RATING REPORT

Artistic Milliners (Private) Limited

REPORT DATE:
November 04, 2019

RATING ANALYSTS:

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RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	**Short-term**	**Long-term**	**Short-term**
Entity	AA-	A-1	AA-	A-1
Rating Date	*Nov 01, 2019*		*Nov 14, 2018*	
Rating Outlook	Stable		Stable	
Outlook Date	*Nov 01, 2019*		*Nov 14, 2018*	

COMPANY INFORMATION

Incorporated in 2006	**External auditors:** EY Ford Rhodes Chartered Accountants
Private Limited Company	**Chairman of the Board and Chief Executive Officer:** Mr. Yaqoob Ahmed **Managing Director (Spinning & Fabric):** Mr. Omer Ahmed **Managing Director (Garments):** Mr. Murtaza Ahmed

APPLICABLE METHODOLOGY(IES)

Applicable Rating Criteria: Industrial Corporates (May, 2016) http://www.vis.com.pk/kc-meth.aspx

Artistic Milliners (Private) Limited

OVERVIEW OF THE INSTITUTION

Artistic Milliners (Private) Limited (AML) was incorporated as a Private Limited Company in 2006.

AML is a family owned business with major shareholding resting held by Mr. Yaqoob Ahmed who is the Chairman of the Board. He possesses over 40 years of experience in the industry and has been responsible for the backward integration starting from Garments to Denim Weaving and Spinning. The Company has been actively involved in CSR initiatives.

The Company has also established a Research and Innovation Centre in Dubai, to offer proximity to their customers and partners; the center comprises three departments: Showroom, Stitching and Laundry.

RATING RATIONALE

Artistic Milliners (Private) Limited (AML) is one of the leading denim fabric and garment manufacturers and exporters with vertically integrated operations in Pakistan. During FY19, the company was amongst the top five exporters of the country. The company deals in manufacturing of yarn, denim fabric and garments and operates through around 17 facilities/units located at Korangi and Landhi in Karachi, Pakistan. Sponsors have over five decades of experience in the textile sector with extensive experience in denim fabric and garment segment. Over the years, the management has placed significant focus on sustainability initiatives. AML owns Pakistan's first LEED (Leadership in Energy and Environmental Design) Certified Garment Factory which consumes 31% less energy, 50% less water and diverts 95% of waste away from landfills compared to conventional building. Focus in this segment is planned to continue. AML's fabric units are ISO9000 certified matching international quality standards.

Spinning- Yarn produced is completely utilized in-house for manufacturing of denim fabric. In April 2019, the company completed expansion in its spinning facility (AM 17) which has increased the company's yarn production capacity by 10%. In-house manufactured yarn now caters to around 90% of the company's yarn requirement. The new spindles are technologically equipped to develop advanced and higher quality products examples of which include Quad Core yarn and higher flexibility to blend different fibers with cotton. Capacity utilization of the spinning segment remains on the higher side.

Denim Fabric- Fabric exports continues to contribute around two fifth to the total sales revenue of the company. Around half of the fabric manufactured is utilized in-house to manufacture garments while the remaining is sold as direct and indirect exports. While remaining on the higher side at over 90%, utilization levels of the weaving segment decreased during FY19 owing to growth in installed capacity outpacing increase in production. Going forward, no further installation of looms is forecasted; however, the company plans to install a new processing unit for white fabric. The cost of the project will primarily be financed through LTFF with the remaining being funded by AML's internal cash flows. Major markets for denim fabric include direct and indirect exports to Bangladesh and Pakistan, respectively. The management plans to diversify country concentration through focus on higher exports to Vietnam, Cambodia, Egypt and Sri Lanka. New client additions along with higher sales from existing customers is expected to result in healthy increase in fabric exports in FY20.

Garments- During FY19, the company completed expansion in its garment division which has enhanced installed capacity by 16%. Garment segment contributes around three fifth to the total sales revenue of the company. Largest market in garment exports includes USA and Europe with clients comprising global top-tier brands. Sales from US brands witnessed an increase in the outgoing and ongoing year partly on account of ongoing US-China trade disruption. Concentration in sales is on the higher side; however the same is partly mitigated by lengthy association of most brands with AML.

Diversification- AML through its wholly owned subsidiary 'Artistic Energy (Private) Limited' (AEL) has diversified in the wind power sector. The plant has an installed capacity of 50MW which has successfully commenced operations on 16th March'2018. Annual dividend of Rs. 1.7b during FY19 has provided sizeable support to the company's profitability and diversified revenue streams. In addition to AEL, the company has also invested 25% equity stake in another 50 MW wind power project by the name of Artistic Wind Power (Private) Limited. Going forward, the company plans to further diversify in the renewable energy segment. In this regard, the group has signed LOI for investment in Solar and Hydel power project.

Key Rating Drivers

Moderate business risk profile supported by stable demand for denim products; US-China Trade disruption to support sales as major buyers look to diversify procurement.

Business risk profile is supported by stable and growing demand for denim products. However, local and international expansion by major players is expected to keep pricing power and hence margins slightly under pressure. VIS expects demand for denim products to remain stable over the medium term. Given the favorable policies & incentives of the government on enhancing exports (to reduce current account deficit) and imposition of duties on Chinese exports to USA, there is significant opportunity for local players to enhance exports. Increased expansion by leading denim and non-denim textile players is also on account of favorable demand and expected increase in orders. AML is well positioned to tap this opportunity given the recently completed expansion in all three segments.

Double-digit sales growth led by volumetric growth in garments division and higher average selling prices supported by currency devaluation. Gross profitability improved due to rupee devaluation and enhanced efficiencies; overall profitability was supported by sizeable dividend income

Net sales of the company witnessed strong double-digit growth with revenues almost entirely comprising export sales. Fabric and garment segment revenues reported an increase of 13% and 21.6% during FY19, respectively. Fabric segment revenue grew largely on account of higher prices led by currency devaluation as quantity of fabric exported declined during the outgoing year due to higher fabric requirement in the garment division. Growth in garment division sales was a function of both, increase in volumes and average selling prices.

Gross margins (GMs) of the company compare favorably to non-denim textile players and have witnessed improvement in FY19 on account of increase in average sales price, sales volume and enhanced efficiencies which resulted in lower cutting wastage and finished product rejections. Management forecasts GMs to be maintained at similar levels. Selling and distribution expenses witnessed a noticeable jump as freight, forwarding charges and sales promotion cost are denominated in foreign currency. Net profitability of the company during the outgoing year was supported by one-off dividend income received from subsidiary. Given a major portion of the debt profile comprising LTFF and ERF, impact of rising interest rates on profitability is limited. Going forward, management expects momentum in profitability growth to sustain given enhanced capacities and continued focus on value addition.

Strong liquidity profile bolstered by healthy cash flow coverages against outstanding obligations

Liquidity profile of the company is considered strong in view of healthy cash flows and strong debt servicing ability. During FY19, despite an increase in debt levels, cash flow coverage of total and long-term debt witnessed improvement to 51% (FY18: 37%) and 106% (FY18: 78%), respectively on account of higher profitability and resultant cash flows. Working capital cycle of the company necessitates utilization of short term borrowing which noticed sizeable increase during FY19 owing to higher capacities in the fabric segment and stock-piling for the orders of the new customer expected in the ongoing year.

Total capex projected for FY20 amounts to Rs. 3.9b, around 54% of which will be financed through LTFF with the remaining balance expected to be met through internal cash generation. VIS expects liquidity profile of the company to remain healthy over the rating horizon given sizeable surplus cash available.

Sound capitalization profile

Equity base of the company has grown at a CAGR of 25% over the last 4 years on account of healthy internal capital generation. Leverage indicators remain at preceding year levels due to improving bottom line despite higher debt withdrawn in the outgoing year to fund expansion in the spinning and garments division and to finance working capital requirements. Going forward, with limited debt drawdown and projected increase in equity base, leverage indicators are projected to improve.

Corporate Governance

Overall scope and functioning of internal audit and IT function are considered adequate. Given the company's shareholding structure and involvement of board of directors in management roles, board composition and oversight is currently constrained.

Artistic Milliners (Private) Limited **Appendix I**

FINANCIAL SUMMARY *(amounts in PKR millions)*			
BALANCE SHEET	**FY16**	**FY17**	**FY18**
Paid Up Capital	1,000	1,000	1,000
Total Equity	15,729	17,622	21,291
INCOME STATEMENT			
Net Sales	26,539	26,514	30,036
Profit Before Tax	4,050	3,296	4,017
Profit After Tax	3,845	3,058	3,882
RATIO ANALYSIS			
FFO	4,845	4,227	4,911
Current Ratio (x)	1.3	1.6	1.5
Gearing (x)	0.35	0.41	0.62

ISSUE/ISSUER RATING SCALE & DEFINITION Appendix 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	Appendix III
Name of Rated Entity	Artistic Milliners (Private) 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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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
November 01., 2019	AA-	A-1	Stable	Reaffirmed
November 14, 2018	AA-	A-1	Stable	Reaffirmed
December 28, 2017	AA-	A-1	Stable	Initial