RATING REPORT

Artistic Apparel (Private) Limited

REPORT DATE:
March 03, 2022

RATING ANALYST:
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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	Positive		Stable	
Rating Date	*March 03, 2022*		*November 16, 2020*	

COMPANY INFORMATION	
Incorporated in 1992	**External Auditors:** Grant Thornton Anjum Rahman Chartered Accountants
Private Limited Company	**Chairman/CEO:** Mr. Muhammad Yousuf Ahmed
Key Shareholding (more than 5%)	
Mr. Muhammad Yousuf Ahmed ~80.9%	
M/s. Artistic Properties (PVT) Ltd ~19.0%	

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

Artistic Apparel (Private) Limited

OVERVIEW OF THE INSTITUTION

Artistic Apparels (Private) Limited 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.

External auditors are 'Grant Thornton Anjum Rahman Chartered Accountants' belongs to category 'A' on the approved list of auditors published by the State Bank of Pakistan (SBP).

Profile of Chairman/CEO:

Mr. Muhammad Yousuf Ahmed was associated with Artistic Group since its foundation whereas subsequent to the distribution of wealth within the family in 2006, he has been serving as CEO of AAPL. He holds extensive experience in the textile export industry. Moreover, he is also serving as a non-executive director on the Board of Artistic Denim Mills Limited (listed entity on PSX).

RATING RATIONALE

Corporate Profile

Headquartered in Karachi, Artistic Apparels (Private) Limited (AAPL) is engaged in the production and export of denim garments and has completed around three decades of operations. It is a family-owned business with major shareholding held by Mr. Muhammad Yousuf Ahmed while his children are part of the management and actively involved in supervision of day-to-day business activities. At present, the company's operations mainly encompass cutting, stitching, washing, finishing and quality control which are carried out through two manufacturing units located at Korangi in Karachi. Power requirement of 2.6MW is met through internal generation with major reliance on gas-based power generators while diesel-based generators are generally used as backup in case the need arises. Moreover, a solar panel of 233Kwh is also in place. AAPL has in place a qualified senior management team with extensive experience. Total staff strength stands at 5K+ employees.

Capacity & Expansion Plans

Overall production capacity has increased by ~40% over the period of past two fiscal years on the back of significant capital expenditures which largely pertained to stitching machines and other efficiency enhancement related initiatives. Utilization levels also witnessed an upward trend on account of sizeable jump in export orders. In view of strong and continued growth in demand, the management planned to further increase the production capacity by ~30% (to 11.0m pieces) for which a facility located in Korangi has been rented while machinery is being imported at a total cost of Rs. 400m; entire project cost is financed through a 10-year Islamic long term financing facility (ILTFF) at concessionary rates. The project is expected to come fully online in April'22.

Figure: Capacity & Production Data

Units in millions	FY18	FY19	FY20	FY21	HFY22
Production Capacity (in pieces)	6.1	6.1	6.3	8.5	4.9
Actual Production (in pieces)	4.9	4.7	5.2	7.9	4.5
Capacity Utilization	***82.2%***	***77.9%***	***82.6%***	***93.1%***	***91.7%***

<u>Key Rating Drivers</u>

Textile and clothing exports have registered a sizeable growth given the surge in demand on account of rerouting of orders to Pakistan and favorable sector policies. Outlook is favorable going forward.

The 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 Rs. 3.8tr (FY20: Rs. 3.3tr) in FY21. Barring seasonal and cyclical fluctuations, textiles products have maintained an average share of about 60% in national exports. Given post pandemic sustained economic recovery and diversion of export orders to Pakistan, export revenues from textile segment (as per PBS) stood at USD 15.4b (FY20: USD 12.5b; FY19: USD 13.6b) in FY21, registering a sizeable year-on-year growth of ~23%. The similar growth trend has been noted in the ongoing year with exports reaching at USD 9.4b during 6M'FY22, up by 26% vis-à-vis SPLY. Knitwear, Readymade and Bed wear segments continued to contribute higher than other segments, with a cumulative contribution of more than 60% in textile exports. While primarily a volumetric driven growth, the exports also received a boost from higher prices (excluding Knitwear). During the year, while average volumes increased by around 20-30% in various segments as compared to the lock down period, average prices increased by 8-10%.

Figure: Textile Exports (as per PBS)

Segments	Value (US$ millions)		YoY(Δ)
	FY20	FY21	
Knitwear products	2,785	3,816	*37%*
Readymade Garments	2,549	3,033	*19%*
Bed wear	2,149	2,772	*29%*
Cotton Cloth	1,830	1,921	*5%*
Cotton Yarn	987	1,017	*3%*
Towels	711	938	*32%*
Made-up Articles	591	756	*28%*
Art, silk and synthetic textile	314	370	*18%*
Tents, canvas and tarpaulin	98	110	*12%*
Others	487	667	*37%*

Going forward, sector dynamics are favorable as Pakistan continues to receive export orders from global economies as competing regional countries remains hampered by the pandemic. Given the surge in demand, the industry is currently operating at full capacity and going through expansion and up-gradation to cater for additional demand.

5-Year (2020-25) textile policy continues to support the industry.

With the 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 would support liquidity constraints of local players. Initiatives are also being undertaken in order to increase production and yield of cotton to support the industry. Going forward, new Covid-19 variants (Omicron) and uncertainty of its impact on overall economy and political environment are the key present 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.

Healthy volumetric sales growth during FY21 and in the ongoing year. Going forward, sales revenue is targeted to cross Rs. 12b mark by FY22 on the back of enhanced capacity and sound revenue visibility reflective of sizeable order book.

Topline of the company has doubled over the period of last two fiscal years and amounted to Rs. 8.9b (FY20: Rs. 6.1b; FY19: Rs. 4.4b) in FY21. The year-on-year uptick of ~47% was mainly attributable to volumetric sales growth driven by diversion of export orders to Pakistan and sizeable demand surge in garment sector. The growth momentum has continued in the ongoing fiscal year with topline amounting to Rs. 5.9b during 6M'FY22. Going forward, the management is targeting sales revenue to reach Rs. 12b in FY22 on the back of enhanced capacity and sound revenue visibility reflective of sizeable order book.

Entire revenue is generated from export sales with major geographic concentration towards European regions; nonetheless, there are plans to tap the US market going forward. At present, denim garment exports dominate the sales mix constituting 93% of total sales with major chunk shared by trousers, jeans and shorts. Other products include jackets, shirts, skirts, dungaree and chinos. The management has planned to diversify product mix through achieving gradual growth in non-denim segment along with the addition of knitted garments to the product portfolio in the medium term. As per management, the non-denim segment is envisaged to constitute one-fourth of total sales. Client-wise concentration remains on the higher side with top 5 clients constituting around 80% of sales revenue. Nevertheless, the risk is partly mitigated given long-term established relationships with these clients ensuring repeat business.

Gross margins have improved on a timeline basis whereas the bottom-line profitability has depicted a volatile trend.
Gross margins have exhibited an increasing trend on a timeline basis (6M'FY22: 16.2%; FY21: 15.7%; FY20: 15.4%) on the back of higher per unit dollar prices coupled with rupee devaluation. The raw material is largely procured from nominated suppliers as specified by the client to ensure quality standards. Operating overheads increased considerably due to higher power cost given gas-supply shortages in the country and increase in salaries expenses. The same over the years has constituted ~30% of manufacturing cost which aligns with labor-intensive denim sector. Financial charges were also reported higher in the ongoing year due to adjustment of forward contracts given higher than anticipated rupee depreciation. This along with sizeable other expenses impacted the bottom-line profitability. Going forward, profitability growth will be a function of projected increase in sales volumes.

Overall liquidity profile is sound with some weakening in cash flow coverages during the ongoing year.
Liquidity profile is considered sound with adequate cash flows to support debt repayment obligations. In absolute terms, Funds from Operations (FFO) was reported at Rs. 228.5m (FY21: Rs. 748.2m) at end-1H'FY22. As a result, FFO to total debt and FFO to long-term debt decreased 12.7% (FY21: 23.9%) and 51.9% (FY21: 55.0%), respectively. Debt Service Coverage Ratio (DSCR) also stood considerably lower at 1.7x (FY21: 4.0x) due to higher finance cost paid. Working capital cycle of the company necessitates utilization of short term borrowings mainly to fund inventory levels. Current ratio remains strong at over 1.0x. Stock levels are elevated, however, trade debts and stock in trade are more than sufficient to cover short term borrowings. Aging profile of trade debts remain within manageable levels.

Leverage indicators are elevated due to increased debt utilization levels. Ratings remain dependent on managing gearing within prudent levels.
Equity base while crossing the Rs. 2b mark has depicted a more than three-fold increase over the past 24 months. The timeline growth has been achieved through profit retention and no dividend payout policy. As per management, there are no plans for the same in near future. Moreover, loan support from directors is planned to be converted into equity. Debt profile comprises a mix of short-term and long-term debt with total interest bearing liabilities increasing to Rs. 3.6b (FY21: Rs 3.1b; FY20: Rs. 2.5b) at end-1H'FY22; short-term debt (ERF) constituted around three-fourth of total debt. As a result, gearing and leverage indicators have weakened and were reported at 1.61x (FY21: 1.52x, FY20: 1.69x) and 2.80x (FY21: 2.54x, FY20: 2.75x), respectively at end-1H'FY22. Going forward, leverage indicators are expected to remain elevated given additional debt drawdown of Rs. 400m planned for capex.

Room for improvement exists in terms of corporate governance framework.
Board of Directors (BoD) comprises 8 members including the CEO and his family members. There are 3 executive, 4 non-executive and one independent member present on the Board. Room for improvement exists in terms of segregating ownership and management. The company has a separate internal audit function that report to Board Audit Committee (BAC) while independent quality control department is also present. Since last review, strengthening with the formalization of policy and procedures along with induction of professional personnel

has been noted in both these functions. IT infrastructure is considered sound with integrated Oracle-based ERP system in place. Moreover, the HR software acquired from a third party vendor is currently in the deployment phase. External auditors are 'Grant Thornton Anjum Rahman Chartered Accountants' belongs to category 'A' on the approved list of auditors published by the State Bank of Pakistan (SBP).

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

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**FY19**	**FY20**	**FY21**	**6M'FY22***
Fixed Assets	2,220	2,866	3,654	3,825
Stock-in-Trade	1,555	2,362	3,526	3,838
Trade Debts	228	326	419	806
Cash & Bank Balances	9	56	73	55
Total Assets	**4,527**	**6,361**	**8,706**	**9,852**
Trade and Other Payables	392	784	1,223	1,749
Short Term Borrowings	1,353	1,739	1,767	2,707
Long Term Debt *(Including current maturity)*	657	741	1,359	881
Total Interest Bearing Debt	2,010	2,481	3,127	3,588
Total Liabilities	**2,644**	**3,628**	**4,772**	**5,758**
Paid up capital	528	1,176	1,176	1,176
Total Equity *(Excluding revaluation surplus and adjusted for interest free sponsor loan)*	**606**	**1,470**	**2,055**	**2,223**
INCOME STATEMENT				
Net Sales	4,432	6,047	8,912	5,972
Gross Profit	495	934	1,396	968
Finance Cost	119	229	256	303
Profit before Tax	76	148	630	214
Profit After Tax	33	89	545	155
RATIO ANALYSIS				
Gross Margin (%)	11.2%	15.4%	15.7%	16.2%
Net Margin (%)	0.7%	1.5%	6.1%	2.6%
Current Ratio (x)	1.29	1.36	1.67	1.34
Net Working Capital	552	924	2,017	1,511
Gearing (x)	3.32	1.69	1.52	1.61
Leverage (x)	4.91	2.75	2.54	2.80
FFO	211	370	748	229
FFO to Long Term Debt (x)	0.32	0.50	0.55	0.52
FFO to Total Debt (x)	0.10	0.15	0.24	0.13
Debt Servicing Coverage Ratio (x)	3.0	2.7	4.0	1.7
ROAA (%)	0.8%	1.6%	7.2%	3.3%
ROAE (%)	6.0%	8.6%	30.9%	14.5%

**Annualized ratios*

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	Artistic Apparels (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				
	03/03/2022	BBB+	A-2	Positive	Maintained
	16/11/2020	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.				
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Due Diligence Meeting Conducted	**Name**	**Designation**	**Date**		
	Mr. Waqas Farooq	Chief Financial Officer	Feb 21, 2022		