RATING REPORT

Artistic Milliners (Private) Limited

REPORT DATE:
December 02, 2020

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	*Dec 02 , 2020*		*Nov 01, 2019*	
Rating Outlook	Stable		Stable	
Outlook Date	*Dec 02, 2020*		*Nov 01, 2019*	

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)

VIS Entity Rating Criteria: Corporates (May 2019)
https://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 41 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. The company has also opened a display showroom in USA in the ongoing year to ease access of US based orders.

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. 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. During FY19, the company enhanced its spinning production capacity through which in-house manufactured yarn now caters to around 90% of the company's yarn requirement as compared to 70% previously. 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 declined during FY20 owing to closure of manufacturing facility for a month amidst COVID-19 pandemic and installation of new spindles at end of the outgoing year.

Denim Fabric- Share of fabric sales in total sales revenue declined to 34% as compared to 40% previously owing to higher utilization of in-house fabric to manufacture value-added garments. Around half of the fabric manufactured is utilized in-house to manufacture garments while the remaining is sold as direct and indirect exports. Utilization levels of the weaving segment decreased during FY20 to 78% (FY19: 91%) owing to growth in installed capacity and decline in production due to plant closure (COVID-19 lockdown). Going forward, no further installation of looms is forecasted; however, the company plans to install a new processing unit for white fabric which is expected to commence operations by 1QFY22. The cost of the project will be financed through a mix of LTFF and internal cash flows. Major markets for denim fabric include direct and indirect exports to Bangladesh and Pakistan, respectively; with indirect exports witnessing a sizeable increase during FY20. The management plans to diversify country concentration through focus on higher exports to Vietnam, Cambodia, Egypt and Sri Lanka. New client additions in different regions along with higher sales from existing customers are expected to result in healthy increase in fabric exports, going forward.

Garments- Garment segment contributes around two third to the total sales revenue of the company. Capacity utilization of the garment segment remained at previous levels (FY20: 81%, FY19: 80%) with limited volumetric growth amidst global pandemic. Largest market in garment exports includes USA and Europe with clients comprising global top-tier brands. 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. The company did not declare dividend during FY20. 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. The targeted commercial operations date is expected is mid-October 2021. 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 and growing demand for denim products; US-China Trade disruption has enhanced sales as major buyers continue to diversify procurement. Even though concerns of a second wave of Covid-19 remain elevated, we expect the order book for the company to remain strong in the ongoing year, easing our business risk apprehensions.

Business risk profile is supported by stable and growing demand for denim products. VIS expects demand for denim products to remain stable over the medium term. Given the favorable policies & incentives of the government on enhancing exports and trade disruption between US and China, there is significant opportunity for local players to enhance exports. However, local and international expansion by major players is expected to keep pricing power and hence margins in check. Moreover, significant investment required by customers as part of sustainability initiative is expected to add to cost pressures for denim manufacturers. Increased expansion by leading denim and non-denim textile players is also on account of favorable demand and expected increase in orders. Even though concerns of a second wave of Covid-19 remain elevated, we expect the order book for the company to remain strong in the ongoing year, easing our business risk apprehensions.

Double-digit sales growth largely led by higher average selling prices supported by currency devaluation. Gross profitability improved due to rupee devaluation and enhanced efficiencies. Subdued growth in net profitability was noted on account of no support of income from subsidiaries and limited exchange gains.
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 14.8% and 14.3% during FY20, respectively. Growth in both divisions was largely manifested by higher average selling prices due to currency devaluation. Volumetric sales in the fabric segment witnessed a meager decline owing to lockdown led plant closure during the outgoing year. The company regained its volumetric growth in both segments during 1QFY21 led by sizeable order backlog. Going forward, AML considers itself well-positioned to surf across the second wave of COVID-19 by maintaining its focus towards volumetric growth of basic fabric and garments. Consequently, management envisages healthy growth in sales revenue going forward supported by higher projected sales volumes.

Gross margins (GMs) of the company compare favorably to non-denim textile players and have witnessed improvement in FY20 on account of increase in average sales price and enhanced efficiencies which resulted in lower cutting wastage and finished product rejections. Management forecasts GMs to be maintained at similar levels. Sales and distribution expenses as a percentage of sales declined during FY20 due to marketing being done online amidst COVID-19. However, costs such as freight, forwarding charges and sales promotion cost continued to increase since the same are denominated in foreign currency. Despite healthy increase in GMs, growth in net profits was subdued on account of no support of income from subsidiaries and limited exchange gains. 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 volumetric growth in sales.

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 FY20, cash flow coverage of total debt witnessed decline to 41% (FY19: 53%) on account of elevated debts levels. However given limited increase in long term debt, coverage of long term debt improved to 131% (FY19: 107%). Working capital cycle of the company necessitates utilization of short term borrowing which noticed sizeable increase during FY20 to finance short term investment and for stock-piling for the orders expected in the ongoing year. Total capex projected for FY21 amounts to Rs. 5.4b, around 57% 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 liquid investments.

Sound capitalization profile
Equity base of the company has grown at a CAGR of 25% over the last 5 years on account of healthy internal capital generation. Leverage indicators remain at preceding year levels due to limited dividend payout during FY20 despite higher debt withdrawn in the outgoing year to fund working capital requirements and short term investments. Going forward, despite debt drawdown for routine capex and processing unit, leverage indicators are projected to improve given projected increase in equity base through expected healthy profitability and low dividend payout.

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 constrained.

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

FINANCIAL SUMMARY *(amounts in PKR millions)*						
BALANCE SHEET	**FY15**	**FY16**	**FY17**	**FY18**	**FY19**	**FY20**
Paid Up Capital	1,000	1,000	1,000	1,000	1,000	1,000
Total Equity	12,085	15,729	17,622	21,291	29,326	36,907
INCOME STATEMENT						
Net Sales	25,037	26,539	26,514	30,036	38,056	43,542
Profit Before Tax	3,559	4,050	3,296	4,017	8,765	9,024
Profit After Tax	3,389	3,845	3,058	3,882	8,293	8,581
RATIO ANALYSIS						
FFO	4,351	4,845	4,227	4,911	10,112	10,300
Current Ratio (x)	1.16	1.3	1.6	1.5	1.7	1.7
Gearing (x)	0.43	0.35	0.41	0.62	0.65	0.68

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.
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.
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. . For conducting this assignment, analyst did not deem necessary to contact external auditors or creditors given the unqualified nature of audited accounts and diversified creditor profile. Copyright 2020 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
December 02, 2020	AA-	A-1	Stable	Reaffirmed
November 01., 2019	AA-	A-1	Stable	Reaffirmed
November 14, 2018	AA-	A-1	Stable	Reaffirmed
December 28, 2017	AA-	A-1	Stable	Initial

Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Munir	CFO	11-Nov-2020