# RATING REPORT

# HKB Retail (SMC-Pvt.) Limited

**REPORT DATE:**
January 11, 2024

**RATING ANALYSTS:**

Tayyaba Ijaz, CFA
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| RATING DETAILS | | | | |
|---|---|---|---|---|
| | Latest Rating | | Previous Rating | |
| Rating Category | Long -term | Short -term | Long -term | Short -term |
| **Entity** | A- | A-3 | A- | A-3 |
| **Rating Outlook** | Stable | | Stable | |
| ***Rating Action*** | *Reaffirmed* | | Initial | |
| **Rating Date** | 11 January, 2024 | | 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 (May 2023)**
https://docs.vis.com.pk/docs/CorporateMethodology.pdf

**VIS Rating scale (2023)**
https://docs.vis.com.pk/docs/VISRatingScales.pdf

## HKB Retail (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(SMC-Private) Limited *(formerly Ahead Brands (SMC-Private) Limited)* is a Single Member Company registered under the (repealed) Companies Ordinance 1984, on June 23, 2016.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 27 rented retail outlets in the country.

### RATING RATIONALE

HKB Retail is a single member private limited (SMC Pvt. Ltd.) 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.

**<u>Key Rating Drivers:</u>**

**Revenue growth and sustained profitability despite economic challenges**

The outgoing year was marked with various challenges, including political unrest, sharp hike in markup rates, dwindling forex reserves and overall economic slowdown. However, despite these difficulties, and intense competition, the company prudently managed its inventory and profit margins while also broadening its market presence. In FY23, HKB posted a YoY growth of ~24% in topline, amounting to Rs. 8.21b (FY22: Rs. 6.62b). The gross margins improved to 42.1% (FY22: 37.9%) primarily on account of favorable rates on carried over inventory. Furthermore, the company concentrated on selling products with better profit margins. The product mix in terms of brands contribution, remained largely consistent, with Beechtree contributing about 72% (FY22: ~75%), Morbagh ~12% (FY22: ~9%), Pepperland 16% (FY22: ~16%). In addition, the management remained focused on unstitched segment, which accounted for nearly 70% of the overall sales mix. Going forward, the management plans to increase the share of the ready-to-wear (RTW) segment in their portfolio to further improve the profit margins.

During FY23, administrative and general expenses, along with selling and distribution expenses recorded an increase largely in line with inflationary pressure. Finance cost augmented to Rs. 523.4m (FY22: Rs. 234.9m) as a result of higher average markup rates and debt levels. Resultantly, despite higher gross profitability, the profit after tax showed minimal change, remaining at around Rs. 197m (FY22: Rs. 193m) while the net margins were slightly lower, standing at 2.4% compared to 2.9% in the previous year.

During 1Q'FY23, the Company generated Rs. 2.01b (1Q'FY22: Rs. 1.97b) in net revenues while gross profitability was reported higher at Rs. 730.6m as compared to Rs. 662.1m in SPLY, yielding relatively better margins. This improvement in gross margins was primarily due to pass on of inflationary impact in selling prices. In full year, the Company projects a moderate growth of ~16% in topline with relatively improved profit margins on the back of better product prices and cost rationalization.

**Growing the retail network to enhance sales and boost profitability**

The Company has been actively pursuing to expand its retail footprint to reach a wider customer base. They are continuously innovating their product lines and brands, ensuring that their offerings are fresh and appealing. Moreover, the Company has been making diligent marketing efforts to enhance brand visibility and attract more customers, effectively growing their market presence. In FY23, 6 new stores were added while some of the existing stores were expanded. By June 30, 2023, HKB's total retail space reached 187,047 sq. ft., up from 140,847 sq. ft. a year earlier. In the ongoing year, the management plans to open 2 new stores having an area of 16,000 sq. ft. Anticipating economic recovery, the management also aim to add another 12 stores, encompassing approximately 100,000 sq. ft. in the next three years, to foster business growth and enhance profitability metrics. Furthermore, the Company has been successfully leveraging e-commerce platforms to grow its market presence. Sales emanated through e-commerce channels accounted for 38% (FY22: 36%) of the revenue mix in the outgoing year. Given the rising internet penetration and a younger demographic, it is expected that online sales will continue to see growth in the coming years.

**Adequate liquidity profile**

The liquidity profile of the Company is underpinned by adequate cash flows in relation to outstanding obligations. Funds from operations (FFO) amounted to Rs. 558m (FY22: 536m) in FY23. However, with increase in overall debt levels, FFO to total debt showed some decrease. Debt service coverage ratio has also remained adequate at 1.19x (FY22: 1.42x).

Current ratio has remained largely unchanged at 1.03x along with steady short-term debt coverage through trade debts and inventory (FY23: 251%; FY22: 291%). The Company has successfully kept its cash conversion cycle within a manageable range, although there was a slight increase observed due to a decrease in inventory turnover amid a general economic slowdown. Specifically, the cycle extended from 76 days in FY22 to 89 days in FY23. The Company has remained focused on improving inventory management and achieving overall operational efficiencies. In pursuit of this goal, it has recently implemented an advanced ERP platform in the past year. Going forward, improvement in cash flow coverages and working capital management will remain imperative for ratings.

**Capitalization underpinned by profit retention and continued sponsor's support in form of interest free loans**

The equity base has augmented to Rs. 1.3b (FY22: Rs. 910m) on the back on internal capital generation and equity injection by sponsor. In the outgoing year, additional equity injection of Rs. 209.2m (FY22: Rs. 272.5m) was made in the form of interest free discretionary loans to support operations. As a result, there has been slight improvement in gearing and debt leverage to 2.19x (FY22: 2.21x) and 3.89x (FY22: 4.28x), respectively, despite increase in debt levels. However, the leverage indicators have remained on the higher side and are expected to rationalize steadily over years through profit retention and equity support. Going forward, realizing the projected plans amidst current macroeconomic challenges will be crucial for ratings.

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

| Financial Summary (in PKR millions) | | | | |
|---|---|---|---|---|
| **BALANCE SHEET** | **FY20** | **FY21** | **FY22** | **FY23** |
| **Fixed Assets** | 422 | 552 | 796 | 1,279 |
| **Stock-in-Trade** | 878 | 1,627 | 2,610 | 3,303 |
| **Trade Debts** | 72 | 47 | 145 | 63 |
| **Cash & Bank Balances** | 108 | 43 | 86 | 10 |
| **Total Assets** | 2,210 | 3,167 | 4,809 | 6,429 |
| **Trade and Other Payables** | 414 | 944 | 1,692 | 2,012 |
| **Long Term Debt** | 666 | 769 | 1,065 | 1,537 |
| **Short Term Debt** | 631 | 759 | 945 | 1,340 |
| **Total Debt** | 1,296 | 1,528 | 2,010 | 2,878 |
| **Total Equity** | 301 | 443 | 910 | 1,316 |
| | | | | |
| **INCOME STATEMENT** | **FY20** | **FY21** | **FY22** | **FY23** |
| **Net Sales** | 2,324 | 4,583 | 6,620 | 8,209 |
| **Gross Profit** | 1,208 | 1,871 | 2,512 | 3,457 |
| **Operating Profit** | 189 | 356 | 563 | 769 |
| **Profit After Tax** | 34 | 160 | 193 | 197 |
| | | | | |
| **RATIO ANALYSIS** | **FY20** | **FY21** | **FY22** | **FY23** |
| **Gross Margin (%)** | 52.0% | 40.8% | 37.9% | 42.1% |
| **Net Margin** | 1.4% | 3.5% | 2.9% | 2.4% |
| **FFO** | 216 | 414 | 534 | 558 |
| **FFO to Total Debt (%)** | 16.6% | 27.1% | 26.6% | 19.4% |
| **FFO to Long Term Debt (%)** | 32.4% | 53.9% | 50.2% | 36.3% |
| **Current Ratio (x)** | 0.93 | 0.95 | 1.03 | 1.03 |
| **Debt Servicing Coverage Ratio (x)** | 1.09 | 1.41 | 1.42 | 1.19 |
| **Gearing (x)** | 4.30 | 3.45 | 2.21 | 2.19 |
| **Leverage (x)** | 6.34 | 6.14 | 4.28 | 3.89 |
| **ROAA (%)** | 2% | 6% | 5% | 3% |
| **ROAE (%)** | 12% | 43% | 28% | 18% |
| **(Stock in Trade + Trade Debts) / Short Term Borrowings** | 151% | 220% | 291% | 251% |

## REGULATORY DISCLOSURES — Annexure II

| | |
|---|---|
| **Name of Rated Entity** | HKB Retail (SMC-Pvt.) Limited |
| **Sector** | Retail-Clothing |
| **Type of Relationship** | Solicited |
| **Purpose of Rating** | Entity Ratings |
| **Rating History** | (see 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. |
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**Rating History**

| Rating Date | Medium to Long Term | Short Term | Rating Outlook | Rating Action |
|---|---|---|---|---|
| **RATING TYPE: ENTITY** | | | | |
| 11-Jan-24 | A- | A-3 | Stable | Reaffirmed |
| 30-Sep-22 | A- | A-3 | Stable | Initial |

**Due Diligence Meetings Conducted**

| Name | Designation | Date |
|---|---|---|
| Mr. Shehryar Ahmed Buksh | CEO | |
| Mr. Muhammad Umer Junaid | CFO | 15 December, 2023 |
| Mr. Naweed Sharif | Principal Consultant | |