RATING REPORT

Dynamic Sportswear (Private) Limited

REPORT DATE:
May 25, 2023

RATING ANALYSTS:
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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 Action	Reaffirmed		Initial	
Rating Date	*May 25, 2023*		*May 16, 2022*	

COMPANY INFORMATION

Incorporated in 1992	**External Auditors:** RSM Avais Hyder Liaquat Nauman, Chartered Accountants
Private Limited Company	**Board Chairman/CEO:** Mr. Mobeen Ahmed
Key Shareholders (with stake 5% or more):	
Mr. Fahad Mobeen Ahmad ~24.8%	
Mr. Saad Mobeen Ahmad ~24.8%	
Mr. Imran Khaled Niazi ~17.7%	
Mrs. Samra Mobeen Ahmad ~16.9%	
Mrs. Zareen Niazi ~7.8%	
Mrs. Ahsan Ghanzanfar ~7.1%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Industrial Corporates (May 2023)
https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

APPLICABLE RATING SCALE(S)

VIS Issue/Issuer Rating Scale:
https://docs.vis.com.pk/docs/VISRatingScales.pdf

Dynamic Sportswear (Private) Limited

OVERVIEW OF THE INSTITUTION

Dynamic Sportswear (Pvt.) Limited (DSPL) is engaged in the business of manufacturing, selling, and dealing in different types of socks

Profile of Chairman/CEO

Mr. Mobeen Ahmed has been the Chief Executive since almost three decades. Prior to starting Dynamic Sportswear, he worked as a Technical Manager at ICI Pakistan Ltd. in their Polyester business unit and also worked at Dawood Hercules Chemicals Ltd. Mr. Ahmed has done B.S Chemical Engineering from University of Kansas, USA and M.S Chemical engineering from University of Michigan, USA

RATING RATIONALE

Corporate Profile

Dynamic Sportswear (Private) Limited (DSL) is a family-owned textile manufacturer with a 30-year history of producing and exporting sports, athletics, medical and casual socks for men, women, and children. It produces various types of heel formats (y-heel, reciprocated/real, pouch, tube) using modern knitting, toe linking, over-locking, dyeing and finishing machines. Entire product range is covered and approved by OkeoTex Certification; DSL is also WRAP, STEP & ISO 9001:2000 certified. At present, total workforce stands at over 1,800 employees.

Average energy demand of 4MW is mainly met through the WADPA gridline, with HFO and diesel generators available as a backup. All production units have their own wastewater treatment unit to meet global environmental standards.

Operating Performance

DSL's head office and factory are located in Lahore. In FY22, installed capacity grew by ~10% to 5.5m dozens per year, with the inclusion of 60 knitting machines, resulting in a total of 771 machines. The capex was financed through a 90:10 ratio of debt and internally generated capital. Production levels after increasing by ~14% in FY22 dropped significantly in the current fiscal year, which management attributed to prevailing recessionary trend and global demand slowdown. The decline is also reflected in utilization ratios.

Table: Capacity & Production Data (Units in millions)

	FY21	FY22	6M'FY23
No. of Knitting Machines	711	771	771
Installed Capacity (dozens)	5.0	5.5	2.7
Actual Production (dozens)	3.7	4.2	1.2
Capacity Utilization	***64%***	***61%***	***44%***

The company acquired land for a new socks manufacturing unit and planned to begin construction in Sept'22, but had to delay due to present economic environment in the country. Construction is now expected to start by year-end if conditions improve. The new plant will have a capacity of 1,000 machines and Platinum LEED certification.

Key Rating Drivers

Business risk profile is constrained by current weak macroeconomic environment both globally and locally, demand slowdown, high interest rate situation, inflationary pressures and recent floods adversely affecting cotton crop while ongoing energy crisis in the country pose a challenge to margins sustainability and future growth.

Pakistan's export proceeds have oscillated in the range of USD 22-25b during the past decade (FY11-FY21), however, in FY22 exports finally broke the threshold, coming in at USD 32.4b. Textile sector contributes nearly one-fourth to industrial value-added segment and 8.5% to the country's GDP, with an estimated market size of around Rs. 4.0tr. Barring seasonal and cyclical fluctuations, textiles sector has maintained an average share of about 60% in national exports.

Table: Pakistan Export Statistics (in USD millions)

	FY20	FY21	FY22		9M'FY22	9M'FY23
Pakistan Total Exports	22,536	25,639	32,450		23,706	21,088
Textile Exports	12,851	14,492	18,525		13,577	12,992
PKR/USD Average rate	158.0	160.0	177.5		171.5	235.5

Source: SBP

Export revenues from textile sector have noted sizeable growth over the years (FY22: $19.3b FY21: $15.4b; FY20: $12.5b; FY19: $13.6b). Knitwear, Readymade and Bed wear segments continue to contribute higher than other segments, with a cumulative contribution of more than 60% in textile exports. While the growth was primarily driven by volume (excluding knitwear and cotton yarn), higher prices also boosted exports.

Table: Textile Export Details (in USD millions)

	FY20	FY21	FY22		9M'FY22	9M'FY23
High Value-Added Segment	**9,669**	**12,427**	**15,605**		**11,482**	**10,318**
- Knitwear	2,794	3,815	5,121		3,730	3,390
- Readymade Garments	2,552	3,033	3,905		2,864	2,657
- Bed wear	2,151	2,772	3,293		2,449	2,032
- Towels	711	938	1,111		820	745
- Made-up Articles	591	756	849		627	535
- Art, Silk & Synthetic Textile	315	370	460		344	309
- Others	555	743	866		650	650
Low to medium Value-Added Segment	**2,858**	**2,972**	**3,717**		**2,760**	**2,158**
- Cotton Cloth	1,830	1,921	2,438		1,795	1,538
- Cotton Yarn	984	1,017	1,207		908	573
- Others	43	34	72		56	47
Total	**12,527**	**15,399**	**19,332**		**14,243**	**12,476**

Source: PBS

Cotton prices rose to a new 12-year high of ~Rs. 22,935/maund as of Sept'22 driven by a scarcity of cotton resulting from the recent floods that impacted the local cotton production. Cotton imports were also up 19.8%, in USD terms, for FY22 vis-à-vis preceding year.

Table: Cotton Prices Trend (In Rs.)

	FY19	FY20	FY21	FY22	9M'FY23
Per Maund	8,770	8,860	13,000	17,380	18,935
YoY % Change	26%	1%	32%	34%	*n/a*

Floods in Sindh and Southern Punjab during recent monsoon season have caused significant damage to the cotton crop. According to industry estimates, ~45% of the crop has been washed, worth more than $2.5b, resulting in significant price increases. The government has announced facilitation for raw materials imports to compensate for domestic shortages. Nonetheless, in addition to affecting profit margins, higher raw material pricing is expected to increase the working capital requirements, which is likely to have a negative impact on the liquidity profile of textile operators, particularly spinners, weavers and dying companies.

Global and domestic challenges, such as slowdown in export demand (primarily from North America and the EU, which has begun to materialize in Pakistan's monthly export proceeds) due to recessionary trend, industrial gas load shedding expected in the country, and rising production costs due to inflation, will weigh on the business risk profile going forward. These factors may result in competitive market pricing for exporters.

Record high revenue posted in FY22 mainly driven by rupee devaluation. However, global demand slowdown has led to volumetric decline in the current year.
Net sales have more than doubled in the last two fiscal years, crossing the Rs. 5b mark in FY22 with a significant YoY growth of ~33%, mainly driven by rupee devaluation followed by meagre contribution from volumetric uptick. However, price in dollar terms dropped sharply as orders were shifted from China to Bangladesh where pricing is substantially lower due to cheaper labor and power cost. Sales have sustained at Rs. 3.7b in 9M'FY23 despite waning volumes due to demand slowdown. Management targets full year sales of Rs. 6b.

Almost entire revenues emanate from exports, with nearly half of it directed towards US featuring geographic concentration. The rest is shared by Europe, Canada and Middle East. Additionally, client concentration risk is also elevated as the company mainly transacts with brokerage houses making large volume purchases, with top three clients contributing nearly 90% of overall revenues. However, having renowned brands like Levis, Dockers, CAT, Everlast, and Dickies as end clients provides comfort. It is worth noting that various compliance audit firms, including SGS, Intertek, CSCC, and BV, conduct annual monitoring of customer performance and code of conduct to ensure adherence to standards and regulations.

Gross margins remained stable, but net profitability was affected by bad debts and significant increase in operating overheads during the review period.
Stable gross margins ranging from 24% to 26% over the last four years remained intact in the current fiscal year, aided by a substantial rupee depreciation. Average cost of raw materials went up by ~43% in FY22, but subsequently dropped due to change in product mix. Procurement volume also declined due to reduced demand in the ongoing year while management reports inventory buffers for the next six months. Procurement mix consists of a 40:60 ratio of imported to local raw materials. Nearly two-third of local raw materials are acquired from fixed suppliers in the open market, while the remainder comes from an associate concern, Dynamic Spinning Mills Limited.

Operating overheads increased sizably in the current year due to higher freight charges, salaries, and power costs, as well as rupee depreciation, which directly impacted commission expenses (2% of sales invoice paid to brokerage houses) denominated in US dollars. Similarly, financial charges also increased yet remains at manageable levels given limited debt present on the balance sheet. Net margins noted a contraction in FY22 owing to bad debt of Rs. 300m and remained at similar level in the ongoing year.

Contrasting cash flow trend led to weakening in debt coverage metrics; cash conversion cycle is elevated due to high inventory holding days.
Despite reduction in bottom-line, Funds flow from operations (FFO) improved in FY22, reaching Rs. 846.5m (FY21: Rs. 503.3m) due to higher depreciation and bad debt reported as non-cash adjustments. However, the contrasting cash flow trend during 6M'FY23, led to a weakening in debt coverage metrics as reflected from FFO to total debt of 0.16x (FY22: 0.47x; FY21: 0.30x) and FFO to long-term debt of 0.55x (FY22: 1.51x; FY21: 0.95x). Similarly, debt servicing coverage ratio dropped significantly to 1.36x (FY22: 3.71x; FY21: 5.09x).

Liquidity profile is satisfactory reflected in consistently high current ratio and satisfactory coverage of short-term borrowings in relation to trade debts and inventory. However, cash conversion cycle is elevated, reporting above 200 days owing to high inventory holding days.

Ageing profile of trade debts remains sound as none of the receivables are outstanding beyond 180 days.

Sound capital buffers; leverage ratios compare favorably to peers.
Supported by healthy retention, equity base grew by ~24% over the last 18 months, reaching Rs. 2.4b at end-6M'FY23. Dividend payout ratio fell from 12% in FY21 to 4% in FY22, with a dividend amounting to Rs. 11.8m (FY21: Rs. 35.3m). Debt profile is a mix of short-term and long-term debt, with total interest-bearing liabilities amounting to Rs. 1.8b at end-6M'FY23; ~71% constituted short-term debt, with entire being the ERF/EFS schemes. Leverage indicators have decreased in the current fiscal year.

Dynamic Sportswear (Private) Limited **Appendix I**

FINANCIAL SUMMARY

(amounts in PKR millions)

BALANCE SHEET	FY20	FY21	FY22	6M'FY23
Fixed Assets	1,837.8	2,624.3	2,697.7	2,785.2
Stock-in-Trade	744.4	1,122.0	1,823.1	1,166.6
Trade Debts	193.9	314.8	509.8	368.2
Cash and Bank Balance	67.1	33.5	187.4	175.9
Total Assets	**3,783.8**	**5,264.4**	**5,984.3**	**5,431.9**
Trade and Other Payables	223.1	547.9	883.6	430.2
Long-Term Borrowings *(Inc. current maturity)*	233.7	529.8	561.0	509.5
Short-Term Borrowings	868.9	1,135.6	1,247.5	1,267.7
Total Debt	1,102.6	1,665.4	1,808.5	1,777.1
Total Liabilities	**1,432.6**	**2,350.1**	**2,812.6**	**2,316.7**
Paid-up Capital	700.0	700.0	700.0	700.0
Total Equity	**1,686.2**	**1,954.9**	**2,264.7**	**2,415.3**
INCOME STATEMENT				
Net Sales	2,457.1	3,877.2	5,167.9	3,013.6
Gross Profit	636.6	944.1	1,344.1	798.8
Operating Profit	291.4	425.0	747.6	253.6
Profit Before Tax	**211.1**	**343.5**	**323.2**	**181.2**
Profit After Tax	**186.6**	**305.1**	**271.2**	**150.6**
RATIO ANALYSIS				
Gross Margin (%)	25.9%	24.3%	26.0%	26.5%
Net Margin (%)	7.6%	7.9%	5.2%	5.0%
Net Working Capital	164.4	215.5	988.9	814.9
Trade Debt/Sales (%)	7.9%	8.1%	9.9%	6.1%*
Current Ratio	1.14	1.12	1.43	1.44
FFO	338.3	503.3	846.5	139.4
FFO to Long-Term Debt (x)	30.7%	30.2%	46.8%	15.7%*
FFO to Total Debt (x)	144.8%	95.0%	150.9%	54.7%*
DSCR (x)	3.58	5.09	3.71	1.36*
Gearing (x)	0.65	0.85	0.80	0.74
Debt Leverage (x)	0.85	1.20	1.24	0.96
Inventory + Receivable/Short-term Borrowings (x)	1.08	1.27	1.87	1.21
ROAA (%)	5.2%	6.7%	4.8%	5.3%*
ROAE (%)	11.7%	16.8%	12.9%	12.9%*

**Annualized*

REGULATORY DISCLOSURES Appendix III

Name of Rated Entity	Dynamic Sportswear (Private) Limited
Sector	Textile
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		
25-05-2023	A-	A-2	Stable	Reaffirmed
16-05-2022	A-	A-2	Stable	Initial

Due Diligence Meeting Conducted

Name	Designation	Date
Mr. Yasir Shafeeq	Manager Accounts	May 03, 2023