RATING REPORT

Shahbaz Garments (Private) Limited

REPORT DATE:
July 26, 2021

RATING ANALYST:
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RATING DETAILS				
Rating Category	**Latest Rating**		**Previous Rating**	
	Long-term	**Short-term**	**Long-term**	**Short-term**
Entity	A-	A-2	BBB+	A-2
Rating Outlook	*Stable*		*Rating Watch - Negative*	
Rating Date	*July 26, 2021*		*April 30, 2020*	

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

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria *Industrial Corporates (May 2019)* ***https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Corporate-Methodology-201904.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. Zeeshan Waseem joined the Company in Feb'21 as a General Manager. Previously, he served as country general manager in Stahl Pakistan. Mr. Zeeshan is a seasoned professional with working experience of around 18 years. He graduated in MBA from Birmingham City University.

Corporate Profile

Shahbaz Garments (Private) Limited (SGL), a subsidiary of Beltexco Limited (based in Hong Kong), has significant expertise in manufacturing and sale of a wide range of industrial gloves to both local and export market. The Company is one of the leading gloves producers in Pakistan and will complete five decades of operations by 2022. Product portfolio also includes yarn and knitted fabric. Headquartered in Karachi, the Company runs its operations through three manufacturing facilities; two units (Spinning & Gloves) are based in Faisalabad while Knitting unit is located in S.I.T.E Karachi. Power requirement of 3.3MW is met through internal generation with major reliance on gas-based power generators while sanctioned load of 4.0MW from national grid (FESCO) is available as a backup. Moreover, in view of optimizing energy cost, the management has planned to install two solar panels of total 437Kwh.

Baring the spinning unit, all production facilities have been operating at low utilization levels. The same also remained under pressure in 2020 due to pandemic-induced slowdown in demand (specifically from Mar-June 2020). Nonetheless, given subsequent economic recovery production volumes have recovered in the ongoing year.

Capacity Utilization	Capacity		Production		Utilization	
	2020	2019	2020	2019	2020	2019
Yarn (M Kgs)	12.9	11.9	11.2	11.5	87%	97%
Knitted Fabric (M Kgs)	2.9	2.9	1.3	1.6	46%	54%
Gloves (M Dpz)	8.7	8.1	4.1	4.4	55%	55%

Sponsor Group

Pangea Limited (PL) – based in Jersey is the ultimate parent Company. Under the ambit of the same sponsor group, there are four more companies namely; Prime Safety Limited (PSL), Midas Clothing Limited (MCL), Industrial Clothing Limited (ICL) and Beltexco Limited (BEL). BEL and PSL are engaged in production and sale of gloves while the other three companies manufacture industrial and safety clothing.

Expansion of operational capacity in spinning and gloves segments.

During the ongoing year, the management acquired land adjacent to both its spinning and glove manufacturing units in order to enhance the operational capacity of each segment by around 50%. Total estimated cost of the project is Rs. 1.3b; of which Rs. 500m is already funded through internal cash flows for acquiring land and building. Remaining cost is planned to be financed through a 10-year long term financing facility (LTFF) at concessionary rates to import plant and machinery. The project is expected to come online in Feb'22.

<u>Key Rating Drivers</u>

Business risk profile is considered low

SGL is relatively better positioned in comparison to small-scale glove producers; however, competitive pressures still may arise given the presence of sizeable informal sector.

Additional comfort is drawn from Company's long-term established relationships with customers and suppliers, integrated production facilities, and comprehensive product suite offering a complete range of industrial gloves.

Textile and clothing exports rebounded post ease in nation-wide lockdowns (due to Covid-19 pandemic); outlook is favorable going forward.
In FY20, export revenues from textile segment dropped by ~6% to USD 12.8b (FY19: USD 13.6b) in the wake of Covid-19 induced lockdowns both domestically and globally. Negative trend was noted in all segments. However, following the ease in pandemic restrictions after the first wave along with the implementation of smart lockdown policy and given subsequent economic recovery, textile exports (as per PBS) rose to USD 12.7b in 10M'FY21 (vis-à-vis USD 10.8b SPLY), registering a sizeable growth of ~17%. This growth was mainly was driven from the value-added sector while growth in knitwear exports (both in terms of value and volume) outpaced the other segments. Meanwhile, the commodities that witnessed negative growth in trade included raw cotton, cotton yarn and cotton cloth.

Segments	Amount in USD (millions)		(%) Change
	10M'FY21	10M'FY20	
Knitwear products	$3,126	$2,392	31%
Readymade Garments	$2,512	$2,232	13%
Bed wear	$2,292	$1,838	25%
Towels	$777	$611	27%
Made-up Articles	$628	$513	22%
Art, silk and synthetic textile	$302	$273	11%
Tents, canvas and tarpaulin	$96	$78	23%
Yarn (other than cotton yarn)	$27	$22	23%

Going forward, sector dynamics are favorable as Pakistan continues to receive export orders from global economies as competing regional countries like India and Bangladesh remains hampered by the Covid-19 outbreak. 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. Nevertheless, downside risk, in the short-tern, remains elevated on account of third wave of Covid-19. In the long run, improvement in value addition, investment in technology and optimization of energy cost would be the key determinants of textile exports.

Sales revenue hit due to pandemic has posted significant recovery in the ongoing year on account of healthy growth in volumes.
After registering a double-digit annual growth in the last three consecutive years, SGL's topline has declined by ~4% in 2020, amounting to Rs. 5.5b (2019: Rs. 5.8b). The decline was mainly attributable to pandemic-induced fall in demand coupled with supply chain

disruptions which led the volumetric sales to decrease by ~32% despite higher average selling prices. However, sales during 6M'2021 depicted a healthy recovery and were reported at Rs. 3.4b, increasing by ~27% SPLY. Going forward, the management is targeting sales revenue to reach Rs. 7.8b by the year-end 2021 on the back of new product development, aggressive pricing and entry in sports gloves segment.

Proportionate share of exports (direct & indirect) to local sales has exceeded 80:20 ratio. Major exports are directed towards USA followed by Bangladesh, Sri Lanka, UAE and other European countries. In terms of product-wise sales mix, around four-fifth of revenue is generated from various types of gloves which is followed by cotton yarn and technical products (including Kevlar and other synthetic fiber products). Client-wise concentration remains on the higher side with top ten clients constituting around one-half of total sales. However, dependence on related party sales was managed to reduce by half during the outgoing year.

Profitability margins have depicted a rising trend over the last four consecutive years. Going forward, margins are expected to sustain while growth in profitability will be a function of increase in production volumes.
Gross margins continue to witness an upward trend over the past four consecutive years (2020: 22.0%; 2019: 20.8%; 2018: 17.3%; 2017: 11:0%) on the back of efficient procurement, production efficiencies and enhanced focus on higher margin products. Improvement in gross margins along with limited growth in operating overheads translated into bottom-line profitability of the Company which has more than doubled in a two year period. Given that entire borrowing is on concessionary rates, financial charges have largely remained static despite increasing debt levels. Profitability profile is also supported by other income which mainly includes gain on short term investments, profit on saving accounts, custom rebates and waste and scrap sales. Going forward, margins are expected to sustain while growth in profitability will be a function of volumetric increase in sales.

Liquidity profile supported by increasing cash flows on timeline basis and adequate debt servicing ability.
In line with the growth in profitability, SGL's overall liquidity profile has improved on a timeline basis with adequate cash flows to support its limited debt obligations. In absolute terms, Fund From Operations (FFO) has increased to Rs. 881m (2019: Rs. 803m; 2018: Rs. 426m) in 2020. Resultantly, FFO in relation to long-term debt and total debt has witnessed improvement while Debt Service Coverage Ratio (DSCR) also stood higher at 16.1x (2019: 7.6x). Current ratio of the Company remains over 1.0x, while trade debts and stock in trade are more than sufficient to cover short term borrowings. Going forward, maintenance of liquidity indicators is considered important from rating perspective.

Liquid assets comprise cash & bank balances and short term investments which collectively were reported at Rs. 1.9b at end-2020. Short term investments of Rs. 1.3b comprise exposure in TDRs.

Capital structure is considered conservative. Leverage indicators have improved on account of increase in equity base; the same are expected to remain at similar levels over the rating horizon.
Equity base of the Company has grown on timeline basis and crossed the Rs. 2b mark in 2020 mainly due to profit retention and no dividend payout policy. Debt profile of the Company comprises a mix of short term and long term debt with total interest bearing

	liabilities amounting to Rs. 1.5b (2019: Rs. 1.1b; 2018: Rs. 1.2b) at end-2020; short-term debt (ERF) constituted more than around four-fifth of total debt. Gearing and leverage indicators have improved and were reported at 0.67x (2019: 0.72x; 2018: 1.05x) and 1.34x (2019: 1.68x; 2018: 1.99x), respectively at end-2020. Going forward, despite the debt draw down planned for expansion, leverage indicators are expected to remain within manageable levels on account of projected improvement in equity base through retained earnings.

Shahbaz Garments (Private) Limited — Appendix

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**2017**	**2018**	**2019**	**2020**
Fixed Assets	1,510.1	1,438.6	1,414.9	1,694.4
Stock-in-Trade	830.0	813.1	1,149.3	874.0
Trade Debts	522.8	533.3	461.7	388.9
Short-term Investments	-	-	-	1,304.2
Cash & Bank Balances	18.3	338.1	867.0	557.5
Total Assets	**3,155.1**	**3,386.0**	**4,219.3**	**5,119.8**
Trade and Other Payables	809.7	832.1	1,147.7	1,054.9
Long Term Debt	224.4	182.3	70.9	224.4
Short Term Debt	1,000	1,000	1,067.3	1,241.5
Total Debt	1,224.4	1,182.3	1,138.1	1,465.9
Total Liabilities	**2,313.1**	**2,254.9**	**2,642.8**	**2,931.3**
Paid up Capital	4.6	4.6	4.6	4.6
Share Premium	398.7	398.7	398.7	398.7
Total Equity	**841.9**	**1.131.1**	**1,576.4**	**2,118.4**
INCOME STATEMENT				
Net Sales	4,399.2	5,059.1	5,761.9	5,524.4
Gross Profit	484.2	873.8	1,197.1	1,216.9
Profit Before Tax	(83.1)	291.2	554.1	670.3
Profit After Tax	(127.4)	240.2	476.5	581.3
RATIO ANALYSIS				
Gross Margin (%)	11.0%	17.3%	20.8%	22.0%
Net Margin	-2.9%	4.7%	8.3%	10.5%
FFO	(49.6)	426.4	803.1	8808
FFO to Total Debt (%)	-22.1%	233.9%	1133.4%	392.4%
FFO to Long Term Debt (%)	-3.2%	36.1%	70.6%	60.1%
Current Ratio (x)	0.88	1.03	1.24	1.47
(Stock + Trade Debts)/ Short term borrowing	135.3%	134.6%	150.9%	101.7%
Debt Servicing Coverage Ratio (x)	0.13	5.23	7.61	16.09
Gearing (x)	1.85	1.05	0.72	0.67
Leverage (x)	2.75	1.99	1.68	1.34
ROA (%)	-4.2%	7.3%	12.5%	12.4%
ROE (%)	-15.1%	24.3%	35.2%	30.9%

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	Shahbaz Garments (Private) Limited				
Sector	Textiles				
Type of Relationship	Solicited				
Purpose of Rating	Entity Ratings				
Rating History	**Rating Date**	**Medium to Long Term**	**Short Term**	**Rating Outlook**	**Rating Action**
	RATING TYPE: ENTITY				
	26/07/2021	A-	A-2	Stable	Upgraded
	30/04/2020	BBB+	A-2	Rating Watch-Negative	Maintained
	02/05/2019	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.				
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. Kashan Mansoori	CFO	July 2, 2021		