RATING REPORT

Artistic Denim Mills Limited

REPORT DATE:
December 31, 2021

RATING ANALYSTS:

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RATING DETAILS				
	Latest Rating		Previous Rating	
Rating Category	Long-term	Short-term	Long-term	Short-term
Entity	A-	A-2	A-	A-1
Rating Date	*December 31, 2021*		*November 18, 2020*	
Rating Outlook	Stable		Stable	
Outlook Date	*December 31, 2021*		*November 18, 2020*	

COMPANY INFORMATION

Incorporated in 1992	**External auditors:** M/s Reanda Haroon Zakaria & Company Chartered Accountants
Public Limited Company **Shareholders holding more than 5%:** - Mr. Faisal 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 (August 2021)
https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

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.

Shareholding pattern of the company demonstrates that it is a family owned business with major shareholding resting with Mr. Faisal Ahmed owning 81% 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' or 'the Company') operates as a vertically integrated denim fabric and garment manufacturer. The Company has an export-oriented revenue base, with local sales averaging 7% of gross revenues during the past 2-year period (FY20-21). Sales are bifurcated between denim fabric and denim garments division. The capacity of the two business segments is shown as follows:

Table 1: Capacity & Production

	FY20	FY21
Spinning		
Actual capacity of yarn (Lbs.)	19,305,000	20,377,500
Production of yarn (Lbs.)	14,513,760	15,342,293
Utilization	**75%**	**75%**
Weaving		
Installed capacity of fabric (meters)	20,898,750	21,143,150
Production of fabric (meters)	13,729,859	14,222,737
Utilization	**65%**	**67%**
Garments		
Installed capacity of fabric (Pcs)	6,000,000	6,000,000
Production of fabric (Pcs)	3,043,079	5,666,673
Utilization	**50%**	**94%**

Sector Update

Table 2: Pakistan Export Statistics

	FY19	FY20	FY21	Q1'FY21	Q1'FY22
Pakistan Exports (In USD' Millions)	24,257	22,536	25,632	5,354	7,241
Textile Exports (In USD' Millions)	13,659	12,867	14,488	3,086	4,240
PKR/USD Rate (Average)	136.3	158.2	160.3	167.0	164.6
Source: SBP					

- Subsequent to posting export contraction in FY20 - owing to the pandemic-induced slowdown experienced in H2'FY20 – Pakistan's export base grew by 14% in FY21, which is partly attributable to a low base effect. Pakistan's export proceeds have oscillated in the range of USD 22-25b during the past decade (FY11-FY21). So the uptick is largely aligned with historical numbers and is not considered material.
- Share of textile exports in total exports has oscillated in the range of 54-59%, coming in at 57% during the past 2-years (FY20-21). In FY21, owing to the similar low-base effect, as discussed above, textile exports were up 13%.
- In USD' terms textile exports have grown at a CAGR of 4.4% during the past 3-year period (FY19-FY21), despite depreciation in average USD/PKR parity of 24%, 16%, and 1% in FY19, FY20 and FY21 respectively.
- As illustrated in the table above, textile exports in Q1'FY22 were 37% higher than SPLY. Inclusive of textile exports for Oct'2021, the number for 4M'FY22 textile exports came in at USD 6b. With additional capacities coming online in January

2022, textile exports for FY22 are likely to exceed the annualized figure of USD 18b.

- As illustrated in the table below, the composition of textile exports has depicted improvement in the last 4-yar period, with contribution from higher value added segment increasing from 72.9% in FY18 to 80.7% in FY21 of aggregate textile exports.

Table 2: Segment-wise textile Exports (All Figures in USD' Millions, except for percentages)

	FY18	FY19	FY20	FY21	FY18	FY19	FY20	FY21
HIGH VALUE-ADDED SEGMENT	**9,854**	**10,046**	**9,669**	**12,428**	**72.9%**	**75.4%**	**77.2%**	**80.7%**
- KNITWEAR	2,711	2,900	2,794	3,816	20.1%	21.8%	22.3%	24.8%
- READYMADE GARMENTS	2,577	2,653	2,552	3,033	19.1%	19.9%	20.4%	19.7%
- BED WEAR	2,261	2,262	2,151	2,772	16.7%	17.0%	17.2%	18.0%
- TOWELS	797	786	711	938	5.9%	5.9%	5.7%	6.1%
- MADE-UP ARTICLES (EXCL. TOWELS & BED WEAR)	685	680	591	756	5.1%	5.1%	4.7%	4.9%
- ART, SILK & SYNTHETIC TEXTILE	310	297	315	370	2.3%	2.2%	2.5%	2.4%
- OTHERS	513	468	555	743	3.8%	3.5%	4.4%	4.8%
LOW TO MEDIUM VALUE-ADDED SEGMENT	**3,667**	**3,282**	**2,858**	**2,972**	**27.1%**	**24.6%**	**22.8%**	**19.3%**
- COTTON CLOTH	2,204	2,102	1,830	1,921	16.3%	15.8%	14.6%	12.5%
- COTTON YARN	1,372	1,125	984	1,017	10.1%	8.4%	7.9%	6.6%
- OTHERS	92	54	43	34	0.7%	0.4%	0.3%	0.2%
TOTAL	**13,521**	**13,328**	**12,527**	**15,400**		-		
SOURCE: PBS								

- Cotton production in Pakistan, on the other hand, was at its lowest level in decades for FY21. Cotton prices rose to a new 11-year high of ~Rs. 13,000/maund as a result of the production shortage, and cotton imports have climbed by 59.8% in quantity and 68.1% in USD terms, for FY21 vis-à-vis preceding year.

Table 3: Cotton Prices

	FY18	*FY19*	*FY20*	*FY21*
Per Maund (Rs.)	**6,953**	**8,770**	**8,860**	**13,000**
% Change	***6%***	***26%***	***1%***	***32%***

- Given favorable weather conditions, cotton production in Pakistan posted strong growth in FY22, with cotton crop for Jul-Nov'22 (Rabi) season being 81% higher than SPLY. Nevertheless, the upward momentum in cotton pricing continued in FY22, with prices as of November 2021 hovering at ~Rs. 16,000 per mound.

- The margins of textile operators have broadly depicted improvement despite the uptick in raw material costs, given that the same was offset by exchange rate movement. Nevertheless, higher raw material pricing has increased the working capital requirements for textile operators, which is likely to weigh on the liquidity of textile players

Denim Segment

- Demand for denim and denim garments suffered a setback during the pandemic-induced lockdowns, as consumer patterns shifted towards comfort wear, suited more for in-door living, instead of denim wear, which is considered more of an attire for outdoors. In FY21, we have noted some recovery in demand for denim products as key markets, EU & North America, have posted improvement in retail spending.

- In tandem with the contraction in demin demand, most South Asian denim manufactures recorded revenue and margin contraction. With gradual demand recovery in key markets, offtake and margins of denim manufacturers have started to normalize towards its long term trend.

Key Rating Driver - ADML

Revenue & Profitability Margins have posted improvement, subsequent to undergoing contraction in FY20

Table 3: P&L (Extract)

	FY19	FY20	FY21	Q1'FY22
Net Sales (PKR million)	7,767	7,941	9,813	4,406
Gross Margin (%)	11.4%	7.9%	11.3%	9.2%
EBIT margin (PKR million)	13.7%	4.9%	6.9%	6.7%
Net Margin (%)	11.2%	1.4%	3.6%	4.0%

- ADML's topline depicted growth of 24% in FY21, following 6% contraction and 2% growth in FY19 and FY20 respectively. During the past 3-year period (FY19-FY21), the Company's topline has grown at a CAGR of 6%.

- The Company's gross margin had posted contraction in FY20, mainly as a result of the pandemic-induced demand contraction. In FY21, the Company's gross margin posted improvement and normalized to ADML's long-term trend.

- The operating margin was slightly higher YoY, however, on the back of exchange losses in contrast to exchange gains, operating margin remains depressed vis-à-vis FY19 level.

- Given the increase in quantum of debt, the finance cost was up 33% YoY. Most of Company's

- On the back of volumetric growth in topline, the bottom line tripled YoY in FY21 (PAT: FY21: Rs. 354m; FY20: Rs. 114m). Nevertheless, bottom line remains lower than historical highs posted in FY17-19.

- Offtake in latest interim period (Q1'FY22) posted notable improvement, with topline being ~90% higher vis-à-vis SPLY. In view of this trend, topline for FY22 is likely to post strong growth. Margins, on the other hand, have come under pressure, given rise in cotton pricing.

Cashflow Coverage Indicators have posted improvement; Given sizable cotton procurement cash conversion cycle has elongated

Table 4: Cash flow Analysis

	FY19	FY20	FY21
FFO (Mn.) (PKR million)	1,364	658	952
FFO to Total Debt (%)	30%	11%	11%
FFO to Long Term Debt (%)	88%	34%	32%
Debt Servicing Coverage Ratio (x)	7.96	3.12	4.48
Current Ratio	1.48	1.41	1.23
(Stock in trade+ trade debts)/STD	1.62	1.29	1.53

- In tandem with the improvement in offtake and margins, the cash flow coverage indicators have posted improvement and become aligned with peers.

- ADML, as a textile company, requires running finance to meet its working capital needs. The short-term borrowings made in this regard are entirely backed by inventory and trade debts. Stock in trade and trade debts account for 1.6x of short-term borrowings.

- We have noted a consistent uptick in stick of inventory and trade debts, which amounted to Rs. 5.3b and Rs. 3.9b, or 28% and 21% of the asset base respectively as of Sep'21. Given this accumulation of inventory and trade debts, the cash conversion cycle has elongated, as reflected in the table below. As per management, this is mainly because the Company opted to procure cotton requirement for the coming in year in anticipation of adverse exchange rate parity, which has allowed ADML to achieve better gross margin. In case of trade debts, the Company maintains conservative counterparty limits and credit risk mitigation techniques, as a result of which they have not had to record bad debt provisions historically.

Table 5: Cash Conversion Cycle (in Days)

	FY19	FY20	FY21
Cash Conversion Cycle	**128**	**208**	**241**
- **Days Inventory Outstanding**	107	181	221
- **Days Sales Outstanding**	100	108	102
- **Days Payable Outstanding**	79	82	82

Capitalization and Funding

Table 6: Balance Sheet (Extract)

	Jun'19	Jun'20	Jun'21	Sep'21
Total Assets (PKR million)	12,998	14,680	17,546	18,964
Total Liabilities (PKR million)	6,244	8,068	10,819	12,058
Total Equity (PKR million)	6,754	6,612	6,728	6,906
Long Term Debt (PKR million)	1,550	1,917	2,942	3,221
Short Term Debt (PKR million)	3,065	4,227	5,501	5,794
Total Debt (PKR million)	4,615	6,143	8,443	9,016

Leverage (x)	0.9	1.2	1.6	1.7
Gearing (x)	0.7	0.9	1.3	1.3

- In the absence of significant internal capital generation, given lower margins, and in combination with continuing stable dividend payout trend, despite lower profitability, net equity depicted YoY contraction in FY20 by 2%. In FY21, the dividend payout was lowered down to 71% from 221% in FY20, as a result of which net equity grew by 2%.

- Despite the dampening in demand noted in denim segment, the management is optimistic about the ongoing demand recovery, which is reflected by sizable capital expenditure of Rs. 2.2b during FY21, which is mainly been undertaken by utilizing the SBP's LTFF/ TERF scheme.

- Given the sizable capital outlay utilizing SBP's TERF scheme, along with working capital requirement driven uptick in short term debt, the Company's gearing has trended up on a timeline.

- Going forward, the Company plans to incur capital expenditure in the range of Rs. 1-1.5b. As per management, they will maintain gearing at same level by maintaining adequate profit retention.

Artistic Denim Mills Limited — Appendix I

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**Jun'19**	**Jun'20**	**Jun'21**	**Sep'21**
Fixed Assets	5,907	6,078	7,746	8,275
Stock-in-Trade	2,446	3,220	5,100	5,284
Trade Debts	2,520	2,242	3,300	3,900
Cash & Bank Balances	1,197	884	371	314
Total Assets	12,998	14,680	17,546	18,964
Trade and Other Payables	1,539	1,777	2,179	2,837
Long Term Debt	1,550	1,917	2,942	3,221
Short Term Debt	3,065	4,227	5,501	5,794
Total Debt	4,615	6,143	8,443	9,016
Paid-up Capital	840	840	840	840
Total Equity	6,754	6,612	6,728	6,906
INCOME STATEMENT	**FY19**	**FY20**	**FY21**	**Q1'FY22**
Net Sales	7,767	7,941	9,813	4,406
Cost of sales	(6,879)	(7,314)	(8,701)	(3,999)
Gross Profit	888	627	1,112	407
Operating Profit	1,067	389	678	294
Finance Cost	112	167	222	71
Profit before Tax	955	222	456	223
Profit After Tax	867	114	354	178
RATIO ANALYSIS	**FY19**	**FY20**	**FY21**	**Q1'FY22**
Gross Margin (%)	11.4%	7.9%	11.3%	9.2%
EBIT Margin	13.7%	4.9%	6.9%	6.7%
Net Margin (%)	11.2%	1.4%	3.6%	4.0%
Net Working Capital	2,297	2,483	1,811	1,737
FFO	1,364	658	952	330
FFO to Total Debt (%)	30%	10.7%	11.3%	14.6%*
FFO to Long Term Debt (%)	88%	34%	32%	41.0%*
Debt Servicing Coverage Ratio (x)	8.0	3.1	4.5	3.1x*
Current Ratio (x)	1.48	1.41	1.23	1.19
Leverage (x)	0.9	1.2	1.6	1.7
Gearing (x)	0.7	0.9	1.3	1.3
ROAA (%)	7.5%	0.8%	2.2%	3.9%*
ROAE (%)	13.5%	1.7%	5.3%	10.5%*
(Stock in trade+ trade debts)/STD	1.62	1.29	1.53	1.59

**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

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

(SO) Rating: A suffix (SO) 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 (SO), 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

'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

Name of Rated Entity	Artistic Denim Mills Limited
Sector	Textile Industry
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see table below
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 Meetings Conducted	see table below

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
31-Dec-2021	A-	A-2	Stable	Downgrade
18-Nov-2020	A-	A-1	Stable	Maintained
24-Apr-2020	A-	A-1	Rating Watch - Developing	Maintained
29-Aug-2019	A-	A-1	Stable	Reaffirmed
07-May-2018	A-	A-1	Stable	Initial

Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Sagheer Ahmed	CFO	November 3, 2021