RATING REPORT

Shahbaz Garments (Private) Limited (SGL)

REPORT DATE:
May 02, 2019

RATING ANALYST:
Narendar Shankar Lal
narendar.shankar@vis.com.pk

Madeeh Ahmed
madeeh.ahmed@vis.com.pk

RATING DETAILS		
	Initial Rating	
Rating Category	Long-term	Short-term
Entity	BBB+	A-2
Rating Outlook	Stable	
Rating Date	May 02, 2019	

COMPANY INFORMATION	
Incorporated on 5th August 1972	**External auditors:** A.F. Ferguson & Co., Chartered Accountants
Private Limited Company	**General Manager:** Mr. Raza Azar

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria *Industrial Corporates (May 2016)*
http://www.vis.com.pk/docs/Corporate-Methodology-201605.pdf

Shahbaz Garments (Private) Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

Shahbaz Garments (Private) Limited (SGL) was incorporated in 1972, as a private limited company. Financial Statements of the company for 2018 were audited by A.F Ferguson & Co.

Profile of GM

Mr. Raza Azar joined the company in 2016 after spending 20 years in ICI Pakistan Limited and has more than 23 years of professional experience.

Shahbaz Garments (Private) Limited (SGL) is engaged in manufacturing and sale of various types of industrial gloves, along with fabric and yarn. The parent group also owns five other companies in Pakistan including Beltexco Limited (BEL), Prime Safety Limited (PSL), Midas Clothing Limited (MCL), Industrial Clothing Limited (ICL), and Work Clothing Limited (WCL). BEL and PSL are also engaged in production and sale of gloves, while the latter three companies manufacture industrial and safety clothing.

The registered office of SGL is based in Karachi. The company has three manufacturing units, out of which two units are based in Faisalabad, while one unit is based in S.I.T.E Karachi.

Rating Drivers

Overall business risk profile of SGL is considered moderate

Inherent cyclicality of cotton price and crop levels drive performance of players involved in manufacturing and sales of yarn. Historically, margins and financial performance of players have depicted seasonality depending upon their procurement strategy. Moreover, competitive intensity is high due to commoditized nature of the product. Ability of the companies engaged in manufacturing and sales of yarn to maintain their customer profiles along with product quality will be a key growth driver.

Risk profile of the gloves segment compares favorably vis-à-vis the spinning segment. Competitive pressures may arise due to presence of sizeable informal sector. However, SGL is relatively better positioned in comparison to the small-scale glove producers on account of long term relationships with customers and suppliers, integrated production facilities, and comprehensive product suite offering a complete range of industrial gloves.

Production Facilities

Open End Spinning: Actual Production of open end yarn spinning witnessed an increase in 2017 with the addition of new rotors. Capacity utilization has remained above 90% on time line basis; internally produced yarn exceeding SGL's requirement is sold in the open-market. The company mostly produces coarse yarn with yarn count of 6/S-16/S.

Ring Spinning: Capacity utilization of ring spinning has remained around half of the total installed capacity due to limited clientele presently. Ring Spinning spindles are being utilized to produce specialty yarn which is utilized in manufacturing of cut resistant fabric. Going forward, management is expecting increase in capacity utilization of ring spinning as it is actively seeking buyers for technical yarn.

Knitted Fabrics: Installed capacity and actual production of knitted fabrics witnessed a decline in 2018 due to deliberate strategy of the management to diversify its product mix.

Gloves: Installed capacity and actual production of gloves was also reduced in 2018. The primarily reason behind this decrease was deliberate decision of the management to curtail production of loss-making articles of gloves.

Topline has depicted modest growth on timeline basis on account of increase in local sales. Management is expecting the growth trend to continue going forward

Net sales of the company have grown at a Compound Annual Growth Rate (CAGR) of 12.5% during the last two years. Growth in sales was primarily a function of increase in product prices as the volumes have been sustained at approximately similar level during the last three years. Around two third of the company sales are geared towards the export market. Growth in overall sales was a result of increase in local sales. Concentration is witnessed in term of client wise sales; however top ten clients include five related parties. Going forward, the management is projecting a double-digit growth in sales aided by expansion in capacity.

After posting a loss in 2017, profitability of the company has depicted improvement in 2018 on account of various internal and external factors

As per management, gross margins witnessed considerable increase in 2018 due to a number of internal and external factors. Management's strategy to focus on higher margin products, favorable cotton procurement strategy, and production efficiencies resulted in improvement in margins. Gross margins were further aided by external factors including currency devaluation and reduction in RLNG prices by the government to facilitate exports.

Improvement in gross margins translated to higher bottom line in 2018. Management is forecasting favorable impact of projected growth in sales on overall profitability going forward. Sustainability in margins and growth profitability in the given rating horizon are important rating determinants going forward.

In line with the trend in profitability, equity base of the company also witnessed sizeable increase in 2018 due to profit retention. Leverage and gearing indicators have also improved in 2018

Equity base of the company witnessed reduction in 2017 due to the loss incurred by the company. However, during the same year, the company also converted long term payable to related parties as advance against issues of shares. With a positive bottom-line in 2018, equity base of the company improved compared to preceding year.

Gearing and Leverage ratios decreased respectively at end-2018. These ratios increased in

2017 due to growth in total debt coupled with decrease in equity. Subsequently, reduction was witnessed in 2018 in the quantum of total debt along with increase in equity base, resulting in lower leverage indicators. Majority of the total debt is short term in nature to finance working capital requirements.

Liquidity indicators of the company have observed an improving trend owing to improvement in company's bottom line.

Fund From Operations (FFO) has varied in line with the company's bottom line. In 2018, FFO of the company improved on account of rising profits. After witnessing a decline in 2017, FFO in relation of outstanding debt obligations improved in 2018.

Debt Service Coverage Ratio is considered adequate to service outstanding obligations. At end-2018, current ratio of the company was above 1.0x, however the same has remained under 1.0x in preceding years. Stock in trade and trade debts provide adequate coverage for short term borrowings.

ISSUE/ISSUER RATING SCALE &DEFINITIONS — Appendix II

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	Shahbaz Garments (Private) Limited
Sector	Textiles
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				
05/02/2019	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.
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