ratings will be important.

| FINANCIAL SUMMARY (all amounts in PKR millions) | | | | | |
|---|---|---|---|---|---|
| **BALANCE SHEET** | **FY19** | **FY20** | **FY21** | **FY22** | **9MFY23** |
| **PPE** | 862 | 803 | 2,525 | 2,712 | 6,213 |
| **Stock in Trade** | 1,652 | 3,035 | 1,350 | 2,311 | 4,554 |
| **Trade Debts** | 1,304 | 1,124 | 1,599 | 1,574 | 2,505 |
| **Loans, advances and deposits** | 327 | 343 | 355 | 195 | 808 |
| **Cash and Bank Balances** | 5 | 4 | 23 | 11 | 141 |
| **Total Assets** | 4,319 | 5,459 | 6,272 | 9,931 | 14,515 |
| **Trade and other payable** | 503 | 572 | 633 | 738 | 1,388 |
| **Long Term Debt (incl. current maturity)** | - | - | 92 | 1,844 | 1,899 |
| **Short Term Debt** | 1,007 | 2,138 | 126 | 1,083 | 4,677 |
| **Total Debt** | 1,007 | 2,138 | 217 | 2,927 | 6,576 |
| **Total Equity** | 2,781 | 2,737 | 3,609 | 4,547 | 4,804 |
| | | | | | |
| **INCOME STATEMENT** | **FY19** | **FY20** | **FY21** | **FY22** | **9MFY23** |
| **Sales Revenue** | 5,312 | 4,556 | 7,284 | 8,703 | 6,359 |
| **Gross Profit** | 518 | 456 | 1,355 | 1,738 | 639 |
| **Selling Expenses** | (84) | (69) | (117) | (115) | (95) |
| **Administrative Expenses** | (51) | (98) | (140) | (418) | (127) |
| **Financing Cost** | (138) | (193) | (108) | (92) | (322) |
| **(Loss)/Profit Before Tax** | 235 | 92 | 947 | 1,078 | 168 |
| **(Loss)/Profit After Tax** | 182 | 46 | 871 | 960 | 68 |
| | | | | | |
| **RATIO ANALYSIS** | **FY19** | **FY20** | **FY21** | **FY22** | **9MFY23** |
| **Gross Margin (%)** | 9.8% | 10.0% | 18.6% | 20.0% | 10.0% |
| **Net Margin (%)** | 3.4% | 1.0% | 12.0% | 11.0% | 1.1% |
| **FFO** | 289.43 | 119.49 | 974.22 | 1055.87 | 102.79 |
| **FFO/LT Debt (x)*** | NA | NA | 10.65 | 0.57 | 0.07 |
| **FFO/Total Debt (x)*** | 0.29 | 0.06 | 4.48 | 0.36 | 0.02 |
| **Current Ratio** | 2.29 | 1.72 | 4.49 | 2.27 | 1.35 |
| **Cash Conversion Cycle (Days)*** | 147 | 261 | 138 | 123 | 201 |
| **Gearing (x)** | 0.36 | 0.78 | 0.06 | 0.64 | 1.37 |
| **Leverage (x)** | 0.57 | 1.02 | 0.26 | 0.83 | 1.68 |
| **Debt Servicing Coverage (x)*** | 3.10 | 1.62 | 11.30 | 7.93 | 1.21 |
| **(Stock in trade + Trade Debts) / Short Term Borrowings (x)** | 2.94 | 1.95 | NA | 4.03 | 1.58 |
| **ROAA (%)*** | 4.8% | 0.9% | 14.9% | 11.9% | 0.6% |
| **ROAE (%)*** | 6.8% | 1.7% | 27.5% | 23.5% | 1.5% |

**Annualized*

| REGULATORY DISCLOSURES | Appendix II |
|---|---|
| **Name of Rated Entity** | Metco Textile (Pvt) Limited |
| **Sector** | Textile |
| **Type of Relationship** | Solicited |
| **Purpose of Rating** | Entity Rating |

**Rating History**

| Rating Date | Medium to Long Term | Short Term | Rating Outlook | Rating Action |
|---|---|---|---|---|
| | | **RATING TYPE: ENTITY** | | |
| 10/06/2023 | A- | A-2 | Negative | Maintained |
| 07/04/2022 | A- | A-2 | Stable | Reaffirmed |
| 05/07/2021 | A- | A-2 | Stable | Maintained |
| 04/16/2020 | A- | A-2 | Rating Watch-Developing | Maintained |
| 02/08/2019 | A- | A-2 | Stable | Initial |

| | |
|---|---|
| **Instrument Structure** | N/A |
| **Statement by the Rating Team** | VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities. |
| **Probability of Default** | VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default. |
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**Due Diligence Meetings Conducted**

| Name | Designation | Date |
|---|---|---|
| Mr. Ali Raza | Finance Manager | Aug 23, 2023 |