RATING REPORT

Artistic Denim Mills Limited

REPORT DATE:
January 09, 2023

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-2
Rating Date	*January 09, 2023*		*December 31, 2021*	
Rating Outlook	Stable		Stable	
Outlook Date	*January 09, 2023*		*December 31, 2021*	

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 3-year period (FY20-22). Sales are bifurcated between cotton yarn, denim fabric and denim garments division. Around 60% of the fabric produced is utilized in-house for garment manufacturing with the remaining sold in the market. The capacity of the three business segments is shown as follows:

Table 1: Capacity & Production

	FY20	FY21	FY22
Spinning			
Actual capacity of yarn (Lbs.)	19,305,000	20,377,500	22,425,000
Production of yarn (Lbs.)	14,513,760	15,342,293	18,819,808
Utilization	**75%**	**75%**	**84%**
Weaving			
Installed capacity of fabric (meters)	20,898,750	21,143,150	21,143,150
Production of fabric (meters)	13,729,859	14,222,737	15,434,953
Utilization	**66%**	**67%**	**73%**
Garments			
Installed capacity of fabric (Pcs)	6,000,000	6,000,000	8,263,200
Production of fabric (Pcs)	3,043,079	5,666,673	7,516,011
Utilization	**51%**	**94%**	**91%**

Over the last two years (FY21-FY22), the company incurred capital expenditure to the tune of Rs. 4.6b, around 50% of which was financed through long-term debt and the remaining through internal cash generation. The said capex was incurred across the value chain with spinning, fabric and garments capacity increasing by 16%, 1%, and 38%, respectively over the two-year period. During the ongoing year, the Company initiated plans to set up a bleaching unit requiring capex to the tune of around Rs. 1.1b, planned to be financed through internal generation: debt ratio of 32%:67%. This unit will enable the company to bleach waste fiber emanating from garments division, which will then be further, converted into yarn consequently further enhancing spinning capacity. In 1QFY23, cost of Rs. 100 for building construction has been incurred through internal resources. Machinery amounting Rs. 750m will be financed through long-term financing. LC for the same has been opened and expected timeline for arrival of the machinery is April-May'2023. Initially the long-term facility will be drawn against term loan as a bridge facility which will be converted into LTFF when the same is available. Management expects COD of the unit by end of FY23.

Business risk profile is supported by industry wide growth in exports over the last year; however, with recent floods adversely affecting cotton crop and ongoing weakening in macroeconomic environment (locally and globally) 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 2: Pakistan Export Statistics (in USD millions)

	FY20	FY21	FY22	1Q'FY22	1Q'FY23
PAKISTAN TOTAL EXPORTS	22,536	25,639	32,450	7,201	7,594
TEXTILE EXPORTS	12,527	15,399	19,332	4,421	4,584
PKR/USD AVERAGE RATE	158.0	160.0	177.5	164.4	229.1

Source: Pakistan Bureau of Statistics (PBS)

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 3: Textile Export Details (in USD millions)

	FY20	FY21	FY22	1Q'FY22	1Q'FY23
High Value-Added Segment	**9,669**	**12,427**	**15,605**	**3,561**	**3,749**
- **Knitwear**	2,794	3,815	5,121	1,145	1,321
- **Readymade Garments**	2,552	3,033	3,905	861	912
- **Bed wear**	2,151	2,772	3,293	803	780
- **Towels**	711	938	1,111	241	237
- **Made-up Articles**	591	756	849	197	180
- **Art, Silk & Synthetic Textile**	315	370	460	108	108
- **Others**	555	743	866	206	211
Low to medium Value-Added Segment	**2,858**	**2,972**	**3,717**	**860**	**835**
- **Cotton Cloth**	1,830	1,921	2,438	557	581
- **Cotton Yarn**	984	1,017	1,207	289	236
- **Others**	43	34	72	14	18
Total	**12,527**	**15,399**	**19,332**	**4,421**	**4,584**

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 4: Cotton Prices Trend (In Rs.)

	FY19	FY20	FY21	FY22
Per Maund	8,770	8,860	13,000	17,380
YoY % Change	26%	1%	32%	34%

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 locally. The government has announced facilitation for raw materials imports for the export sector 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 encompassing 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.

Sales revenue reported a three year compounded growth rate of 28% attributable to volumetric growth, USD/PKR parity and favorable product mix.

Sales revenue of the company has grown at a CAGR of 28% over the past three years (FY19-FY22). Sales revenue almost entirely comprises exports sales. Sales growth of 67% in FY22 was on account of both greater quantity sold and higher average selling price due to increase in orders in hand and currency devaluation, respectively. In terms of geographical concentration in revenues, around 50% of sales are generated from European counties while remaining are originated from the US. Going forward, based on the energy crisis in European market, geographic concentration is expected to be skewed towards the American market. Top 10 client concentration is on the higher side; however, comfort is drawn from the long-term association with clients.

Sales revenue for 1QFY23 was reported at Rs. 3.5b (1QFY22: Rs. 4.4b) as a result of global demand weakening due to global recession. As per management, gradual improvement in sales revenue is expected in the later half of the ongoing year with targeted revenue base of Rs. 15-16b in FY23. Materialization of the same is contingent on improving global market dynamics over the rating horizon.

Margins depicted a downtick in the outgoing year due to higher input costs (largely fuel); however, the same improved in the ongoing year due to PKR devaluation and cost efficiencies.

Gross margins (GMs) of the firm decreased during FY22 owing to higher cost of raw material, elevated energy costs and greater salaries expensed with the same reported lower at 7.8% (FY21: 11.3%; FY20: 7.9%). Fuel costs escalated due to lower gas available in FY22 and resorting to the utilization of diesel. With targeted commencement of load from KE in the ongoing year, the same is expected to add cost efficacy, as per management. Administrative and selling expenses increased by 16% during FY22 on account of higher salary allowances. In addition, finance charges also increased to Rs. 412.6m (FY21: Rs. 221.7m) during FY22 due to higher benchmark rates along with higher quantum of debt drawdown to finance expansion and working capital needs. However, with the support of exchange gains to the tune of Rs. 569.6m (FY21: Nil) in FY22 net profitability margin of the company was reported higher at 4.0% (FY21: 3.6%; FY20: 1.4%) during FY22.

During 1QFY23, gross and net margins increased to 11.6% and 7.1%, respectively, due to exchange-rate driven revenue base and support of exchange gain. Going forward, meeting projected profitability levels amidst subdued macroeconomic environment (locally and globally) will be considered important. *As per management, orders in hand are covered till 3QFY23.*

Adequate cash coverages against outstanding obligations

Despite increasing quantum of debt on a timeline basis, funds from operations (FFO) provide reasonable coverage against outstanding obligations. In absolute terms, FFO was reported higher at Rs. 1.3b (FY21: Rs. 952.4m; FY20: Rs. 657.7m) during FY22 in tandem with increase in profitability. However, Debt Servicing Coverage ratio dipped in the review period (FY22 and 1QFY23) due to greater quantum of current portion of long-term debt and elevated finance costs. During 1QFY23, FFO to Total Debt, FFO to Long Term Debt and Debt Servicing Coverage ratio were reported at 14.3% (FY22: 13.0%, FY21: 11.3%), 36.8% (FY22: 33.1%; FY21: 32.4%) and 2.6x (FY22: 2.8x; FY21: 4.5x), respectively.

Current ratio remained at an adequate level of 1.2x at end-September'22. Trade debts in relation to sales revenue has been improving on a timeline basis with satisfactory ageing profile where 74% of trade debts were not over-due. Overall cash conversion cycle of the company has improved in FY22. Stock in trade and trade debts provided sufficient coverage against short-term debt. Maintaining similar levels amidst weak macroeconomic environment will be important.

Table 5: Cash flow Analysis

	FY20	FY21	FY22	1Q23
FFO (Mn.) (PKR million)	658	952	1,340	398
FFO to Total Debt (%)	11%	11%	13%	14%
FFO to Long Term Debt (%)	34%	32%	33%	37%
Debt Servicing Coverage Ratio (x)	3.12	4.48	2.83	2.60
Current Ratio	1.41	1.23	1.17	1.15

Table 6: Cash Conversion Cycle (in Days)

	FY20	FY21	FY22
Cash Conversion Cycle	**168**	**194**	**148**
- **Days Inventory Outstanding**	141	174	124
- **Days Sales Outstanding**	108	102	78
- **Days Payable Outstanding**	82	82	54

Capitalization indicators are expected to remain within manageable levels

Attributable to profit retention, equity base of the company increased (1QFY23: Rs. 7.5b; FY22: 7.2b; FY21: Rs. 6.7b). With growth in debt levels being greater than equity base, gearing and leverage ratios of the company were reported higher at 1.96x (FY22:1.77x, FY21: 1.61x) and 1.49x (FY22: 1.42x, FY21: 1.25x), respectively at end-Sept'22. Debt levels increased to Rs. 11.2b (FY22: Rs. 10.3b; FY21: Rs. 8.4b) at end-Sep'22 to finance expansion plans and higher working capital needs. Around 60% of debt portfolio is short-term in nature. The company enjoys the benefit of concessionary rate financing with around 97% of the total debt portfolio comprising ERF and LTFF at end-June'22. Dividend payout has decreased to 26% (FY21: 48%) in FY22 as a management's strategy to finance a portion of expansion plans through internal cash generation. Although management plans to drawdown additional debt for the bleaching unit, capitalization indicators are expected to remain within manageable levels supported by profit retention. Maintenance of the same in accordance with the benchmarks for the assigned ratings is considered important.

Table 7: Balance Sheet (Extract)

	Jun'20	Jun'21	Jun'22	Sep'22
Total Assets (PKR million)	14,680	17,546	20,080	22,164
Total Liabilities (PKR million)	8,068	10,819	12,840	14,680
Total Equity (PKR million)	6,612	6,728	7,240	7,485
Long Term Debt (PKR million)	1,917	2,942	4,051	4,327
Short Term Debt (PKR million)	4,227	5,501	6,223	6,821
Total Debt (PKR million)	6,143	8,443	10,274	11,148
Leverage (x)	1.2	1.6	1.8	2.0
Gearing (x)	0.9	1.3	1.4	1.5

Artistic Denim Mills Limited Appendix I

FINANCIAL SUMMARY *(amounts in PKR millions)*					
BALANCE SHEET	**FY19**	**FY20**	**FY21**	**FY22**	**1Q23**
Fixed Assets	5,907	6,078	7,746	9,645	10,049
Stock-in-Trade	2,446	3,220	5,100	5,106	6,703
Trade Debts	2,520	2,242	3,300	3,754	3,375
Cash & Bank Balances	1,197	884	371	629	537
Total Assets	12,998	14,680	17,546	20,080	22,164
Trade and Other Payables	1,539	1,777	2,179	2,315	3,279
Long Term Debt	1,550	1,917	2,942	4,051	4,327
Short Term Debt	3,065	4,227	5,501	6,223	6,821
Total Debt	4,615	6,143	8,443	10,274	11,148
Total Equity	6,754	6,612	6,728	7,240	7,485
INCOME STATEMENT	**FY19**	**FY20**	**FY21**	**FY22**	**1Q23**
Net Sales	7,767	7,941	9,813	16,353	3,463
Cost of sales	6,879	7,314	8,701	15,081	3,063
Gross Profit	888	627	1,112	1,272	401
Operating Profit	1,067	389	678	1,296	418
Finance Cost	112	167	222	413	131
Profit Before Tax	955	222	456	883	287
Profit After Tax	867	114	354	654	245
RATIO ANALYSIS					
Gross Margin (%)	11.4%	7.9%	11.3%	7.8%	11.6%
Net Margin (%)	11.2%	1.4%	3.6%	4.0%	7.1%
Net Working Capital	2,297	2,483	1,811	1,500	1,587
FFO	1,364	657.7	952.4	1,340.4	398
FFO to Total Debt (%)	30%	10.7%	11.3%	13.0%	14.3%
FFO to Long Term Debt (%)	88%	34.3%	32.4%	33.1%	36.8%
Debt Servicing Coverage Ratio (x)	8.0	3.1	4.5	2.8	2.60
Leverage (x)	0.9	1.2	1.6	1.8	2.0
Gearing (x)	0.7	0.9	1.3	1.4	1.5
ROAA (%)	7.5%	0.8%	2.2%	3.5%	4.6%
ROAE (%)	13.5%	1.7%	5.3%	9.4%	13.3%
(Stock in trade+ trade debts)/STD	1.62	1.29	1.53	1.42	1.48

**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	

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
09-Jan-2023	A-	A-2	Stable	Reaffirmed
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

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. Sagheer Ahmed	CFO	December 5, 2022
Mr. Salman Arif	Manager Finance	December 5, 2022