RATING REPORT

Artistic Apparels (Private) Limited

REPORT DATE:
November 16, 2020

RATING ANALYSTS:

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RATING DETAILS

Rating Category	Latest Rating	
	Long-term	Short-term
Entity (Indicative)	BBB+	A-2
Rating Date	*November 16, 2020*	
Rating Outlook	Stable	
Outlook Date	*November 16, 2020*	

COMPANY INFORMATION

Incorporated in 1992	**External auditors:** Rizwani Imtiaz & Co. Chartered Accountants
Private Limited Company	**Chief Executive Officer:** Mr. Yousuf Ahmed

APPLICABLE METHODOLOGY(IES)

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

Artistic Apparels (Private) Limited

OVERVIEW OF THE INSTITUTION

Artistic Apparels (Private) Limited (AAPL) was incorporated as a Private Limited Company in 1992. The company is engaged in the manufacturing and export of various kinds of readymade, textile and fashion garments.

AAPL is a family owned business with major shareholding resting held by Mr. Yousuf Ahmed who is the Chairman of the Board. He possesses over extensive experience in the industry.

External auditors of the company are Rizwani Imtiaz & Co. Chartered Accountants. The firm is not categorized in the SBP Panel of auditors; however they possess a satisfactory QCR rating.

RATING RATIONALE

Artistic Apparels (Private) Limited (AAPL) deals in manufacturing and exporting of denim garments. The company operates through around 2 facilities/units located at Korangi and Landhi in Karachi, Pakistan. Sponsors have extensive experience in the textile and denim segment. AAPL offers one-stop solution for cutting, stitching, washing, finishing, quality control to clearance and delivery of denim apparels Over the years, the management has placed significant focus on sustainability initiatives. AAPL has installed a waste water treatment (ETP plant) plant at its premises to minimize soil and water contamination at the washing unit. The company has also installed a Reverse Osmosis (RO) plant using latest technologies of reverse osmosis to purify and clean water from different sources. Power requirement of the manufacturing units are met through gas based generators with diesel based generators as backup. Total plant capacity (3.65MW) surpasses the company's requirement of 1.2MW. AAPL has compliance with major international safety and quality standards. AAPL's units are ISO14001 certified matching international quality standards. Focus on sustainability initiatives through continued investments is planned to continue.

Operations

The company has increased its capacity since FY19 to an average of 6.4m pieces at end-FY20 (FY18: 2.75m pieces). Capacity utilization has been increasing on a timeline basis and was reported at 83% (FY19: 78%) during FY20. Going forward, continuous expansion in installed capacity is planned over the rating horizon. Expansion is expected to be funded through a mix of debt and equity with the machinery imports to be financed by LTFF. The company also has backward integration plan in place to meet its fabric requirements along with selling the utilized fabric in the export and local market.

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.
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.

Double-digit sales growth over the past two years led by volumetric increase in sales from garments division and higher average selling prices due to currency devaluation. In line with industry trend, geographical concentration risk is considered on the higher side; however the same is mitigated with long term association with major clients. Healthy order pipeline is expected to translate into continued sales growth, going forward.
Sales revenue of the company has grown at a CAGR of 16% over the past three years (FY17-FY20). Sales revenue almost entirely comprises exports sales. Sales growth was recorded at 36% in FY20 and was on account of a 22% increase in quantity sold with the remaining owing to higher average selling prices (largely due to currency devaluation). Product wise sales depicts higher concentration towards jeans which is envisaged to remain the same given high quantum of orders emanating from the same. The company also possesses competitive advantage stemming from cutting edge at its manufacturing facilities. Product portfolio also includes sales of trousers, shorts, jackets, shirts, skirts and dungaree which represents around 34% of total dollar based revenues. In terms of geographical concentration in revenues, around 99% of sales are generated from European counties. Going forward, the company plans to tap the US market which will improve diversification in region wise sales. Client concentration risk is largely mitigated given long term association with major customers. Going forward, orders booked are higher than capacity; which are expected to be fulfilled with the ongoing expansion which shall further translate into higher projected sales revenue

Overall profitability profile of the Company has depicted improvement over the last 2 years. Net margins remain on the lower side vis-à-vis peers.

Gross margins (GMs) of the company have remained elevated over the last 2 years due to increasing per unit dollar prices, rupee devaluation and rebate. Despite significant jump expected in power cost, management expects to sustain margins on the back of increase in projected volumetric growth. Elevated administrative, general and selling expenses in FY20 were on account of higher travelling costs, export development surcharge, legal and professional charges, fees and subscriptions, repairs and maintenance, and salaries. The company also incurred a sizeable quantum of GIDC during FY20. Overall profitability of the company was supported by one-off gain on sale of fixed assets. Going forward, management expects momentum in profitability growth to improve given enhanced capacities, and continued focus on value addition.

Adequate liquidity profile as evident by sufficient cash flow coverages against outstanding obligations

Liquidity profile of the company is considered adequate in view of improving cash flows on account of increasing profitability. Despite higher debt drawdown during FY20, cash flow coverage of total and long-term debt improved to 15% (FY19: 10%) and 50% (FY19: 32%), respectively at end-FY20. Working capital cycle of the company necessitates utilization of short term borrowing which noticed increase during FY20. Stock levels were elevated at end-FY20; however, trade debts and stock provide sufficient coverage to short term borrowings. Total capex projected for expansion will be financed through a mix of LTFF and internal cash generation.

Leverage indicators have improved on a timeline basis owing to healthy growth in equity base through equity injection in FY20. Despite projected increase in debt levels, management foresees leverage indicators to remain at similar levels owing to projected improvement in internal capital generation with no expected dividend payout plans.

Equity base of the company has grown at a CAGR of 23% over the last 4 years. During FY20, the sponsors injected equity worth Rs. 648m in the form of land, consequently improving leverage indicators. Nevertheless, the size of equity base is low vis-à-vis other peer companies. Total debt of the company has been increasing on a timeline basis to fund expansion and working capital requirements. Leverage indicators improved on a timeline basis, despite increasing debt levels, owing to equity injection during FY20. Ratings remain dependent on maintenance of leverage indicators at similar levels.

Corporate Governance

Board of Directors consists of eight members comprising CEO and his family members in addition to one independent member who is also a close family associate. There are two committees formed- BoD and Board Audit Committee (BAC). The BAC comprises CFO and four directors. Given the company's shareholding structure and involvement of board of directors in management roles, board composition and oversight is currently constrained.

Over the years, strategic strengthening has been noted with induction of professional personnel (Head of Operations, HR, IT, Finance, and Marketing) in the management team, formation of a separate Quality team, setup of BOD, committees and a separate internal audit function that reports to the BAC, and laying down defined KPIs and objectives for employees at all levels.

Functioning of the IT department is considered adequate. In FY18, the company has employed Oracle Enterprise Business Suite Release 12.2.6 as its ERP software encompassing all modules for operational and financial management. Moreover, the company has installed firewalls at the corporate head office and at one of the manufacturing units.

FINANCIAL SUMMARY *(amounts in PKR millions)*				
BALANCE SHEET	**FY17**	**FY18**	**FY19**	**FY20**
Paid Up Capital	28	28	528	1,176
Total Equity (adjusted for interest free sponsor loan)	853	497	606	1,470
INCOME STATEMENT				
Net Sales	3,924	3,951	4,432	6,047
Profit Before Tax	30	(414)	76	148
Profit After Tax	11	(453)	33	89
RATIO ANALYSIS				
FFO	54	(377)	211	370
Current Ratio (x)	1.0	0.9	1.3	1.4
Gearing (x)	1.27	3.50	3.32	1.69

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 Apparels (Private) Limited
Sector	Textile Industry
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				
16-Nov-2020	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.
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.
Due Diligence Meetings Conducted	

Name	Designation	Date
Waqas Farooq	CFO	25-Sept-2020
Muhammad Ahsan Abdullah	Manager Finance	25-Sept-2020