RATING REPORT

Crescent Bahuman Limited

REPORT DATE:
December 24, 2019

RATING ANALYSTS:
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RATING DETAILS		
Rating Category	**Initial Rating**	
	Long-term	**Short-term**
Entity	A-	A-2
Rating Outlook	*Stable*	
Rating Action	Initial	
Rating Date	*20th Dec'19*	

COMPANY INFORMATION	
Incorporated in 1993	External auditors: Riaz Ahmad & Co. Chartered Accountants.
Public Limited (Unlisted) Company	Chairman/CEO: Mr. Nasir Shafi
Key Shareholders (with stake 5% or more):	
Directors & family members – 55.8% The Crescent Textile Mills – 19.8% International Finance Corp – 5.89%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: Corporates (May 2019) *https://www.vis.com.pk/kc-meth.aspx*

Crescent Bahuman Limited

OVERVIEW OF THE INSTITUTION

Crescent Bahuman Limited (CBL) was incorporated in 1993 under the repealed Companies Ordinance, 1984 (now Companies Act, 2017). The principal activity of the company is manufacturing and export of denim fabric and garments. The production facility is located at Sargodha Road, Pindi Bhattian and head office is located at 45-A Zafar Ali Road, Gulberg-V Lahore.

Profile of the Chairman/CEO:

Mr. Nasir Shafi is one of the founder members of CBL. He has been serving as CEO of CBL since incorporation. Mr. Nasir is an MBA from IBA, Karachi and has more than 48 years of work experience.

RATING RATIONALE

The assigned ratings take into account moderate business risk profile of the company, underpinned by extensive experience of sponsors and senior management, vertically integrated denim jeans production capabilities, longstanding business relation with world renowned denim brands, improving supply chain efficiencies, and continued investment in automation, product development and sustainability initiatives. The ratings draw comfort from growing revenues and sustained profitability. However, profit margins have depicted volatility due to strong bargain power of customers, intensifying competition from the local and regional players, change in product mix and recognition of currency depreciation, in terms of exchange gain, in other income. Improvement in overall liquidity position has emanated from higher cash flows generation and considerable improvement in operating cycle over the past three years. The company's capacity to meet its financial obligations is considered sufficient owing to adequate debt service coverage ratio. The ratings also factor in manageable financial risk profile of the company, reflected in improving gearing and debt leverage on account of profits retention and decrease in debt utilization on a timeline basis. Given no major expansion plan, leverage indicators are projected to improve further with the accumulation of profits, going forward.

Industry Overview

The size of global denim jeans market stood at $66b during FY18 and is projected to reach $84.5b by 2025, growing at a CAGR of 3.7%. The U.S. is one of the major consumers of denim jeans with market size of $16.4 billion during 2018, followed by the Europe. The jeans category returned to growth in the U.S. in 2018, after years of decline owing to shifting consumer preference towards comfortable athletic bottoms such as leggings and sweatpants amidst the growing athleisure trend. Now, with athleisure solidified in the US market, consumers who had purchased sufficient athletic bottoms over the last few years returned to economy and standard jeans, as fit and fabric innovations made these products attractive for casualwear.

With increasing disposable income and inclination towards western fashion trends, emerging economies are also shifting their purchasing patterns towards denim jeans as a part of their casual wear. Higher quality, durability, comfort level, low maintenance, and easy availability are the main reasons for growing demand for denim products amongst the youth. Despite rising acceptance of denim products across all age groups, demand for men is forecasted to surpass that for women. Evolution of e-commerce has increased accessibility thereby improving distribution channel and facilitating consumption.

US's top three suppliers of denim jeans include China, Mexico and Bangladesh. The largest supplier of denim garments to EU is Bangladesh, followed by China. Top denim fabric importing countries include Bangladesh and Mexico. Top denim fabric exporting countries include China, Pakistan, Turkey, Hong Kong, Italy, India, Spain and Brazil. Supply growth of denim fabric is expected to supersede the increase in demand due to sizeable capacities coming online around the globe posing pressure on bargaining power of fabric and garments manufacturers.

Domestic denim sector's market size hovers around 10-15% of total textile exports of Pakistan, with denim fabric: garments product mix of 30:70. Major markets for fabric exports include Bangladesh, Turkey, Egypt and nominated sales to local players. Prime markets for denim garments comprise US and Europe. The local denim fabric industry comprises few large players and multiple smaller players. Domestic denim fabric producing capacity is estimated at around 500m sq. meters annually, approximately three-fourth of which relates to tier 1 and tier 2 players. Most of the tier-1 and tier-2 players are operating at over 80% capacity utilization. The determinant which governs player size is the number of looms installed and the speed of the same.

Total domestic denim garments manufacturing capacity is estimated at around 15m-20m pieces per month. With sales entirely directed to the international market and being the final product in the value chain, this division spurs higher margins compared to the fabric segment. Given the increasing demand and in order to maintain market share, most of the major players are expanding capacities of garment division. Moreover, new players who have a strong foothold in non-denim segment are also entering the denim segment. Major players in this segment include Artistic Milliners (Private) Limited, Soorty Enterprises (Private) Limited, US Apparels, Rajby Industries, Artistic Denim Mills, Nishat Apparels, Crescent Bahuman Limited (CBL), Kassim Denim Mills, and Siddiqsons Denim City.

Business Risk

- Capacity enhancements by local and international denim textile units to capture a bigger exports share is expected to keep pricing under pressure. Despite higher demand from the multinational retailers, all the major players have witnessed declining trend in margins. Given increase in global supply, VIS expects industry margin to remain under pressure.
- Most of the large players in denim segment now have vertically integrated operations and have consistently increased their capacity over the last decade. Given the declining margins and increasing requirements from customers, smaller players will face a challenging operating environment unless they differentiate themselves through product innovation.
- Players that have sizeable denim fabric exports to Bangladesh will be impacted given the significant fabric capacities coming online in Bangladesh.
- Focus on innovation and product development and keeping abreast with fashion changes remains critical to denim market growth which has evolved significantly over time with products now including stretchable, skinny, ripped and jogger jeans.
- Increasing cost of sustainability initiatives in order to cater to the requirements of customers has resulted in rising cost of doing business for denim fabric and garment manufacturers.
- Changes in duty structure in key export markets in order to protect local industry or other external factors may impact company's sales.

Key Rating Drivers

Growth in revenue emanating from higher demand
CBL is an export-oriented, vertically integrated denim fabric and garment manufacturing company. CBL was established as a joint venture between the Crescent Group and Greenwood Mills – U.S-based fabric manufacturing company – in 1995, however, the business incurred losses amidst U.S. sanctions between 1998 and 2000. Subsequently, the venture was dissolved and an extensive restructuring was carried out in 2001, whereby the Crescent Group assumed full ownership of the business and renamed it as Crescent Bahuman Limited.

Net revenue of the company has increased on a timeline basis on account of favorable pricing in rupee terms and higher demand for denim products in North America. Growth in net revenue was led by increased contribution of exports, as the company reduced its interest in local retail business. Product mix of the company also changed slightly during FY19 due to increased nomination fabric sales. Customer base of the company comprises leading multinational denim retail chains. The concentration risk is considered high as top-10 customer account for majority of total revenue. However, the established business relations, high customer satisfaction underpinned by focus on quality and sustainability, and fairly cumbersome supplier switching process help mitigate the intensity of concentration risk. Despite higher revenue, CBL reported lower gross profit and margin due to relatively lower increase in selling price vis-à-vis cost, which was due to the change in product mix during FY19. Moreover, gain of currency devaluation is not recorded in sales while loss on import of raw material remained a part of cost of sales. In line with lower gross profit and higher finance cost and taxes, the company reported slightly lower net profit during FY19, though rupee deprecation positively impacted the bottom-line to some extent.

Improved working capital management supporting overall liquidity position
Funds from operations (FFO) generation of the company was recorded lower during FY19 on account of reduction cash flows generation before working capital changes. Resultantly, FFO to long-term debt and FFO to total debt ratios stood slightly lower at end-FY19. Due to lower proportion of long-term debt in overall capital structure, the debt service coverage ratio stood at 2.79x, which is considered adequate. Improvement in working capital management and higher cash flows generation in the past two years has supported overall liquidity position of the company, as reflected in upward trend in current ratio. Cash conversion cycle has improved on a timeline basis to owing to considerable reduction in inventory and sales days outstanding.

Leverage indicators continue to improve on account of equity augmentation and deleveraging efforts
Total liabilities were recorded lower at end-FY19 mainly due to decrease in borrowings. The debt profile of the company comprises a mix of short-term and long-term debt, though the proportion of former is higher. The outstanding balance of short-term borrowings stood lower at end-FY19. Going forward, the utilization of short-term debt is projected to remain around at the current levels over the next three years. However, long-term debt, inclusive of current maturity, increased slightly as CBL mobilized new long-term debt to partially finance the capex. Tier-1 equity of the company augmented with the retention of profits, which resulted in improved gearing and debt leverage ratios at end-FY19. Given no major expansion plan, gearing and debt leverage indicators are projected to improve gradually, going forward.

Crescent Bahuman Limited Annexure I

FINANCIAL SUMMARY *(amounts in PKR millions)*			
	FY17	**FY18**	**FY19**
Paid-up Capital	3,454	3,454	4,053
Tier-1 Equity	3,035	3,769	4,395
Net Sales	9,091	12,156	14,047
Profit Before Tax	94	701	707
Profit After Tax	10	600	572
FFO	473	1,168	883
Gearing (x)	1.44	1.07	0.84
Current Ratio (x)	0.98	1.10	1.20

ISSUE/ISSUER RATING SCALE & DEFINITIONS Annexure II

VIS Credit Rating Company Limited

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 — Annexure III

Name of Rated Entity	Crescent Bahuman Limited
Sector	Textile
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings
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.
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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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
20/12/2019	A-	A-2	Stable	Initial