RATING REPORT

Shahbaz Garments (Private) Limited

REPORT DATE:
September 06, 2022

RATING ANALYSTS:
Asfia Aziz
asfia.aziz@vis.com.pk

Sundus Qureshi
sundus.qureshi@vis.com.pk

RATING DETAILS				
Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A-	A-2	A-	A-2
Rating Outlook	*Stable*		*Stable*	
Rating Date	*Sep 06, 2022*		*July 26, 2021*	
Rating Action	*Reaffirm*		*Upgrade*	

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 Methodology – Industrial Corporates (August 2021) https://docs.vis.com.pk/docs/CorporateMethodology202108.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 2021 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 a family owned business with ultimate parent company (Pangea Limited) based in Canada. Owners include Mr. Mustafa Kassam and Mr. Hussain Kassam. The Company is one of the leading gloves producers in Pakistan and has completed five decades of operations at end-June'22. Product portfolio also includes cotton yarn, technical 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 at 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 successfully installed two solar panels of total 437Kwh in 2021 through arranging subsidized rate financing from SBP for renewable energy. Going forward, the company plans to further add solar capacity to generate energy savings.

Baring the spinning unit, all production facilities have been operating at low utilization levels. However, the same have depicted improvement in 2021 due to recovery in demand with ease in global macro-economic environment. Moreover, given planned expansion in the spinning and knitting units in lieu of projected demand growth, capacity utilization levels for other segments is expected to improve over the rating horizon.

Capacity Utilization	Capacity		Production		Utilization	
	2020	2021	2020	2021	2020	2021
Yarn (M Kgs)	12.9	12.9	11.2	11.4	87%	88%
Knitted Fabric (M Kgs)	2.9	2.9	1.3	1.8	46%	62%
Gloves (M Dpz)	8.7	8.7	4.1	4.9	55%	56%

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 2021 and 1Q2022, the management has been incurring capital expenditure for enhancement in capacity of open-head spinning (additional third unit) by 50%. Also, the company has increased floor area of the knitting unit and plans to marginally increase capacity of the same. Total estimated cost of the project is Rs. 2.5b to 3.0b. Around Rs. 500m LTFF has been availed with additional Rs. 250m expected to be drawn in the ongoing year by end-June'22. The remaining cost was financed through internal cash generation. The projects is expected to come online by end-Sept'22.

<u>Key Rating Drivers</u>

Business risk profile is considered medium to low due to better market position. However, due to current macroeconomic environment, slowdown is expected in the short to medium term.

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. An overview of the textile sector in FY21 is summarized below:

- Subsequent to posting export contraction in FY20 - owing to the pandemic-induced slowdown experienced in H2'FY20 – Pakistan's export base grew by 14% in FY21, which is partly attributable to a low base effect. Pakistan's export proceeds have oscillated in the range of USD 22-25b during the past decade (FY11-FY21). Therefore, the uptick is largely aligned with historical numbers and is not considered material.
- Share of textile exports in total exports has oscillated in the range of 54-59%, coming in at 57% during the past 2-years (FY20-21). In FY21, owing to the similar low-base effect, as discussed above, textile exports were up 13%.
- In USD' terms textile exports have grown at a CAGR of 4.4% during the past 3-year period (FY19-FY21), despite depreciation in average USD/PKR parity of 24%, 16%, and 1% in FY19, FY20 and FY21 respectively.
- In the textile sector, the highest exports were of Knitwear segment with a growth of 37% on a YoY basis. The Knitwear exports were $ 3.83 billion in FY21 compared to $ 2.80 billion in FY20. Whereas, Exports of Bed Wear and Readymade Garment's segments had substantial growth by 29% YoY and 19% YoY, respectively.
- Textile exports in Q1'FY22 were 37% higher than SPLY. Inclusive of textile exports for Oct'2021, the number for 4M'FY22 textile exports came in at USD 6b. With additional capacities coming online in January 2022, textile exports for FY22 are likely to exceed the annualized figure of USD 18b.

- The composition of textile exports has depicted improvement in the last 4-yar period, with contribution from higher value added segment increasing from 72.9% in FY18 to 80.7% in FY21 of aggregate textile exports.
- Cotton production in Pakistan, on the other hand, was at its lowest level in decades for FY21. Cotton prices rose to a new 11-year high of ~Rs. 13,000/maund as a result of the production shortage, and cotton imports have climbed by 59.8% in quantity and 68.1% in USD terms, for FY21 vis-à-vis preceding year.
- Given favorable weather conditions, cotton production in Pakistan posted strong growth in FY22, with cotton crop for Jul-Nov'22 (Rabi) season being 81% higher than SPLY. Nevertheless, the upward momentum in cotton pricing continued in FY22, with prices as of November 2022 hovering at ~Rs. 16,000 per mound.
- The margins of textile operators have broadly depicted improvement despite the uptick in raw material costs, given that the same was offset by exchange rate movement. Nevertheless, higher raw material pricing has increased the working capital requirements for textile operators, which is likely to weigh on the liquidity of textile players.
- VIS expects some pressure on the order book for the industry in the short to medium term.

Double-digit growth in topline during 2021 attributable to uptick in exports quantum, benefit of rupee devaluation and ease in global macroeconomic conditions.

After registering a 4% decline in revenue base in 2020, SGL's topline has inclined by ~26% in 2021, amounting to Rs. 7.0b (2020: Rs. 5.5b) attributable to uptick in exports quantum, benefit of rupee devaluation on prices and ease in global macroeconomic conditions post COVID-19. Further, in 1Q22, sales were reported at Rs. 2.5b, depicting a similar trend. Proportionate share of exports (direct & indirect) to local sales was reported higher at 80:20 (2020: 75:25) ratio in 2021. Major exports are directed towards Bangladesh followed by USA, Sri Lanka, Germany and other European countries. Indirect exports of technical yarn is directed towards related company-Beltexco Pakistan, In terms of product-wise sales mix, around one-half 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 64% (2020: 58%) of total sales in 2021. Sizeable 16% was contributed by one client- Style Textile (Pvt.) Limited with which SGL has longstanding relationship. However, to increase diversification, the company plans to add new clientele with small quantum of orders. Materialization of the same is yet to be seen.

Going forward, sales are expected to escalate on account of higher orders through capacity enhancement in lieu of growing demand. However, VIS expects some pressure on the order book in the short to medium term amidst current local macroeconomic environment.

While Gross Margins of the company improved in the review period largely due to inventory gains and higher sales revenue, net profitability reduced due to higher operating and non-operating expenses, and lower other income in comparison to 2020.

Gross margins of the company depicted a timeline increase to 24.4% (2021: 22.5%, 2020: 22.0%) during 1Q2022 largely due to inventory gains and higher sales revenue. Despite improvement in gross profitability, overall profitability was negatively affected by higher administrative expenses (2021: Rs. 661.3m, 2020: Rs. 458.1m) and other operating expenses (2021: Rs. 113.4m, 2020: Rs. 48.2m) due to higher salaries & donation and provision for tax assessment & sales tax refundable, respectively in 2021. Finance charges increased slightly to Rs. 65.3m (2020: Rs. 61.5m) in 2021 due to higher debt utilization. Other income support also declined (2021: Rs. 169m, 2020: Rs. 256m) due to lower custom rebates and lower reversal of provision against taxes recoverable. Consequently, net margins declined to 7.5% (2020: 10.5%) during the same period. Maintaining profitability profile in view of projected short-term slowdown, higher debt levels and implementation of super tax is considered important.

With decline in net profitability, cash flow coverages against obligations reduced, however remains sufficient for the assigned ratings.

In absolute terms, Funds from Operations (FFO) amounted to Rs. 861.5m (2020: Rs. 880.8m) depicting a decrease on account of lower overall profitability during 2021. Resultantly, FFO in relation to total debt and Debt Service Coverage Ratio (DSCR) also weakened and were reported at 57.5% (2020: 60.1%) and 14.1x (2020: 16.1x), respectively in 2021, respectively. On the other side, FFO in relation to long-term debt stood higher at 255.5% (2020: 220%) in 2021 on account of repayment of debt during the period. Albeit declining coverages, the same are considered sufficient for the assigned ratings. Inventory and trade debts provide sufficient coverage for short-term debt obligations. Current ratio was reported at 1.5x at end-Mar'22. Working capital cycle improved in 2021; maintaining the same and inventory days due to bulk buying of raw material in anticipation of increasing prices will also be important from a liquidity perspective. Trade debts aging also remains comfortable with majority of receivables (73%) due within 30 days at end-2021. In view of the aforementioned indicators, overall liquidity profile is considered sound.

Conservative capital structure with expansions being financed majorly through internal cash generation. Major debt portfolio (around 75%) comprises short-term debt to finance working capital needs.

Equity base of the company was reported higher at Rs. 2.9b (FY21: Rs. 2.8b; FY20: Rs. 2.2b) at end-Mar'22 on account of profit retention and no dividend pay-out. In 1Q2022, short-term borrowing accounted for 74% (2021: 78%) of the total debt. Quantum of total debt increased at end-Mar'22 to finance working capital requirements and expansions. Debt comprises ERF, LTFF and TERF facilities of SBP depicting comparatively lower interest rate risk. With SBP increasing interest rates for these loan categories as well, impact of higher finance charges will be seen going forward. With similar increase in equity base and debt levels, gearing and leverage ratios were maintained at 0.63x (FY21: 0.54x; FY20: 0.67x) and 1.34x (FY21: 1.20x; FY20: 1.34x), respectively at end-Mar'22. With gradual repayment of debt and retention of profits, leverage indicators are expected to improve over the rating horizon.

Shahbaz Garments (Private) Limited Appendix I

Financial Summary (amounts in PKR millions) - Period End December				Appendix I
	2019	2020	2021	1Q22
BALANCE SHEET				
Property, Plant and Equipment	1,392.6	1,670.7	2,332.9	2,447.5
Other Fixed Assets	22.3	23.7	31.6	15.8
Stock-in-Trade	1,149.3	874.0	1,761.6	1,340.4
Trade Debts	461.7	388.9	630.0	1,100.9
Cash & Bank Balances	867.0	557.5	983.2	1,324.6
Total Assets	4,219.3	5,119.8	6,345.4	6,870.4
Trade and Other Payables	1,147.7	1,054.9	1,662.5	753.9
Long Term Debt (including contingencies and commitments)	138.1	400.4	337.2	476.1
Short Term Debt	1,000.0	1,065.5	1,162.0	1,384.4
Total Debt	1,138.1	1,465.9	1,499.2	1,860.4
Total Liabilities	2,642.8	2,931.3	3,582.4	3,935.3
Total Equity (excluding revaluation)	1,576.4	2,188.4	2,763.0	2,935.0
Paid-up Capital	4.6	4.6	4.6	4.6
INCOME STATEMENT				
Net Sales	5,761.9	5,524.4	6,978.8	2,447.4
Gross Profit	1,197.1	1,216.9	1,567.6	596.4
Operating Profit	611.1	731.8	676.1	255.7
Profit Before Tax	554.1	670.3	610.8	259.1
Profit After Tax	476.5	581.3	521.7	228.5
RATIO ANALYSIS				
Gross Margin (%)	20.8%	22.0%	22.5%	24.4%
Net Profit Margin (%)	8.3%	10.5%	7.5%	9.3%
Net Working Capital	550.9	1,087.4	915.6	1,427.1
FFO	803.1	880.8	861.5	280.5
FFO to Total Debt (%)	70.6%	60.1%	57.5%	60.3%
FFO to Long Term Debt (%)	581.4%	220.0%	255.5%	235.7%
Debt Servicing Coverage Ratio (x)	7.6	7.5	3.8	2.9
ROAA (%)	12.5%	12.4%	9.1%	13.8%
ROAE (%)	35.2%	30.9%	21.1%	32.1%
Current Ratio (x)	1.2	1.5	1.3	1.5
(Stock in trade + Trade Debts)/STD (%)	161.1%	118.5%	205.8%	176.3%
Gearing (x)	0.7	0.7	0.5	0.6
Leverage (x)	1.7	1.3	1.3	1.3

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				
06/09/2022	A-	A-2	Stable	Reaffirm
26/07/2021	A-	A-2	Stable	Upgrade
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.
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 Meeting Conducted

Name	Designation	Date
Mr. Fahad Noor	CFO	June 28, 2022
Mr. Wasay Altaf	Assistant Manager	June 28, 2022