RATING REPORT

M.K. Sons (Private) Limited

REPORT DATE:
June 14, 2024

RATING ANALYSTS:
M. Amin Hamdani
amin.hamdani@vis.com.pk

Mahekash Kumar
mahekash.kumar@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	*June 14, 2024*		*May 29, 2023*	

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)

Applicable Rating Criteria: Corporates:
https://docs.vis.com.pk/docs/CorporateMethodology.pdf

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 31 years of experience in the textile industry.

RATING RATIONALE

Corporate Profile
M.K. Sons (Private Limited ("MKSL" or "the Company") was incorporated on June 02, 1985 as a private limited company under the Companies Ordinance, 1984. The Company's core line of business includes manufacturing and sales of value added fabrics, home textile products and denim garments.

The Company has its registered office at 2-KM Jaranwala Road, Khurrianwala, Faisalabad and its production facilities are situated at 2-KM Jaranwala Road & 32-KM Sheikhpura road, Faisalabad. The production facilities of the Company includes: Weaving, Bleaching, Dyeing, Washing, Printing, and Stitching.

MKSL employs more than 3,100 individuals. The Company fulfills its energy demand of about 7 MW through gas generators and grid, supplemented by a 2 MW solar plant. It utilizes an integrated SAP S4 Hana system to oversee production and management processes seamlessly. Additionally, HR management is facilitated by an in-house developed system.

Operational Performance
MKSL's main office, along with four manufacturing facilities specializing in weaving, processing, stitching, and denim garments, is located in Faisalabad. The Company has not augmented its capacity for any division during the review period. Capacity utilization levels for fabric processing and denim garments remain low, as production is tailored to meet current market demands and existing orders.

Table: Capacity & Production Data (Units in million)

	FY20	FY21	FY22	FY23	10M'FY24
Weaving					
Installed Capacity (Sq. meter)	59.8	59.8	59.8	59.8	49.9
Actual Production (Sq. meter)	47.5	48.9	43.5	48.2	40.9
Utilization (%)	***79.3%***	***81.7%***	***72.7%***	***80.6%***	***82.1%***
Fabric Processing					
Installed Capacity (meter)	56.4	56.4	56.4	56.4	47.0
Actual Production (meter)	44.2	50.1	49.6	41.9	37.7
Utilization (%)	***78.3%***	***88.9%***	***87.9%***	***74.3%***	***80.3%***
Denim Garments					
Installed Capacity (pieces)	1.8	1.8	3	3.0	2.5
Actual Production (pieces)	-	0.8	2.0	2.2	1.3
Utilization (%)	***-***	***47.4%***	***67.1%***	***74.0%***	***51.3%***

The Company is focused on fabric processing and denim garments segments and management is prioritizing these divisions to optimize their potential. In the long-run, Company may implement a capacity expansion plan for Denim Garments upon viable economic situation of the Country.

Sector Update

The business risk profile of the textile sector in Pakistan is characterized by a high level of exposure to economic cyclicality and intense competition. This sector's performance is significantly influenced by the broader economic conditions in the country, making it inherently vulnerable to fluctuations in demand driven by economic factors.

In FY23, the textile sector faced challenges due to various economic and environmental factors. These included damage to the cotton crop resulting from flooding in 1HFY23, escalating inflation, and import restrictions due to diminishing foreign exchange reserves.

During FY23, Pakistan's yarn production registered a substantial decline, primarily due to reduced availability of cotton, as a result of crop damage and import restrictions. The sector's profitability was constrained by factors such as higher production costs, increased raw material costs, and rising energy expenses, all of which constrained the sector's profit margin. The industry's performance is closely intertwined with the outlook of the cotton and textile industries, both of which were affected in FY23. Reduction in cotton supply, coupled with global economic slowdown and contractionary economic policies, led to a decrease in demand for textile products and, consequently, cotton yarn.

While the global outlook for cotton production is expected to rebound, local challenges persist. These challenges include high interest rates, increasing energy costs and inflationary pressures. Additionally, the sector's vulnerability to global market dynamics and the domestic economic landscape further contribute to its high business risk profile. However, there is optimism as an anticipated bigger cotton crop in FY24 is expected to alleviate some pressure on input costs and margins.

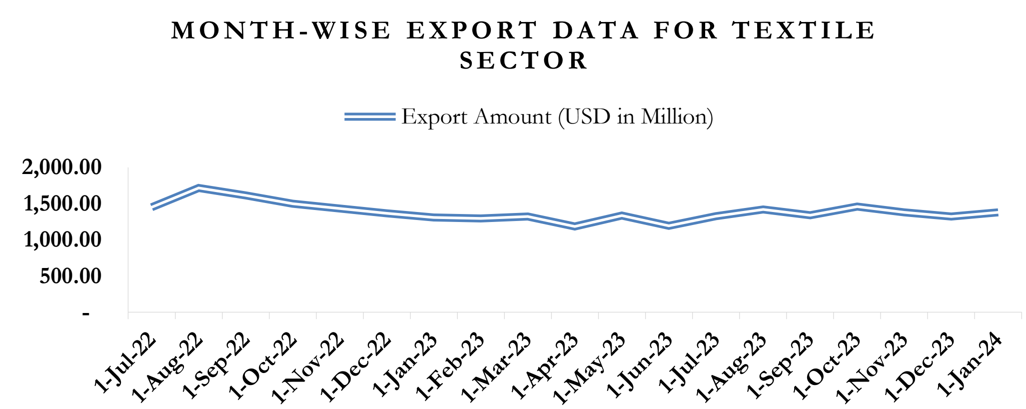

Figure 1: MoM Textile Exports (In USD' millions)
Source: SBP

Key Rating Drivers

Gross Margins remain healthy; while net margins reduced amid high finance cost
The Company experienced a marginal decrease in sales primarily due to reduced demand amid economic slowdown. Conversely, there was a slight increase in the Company's gross profit margins, rising from 15.7% in FY22 to 16.6% in FY23 attributed to efficiency in fuel and power utilization. Export sales constituted 84% of the total sales in FY23, with the remaining sales occurring domestically.

Administrative expenses grew in tandem with inflationary pressures in the economy during FY23. Conversely, there was some improvement in distribution expenses, which accounted for 5.2% of net sales in FY23, compared to 6.5% in FY22. As a result, the Company's operating profit margin increased to 8.3% in FY23 from 6.6% in FY22. However, despite the higher operating profit margin, the Company's net profit margin decreased from 3.4% in FY22 to 2.0% in FY23. This decline is attributed to the Company facing higher finance costs due to the prevailing high-interest-rate environment in the country.

Product-wise sales are primarily driven by home textile made-ups, representing over 50% of total sales in both years FY22 and FY23. Europe stood out as the top destination for exports in FY23 and 10M'FY24, comprising over 55% of total sales, while the rest are spread across America, Africa, Asia, and Australia. Notably, no individual client contributes more than 6% to the total sales, reflecting the Company's strategy of engaging in short-term contracts lasting less than one year. This approach is aimed at minimizing the risk of potential losses stemming from fluctuating economic conditions.

In the 10M'FY24 period, MKSL's gross margin and net margin were recorded at 16.6% and 1.7% respectively. Moving forward, the Company projects its profitability to increase based on expected increase in product demand, cost efficiency in utilities, and reduction in finance cost on the back of expected decrease in interest rates.

FFO experiences slight decline in FY23, While DSCR and Current Ratio maintain adequate levels
The slight reduction in net margins along with marginal topline growth during FY23 resulted in a decrease in funds from operations ("FFO") to Rs. 1.1 billion (FY22: Rs. 1.2 billion). Subsequently, FFO to total debt has inched down to 0.16x in FY23 compared to 0.17x in prior year. FFO to long-term debt has shown improvement from 1x in FY22 to 1.1x in FY23 attributed to timely repayment of long-term loans. On the contrary, the Debt Service Coverage Ratio ("DSCR") of the Company decreased from 1.8x in FY22 to 1.6x in FY23. The Company maintained an adequate liquidity profile, with its current ratio maintained at 1.2x (consistent with FY22) in FY23.

During the 10M'FY24 period, FFO amounted to Rs. 0.7 billion. Both annualized FFO to total debt and FFO to long-term debt ratios have shown a decline in coverage compared to FY23, with ratios at 0.1x and 0.9x respectively attributed to higher total debt on Company's books as of Apr'24. The Company's DSCR was recorded at 1.4x. The same is considered adequate from ratings perspective. The current ratio of the Company continued to remain manageable at 1.2x during the 10M'FY24 period. Going forward, improvement in liquidity, cash flow and debt coverages is important from the ratings perspective while any further drop in same will put negative pressure on the given ratings.

Capitalization indicators remain within manageable levels

The Company increased its paid-up capital as of Jun'23 by issuing fully paid bonus shares. However, this has no impact on overall equity of the Company. Profit retention has resulted in 10.5% Y/Y growth in equity base excluding revaluation surplus ("tier-1 equity") as of Jun'23.

Debt profile declined as of Jun'23 compared to Jun'22, comprising of 14.3% long-term debt and 85.7% short-term debt. As a result, gearing of the Company has declined from 1.8x in Jun'22 to 1.6x in Jun'23. Leverage of the Company has also depicts improvement from 2.5x to 2.2x for the same period.

As of Apr'24, Company's tier-1 equity grew attributed to strong profit retention. The Company increased its short-term borrowings as of Apr'24. The growth in equity and debt has resulted in gearing to remain constant at 1.6x as of Apr'24. However, leverage of the Company has shown some improvement, reaching 2.1x as of Apr'24, compared to 2.2x in Jun'23. The Company has no plans to increase its long-term financing in the near future.

REGULATORY DISCLOSURES — Appendix I

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
14-06-2024	A-	A-2	Stable	Reaffirmed
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.
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.
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information.

Due Diligence Meeting Conducted

Name	Designation	Date
Mr. Asif Nadeem	CFO-Chief Financial Officer	June 06, 2024
Mr. Muhammad Haroon Aziz	Deputy GM Accounts and Finance	