RATING REPORT

M.K. Sons (Private) Limited

REPORT DATE:
May 29, 2023

RATING ANALYSTS:
Muhammad Tabish
muhammad.tabish@vis.com.pk

Vernon Joseph Vellozo
vernon.joseph@vis.com.pk

RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A-	A-2	A-	A-2
Rating Outlook	Stable		Stable	
Rating Action	Reaffirmed		Reaffirmed	
Rating Date	*May 29, 2023*		*April 22, 2022*	

COMPANY INFORMATION

Incorporated in 1987	**External Auditors:** Kreston Hyder Bhimji & Co. Chartered Accountants
Private Limited Company	**Chairman/CEO:** Mr. Javed Akhtar
Key Shareholders:	
Mr. Javed Akhtar ~34%	
Mr. Mohammad Babar ~30%	
Ms. Fareeha Javed ~16%	
Mr. Mohammad Erkan ~10%	
Mr. Mohammad Aneeq ~10%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Industrial 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

M.K. Sons (Pvt.) Limited

OVERVIEW OF THE INSTITUTION

M.K. Sons (Pvt.) Limited (MKSL) was established in 1987 as a trading-based export house.

Profile of the Chairman/CEO

Mr. Javed Akhtar serves as the Chairman of the Board and Chief Executive Officer. He has over 30 years of experience in the textile industry.

RATING RATIONALE

Corporate Profile

M.K. Sons (Private) Limited (MKSL), with a family-owned structure and 35-years history, specializes in the production and export of value-added fabrics, home-textile products, and denim garments while covering operations from sizing to stitching. MKSL has been awarded various global standard certifications and has a workforce of over 2,800 employees. The company leverages an integrated SAP ERP system for seamless oversight of production and management processes while HR management is handled through an in-house developed oracle system.

Average 7MW energy demand is primarily met through gas generators, with backup support from the national grid and diesel generators. Management plans to install a 2MW solar power project in the near future to optimize costs.

Operational Performance

MKSL's headquarters, along with four manufacturing facilities dedicated to weaving, processing, stitching, and denim garments, are located in Faisalabad. The company has increased daily capacity of denim garments division from 5,000 to 10,000 pieces while maintaining capacity in other segments. Going forward, management plans to invest Rs. 1.2b – Rs. 1.4b in installing 30-35 new air jet looms to increase denim garment capacity; funding will come from a mix of debt and equity. Production levels in the weaving division have exhibited a contrasting trend, with fabric processing segment experiencing a decline over the review period, which management attributed to the slowdown in demand. The same trend is reflected in utilization ratios.

Table: Capacity & Production Data (Units in million)

	FY20	FY21	FY22	9M'FY23
Weaving				
Installed Capacity (Sq. meter)	59.8	59.8	59.8	44.8
Actual Production (Sq. meter)	47.5	48.9	43.5	36.3
Utilization (%)	***79.3%***	***81.7%***	***72.7%***	***80.9%***
Fabric Processing				
Installed Capacity (meter)	56.4	56.4	56.4	42.3
Actual Production (meter)	44.2	50.1	49.6	30.8
Utilization (%)	***78.3%***	***88.9%***	***87.9%***	***72.8%***
Denim Garments				
Installed Capacity (pieces)	1.8	1.8	3	2.2
Actual Production (pieces)	-	0.8	2.0	1.7
Utilization (%)	***-***	***47.4%***	***67.1%***	***75.6%***

Fabric sales are strategically managed through three distinct sources, each selected based on factors such as order demand, pricing, and resource availability in the market. These sources include in-house production, conversion of yarn to fabric via third-party vendors, and direct purchase.

Key Rating Drivers

Business risk profile is constrained by current weak macroeconomic environment both globally and locally, demand slowdown, high interest rate situation, inflationary pressures and recent floods adversely affecting cotton crop while ongoing energy crisis in the country pose a challenge to margins sustainability and future growth.

Pakistan's export 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		9M'FY22	9M'FY23
Pakistan Total Exports	22,536	25,639	32,450		23,706	21,088
Textile Exports	12,851	14,492	18,525		13,577	12,992
PKR/USD Average Rate	158.0	160.0	177.5		171.5	235.5

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.

Table : Textile Export Details (in USD millions)

	FY20	FY21	FY22		9M'FY22	9M'FY23
High Value-Added Segment	**9,669**	**12,427**	**15,605**		**11,482**	**10,318**
- Knitwear	2,794	3,815	5,121		3,730	3,390
- Readymade Garments	2,552	3,033	3,905		2,864	2,657
- Bed wear	2,151	2,772	3,293		2,449	2,032
- Towels	711	938	1,111		820	745
- Made-up Articles	591	756	849		627	535
- Art, Silk & Synthetic Textile	315	370	460		344	309
- Others	555	743	866		650	650
Low to medium Value-Added Segment	**2,858**	**2,972**	**3,717**		**2,760**	**2,158**
- Cotton Cloth	1,830	1,921	2,438		1,795	1,538
- Cotton Yarn	984	1,017	1,207		908	573
- Others	43	34	72		56	47
Total	**12,527**	**15,399**	**19,332**		**14,243**	**12,476**

Source: PBS

Cotton prices rose to a new 12-year high of ~Rs. 21,600/maund as of March'22, as a result of the shortage and higher input costs of fertilizer and energy. Cotton imports were also up 19.8%, in USD terms, for FY22 vis-à-vis preceding year.

Table: Cotton Prices Trend (In Rs.)

	FY19	FY20	FY21	FY22	9M'FY23
Per Maund	8,770	8,860	13,000	17,380	18,935
YoY % Change	26%	1%	32%	34%	n/a

Floods in Sindh and Southern Punjab during recent monsoon season have caused significant damage to the cotton crop. According to industry estimates, ~45% of the crop has been washed, worth more than $2.5b, resulting in significant price increases. The government has announced facilitation for raw materials imports to compensate for domestic shortages. Nonetheless, in addition to affecting profit margins, higher raw material pricing is expected to increase the working capital requirements, which is likely to have a negative impact on the liquidity profile of textile operators, particularly spinners, weavers and dying companies.

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.

Sizeable revenue growth achieved in FY22 fueled by higher export prices, increased sales volume, and currency devaluation. However, global demand slowdown has led to a significant volumetric decline in the current year.

Sales revenue has nearly doubled over the period of last two fiscal years, reaching Rs. 18.9b in FY22 with a significant YoY growth of ~34%, which can be attributed to two major factors – nearly one-half is driven by volumetric uptick coupled with higher prices in dollar terms and the rest is rupee devaluation impact. However, recent demand slowdown due to economic downturn in major world economies has impacted the growth in the current fiscal year, with net sales amounting to Rs. 13.7b in 9M'FY23. Management anticipates topline to reach previous year level of Rs. 19b for the full year FY23.

Export to local sales breakup has remained consistent at 88:12 in the past two years. Product-wise, home textile made-ups represent more than half of the revenue mix, followed by processed fabric, denim garments and greige fabric. Europe, representing three-fifth of total exports, remains the primary export market with Italy, Germany, Spain, and France being the major destinations. Rest is diversified among US, Asia and Middle Eastern countries. Moreover, client base is sufficiently spread out, with no single client contributing more than 10% to total sales, mitigating the concentration risk.

Steady growth in gross margins over time, but sizeable jump in finance cost in the current fiscal year led to a slim net margin. Improving the same is important for sustenance of ratings.

Gross margins have shown a consistent upward trend, driven by factors such as rupee depreciation, robust export growth, and minimal reliance on imported yarn or fabric (less than 10% historically). Management ensures a 45-day inventory buffer for fabric while yarn is kept stocked for 10 to 15 days allowing for timely production and order fulfillment. However, procurement volumes declined in the ongoing year due to reduced demand.

Operating overheads grew sizably over the review period due to sizeable jump in freight charges, salaries, utilities, and commission expense. Financial charges following an initial increase in FY22 escalated sizably in the current fiscal year due to uptick in benchmark rates. This led to a contraction in the net margins, reducing by half.

Cash flow trend mirrors profitability performance, while debt coverage metrics remain satisfactory; elevated cash conversion days.
Improved profitability trend over the last two years led to a significant improvement in funds flow from operations (FFO), reaching Rs. 1.2b (FY21: Rs. 0.9b; FY20: Rs. 0.5b) at end-FY22. However, the same was impacted in the current fiscal year by a decline in bottom-line. Debt coverage metrics remain adequate as reflected by FFO to long-term debt of 0.80x (FY22: 0.88x; FY21: 0.57x) and FFO to total debt of 0.13x (FY22: 0.16x; FY21: 0.14x) by end-9M'FY23. On the flip side, debt servicing coverage ratio dropped considerably to 1.80x (FY22: 1.90x; FY21: 3.18x).

Current ratio is consistently reported above 1.0x for the last three fiscal years and coverage of short-term borrowings in relation to trade debts and inventory remains sufficient, indicating a satisfactory liquidity profile. However, cash conversion cycle is elevated, reporting above 120 days owing to high inventory holding days. Ageing profile of trade debts remains sound as all receivables are settled within 180 days.

Healthy growth in equity base; leverage metrics remain on the higher side.
With strong retention, equity base (excluding revaluation surplus) grew by ~34% in the past 21 months, reaching Rs. 4.3b in FY22. The company has not historically paid dividends, except for Rs. 25m payout in FY22. No dividends are planned for the current fiscal year. Debt profile rose to Rs. 7.3b and comprises a mix of short-term and long-term borrowings; ~84% constituted short-term debt while aggregated running finance lines stands at Rs. 7b with two-third being the ERF facility. Leverage metrics though have depicted improvement over time yet remain on the higher side.

M.K. Sons (Pvt.) Limited **Appendix I**

FINANCIAL SUMMARY *(amounts in PKR millions)*

BALANCE SHEET	FY20	FY21	FY22	9M'FY23
Non-Current Assets	3,230	5,527	5,519	5,319
Stores, Spares, and Loose Tools	422	543	712	907
Stock-in-Trade	3,445	4,721	5,825	6,489
Trade Receivables	709	1,190	2,039	1,442
Tax Refund Due from Govt.	799	999	1,022	1,054
Cash & Bank Balance	84	54	344	193
Total Assets	**8,935**	**13,629**	**15,865**	**15,868**
Trade and Other Payables	1,248	1,654	2,391	2,274
Short-Term Borrowings	3,869	5,128	6,055	6,097
Long-Term Borrowings *(Incl. current maturity)*	944	1,437	1,202	1,026
Total Liabilities	**6,192**	**8,492**	**10,077**	**9,840**
Paid up Capital	500	500	500	500
Tier-1 Equity *(Excl. revaluation surplus)*	**2,743**	**3,200**	**3,960**	**4,274**
INCOME STATEMENT				
Net Sales	9,983	14,044	18,859	13,688
Gross Profit	1,337	2,081	2,962	2,189
Profit Before Tax	**321**	**614**	**823**	**469**
Profit After Tax	**214**	**456**	**637**	**245**
RATIO ANALYSIS				
Gross Margin (%)	13.4	14.8	15.7	16.0
Net Margin (%)	2.1	3.2	3.4	1.8
Current Ratio	1.09	1.10	1.16	1.19
Net Working Capital	486	741	1,392	1,686
FFO	467	909	1,196	724
FFO to Long-Term Debt	0.45	0.57	0.88	0.80*
FFO to Total Debt	0.10	0.14	0.16	0.13*
Debt Servicing Coverage Ratio (x)	1.54	3.18	1.90	1.80*
Gearing (x)	1.79	2.10	1.87	1.71
Debt Leverage (x)	2.26	2.65	2.54	2.30

**Annualized*

REGULATORY DISCLOSURES — Appendix II

Name of Rated Entity	M.K. Sons (Pvt.) Limited
Sector	Textile
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
29-05-2023	A-	A-2	Stable	Reaffirmed
22-04-2022	A-	A-2	Stable	Reaffirmed
05-03-2021	A-	A-2	Stable	Maintained
27-04-2020	A-	A-2	Rating Watch Negative	Maintained
30-12-2019	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.
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Due Diligence Meeting Conducted

Name	Designation	Date
Mr. Asif Nadeem	CFO-Chief Financial Officer	May 10, 2023
Mr. Haroon	Deputy GM Accounts and Finance	