RATING REPORT

Shahbaz Garments (Private) Limited

REPORT DATE:
April 16, 2024

RATING ANALYSTS:
M. Amin Hamdani
amin.hamdani@vis.com.pk

Muhammad Meeran Siddique
meeran.siddiqui@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	*April 16, 2024*		*Sep 06, 2022*	
Rating Action	*Reaffirm*		*Reaffirm*	

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* https://docs.vis.com.pk/docs/CorporateMethodology.pdf

APPLICABLE RATING SCALE(S)
VIS Issue/Issuer Rating Scale: https://docs.vis.com.pk/docs/VISRatingScales.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' or 'the Company'), a subsidiary of Beltexco Limited headquartered in Hong Kong, specializes in the manufacturing and distribution of a diverse range of industrial gloves, catering to both local and international markets. As a family-owned enterprise, with its ultimate parent company, Pangea Limited, situated in Canada, SGL has extensive experience and expertise in its field. The Company, under the ownership of Mr. Mustafa Kassam and Mr. Hussain Kassam, stands as a prominent player in Pakistan's gloves manufacturing sector, having successfully operated for over five decades since its establishment by offering not only gloves but also cotton yarn, technical yarn, and knitted fabric within its product portfolio.

Operational Update

The Company operates three manufacturing facilities: two units, Spinning and Gloves, are located in Faisalabad, while the Knitting unit is situated at S.I.T.E Karachi. To enhance cost efficiency in energy consumption, management successfully installed a 0.2 MW solar panel, at a cost of USD 0.18 mn, in Karachi during CY23. Additionally, plans are underway to install another solar project of 3.6 MW, costing USD 2.40 mn, in Faisalabad during CY24. These solar projects have been financed using internally generated funds. Going forward, the Company intends to further expand its solar capacity to achieve greater energy savings.

Throughout CY23, the production facilities experienced low utilization rates due to a slowdown in demand, as indicated by the decrease in product-specific capacity utilization. Yarn utilization dropped to 75% from 81% in CY22, while Gloves utilization decreased to 39% from 48% in CY22. However, there is optimism for improvement in capacity utilization levels in the future, in line with projected demand growth.

Sponsor Group

Pangea Limited (PL), headquartered in Jersey, serves as the parent company within its sponsor group. Additionally, four other companies operate under the same sponsor group: Prime Safety Limited (PSL), Midas Clothing Limited (MCL), Industrial Clothing Limited (ICL), and Beltexco Limited (BEL). BEL and PSL specialize in the production and sale of gloves, while the remaining three companies focus on manufacturing industrial and safety clothing.

Sector Update

The business risk profile of the textile sector in Pakistan is characterized by high level of exposure to economic cyclicality and intense competition. This sector's performance is significantly influenced by the broader economic conditions in the country, making it inherently vulnerable to fluctuations in demand driven by economic factors.

Pakistan's textile industry spans the entire value chain, from the production of raw materials like cotton to the manufacturing of finished textile products such as apparel and home textiles. Many companies operate as integrated units, controlling multiple stages of production to ensure quality, efficiency, and cost-effectiveness.

In FY23, Pakistan witnessed a significant drop in yarn production, mainly attributed to reduced cotton availability stemming from crop damage and import limitations. The sector's profitability faced challenges due to escalated production expenses, heightened raw material costs, and rising energy expenditures, all of which contracted profit margins. The performance of the industry closely correlates with the prospects of the cotton and textile sectors, both of which were adversely impacted during FY23. A global economic slowdown and implementation of contractionary economic measures resulted in reduced demand for textile goods and subsequently, cotton yarn.

While the global outlook for cotton production is expected to rebound, local challenges persist. These challenges include high interest rates, increasing energy costs, and persistent inflationary pressures. These factors are likely to result in continued sluggish performance for the spinning sector in FY24.

Key Rating Drivers

Growth in topline attributable to uptick in sales volumes and unit prices, coupled with improved gross and net margin in CY22; however, profitability has weakened during 9MCY23

The Company's sales portfolio encompass Knitted Fabric, Gloves, and Yarn. In CY22, yarn accounted for ~44.6% of total sales, with gloves being the second-largest contributor, comprising 41.1%. In CY22, the increase in net revenue, by ~29.9%, to Rs. 9,063.18 mn (CY21: Rs. 6,978.81 mn) was attributed to a rise in sales volumes coupled with an increase in unit prices. The rise in unit prices resulted in the Company reporting a higher gross margin of 24.5% (CY21: 22.5%). Despite the surge in finance costs to Rs. 113. 37 mn (CY21: Rs. 65.32 mn), mainly due to the utilization of export refinance facilities obtained from commercial banks at a markup of 14%/annum (CY21: 3%/annum), the Company's bottom-line was supported by interest income earned and FCY gains. Consequently, the profit after tax (PAT) was reported at Rs. 940. 57 mn (CY21: Rs. 521. 74 mn), while the net margin improved to 10.4% (CY21: 7.5%).

During 9MCY23, local sales represented ~45.7% of total sales, while export sales accounted for ~29.4%. Additionally, related party sales contributed ~24.9% to the overall sales revenue. In the same period, gloves and yarn comprised ~40.2% and 41.8% of total sales respectively, serving as primary revenue streams for SGL. The top-3 clients, Style Textile (Pvt.) Ltd., Prime Safety Ltd., and Industrial Hand Protection, constituted ~28.56% of total sales; though this signals moderate concentration risk, the management intends to diversify its clientele.

During 9MCY23, the Company's sales revenue was reported at Rs. 7,704.78 mn (9MCY22: Rs. 7,090.00 mn). This growth in topline despite a volumetric decline in sales is attributed to the rise in unit prices, compensating for the slowdown in demand. However, amidst these revenue dynamics, the Company's gross margin during 9MCY23 was down to 21.8% from 24.5% in CY22. Despite this decline, the management anticipates a gross margin of around 24-25% for CY23. This is primarily attributed to the Company's ability to mitigate increased costs by passing them to customers through higher prices. During the period under review, the Company incurred increased raw material, fuel, power, and operating costs amid inflationary pressures. The operating profitability pressure, coupled with higher finance cost, resulted in significant contraction of the bottom-line and deterioration of net margin to 3.1% during 9MCY23 (CY22: 10.4%).

The annualized topline for CY23 is projected around Rs. 10,500-11,000 mn. Going forward, growth in topline and improvement in profitability margins will remain important from the ratings perspective.

Strong bottom-line supports Funds from Operations (FFO) and cashflow coverages during CY22; however, decline in net profitability results in reduced FFO during 9MCY23; yet, liquidity profile remains healthy

In CY22, the Funds from Operations (FFO) was reported at Rs. 1,188.27 mn (CY21: Rs. 813.72 mn), owing to higher net profitability. Resultantly, the Debt-Service-Coverage-Ratio increased to 4.22x (CY21: 3.64x). The FFO/Total Debt rose to 0.78x (CY21: 0.54x); in contrast, the FFO/Long-term Debt ratio slightly reduced to 4.95x (CY21: 5.68x), on account of higher long-term borrowings which amounted to Rs. 239.87 mn as at Dec'22 (Dec'21: Rs. 143.36 mn). During CY22, the rise in long-term borrowings was facilitated by favorable loan terms offered by the State Bank of Pakistan (SBP), particularly through the LTFF. The cash conversion cycle increased to 37 days (CY21: 24 days), while the Company continued to maintain a favorable liquidity position as the current ratio stood at 1.38x (CY21: 1.30x).

During 9MCY23, the Funds from Operations (FFO) was reported at Rs. 454.00 mn (9MCY22: Rs. 965.00 mn), primarily attributed to lower net profitability. Consequently, the Debt-Service-Coverage Ratio declined to 2.68x (CY22: 4.22x). Profitability pressures were further evident as cashflow coverages declined, with FFO/Long-term debt reducing to

2.44x (CY22: 4.95x), and FFO/Total Debt falling to 0.41x (CY22: 0.78x). Moreover, the Company observed an increase in its days receivables, indicating a slight ease in receiving terms, while trade payables were settled promptly. Consequently, the cash conversion cycle extended to 75 days (CY22: 37 days).

Albeit weakening cashflow metrics, the Company has maintained a healthy liquidity profile, as the current ratio improved to 1.57x (CY22: 1.38x) due to a relatively greater increase in current assets compared to current liabilities; notably, the short-term borrowings stayed intact at Rs. 1,234.00 mn as at Sep'23 (Dec'22: 1,282.84 mn), while both stock-in-trade and trade receivables experienced growth during the period under review. Going forward, improving cashflow coverages and maintaining the liquidity profile will remain important from the ratings perspective.

Improved financial strength and capital structure through strategic debt management during CY22 and 9MCY23

As at Dec'22, equity base of the Company expanded, totaling Rs. 3,744.59 mn (Dec'21: 2,762.99 mn), owing to improved profitability. Despite an increase in working capital requirements, evident from the extended cash conversion cycle, the short-term borrowings reduced as at Dec'22, amounting Rs. 1,281.84 mn (Dec'21: Rs. 1,355.81 mn), since the Company opted to utilize internal cash reserves to meet its working capital needs. Total Debt of the Company was reported to be Rs. 1,521.70 mn as at Dec'22 (Dec'21: 1,499); the relatively greater increase in total equity compared to total debt improved the gearing ratio to 0.41x (CY21: 0.54x), while the leverage ratio also decreased to 0.92x (CY21: 1.30x).

Total equity of the Company was reported to be Rs. 3,938.61 mn as at Sep'23 (Dec'22: Rs. 3,744.59 mn), on account of profit retention and no dividend pay-outs. During the period under review, the short-term debt accounted for 83.3% of total debt (Dec'22: 84.2%). Total Debt of the Company decreased to 1,482.00 mn as at Sep'23 (Dec'22: Rs. 1,521.70 mn). Consequently, the gearing ratio slightly improved to 0.38x (CY22: 0.41x), while the relatively greater increase in total liabilities compared to total equity, resulted in a higher leverage ratio of 1.05x (CY22: 0.92x). Going forward, the management anticipates that gradual repayment of debt coupled with profit retention would further improve the capitalization metrics.

REGULATORY DISCLOSURES					Appendix II
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				
	16/04/2024	A-	A-2	Stable	Reaffirm
	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. Copyright 2024 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.				
Due Diligence Meeting Conducted	**Name**	**Designation**	**Date**		
	Mr. Arsalan Majeed	CFO	March 08, 2024		