RATING REPORT

Artistic Garments Industries (AGI Denim) (Private) Limited

REPORT DATE:
June 11, 2024

RATING ANALYSTS:
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RATING DETAILS				
	Latest Rating		**Previous Rating**	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	A+	A-1	A	A-2
Rating Outlook	Stable		Stable	
Rating Action	Upgrade		Reaffirmed	
Rating Date	*June 11, 2024*		*Sept 21, 2023*	

COMPANY INFORMATION	
Incorporated in 1988	**External Auditors:** Kreston Hyder Bhimji & CO., Chartered Accountants
Private Limited Company	**Chief Executive Officer**: Mr. Javed Ahmed
Key Shareholders (with stake 5% or more):	
Mr. Javed Ahmed ~99.0%	

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

Artistic Garment Industries (AGI Denim) (Private) Limited.

OVERVIEW OF THE INSTITUTION

AGI Denim is engaged in the manufacturing of rope dyed denim fabric, yarn and all kinds of ready-made garments, etc.

The company has 11 units situated in Korangi, 4 units in Malir and 3 unit in Landhi Industrial Trading Estate, Karachi.

Profile of CEO:
Javed Ahmed is the CEO of AGI Denim. He graduated with BSc in Business Administration from The Ohio State University, USA. He is a seasoned professional with over 29 years of experience as a business leader and entrepreneur. He started his career with AGI Denim (Formerly known as AFGI) in 1988.

RATING RATIONALE

Corporate Profile

Artistic Garment Industries (AGI Denim) (Private) Limited or 'the Company' is a complete end-to-end enterprise focused on the production and export of denim fabric, yarn, and an extensive array of ready-made denim garments. With an operating track record of more than 3 decades, the Company undertakes all stages of the production cycle, including spinning, weaving, dyeing, and finishing. Average energy demand of AGI Denim is around 30 MW, which is primarily fulfilled by gas generators, supplemented by the national-grid line, with diesel and furnace oil generators and solar. Going forward, due to the addition of the garment's unit and modernization in denim dyeing process, energy demand is expected to increase to 35MW.

Sector Update

The business risk profile of the textile sector in Pakistan is characterized by a 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. In FY23, the textile sector faced challenges due to various economic and environmental factors. These include high interest cost, unavailability of skilled labor, escalating inflation, import restrictions due to diminishing foreign exchange reserves and volatile exchange rate.

During FY23, Pakistan's yarn production registered a substantial decline, primarily due to reduced availability of cotton, as a result of crop damage and import restrictions. The sector's profitability was constrained by factors such as higher production costs, increased raw material costs, and rising energy expenses, all of which constrained the sector's profit margin. The industry's performance is closely intertwined with the outlook of the cotton and textile industries, both of which were affected in FY23. Reduction in cotton supply, coupled with global economic slowdown and contractionary economic policies, led to a decrease in demand for textile products and, consequently, 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 inflationary pressures. Additionally, the sector's vulnerability to global market dynamics and the domestic economic landscape further contribute to its high business risk profile. However, there is optimism as an anticipated bigger cotton crop in FY24 is expected to alleviate some pressure on input costs and margins.

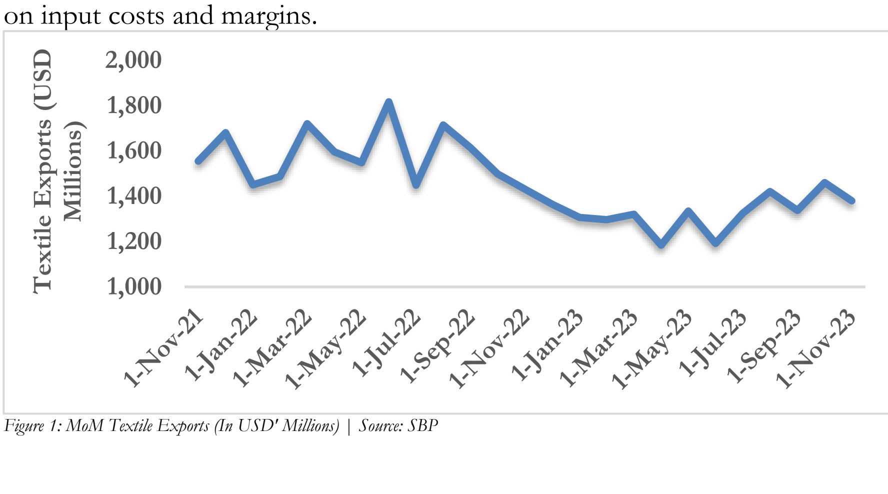

Figure 1: MoM Textile Exports (In USD' Millions) | Source: SBP

Operating Performance:

Property, plant, and equipment increased during FY23 and 9M'FY24 and the major additions pertained to property and machinery and building on leasehold land. The Company is currently in process of adding a new garments unit on 8 acres land, which is expected to come online by end-June'24. With the addition of this plant, garments stitching capacity is expected to increase to ~30m pcs/annum from 25.8m pcs/annum. As per the senior management. total cost associated with this garment unit is entirely financed through internal capital. Spinning utilization levels improved during the review period. While utilization levels of garments and denim registered a marginal decline amid lower demand in FY23. In 9MFY24, utilization levels of the AGI Denim have displayed robust improvement.

Table: Capacity & Production Data (Units in millions)

Capacity Utilization	FY21	FY22	FY23	9M'FY24
Spinning				
Installed Capacity (lbs)	-	43.2	43.2	32.4
Actual Production (lbs)	-	23.5	34.2	30.8
Capacity Utilization	**-**	**54%**	**79%**	**95%**
Garment				
Installed Capacity (pcs)	25.8	25.8	25.8	22.0
Actual Production (pcs)	22.1	22.4	21.4	20.3
Capacity Utilization	**85%**	**87%**	**83%**	**92%**
Denim				
Installed Capacity (meters)	30.3	37.5	37.5	32.5
Actual Production (meters)	30.0	31.7	30.2	31.1
Capacity Utilization	**97%**	**85%**	**81%**	**95%**

Key Rating Drivers

Notable growth in topline and improved gross margins in FY23 amid rupee depreciation. Overall profitability displayed continued growth in absolute terms over the review period.

During FY23, topline increased by 31% Y/Y, with net sales recorded high as compared to FY22, primarily on the back of higher selling prices despite lower volumetric sales. Export sales constituted approximately ~98% of total sales, with export garments making up nearly 4/5th of the total sales mix. Client concentration risk remained high since top 10 customers constituted 80% (FY22: 77%) of the total sales mix, with little to no variation in the top clients; however, comfort is drawn on the basis that the company has long-withstanding relations with its customers. During FY23, cost of sales increased primarily due to pressures from salary and wages benefits amidst inflationary pressures, while raw material procurement prices did not change significantly due to strategic procurement and timely locking of forward contracts. Gross profit surged with gross margins improving to 20.5% (FY22: 14.9%). The significant improvement in gross margins was primarily due to better average selling prices amid rupee depreciation coupled with lower cost inventory. Operating expenses saw an increase, with administrative expenses augmenting mainly due to adjustment in salaries and wages amidst inflationary pressures while distribution costs also increased. Finance costs increased significantly primarily attributed to higher reliance on working capital financing coupled with increased markup rates. Despite higher operating expenses and finance costs, the bottom line recorded a profit with net margins improved.

During 9M'FY24, topline improved by 43% Y/Y, as compared to 9M'FY23, showing a significant increase due to higher volumetric sales coupled with higher selling prices. Client concentration continues to remain high since more than 3/4th of the net sales emanated from top 10 clients. Gross margin was recorded at 16.0% (9M'FY23: 18.1%) which experienced a reduction, due to an increase in wages, fluctuations in the exchange rate during this period coupled with the impacts of notable rise in energy costs. Distribution costs remained muted, while administrative expenses slightly increased. Finance costs increased due to reliance on working capital financing coupled with higher markup rates. During 9M'FY24, AGI Denim realized net margins at 11.4% vis-à-vis 15.7% in 9M'FY23.

Strong improvement in liquidity metrics and cash flow coverages on the back of higher profitability.
Liquidity profile of the Company improved during the review period. Funds from operations (FFO) increased 2x as compared to FY22, mainly on the back of higher operating profit. Furthermore, FFO in 9M'FY24 also improved. Although Debt service coverage ratio (DSCR) fluctuated during the review period, it remained sound at 3.85x (FY23: 5.94x; FY22: 4.39x), primarily on the back of strong FFO, emanating from internal capital generation.

Current ratio improved to 1.80x (FY23: 1.43x; FY22: 1.15x), on the back of lower short-term borrowings as at reporting date, i.e., end-Mar'24. Net operating cycle has shown improvement during the review period to 81 days (FY23: 105 days; FY22: 101 days). This improvement was chiefly driven by reductions in days inventory outstanding and days sales outstanding, signaling enhanced operational efficiency and improved cash flow management.

Sound equity growth and improved leverage and gearing indicators driven by internal capital generation during the review period.
Equity (adjusted for surpluses) increased significantly by 87% during that last 1.5 years, driven by internal capital generation. Total debt of the Company decreased significantly as compared to Jun'23. The overall debt has declined over the review period amid scheduled repayment of long-term loans with absence of any new long term debt mobilization on balance sheet. Further, with the better internal cash generation and improved working capital cycle, the Company also utilized lower short-term financing. As of 31st Mar,'24, average borrowing cost of short-term borrowings stands at 18.1-19%, while average borrowing cost of long-term borrowings is ~5% since entire long-term loans are based on subsidized rates. On the back of equity growth, gearing and leverage improved to 0.41x (FY23: 0.90x; FY22: 1.23x) and to 0.78x (FY23: 1.25x; FY22: 1.66x) respectively. During the rating review period, AGI Denim did not mobilize any long-term loans and does not intend to do so during the rating horizon. However, regular BMR will continue, which will be funded through internal capital generation. The Company also plans to establish a garment washing plant; however, no concrete finalizations of the plan is expected until the economy stabilizes. Looking ahead, maintaining capitalization indicators is important from rating's perspective.

REGULATORY DISCLOSURES					Appendix I
Name of Rated Entity	Artistic Garment Industries (AGI Denim) (Private) Limited				
Sector	Textile				
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				
	11/06/2024	A+	A-1	Stable	Upgraded
	21/09/2023	A	A-2	Stable	Reaffirmed
	20/07/2022	A	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.				
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Due Diligence Meeting Conducted	**Name**	**Designation**	**Date**		
	Mr. Abdul Rahim	CFO	May 20, 2024		
	Mr. Syed Sajjad Haider	Group Manager Financial Reporting/ Company Secretary			