

## RATING REPORT

## Artistic Denim Mills Limited

**REPORT DATE:**

August 29, 2019

**RATING ANALYSTS:**

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## RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A-	A-1	A-	A-1
<i>Rating Date</i>	<i>August 26, 2019</i>		<i>May 7, 2018</i>	
Rating Outlook	Stable		Stable	
<i>Outlook Date</i>	<i>August 26, 2019</i>		<i>May 7, 2018</i>	

## COMPANY INFORMATION

Incorporated in 1992

**External auditors:** M/s EY Ford Rhodes Chartered Accountants

**Public Limited Company**  
**Shareholders holding more than 5%:**

- Mr. Faisal Ahmed
- Mr. Muhammad Iqbal Ahmed
- Ms. Sadia Zain

**Chairman of the Board:** Mr. Muhammad Iqbal Ahmed

**Chief Executive Officer:** Mr. Faisal Ahmed

## APPLICABLE METHODOLOGY(IES)

*Applicable Rating Criteria: Corporates (May, 2016)* <https://www.vis.com.pk/kc-meth.aspx>

## Artistic Denim Mills Limited

OVERVIEW OF  
THE  
INSTITUTION

*Artistic Denim Mills Limited (ADML) was incorporated in 1992 as a Public Limited Company.*

*The operations of the company are housed at a composite unit in Korangi Industrial Area, Karachi, Pakistan.*

*As on June 30, 2018 shareholding pattern of the company demonstrates that it is a family owned business with major shareholding resting with Mr. Faisal Ahmed owning 60% of the shares of the company.*

*ADML is fully compliant with International Social and Environmental & Quality standards. It also has a liaison office in Bangladesh encompassing a showroom and a dedicated country manager to stay in proximity to the customers.*

## RATING RATIONALE

Artistic Denim Mills Limited (ADML) operates as a vertically integrated denim fabric and garment manufacturer. The revenues of the company comprise exports with sales generated through both denim fabric and denim garments division. The capacity of the two business segments is shown as follows:

Capacity & Production		
	FY17	FY18
<b>Spinning</b>		
<b>Number of rotors installed</b>	864	864
<b>Number of spindles installed</b>	20,448	20,448
<b>Actual capacity of yarn (lbs)</b>	18,232,500	18,232,500
<b>Production of yarn</b>	15,974,120	17,235,279
<b>Utilization</b>	<b>88%</b>	<b>95%</b>
<b>Denim Fabric</b>		
<b>Number of looms installed</b>	154	160
<b>Installed capacity of fabric (meters)</b>	19,646,250	19,970,250
<b>Production of fabric (meters)</b>	19,316,148	19,114,648
<b>Utilization</b>	<b>98%</b>	<b>96%</b>

**Key Rating Drivers****Sector Dynamics and Business Risks**

Business risk profile is supported by stable demand for denim fabric and garments across various geographical markets. However, global trade dynamics have been impacted by the ongoing tariff-infused US-China trade war. Bangladesh and China have remained the major suppliers to the key markets of US & Europe in 2017, whereas in 2018 Vietnam has emerged as another key supplier. This trend is driving stiff competition in the global market as countries such as Bangladesh & Vietnam have an edge due to their lower cost of doing business. The pricing power is vested with the top notch retailers who demand competitive pricing, innovation and quality. The rising share of exports from these countries will keep margins under pressure for the domestic industry. However, we expect the denim industry to be positively impacted by the recently undertaken PKR devaluation, despite higher inflation forecasts over the short to medium term horizon.

**Sales & Profitability**

Being an export driven business, ADML's profitability has been positively impacted by the PKR devaluation. Even though the net margins remained relatively flat in FY18, we have noticed improvement during 9MFY19 as compared to same period last year. Given the quantum of PKR devaluation undertaken so far, we expect margins to remain stable, after accounting for higher inflation forecasts.

**Liquidity**

The fund flow from operations has improved during FY18 on account of the improvement in profitability (FY18: Rs 998 m; FY17: 627 m), thereby increasing FFO/Total debt ratio to 40% (FY17: 25%) at end-FY18: Being a textile business, ADML requires running finance to fund working capital requirements. The short-term borrowings, undertaken in this regard, remain entirely backed by the stock in trade and trade debts. The coverage of borrowings by stock and debts stood at 1.5x, as of 9MFY19. The total debt servicing cover stands at 8.4x (FY17:8.1x) at end-FY18.

**Capitalization and Funding**

The equity base of the company amounted to Rs 6.3b (FY18: Rs. 6.1b, FY17: Rs. 5.7b) at end-9MFY19. Equity has grown at a 3-yr CAGR of 4% with dividend payout ratio being maintained at an average of 42% during the last 3 years. The long term debt of the company is reported at Rs 1.5b (FY18: 900m), which increased by Rs 500mn FY18, owing weaving segment expansion related capital expenditure. The gearing and leverage indicators have trended upwards due to the same and were reported at 0.7x & 1.0x (FY18: 0.4x & 0.7x) at end 9MFY19. Accounting for the expansion and the prospective running finance requirements, we expect the gearing to remain at the similar level over the near to medium term horizon.

**Corporate Governance**

Given the company's status as the listed company in the denim sector, transparency and disclosures compare favorably vis-à-vis other peers in the denim sector. However, board composition has room for improvement through inclusion of additional independent directors on the board. The company uses Microsoft Dynamics along with other in-house developed modules for its IT related needs. Progress against planned initiatives on the IT front will be tracked by VIS.

## Artistic Denim Mills Limited

## Appendix I

FINANCIAL SUMMARY <i>(amounts in PKR millions)</i>				
<b><u>BALANCE SHEET</u></b>	<b>FY17</b>	<b>FY18</b>	<b>9MFY19</b>	
Fixed Assets	5,458	5,305	5,789	
Stock-in-Trade	1,361	1,718	2,734	
Trade Debts	1,496	1,807	1,910	
Cash & Bank Balances	63	87	1,014	
Total Assets	9,470	10,100	12,552	
Trade and Other Payables	1,174	1,488	1,604	
Long Term Debt	852	899	1,496	
Short Term Debt	1,670	1,570	3,065	
Total Debt	2,522	2,469	4,561	
Total Equity	5,759	6,100	6,328	
<b><u>INCOME STATEMENT</u></b>				
Net Sales	6,907	8,240	5883	5,794
Cost of sales	(6,167)	(7,448)	(5,291)	(5,132)
Gross Profit	740	792	592	663
Operating Profit	534	693	495	571
Finance Cost	(88)	(92)	(68)	(74)
Profit After Tax	429	517	388	438
<b><u>RATIO ANALYSIS</u></b>				
Gross Margin (%)	10.7%	9.6%	11.4%	
Net Margin (%)	6.2%	6.3%	7.6%	
Net Working Capital	1,102	1,267	1,960	
FFO	627	998	780	
FFO to Total Debt (%)*	25%	40%	23%	
FFO to Long Term Debt (%)*	74%	111%	70%	
Debt Servicing Coverage Ratio (x)*	8.1	8.4	6.2	
Leverage (x)	0.6	0.7	1.0	
Gearing (x)	0.4	0.4	0.7	
ROAA (%)*	4.8%	5.3%	5.2%	
ROAE (%)*	7.6%	8.7%	9.4%	

\*Annualized

**ISSUE/ISSUER RATING SCALE & DEFINITION** **Appendix II**

**RATING SCALE & DEFINITIONS: ISSUES / ISSUERS**

Medium to Long-Term

**AAA**

Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

**AA+, AA, AA-**

High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

**A+, A, A-**

Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

**BBB+, BBB, BBB-**

Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

**BB+, BB, BB-**

Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

**B+, B, B-**

Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

**CCC**

Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

**CC**

A high default risk

**C**

A very high default risk

**D**

Defaulted obligations

Short-Term

**A-1+**

Highest certainty of timely payment; Short-term liquidity, including internal operating factors and / or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

**A-1**

High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

**A-2**

Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

**A-3**

Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

**B**

Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

**C**

Capacity for timely payment of obligations is doubtful.

**Rating Watch:** VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. [www.vis.com.pk/images/criteria\\_watch.pdf](http://www.vis.com.pk/images/criteria_watch.pdf).

**Rating Outlooks:** The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details. [www.vis.com.pk/images/criteria\\_outlook.pdf](http://www.vis.com.pk/images/criteria_outlook.pdf)

**(SD) Rating:** A suffix (SD) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and / or credit support from a third party to the transaction. The suffix (SD), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

**(blr) Rating:** A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

**'p' Rating:** A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. [www.vis.com.pk/images/policy\\_ratings.pdf](http://www.vis.com.pk/images/policy_ratings.pdf)

**'SD' Rating:** An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES				Appendix III	
<b>Name of Rated Entity</b>	Artistic Denim Mills Limited				
<b>Sector</b>	Textile Industry				
<b>Type of Relationship</b>	Solicited				
<b>Purpose of Rating</b>	Entity Rating				
<b>Rating History</b>	<b>Rating Date</b>	<b>Medium to Long Term</b>	<b>Short Term</b>	<b>Rating Outlook</b>	<b>Rating Action</b>
	29-Aug-2019	A-	A-1	Stable	Reaffirmed
	07-May-2018	A-	A-1	Stable	Initial
<b>Instrument Structure</b>	N/A				
<b>Statement by the Rating Team</b>	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.				
<b>Probability of Default</b>	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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