RATING REPORT

Best Exports Limited (BEL)

REPORT DATE:
July 01, 2021

RATING ANALYSTS:
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RATING DETAILS				
Rating Category	**Latest Rating**		**Previous Rating**	
	Long-term	**Short-term**	**Long-term**	**Short-term**
Entity	BBB	A-2	BBB	A-2
Rating Outlook	Stable		Rating Watch - Developing	
Rating Date	*30th Jun'21*		*27th Apr' 2020*	

COMPANY INFORMATION	
Incorporated in 1996	External auditors: Deloitte Yousuf Adil & Co. Chartered Accountants
Private Limited Company	Chairperson/CEO: Mr. Waqas Ali
Key Shareholders (More than 5%):	
Mr. Waqas Ali – 85.0% Ms. Hajra Waqas – 15.0%	

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

Best Exports Limited

RATING RATIONALE

The ratings assigned to Best Exports (Pvt.) Limited (BEL) take into account the company's presence in the export-oriented value-added textile segment coupled with relatively sound current business risk profile of the textile sector; the same is underpinned by stable and growing demand as US-China Trade disruption enhance sales given major buyers continue to diversify procurement. Ratings also incorporate the company's fair financial risk profile as evident from improvement in margins from pre-covid values, conservative capital structure with minimal reliance on long-term debt, adequate liquidity and comfortable debt service coverages. The impact of one-off event leading to sizable growth in local sales during FY19 on account of change in tax structure has been incorporated in the assigned ratings. Further, management's focus on expanding current operations coupled with backward integration with set up of spinning unit bodes well for the company. Given improvement in the company's operational performance owing to pandemic led boom in textile sector during the period under review, the outlook assigned to BEL's ratings has been revised to 'Stable'. Even though concerns of successive waves of Covid-19 are present, strong order book of the industry in the ongoing year along with vaccine rollout has largely subsided business risk concerns. However, the ratings continue to remain constrained by relatively limited scale of operations. Going forward, the ratings are dependent on sustenance of margins, maintenance of leverage indicators, realization of projected targets and incremental cash flow generation from backward integration planned along with evolution of sector dynamics post ongoing pandemic.

Local Textile Sector performance during COVID-19: The coronavirus pandemic led to 3% drop in global trade volumes in the 1QFY20 according to United Nations conference on Trade and Development forecasts. Industries whose operations were more globalized (particularly those who relied on Chinese inputs for production) were highly exposed to initial supply side disruptions. However, given most of the textile companies in Pakistan are heavily reliant on local cotton produce; the supply side risk was largely curtailed. In addition, the lockdown in China at the initial stage turned advantageous as the orders got shifted to Pakistan. Prior to onslaught of the pandemic, the European buyers were attracted by repetitive rupee weakening since 4QFY18, as unit prices fell only for Pakistan in 9MFY20 vis-à-vis its competitors. The price effect was further enforced by duty-free/quota free access under the GSP Plus agreement. Bangladesh and Pakistan have been able to increase their exports to the bloc as they enjoy preferential trade treatment within EU. Moreover, US-China trade war with USA applying additional tariffs on Chinese apparel imports since Sep'19 has aided low cost suppliers including Pakistan in capturing the untapped share. So after global onslaught of corona virus European and American retailers, the two main destination markets for this sector, cancelled their orders causing serious concerns in many sourcing countries. With only a few buyers honoring their import commitments with local manufactures, exports declined during April'20. Exports of readymade garments dipped by 69% in April'20 compared to same month in the preceding year.

The country's textile industry has scaled up production to pre-Covid level of full-capacity as a significant improvement in containment of the pandemic in the country led the world buyers to partially divert their orders to domestic manufacturers. The growth in production

OVERVIEW OF THE INSTITUTION

Best Exports (Pvt.) Limited was established in 1996 under the Companies Act, 1984 (now Companies Act, 2017). The company is a small sized weaving unit that is primarily involved in manufacturing and export of grey, bleached, dyed and made ups consisting of bed sets, pillow covers, quilt covers, cotton bags, table covers and curtains.

Profile of the Chairperson/CEO

Mr. Waqas Ali along with his father founded the company in 1996. Mr. Waqas has studied at Aitchison College, Lahore and has obtained Master's degree from Oxford University, UK.

Financial Snapshot

Total Equity: end-HY21: Rs. 3.2b; end-FY20: Rs. 3.2b; end-FY19: Rs. 3.0b; end-FY18: Rs. 3.0b

Assets: end-HY21: Rs. 4.7b; end-FY20: Rs. 4.7b; end-FY19: Rs. 4.5b; end-FY18: Rs. 4.2b

Profit After Tax: HY21: Rs. 37m; end-FY20: Rs. 65m; FY19: Rs. 86m; FY18: Rs. 130m is backed by a big jump in the import of basic raw materials – cotton and man-made yarn – after the recent heavy rainfall and pest attack damaged notable portion of cotton crops in the fields to a multi-year low. Secondly, the industry recovered on a fast pace with the government's support in the shape of rationalizing energy price to a regional competitive level, the same included continued supply of raw material and subsidized financing for the expansion of production and setting up new units. Further, the textile exports have also largely recovered from the Covid-19 pandemic shocks and are still growing both in terms of their quantity and dollar value. The textile shipments have surged by 3.8% to $4.8 billion between July and October from $4.6bn in the corresponding period last year. The rise in the textile and clothing group has been slightly faster than the 0.6% growth in the overall export. The export recovery is most prominent in the knitwear, home textiles and denim segments.

Production Update: BEL follows a build to order approach where products are produced when orders are confirmed. The company links the inventory at hand with the forecasted demand for the next three months with an estimated order processing time of around 2-3 months. In response to the ongoing pandemic resulting in dampened demand, the production activities and capacity utilization took a downturn during FY20. Installed capacities and actual production are tabulated below:

Capacity Analysis	FY18	FY19	FY20
Weaving Unit:			
Number of looms installed	445	445	445
Number of looms worked	445	445	445
Standard cloth production (Sq. meters)'000	24,000	24,000	24,000
Actual cloth production (Sq. meters)'000	20,200	21,120	19,963
Capacity Utilization %	84	88	83

Topline and profitability indicators impacted during FY20: The company revenues were recorded lower at Rs. 2.2b (FY19: Rs. 3.2b) during FY20 on account of change in taxation regime during FY20 which led to an upsurge in local sales in the preceding year. The uptick in local sales to Rs. 1.1b during FY19 was attributable to the change in tax structure as zero tax rate was applicable on local sales in FY19 while sales tax of 17% was re-imposed on domestic textile transactions in July'20; therefore, increased fabric procurement was made before the application to take advantage of lower prices. Subsequently, local sales comprising grey cloth normalized to Rs. 227.9m (FY19: Rs. 1.1b; FY18: Rs. 338.8m) during FY20. Exports remain the major revenue driver amounting to Rs. 2.0b (FY19: Rs. 2.1b) with sizable increase in contribution to 90% (FY19: 66%); the same was yet again an outcome of decline in local sales. The export sales were recorded lower by Rs. 100.0m during the outgoing year in line with order cancellation amid pandemic crisis. Export sales majorly include home textile made-ups constituting 55% (FY19: 56%) of the total exports with sales revenue of Rs. 1.1b (FY19: 1.2b) booked during FY20. Moreover, export sale of printed cloth registered an increase and was recorded higher at Rs. 716.8m during FY20 as compared to Rs. 630.4m in the preceding year. Change in the geographical mix of revenues was witnessed in line with repercussions of ongoing pandemic as European countries were the hardest hit; hence share of exports to Europe dropped to 47% (FY19: 71%) during FY20. The same forgone share was filled in by higher export to Middle East constituting around 19% (FY19: 1%) of exports during FY20. The concentration risk is considered manageable as top-10 customers constituted 35% (FY20: 33%) of total revenue during the outgoing year. The concentration risk is largely mitigated by long-standing business relations with customers and high customer satisfaction underpinned by focus on quality and product specifications.

Gross margins increased significantly to 16.9% (FY19: 9.1%) in line with higher contribution of exports to the revenue mix, entailing better margins than local sales, coupled with increase in average selling price of the entire product range. BEL's procurement mix is heavily reliant on local yarn which constitutes 91% of the total yarn requirement. Selling and distribution expenses largely remained at prior year's level at Rs. 54.0m (FY19: Rs. 53.6m) despite sizable dip in in scale of operations on account of higher freight expenses in respect to revenues; the same was a function of higher proportion of exports. On the other hand, administrative expenses were reported higher at Rs. 57.1m (FY19: 45.4m) during FY20 in line with higher employee related expenses owing to inflationary pressure leading to annual salary adjustments. In the backdrop of increasing average benchmark interest rates coupled with higher average utilization of short-term borrowings, finance cost of the company increased to 162.3m (FY19: Rs. 114.5m) during FY20. Subsequently, despite slash in scale of operations BEL reported a higher profit before tax of Rs. 95.8m as compared to Rs. 75.1m in the preceding year owing to significant improvement in margins. However, given taxation expense of Rs. 30.7 was incurred in FY20 as opposed to sizable tax asset amounting to Rs. 11.3m recorded during FY19, the bottom line for outgoing year reduced to Rs. 65.1m (FY19: 86.5).

The declining trend in quantum sales was largely rescued during the ongoing year with the company's operations back at full capacity. BEL's topline (annualized) was recorded higher at Rs. 1.3b at HY21 owing to a combined impact of increase in export quantum coupled with higher prices on account of positive momentum in demand of home textile products. The increased demand of domestic products is underpinned by capitalizing on supply gaps as production units in competing countries were not operating at full potential owing to COVID-19 related lockdowns. In addition, the power subsidy announced by the government for the sector has made the prices even more competitive globally, therefore positively resulted in the off-take of local products. The orders from Europe got cancelled in HY21; however, the same got shifted towards Middle East. Going forward, the management projects to close FY21 with a topline of Rs. 2.6b; VIS believes that the company is on track of meeting the projected target. However, margins declined during the ongoing year to 11.8% (FY20: 16.9%) on account of increase in average price of locally procured yarn to Rs. 15,462/bag (FY20: Rs. 15,140/bag) during HY21. Despite the dip in the margins of the current year; the same are still higher than the pre-covid values as the output prices of exported grey cloth were recorded higher at Rs. 190/meter during HY21 as opposed to Rs. 180/meter in FY19. The operating expenses were rationalized in terms of growth in revenues; the same is likely to have a positive impact on profitability indicators going forward. In addition, finance cost was also recorded lower at Rs. 49.5m during HY21 owing to sharp dip in benchmark interest rates despite increase in total borrowings of the company during the period under review. As a result of positive trajectory of revenues, rationalization of operating expenses and curtailment of interest expense, BEL reported healthy profit before tax of Rs. 50.2m during HY21.

Adequate liquidity profile as evident from healthy cash flows in relation to outstanding obligations and sound debt service ability: Liquidity profile of the company is considered sound in view of sizable cash flows in relation to outstanding obligations and adequate debt service capacity. In line with improved margins and higher profit before tax recorded, Funds from Operations (FFO) exhibited improvement on a timeline basis and were recorded higher at Rs. 101.8m (FY20: Rs. 182.1m, FY18: Rs. 174.0m) during HY20. As a result, the increase in quantum of debt during the review period was offset by growth in FFO hence, FFO in terms of total debt remained at FY19's level of 0.14x (FY20: 0.13x; FY19: 0.14x) at end-HY21. However, given the company had long-term debt free balance sheet in FY19 so with the procurement of long-term funding during the rating review period, FFO in terms of long-term debt stood at 1.8x (FY20: 2.4x; FY19; nil) during HY21; the same is considered sizable however a declining trend was witnessed owing to increased procurement of long-term credit during HY21. Moreover, debt service coverage remained sound during the period under review. Going forward, cash flows are expected to replicate the trend in profitability indicators.

Stock in trade exhibited an increasing trend on a timeline basis and was reported higher at Rs. 1.01b (end-FY20: Rs. 1.14b; end-FY19:773.8m) at end-HY21; however, the same is largely in sync in growth in scale of operations. The inventory levels peaked at end-FY20 owing to delay in shipment of orders leading to higher quantum of unsold finished goods; however, the same is being subsided during the ongoing year. Trade debts on the other hand were reported lower at Rs.569.3m (end-FY20: Rs. 499.1m end-FY19: Rs. 879.7m) on a timeline basis at end-HY21 on the back of decline in local sales involving higher credit period. The aging of receivables is considered satisfactory given all receivables pertained to less than six-month overdue bracket. Advances and prepayments stood higher at Rs. 228.7m (end-FY20: Rs. 226.6m, end-FY19: 107.6m) at end-HY21 on account of advance payments to suppliers in line with higher forecasted demand; the same is a function of increase in scale of operations. Other receivables were also recorder higher at Rs. 220.4m (end-FY20: 203.2m; end-FY19: 96.6m) at end-HY21 on account of last installment of sale of spinning unit made in FY17. Further, liquidity of the company is slightly impacted due to sizable tax refunds amounting to Rs. 318.4m (end-FY20: Rs. 321.6m; end-FY19: Rs. 207.9m) due from government at end-HY21; the company is unable to rectify the situation given it is an exogenous factor and inherent in the local textile industry. Trade and other payables increased to Rs. 86.5m (end-FY19: Rs. 55.1m) at end-FY20 due to higher advances from customers booked; however, the quantum of the same declined during the outgoing year. Given increase in inventory and recoverable from government current ratio of the company showcased slight improvement during the rating review period.

Conservative capital structure with minimal reliance on long-term funding: The Tier-I equity of BEL increased slightly on a timeline basis to Rs. 1.8b (end-FY20: Rs. 1.7b, end-FY19 Rs. 1.6b) at end-HY21 owing to internal capital generation. The debt matrix is heavily tilted towards short term credit owing to limited reliance of the company on long-term borrowings. There was a slight increase in utilization of short-term borrowings witnessed during the period under review with highest procurement made under export finances. On the other hand, the company procured long term debt amounting to Rs. 114.3m (end-FY20: Rs. 75.1m; end-FY19: nil) at end-HY21; out of the total Rs. 74.0m is obtained under SBP's temporary refinance scheme for payment of salaries and wages of employees and workers. The facility is secured against token registered mortgage of Rs. 0.1m and equitable mortgage over personal properties of director of the company. The other long-term loan amounting to around Rs. 40.3m was procured to fund normal BMR requirements to enhance production efficiencies; the facility carries a markup charge of 6.0% and is secured against first exclusive/specific charge over fixed assets of the company along with personal guarantees of directors of the company. Subsequently, total debt levels of the company increased on a timeline basis by end-HY21; however, despite the increase gearing was largely maintained at FY19's level at 0.78x (FY20: 0.79x; FY19: 0.79x) at end-HY21 in line with growth in equity base. Further, debt leverage decreased on a timeline basis primarily on the back of equity augmentation given slight increase in liabilities was evidenced.

During FY19, BEL planned to add 72 Airjet looms with a total capex estimated around Rs. 1.4b, however the plan has been shelved and since then the company has shifted its focus towards backward integration with set of spinning unit with 30,000 spindles. Total cost for the project is estimated around Rs. 1.9b for which the company plans to procure additional debt amounting to Rs. 1.3b under SBP's long-term financing facility (LTFF) by end-FY22; the equity contribution is capped at Rs. 600.0m. For the setup of the aforementioned spinning unit, the company already invested Rs. 76.4m by end-May'21 for the purchase of land; out of the same Rs. 24.8m was paid during the outgoing year. The civil works for the project are underway and are expected to completed by end- Sep'21, meanwhile the unit will come online by end-3QFY22. The estimated incremental revenue generation from the project is around Rs. 3.0b; the results of the same will be visible in FY23 with the projection being contingent upon the timely completion of the project.

Best Exports Limited Appendix I

BALANCE SHEET *(Rs. Millions)*	June 30, 2018	June 30, 2019	June 30, 2020	Dec 31, 2020
Non-Current Assets	2,089	2,043	2,080	2,060
Store, Spares and Loose Tools	77	109	134	138
Stock-in-Trade	640	774	1,137	1,091
Trade Debts	555	880	499	569
Other Receivables	-	97	203	220
Tax Refunds Due from Government	218	208	322	318
Cash and Bank Balances	42	63	84	108
Total Assets	4,189	4,461	4,686	4,733
Trade and Other Payables	58	55	86	57
Short Term Borrowings	1,033	1,247	1,296	1,301
Long Term Borrowings *(including current maturity)*	-	-	75	114
Total Debt	1,033	1,247	1,371	1,415
Total Liabilities	1,143	1,425	1,525	1,534
Tier-1 Equity	1,403	1,585	1,741	1,817
Paid-up Capital	411	411	411	411
Total Equity	3,046	3,036	3,161	3,198

INCOME STATEMENT	June 30, 2018	June 30, 2019	June 30, 2020	Dec 31, 2020
Net Sales	2,593	3,220	2,223	1,304
Gross Profit	329	293	376	154
Profit Before Tax	156	75	96	50
Profit After Tax	130	87	65	37
Funds from Operations	149	174	182	102

RATIO ANALYSIS	June 30, 2018	June 30, 2019	June 30, 2020	Dec 31, 2020
Gross Margin (%)	12.7	9.1	16.9	11.8
Net Margins	5.0	2.7	2.9	2.9
Current Ratio (x)	1.7	1.8	1.8	1.9
Net Working Capital	774	1,069	1,181	1,264
FFO to Total Debt (x)	0.14	0.14	0.13	0.14
FFO to Long Term Debt (x)	-	-	2.43	1.79
Debt Leverage (x)	0.81	0.90	0.88	0.84
Gearing (x)	0.74	0.79	0.79	0.78
Debt Servicing Coverage Ratio (x)	2.80	2.50	2.10	3.02
ROAA (%)	3.8	2.0	1.4	1.6
ROAE (%)	9.7	5.8	2.1	2.3
(Stock +Trade Debt) to Short-Term Borrowings	1.20	1.30	1.26	1.28

ISSUE/ISSUER RATING SCALE & DEFINITIONS — 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	Best Exports 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				
	30-06-2021	BBB	A-2	Stable	Maintained
	27-04-2020	BBB	A-2	Rating Watch – Developing	Maintained
	30-12-2019	BBB	A-2	Stable	Reaffirmed
	05-11-2018	BBB	A-2	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.				
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Due Diligence Meetings Conducted		**Name**	**Designation**	**Date**	
	1	Rohan Tariq	General Manager Finance	11-06-2021	