RATING REPORT

HKB Retail (SMC-Pvt.) Limited

REPORT DATE:
September 30, 2022

RATING ANALYSTS:

Syeda Batool Zehra Zaidi
batool.zaidi@vis.com.pk

RATING DETAILS		
Rating Category	**Initial Rating**	
	Long-term	**Short-term**
Entity	A-	A-3
Rating Outlook	Stable	
Rating Action	Initial	
Rating Date	30 September, 2022	

COMPANY INFORMATION	
Incorporated in 2016	**External auditors:** Kreston Hyder Bhimji & Co. Chartered Accountants.
Private Limited Company	**CEO:** Mr. Shehryar Ahmed Buksh
Key Shareholders (with stake 5% or more):	
Mr. Shehryar Ahmed Buksh -100%	

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

HKB Retail (SMC-Private) Limited *(Formerly Ahead Brands (SMC-Private) Limited)*

OVERVIEW OF THE INSTITUTION

HKB Retail (SMC-Private) Limited *(formerly Ahead Brands (SMC-Private) Limited)* is a Single Member Company registered under the (repealed) Companies Ordinance 1984, on June 23, 2016. The Company is principally engaged in the business of retail and e-commerce of branded apparels, shoes & accessories all over Pakistan. Presently, the Company is operating through 22 rented retail outlets in the country.

RATING RATIONALE

HKB Retail is a single member private limited company owned by Mr. Shehryar Ahmed Buksh. The Company is a part of HKB group, which presently comprises of two other business concerns, namely, H.Karim Buksh Enterprises (AOP) and H.Karim Buksh (Pvt.) Limited (Company) (the departmental stores business). Mr. Shehryar holds around 36 % and 13% shareholding respectively in above mentioned businesses. Mr. Shehryar joined the family business and diversified into brand management after completing his graduation from LUMS in 1995. Foreseeing the demand of branded products at reasonable prices in HKB departmental stores, Mr. Shehryar developed two brands "Beechtree' and "Pepperland" and more recently "Morbagh" catering to apparel needs of women and children, respectively. For some years, these brands were only available in HKB departmental stores. However, the retail clothing business was separated from HKB departmental stores into a sole proprietary concern namely, Ahead Brands. In 2016, the business was then converted into a single member company, Ahead Brands (SMC-Pvt) Ltd. The Company's name was subsequently changed to HKB Retail (SMC-Pvt.) Limited. Conversion to public limited concern remains part of long-term strategy of the Company.

Presently, the Company has 22 stores in 11 cities of Pakistan, with a retail space of approximately 140,000 sft. The stores are located in major cities, including six stores in Lahore, one in Rawalpindi, three in Islamabad, five in Karachi and one each in Sialkot, Mirpur, Peshawar, Multan, Faisalabad, Gujranwala and Bahawalpur. The Company intends to open 12-13 stores over the next two to three years retail stores with a retail space of 100,000 sft mainly under Beechtree and Pepperland brands. Over time, Pepperland sales have picked up and now contribute about 16% to total sales. E-commerce sales have also exhibited a higher share. In FY22, e-commerce sales accounted for 38% of total sales.

Procurement, outsourcing and distribution: The Company has a dedicated design team of around 30 personnel, led by separate heads for pret, unstitched and Pepperland categories. The design team conceives designs while these are approved within price range for each category with coordination of sourcing division. The sourcing department has a general manager, each one for pret and unstitched category. Production department prepares samples. Once the designing and fabric selection are completed, and samples are finalized, the unfinished grey fabric is procured. At times, the company also procures finished fabric from the market for unstitched category.

Designing and finishing process of grey fabric, which involves dyeing, stitching, printing or embroidery, is outsourced to other vendors. After completion of the aforementioned activities, the finished products are delivered at the warehouse for distribution to shops, online sale or as reserve stock. In addition, the company has a dedicated logistics and warehousing team to manage fabric and finished goods for physical retail stores and e-commerce inventories.

The marketing team comprises a brand manager, team lead for visual marketing, team lead architecture along with public relations and marketing manager. The company has been availing digital marketing services of Shopistan for Beechtree and Pepperland and Adex360 for Morbagh. For online sales, dispatch and delivery of orders are very critical. The management aims to ship 90% of the orders in two days after the order is being placed whereas 100% orders are targeted to be delivered in five days to the customers.

Presently, the company is using SAP as an Enterprise Resource Planning (ERP) software. The Company is in process of deploying a Canias 4.0 ERP system (a German-based ERP). The new ERP system is a fully integrated and flexible software with specific capabilities for Textile business. Canias 4.0 offers solutions that include planning, procurement, material management, and production and sales, customer relationship management, finance, and document management. It is planned to be fully implemented by Feb 2023. The Company has also installed latest versions of Retail Pro (POS) and Omni Connect for retail solutions, and Connect for Human Resources Management System (HRMS). The ERP system is expected to bring greater visibility and tracking of business processes, which in turn will improve inventory management and cost reduction.

Sourcing of all raw material is locally based mostly against 120 day credit. Sales on the retail side are 70% against cash while online sales are 95% against Cash on delivery.

Industry:

Pakistan's retail market is among the fastest growing in the world. A global market communications firm has put Pakistan among the 12 countries that will be the biggest contributor to the next billion middle class consumers. Expanding middle class with rising disposable incomes, especially millennials are demanding branded and packaged consumer goods. Strong demand in rapid growth n sale of consumer products and services is driving other sectors including retail, e-commerce, paper and packaging, media, advertising and entertainment. Apparel retail business has also experienced growth in Pakistan on the back of rising consumer spending further fueled by e- commerce. As per market research, retail sector growth has been estimated at CAGR of 20%. Growing population with 60% of the population aged between 15-64 support consumers spending. However, in light rising inflation and pressure on GDP growth, we may expect some demand contraction.

Leading players in Pakistan's apparel retail market include Sefam (Pvt.) Limited (main brands includes, Bareeze, Kayseria, Minnie Minors, Leisure Club), Nishat Linen, Ideas by Gul Ahmad, Outfitters (including Ethnic), Junaid Jamshed (including Almirah) and Khaadi. Overall retail clothing market of Pakistan is categorized by high volume and relatively thin net margins while some players have advantage over others in supply chain management from related parties or by having fully integrated production facilities. Store location dynamics also play a key role in retail business.

Key Rating Drivers:
Robust topline growth. Higher brand recognition

Revenues of the Company have registered strong topline growth increasing by about 44% in FY2022. The growth has been primarily volume led, with 39% increase recorded in volume sales, driven by increase in stores, leveraging of e- platform and higher brand recognition. As per management, revenue target fell short of projected levels (Rs 7bn) due to disruption in last 10 days of FY22 whereby sharp rise in fuel prices by the Government as well as curtailment in shop timings and Sunday closures impacted sales. In addition, imposition of 2% sales tax in Jan 2022 also impacted sales revenues. Off the three brands, Beechtree continued to lead with 74 % contribution. Pepperland contributed 16% to the revenue mix while Morbagh, the recently lunched brand, generated 10% of total sales.

Going forward, Company plans to aggressively increase its retail footprint with addition of 8 stores in FY23 and another 5 in FY24. Sales are projected to increase to Rs. 10b at the end of FY23. Management confirms they remain on target for the current year.

Retail expansion to support volume growth and result in margin improvement

Expansion of retail network with addition of 100,000 sq ft over the rating horizon is expected to support volume growth. Enhancement in exposure through penetration in new cities and locations has been carefully planned. Management has remained cautious of location choices and continues to plan shops within a 8-10% rent to revenue ratio benchmark. Volume growth is expected to streamline fixed costs and resultantly improve margins of the business. In addition, from next year management plans to shift 20% of its backend process, which currently is all independently outsourced, to a complete packaged item from the vendor. While this may impact their gross margin in the short run to some extent it is expected to reduce working capital deployment, thereby improving overall net margins of the business.

Adequate liquidity profile

Liquidity profile of the Company is adequate, however, depicts improvement at the end of FY22. Projected financials also support further improvement, going forward. Adequate liquidity in terms of cash flow coverages: Funds from operations (FFO) increased to Rs. 536m (FY21: Rs. 414m; FY20: Rs. 301m) in line with higher profitability. However, with total debt increasing FFO to total debt was remained stagnant during FY22. Debt service coverage ratio has also remained adequate at 2.35x.

Current ratio has improved to 1.03x (FY21: 0.95x) while short-term debt coverage through trade debts and inventory also improved to 291% (FY21: 220%). Cash conversion cycle of the Company continues to improve on a timeline basis reducing to 75 days in FY22 from 82 days in FY21. With the ERP platform becoming operational at the start of 2023, management expects significant improvement in inventory management, which will further improve the cash conversion cycle and liquidity of the Company. Improvement in liquidity profile, going forward, will remain important for ratings.

Equity injection by sponsor. Achievement of projected capitalization indicators remains a key rating driver

Leverage and gearing indicators depict notable improvement on a timeline basis supported by higher profitability and equity injection by sponsor of ~Rs. 270m. Equity at the end of FY22 stood at Rs. 910m (FY21: Rs 443m) while leverage and gearing improved to 4.28x (FY21: 6.14x) and 2.21x (FY21: 3.45x) respectively. However, capitalization indicators remain on the higher side and ratings will remain sensitive to rationalization of the same through higher profit generation and equity support in line with the benchmarks for the assigned ratings. Going forward, achievement of projected plans in the wake of rising inflationary pressures will remain key for ratings.

HKB Retail (SMC-Pvt.) Limited — Annexure I

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**FY19**	**FY20**	**FY21**	**FY22**
Fixed Assets	285	422	552	796
Stock-in-Trade	520	878	1,627	2,610
Trade Debts	5	72	47	145
Cash & Bank Balances	81	108	43	86
Total Assets	1022	2210	3167	4,809
Trade and Other Payables	190	414	944	1,692
Long Term Debt	72	666	769	1,065
Short Term Debt	319	631	759	945
Total Debt	391	1,296	1,528	2,010
Total Equity	271	301	443	910
INCOME STATEMENT				
Net Sales	2,448	2,324	4,583	6,620
Gross Profit	1,057	1,208	1,871	2,662
Operating Profit	157	192	361	570
Profit After Tax	66	34	160	193
RATIO ANALYSIS				
Gross Margin (%)	43.2%	52.0%	40.8%	40.2%
Net Margin	2.7%	1.4%	3.5%	2.9%
FFO	132	216	414	536
FFO to Total Debt (%)	33.7%	16.6%	27.1%	26.7%
FFO to Long Term Debt (%)	161%	32.4%	53.9%	50.3%
Current Ratio (x)	0.97	0.93	0.95	1.03
Debt Servicing Coverage Ratio (x)	2.74	2.07	3.03	2.35
Gearing (x)	1.44	4.30	3.45	2.21
Leverage (x)	2.77	6.34	6.14	4.28
ROAA (%)	7.1%	2.1%	6.0%	4.8%
ROAE (%)	27.2%	11.7%	43.1%	28.5%
(Stock in Trade + Trade Debts) / Short Term Borrowings	165%	151%	220%	291%

ISSUE/ISSUER RATING SCALE & DEFINITIONS Annexure III

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	Annexure IV
Name of Rated Entity	HKB Retail (SMC-Pvt.) Limited *(Formerly Ahead Brands (SMC-Pvt.) Limited)*
Sector	Retail-Clothing
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings
Rating History	see table below
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. Copyright 2022 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.
Due Diligence Meetings Conducted	see table below

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
30-Sep-22	A-	A-3	Stable	Initial

Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Shehryar Ahmed Buksh	CEO	September 6th, 2022
Mr. Zubair Ikram	CFO	September 6th, 2022
Mr. Naweed Sharif	Principal Consultant	September 6th, 2022