RATING REPORT

Artistic Milliners (Private) Limited

REPORT DATE:
December 13, 2022

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 Outlook	Stable		Stable	
Rating Date	*Dec 13, 2022*		*Dec 28, 2021*	

COMPANY INFORMATION	
Incorporated in 1980	**External Auditors:** BDO Ebrahim & Co. Chartered Accountants
Private Limited Company	**Board Chairman:** Mr. Yaqoob Ahmed
Family Owned Business	**Chief Executive Officer:** Mr. Omar Ahmed
	Managing Director: Mr. Murtaza Ahmed

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: Industrial Corporates (August 2021) *https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf*

Artistic Milliners (Private) Limited

OVERVIEW OF THE INSTITUTION

Artistic Milliners (Private) Limited (AML) was incorporated as a Private Limited Company in 1980 and commenced commercial operations in 2006.

Profile of Chairman/CEO

AML is a family owned business with major shareholding resting held by Mr. Yaqoob Ahmed, who is the Board Chairman. 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 as well.

RATING RATIONALE

Corporate Profile

Artistic Milliners (Private) Limited (AML) has grown from a small retail store, established in 1949, to become amongst the top garment and denim fabric manufacturers and exporters in Pakistan. Product portfolio include denim fabric and clothing (including pants, shorts, skirts and jackets) while operations are carried out through 17 manufacturing units located in Korangi and Landhi in Karachi. Power requirement are met through a mix of grid-based energy, diesel and gas generators.

AML is committed to sustainability initiatives and is the world's first Cradle-to-Cradle certified denim manufacturer. It is also Pakistan's first LEED (Leadership in Energy & Environmental Design) certified garment factory, which consumes 31% less energy, 50% less water, and diverts 95% of waste away from landfills. The fabric units are ISO 9000 certified, ensuring international quality standards.

Strategic Investment Portfolio

AML has diversified its portfolio to include renewable energy with a current capacity of 100 MW of wind energy, and has a growing interest in solar and hydro plants. At present, long-term investments in subsidiaries comprises two entities i.e. Artistic Energy and Artistic Wind Power.

Operational Performance

Since last review, total 768 spindles have been added to the spinning division, while number of loom installed increased by 100. Total capex stood at Rs. 12.8b (FY21: Rs. 7.6b) with 37% financed through LTFF for the import of machinery and the remainder funded through internal capital generation for construction of production unit and all related civil work. Major additions in fixed assets pertained to denim segment followed by spinning, processing and garment divisions. As a result, production capacity increased across the board.

Capacity utilization for fabric remained strong and consistent with previous year levels, while garment segment utilization returned to historic levels (last year's high utilization was a one-off due to impact of post-pandemic delayed sales). The entire yarn requirement for denim fabric is met in-house, while half of fabric production is used to make garments. With global slowdown in demand, particularly in fabric sales, management expects fabrics segment utilization to be between 90% and 95%, while garment utilization will remain around 85% for the year FY23.

Figure: Capacity & Production Data

	FY18	FY19	FY20	FY21	FY22
Number of spindles installed	56,952	81,144	81,144	84,744	85,512
Number of looms installed	413	461	537	537	638
Installed capacity of yarn (kgs in m.)	29.9	32.9	41.3	44.3	46.8
Actual production of yarn (kgs. in m)	26.9	28.9	29.7	42.5	45.2
Utilization – Yarn	***90%***	***88%***	***72%***	***96%***	***97%***
Installed capacity of fabric (meters in m)	67.8	79.9	85.3	85.3	93.0
Actual production of fabric (meters in m)	66.8	72.9	66.4	82.4	92.3
Utilization – Fabric	***98%***	***91%***	***78%***	***97%***	***99%***
Installed capacity of garments (pieces in m)	24.8	28.8	28.3	28.8	41.7
Actual production of garments (pieces in m)	20.7	22.9	22.9	28.6	36.2
Utilization - Garment	***84%***	***80%***	***81%***	***99%***	***87%***

Key Rating Drivers

Business risk profile is supported by industry wide growth in exports over the last year; however, recent floods across the country, rising interest rates, inflationary pressures, and higher electricity costs 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.

Figure: 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	12,851	14,492	18,525		4,241	4,777
PKR/USD Average rate	158.0	160.0	177.5		164.4	229.1

Source: SBP

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.

Figure: 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: SBP

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. The government has announced facilitation for raw materials imports 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, such as 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.

5-Year (2020-25) textile policy continues to support the industry.
With an aim to double textile exports in five years, GoP through a five-year textile policy (2020-25) has provided incentives in form of preferential energy rates, low interest rates financing schemes (such as EFS, LTFF and TERF) and timely payments of DLTL, Income tax & Sales tax refund which support liquidity constraints of local players. Initiatives have also been undertaken to increase production and yield of cotton to support the industry. However, imposition of 10% super tax would have a negative effect on profitability profile of textile players. In addition, contractionary monetary policy and political uncertainties in the country are the present major business risk factors. In the long run, improvement in value addition, investment in technology and optimization of energy cost would define the future of textile exports.

Ratings continue to drive strength from strong market position as a leading exporter.
With operating history of more than four decades, AML is one of the leading manufacturer and exporter of denim fabric and garments with vertically integrated operations. During FY22, the company was ranked fourth among Pakistan's top ten exporters. Although primarily a denim company, management has recently enhanced focus to diversify into non-denim segments, which has resulted in improvement of overall business risk profile.

Robust growth in sales revenue over the years.
While crossing the Rs. 83b mark in the FY22, net sales have nearly doubled over the last two fiscal years while a 5-Year CAGR stood at ~23% for the period (FY18-22). The sizeable year-on-year uptick of ~48% (exceeding the projected growth) was mainly driven by price increase coupled with rupee depreciation while owing to capacity increase and strong demand, annual volumetric growth in fabric and garment segment was 15% and 29%, respectively. In terms of product mix, garment exports generate two-third of revenues, with the remainder coming from fabric sales, which is further segmented into direct/indirect exports. Within garments segment, nearly 90% of revenue is generated from the sale of pants followed by shorts, jackets and skirts. Given the global slowdown in fabric demand, management anticipates further increase in garment sales contribution in the ongoing year.

More than 60% of fabric and garment exports are directed to Bangladesh and USA, respectively, thus featuring geographic wise concentration. Client concentration also remains elevated with top five clients (including both segments) comprising 79% of total sales revenue; however, comfort is drawn from long standing association with major clientele. Major brands in garment exports include Gap, Target, Levi's and HnM among others.

Profitability margins have recouped in the ongoing year; debt coverage metrics remain strong.
Gross margins, following a decline in the outgoing fiscal year, have recouped strongly during 3M'FY23 owing to inventory gains, lower cost raw material purchased earlier, and previously held finished goods inventory. However, average rate of cotton procured has increased by ~35% during the year, and stock levels are maintained till Aug'23. Given significant price difference between domestic and imported cotton, proportion of domestic cotton procured increased from 68% to 84% in FY22. On the cost front, administrative overheads increased in line with inflation, while financing charges remained limited. Sizeable exchange gain translated into strong uptick in net profits, which more than doubled compared to same period last year.

Moreover, dividend income from subsidiaries and mutual fund investment income also continue to support the earnings profile.

Cash flow coverage indicators have remained strong and aligned with peer median. In line with industry phenomenon, the uptick in inventory holdings has led to increase in cash conversion cycle on a timeline basis. Trade debts have noted a sizeable increase as management decided not to discount the receivables for early payments in order to benefit from rupee depreciation. Ageing profile of trade debts is sound with no receivables outstanding for more than 180 days.

Sizeable capital buffers and abundant liquidity, elements that provide financial flexibility and support the ratings.
Sizeable internal capital generation and adequate retention continue to reinforce capital buffers, wherein net equity has nearly doubled over the last 27 months, reaching to Rs. 71.9b at end-1Q'FY23. The company has not paid dividends on a timeline basis. Debt profile is a mix of short-term and long-term debt with total interest bearing liabilities amounting to Rs. 35.8b (FY22: Rs. 41.2b) at end-1Q'FY23; almost entire debt comprises financing under SBP's concessionary rate export financing schemes. Overall debt utilization remains conservative, as reflected by low leverage levels.

In addition, the company has a sizable liquidity available on the balance sheet, which is largely placed in money market mutual funds, thus diversifying revenue base. Adjusting for liquid assets, net debt reduced to Rs. 15.9b, translating into gearing of 0.3x, which is considered to be on the lower side.

Experienced senior management team. Room for improvement exists in terms of segregating ownership and management.
Sponsors have over five decades of experience in the textile sector and senior management team comprises seasoned professionals. Organizational structure in well-designed under assigned heads, directors, and sales team for carrying out business operations.

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. During the review period, new external auditors, BDO Ebrahim & Co. Chartered Accountants have been appointed; audit of financial statements for the year FY22 is currently underway.

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix I

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 II

Name of Rated Entity	Artistic Milliners (Private) Limited
Sector	Textile
Type of Relationship	Solicited
Purpose of Rating	Entity Rating

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
12/13/2022	AA-	A-1	Stable	Reaffirmed
12/28/2021	AA-	A-1	Stable	Reaffirmed
12/02/2020	AA-	A-1	Stable	Reaffirmed
11/01/2019	AA-	A-1	Stable	Reaffirmed
11/14/2018	AA-	A-1	Stable	Reaffirmed
12/28/2017	AA-	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.
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.

Due Diligence Meeting Conducted

Name	Designation	Date
Mr. Munir	Chief Financial Officer	Nov 15, 2022
Mr. Jazib Owais	Manager – Financial Reporting	