RATING REPORT

Artistic Denim Mills Limited

REPORT DATE:
March 29, 2024

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-2	A-	A-2
Rating Date	*March 29, 2024*		January 09, 2023	
Rating Outlook	Stable		Stable	
Rating Action	Reaffirmed		Reaffirmed	

COMPANY INFORMATION	
Incorporated in 1992	**External auditors:** M/s Reanda Haroon Zakaria & Company Chartered Accountants
Public Limited Company **Shareholders holding more than 5%:** - Mr. Muhammad Faisal Ahmed - Ms. Sadia Zain	**Chairman of the Board:** Mr. Muhammad Iqbal Ahmed **Chief Executive Officer:** Mr. Muhammad Faisal Ahmed

APPLICABLE METHODOLOGY(IES)
Applicable Rating Criteria: Corporates (May 2023) ***https://docs.vis.com.pk/docs/CorporateMethodology.pdf*** ***VIS Issue/ Issuer Rating Scale:*** ***https://docs.vis.com.pk/docs/VISRatingScales.pdf***

OVERVIEW OF THE INSTITUTION

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

Shareholding pattern of the company demonstrates that it is a family owned business with Mr. Faisal Ahmed as the majority shareholder with 81% of the shares of the company.

The Company has a total of 7 directors: 2 independent, 3 non-executive directors, and 1 executive director.

RATING RATIONALE

Artistic Denim Mills Limited ("ADML" or "the Company") operates as a vertically integrated denim fabric and garment manufacturer. This includes the four key sectors: spinning, weaving, garments and recycling. The core line of ADML is to manufacture and sell Yarn, Rope Dyed, Denim Fabric and Value-Added Textile Products. The Company has its registered office in Karachi and has two manufacturing facilities located in area of Korangi and Landhi respectively.

Operational Update

Sales of the Company are bifurcated between cotton yarn, denim fabric and denim garments division. The capacity of the three business segments is shown as follows:

Table 1: Capacity & Production

	FY21	FY22	FY23
Spinning			
Actual capacity of yarn (Lbs.)	20,377,500	22,425,000	24,325,000
Production of yarn (Lbs.)	15,342,293	18,819,808	13,944,495
Utilization	**75%**	**84%**	**57%**
Weaving			
Installed capacity of fabric (meters)	21,143,150	21,143,150	17,621,900
Production of fabric (meters)	14,222,737	15,434,953	11,246,000
Utilization	**67%**	**73%**	**64%**
Garments			
Installed capacity of fabric (Pcs)	6,000,000	8,263,200	8,263,200
Production of fabric (Pcs)	5,666,673	7,516,011	5,066,309
Utilization	**94%**	**91%**	**61%**

Spinning: During the period (FY22-FY23), the Company has increased its installed capacity from 22.4 Million Lbs to 24.3 Million Lbs for spinning by installing additional open-hand rotors. Decline in utilization is due to the reduced demand from customers.

Weaving: There is no change in number of machines for weaving. The reduction in annual capacity from 21.1 Million meters to 17.6 Million Meters is due to enhanced quality of fabric requiring higher number of picks.

Bleaching & Recycling: The Company has set up a bleaching and a recycling unit with a capacity of 1 million units per month. The capital expenditure amounted to Rs. 1.6 Billion funded via long-term loan. However, the Company has repaid Rs. 1.4 Billion early and only Rs. 200 Million repayments are pending for the same. This unit will enable the Company to bleach waste fiber emanating from garments division, which will then be further, converted into yarn consequently. Going forward the Company strategizes to focus on increasing its clientele base for garments segment by targeting brands from the USA.

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.

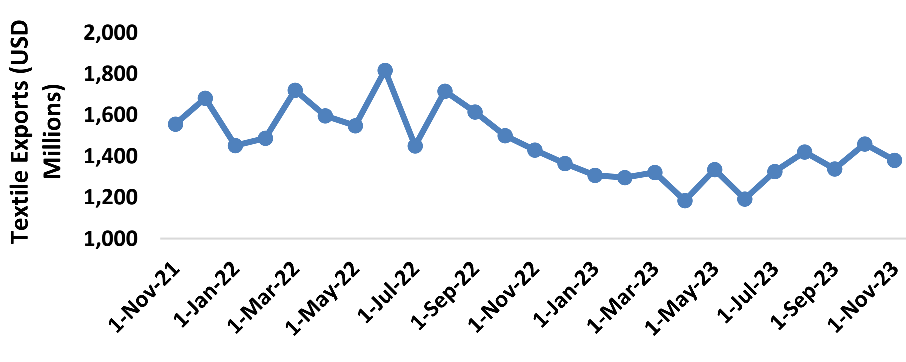

Figure 1: MoM Textile Exports (In USD' Millions)
Source: SBP

Key Rating Drivers

Topline posted a meagre growth of 1% YoY supported by rupee depreciation in FY23. Volumes have started to rebound during 1HFY24.

Sales revenue of the Company has grown at a CAGR of 20% over the past three years (FY21-FY23). Although the Sales of the Company faced a volumetric decline in FY23, there was a marginal 1% YoY increase in net sales from FY22 to FY23 owing to rupee devaluation. Gross Profit in FY23 amounted to Rs. 2.9 Billion showing a notable increase from Rs. 1.8 Billion in the prior year with over 1.5x growth in Gross Profit Margin from 11% to 17.1% for the same period. The core reasons for increase in gross margin were inventory gains and rupee depreciation. The Distribution and Admin expenses grew in line with the inflationary trend in the economy. On the other hand, there was an over 2x surge in the finance cost due to increase in long-term financing by the Company amid higher policy rate, accounting for 6% of the sales in FY23 (Rs. 981 Million) compared to only 3% in FY22 (Rs. 413 Million). Nevertheless, strong topline growth and higher gross Margins in FY23 led to a higher a net profit margin of 6.3% compared to 4% in prior year.

The top-10 client concentration continues to be at the higher end with over 65% of the total revenue. However, the comfort is present due to long-term association with clients. As for the geographic concentration of sales, American market accounted for the largest proportion of export sales at 28.58%, making it a key focus for ADML. Moving forward, the company aims to expand its customer base in the USA.

For the period 1H'FY24, Sales of the company amounted to Rs. 10.8 Billion and it demonstrated a 40% increase in Sales compared to December 2022 due to rebound in volumetric offtake of the Company. Gross and Net margins for the same period declined to 12.6% and 2.5%, respectively, due to increase in cost of raw materials and rising energy costs resulted an escalation in overall production costs. The Finance cost continued to be on the higher side as the short- term as the Company has increased its Short term borrowings by Rs. 1.0 Billion during the period.

Adequate Liquidity and Cash flow Coverage Indicators

The Funds from Operations ("FFO") clocked in at Rs. 2.1 Billion in FY23 (FY22: 1.3 Billion), demonstrated a significant growth of 63% from FY22 to FY23, aligning with the profitability. Although Debt Service Coverage Ratio ("DSCR") has marginally reduced from 2.68x in FY22 to 2.24x in FY23 due to surging finance cost, however, the same is considered adequate from the ratings perspective. The FFO/Total Debt ratio slightly improved to 0.19x (FY22: 0.13x), similarly, the FFO/Long-term Debt ratio has also positioned better to 0.39x (FY22: 0.33x). On the liquidity front, the Current Ratio of the Company remained stable at 1.16x as at Jun'23. The Company maintained its cash conversion cycle at 147 days in FY23 (FY22: 147 days). For the 1H'FY24, the FFO has declined to came in at Rs. 829 Million which has also weakened the DSCR to drop at 1.65x. This is a result of increased drawdown of debt and higher finance cost for the period due to high interest rate environment. On the liquidity front, the current ratio of the Company has declined to 0.97x as of Dec'23 even though the short-term borrowings of the Company have increased. However, if we exclude the current maturity of the long-term loans, the current ratio stood at 1x, which is considered adequate.

Capitalization Indicators are expected to remain within manageable levels

The Equity base of ADML has grown to Rs. 8.1 Billion as at Jun'23 from Rs. 7.2 Billion as at Jun'22 while ADML has also paid a dividend of Rs.168 Million during FY23. As at Dec'23, the total equity marginally dropped by Rs. 21.4 Million as ADML has a paid a dividend of Rs. 294 Million amid a net earning of Rs.272.6 Million during 1HFY24. With the same increase in debt levels as equity, gearing ratio of ADML stayed intact at 1.41x as at Jun'23 (Jun'22: 1.42x). However, during 1HFY24, amid a reduction of around Rs. 592 Million in total debt, gearing ratio has inched down to 1.34x as at Dec'23. Leverage ratio of ADML has continued to trend upwards during the review period as current liabilities registered an uptick during FY23 and 1HFY24. Going forward, gearing ratio of ADML is forecasted to decline gradually amid retirement of long term debt while the management is also aiming to reduce short term financing with efficient working capital management.

Environmental, Social and Governance (ESG)

ADML is dedicated to conserving energy and natural resources through its own power generation plant and Solar Power System. The Company continuously strives for energy conservation and cost reduction through technological advancements and waste heat recovery. Additionally, ADML places a high priority on the health, safety, and environmental well-being of its workforce and surroundings, actively working to eliminate unsafe practices and conditions. Regular testing and compliance measures are in place to maintain high standards in these areas. Furthermore, the company operates a waste water treatment plant that complies with SEPA Pakistan's standards, using advanced technologies to purify waste water and efficiently manage water resources for environmental preservation.

The Company is fully compliant with the requirements of the Listed Companies (Code of Corporate Governance) Regulations, 2019. The Company has a total of 7 directors comprising of 02 independent directors, 04 Non-Executive Directors and 01 Executive Director. To enhance oversight, the Board of Directors has established two committees - Audit Committee and a Human Resource and Remuneration Committee ("HR&RC"). The Audit Committee comprises one independent director and two non-executive directors, with the Chairman being an independent director. The HR&RC consists of three members, including one non-executive director, one executive director, and one independent director, with the leadership of the Committee being guided by an independent director serving as Chairman. Furthermore, the Company's auditor, M/s Reanda Haroon Zakaria & Company Chartered Accountants is on the State Bank of Pakistan's approved panel, holding a 'B' category, signifying professional competence and credibility.

Artistic Denim Mills Limited **Appendix I**

FINANCIAL SUMMARY				*(Amount in PKR Millions)*
BALANCE SHEET	**FY21**	**FY22**	**FY23**	**1H'FY24**
Non-Current Assets	7,777	9,677	11,804	11,999
Stores, Spares. And Loose Tools	306	243	248	263
Stock-in-Trade	5,100	5,106	5,469	5,812
Trade Debts	3,300	3,754	3,442	4,501
Other Receivables	95	102	140	180
Tax Refund Due From Government/Income Tax	118	177	195	284
Short term investments	96	76	72	124
Cash and Bank Balances	371	629	1,174	432
Total Assets	**17,546**	**20,080**	**22,894**	**23,709**
Trade and Other Payables	2,179	2,315	2,794	4,200
Short-Term Borrowings	5,501	6,223	5,973	7,005
Long-Term Borrowings *(Inc. current maturity)*	2,942	4,051	5,420	3,797
Total Liabilities	**10,819**	**12,840**	**14,800**	**15,637**
Paid-Up Capital	840	840	840	840
Total Equity	**6,728**	**7,240**	**8,093**	**8,072**
INCOME STATEMENT	**FY21**	**FY22**	**FY23**	**1H'FY24**
Net Sales	9,813	16,940	17,073	10,781
Gross Profit	1,112	1,841	2,920	1,363
Finance Cost	(222)	(413)	(982)	(654)
Other Income	104	71	110	113
Profit Before Tax	456	883	1,309	436
Profit After Tax	354	654	1,061	273
FFO	952	1,306	2,129	829
RATIO ANALYSIS	**FY21**	**FY22**	**FY23**	**1H'FY24**
Gross Margin (%)	11.3%	11.0%	17.1%	12.6%
Net Margin (%)	3.6%	4.0%	6.2%	2.5%
Net Working Capital	1,811.3	1,500.0	1,512.3	(391)
ROAA (%)*	2.2%	3.5%	4.9%	2.3%
ROAE (%)*	5.3%	9.4%	13.8%	6.7%
Current Ratio (x)	1.23	1.17	1.16	0.97
FFO	952	1,306	2,129	829
FFO to Long-Term Debt*	0.32	0.32	0.39	0.22
FFO to Total Debt*	0.11	0.13	0.19	0.08
Debt Servicing Coverage Ratio (x)	4.28	2.68	2.24	1.65
Inventory + Receivable/Short-term Borrowings (x)	1.53	1.42	1.49	1.47
Net Operating Cycle (Days)	195	147	147	109
Gearing (x)	1.25	1.41	1.41	1.34
Leverage (x)	1.61	1.83	1.83	1.94

**Annualized*

REGULATORY DISCLOSURES	Appendix II
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
29-Mar-2024	A-	A-2	Stable	Reaffirmed
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.
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Due Diligence Meetings Conducted	

Name	Designation	Date
Mr. Sagheer Ahmed	CFO	March 15, 2024