RATING REPORT

Artistic Denim Mills Limited

REPORT DATE:
May 7, 2018

RATING ANALYSTS:

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RATING DETAILS

Rating Category	Latest Rating	
	Long-term	Short-term
Entity	A-	A-1
Rating Date	*May 7, 2018*	
Rating Outlook	Stable	
Outlook Date	*May 7, 2018*	

COMPANY INFORMATION

Incorporated in 1992	**External auditors:** M/s EY Ford Rhodes Chartered Accountants
Public Limited Company **Shareholders holding more than 5%:** - Mr. Faisal Ahmed - Mr. Muhammad Iqbal Ahmed - Ms. Sadia Zain	**Chairperson of the Board:** Mrs. Maliha Faisal **Chief Executive Officer:** Mr. Faisal Ahmed

APPLICABLE METHODOLOGY(IES)

Applicable Rating Criteria: Industrial Corporates (May, 2016) http://www.jcrvis.com.pk/kc-meth.aspx

Artistic Denim Mills Limited

OVERVIEW OF THE INSTITUTION

Artistic Denim Mills Limited (ADML) was incorporated in 1992 as a Public Limited Company.

As on June 30, 2017 shareholding pattern of the company demonstrates that it is a family owned business with major shareholding resting with Mr. Faisal Ahmed owning 60% of the shares of the company. Other shareholders include local individuals (36%), State Life Insurance (2%), Artistic Properties (Pvt) Limited (2%) and Financial Institutions (1%).

ADML is fully compliant with International Social and Environmental & Quality standards. It also has a liaison office in Bangladesh encompassing a showroom and a dedicated country manager to stay in proximity to the customers.

RATING RATIONALE

Artistic Denim Mills Limited (ADML) commenced its operations in 1993 as a denim fabric manufacturer. It later backward integrated into the spinning division and in 2008 established its garments division thereby attaining the status of a vertically integrated denim player. Revenues largely comprise exports with sales generated through both fabric and garments division. Operations of the company are housed at a composite unit in Korangi Industrial Area, Karachi, Pakistan. ADML's operations encompasses the following three divisions:

Spinning- ADML's monthly capacity of yarn production was reported at 1.5m lbs (annual capacity- 18.2m lbs) at end-FY17 which is completely utilized in-house to manufacture denim fabric. Capacity utilization of the spinning division has been increasing on a timeline basis from 62% in FY15 to 88% in FY17. Management expects capacity utilization to remain on the higher side; going forward.

Weaving- Monthly capacity of denim fabric was reported at 1.64m mtrs (annual capacity- 19.65m mtrs) at end-FY17. Utilization levels of the weaving segment has been rising on a timeline basis from 64% in FY15 to 98% in FY17. Given that utilization level on the higher side, the company continuously undergoes expansions in its weaving division through regular BMR activities. In volumetric terms, around three fifth of the total fabric produced is sold in the local and international market while the remaining is utilized in-house for garment manufacturing. Fabric sales of the company are concentrated in Pakistan (nominated sales), Bangladesh and Turkey. ADML plans to diversify its fabric sales to new markets including Colombia, Vietnam, Portugal, Sri Lanka and Latin American markets through the agency model.

Garments- ADML manufactures a large variety of garment products; therefore precise actual capacity for the same cannot be determined. However, on an average estimated monthly capacity of garments was reported at 500k pieces (annual capacity- 6m pieces) during FY17 with utilization levels of 80%. Given rising demand for denim products, the company has future plans to increase capacity of its garments unit. Major markets for garment's sales include Europe and USA. In Europe, increasing share is a function of higher sales in Germany. Going forward, the company has plans to increase its foothold in USA due to better prices and volumes.

Key Rating Drivers

Sector Dynamics and Business Risks

Business risk profile is supported by stable and growing demand for denim fabric and garments. However, local and international expansion by major players is expected to keep pricing power and hence margins under pressure. Moreover, significant investment required by customers as part of sustainability initiative is expected to add to cost pressures for denim manufacturers. ADML's operations are currently concentrated with exposure entirely to the denim industry which might significantly impact business risk profile in case of change in demand patterns or any other industry specific factors. Therefore keeping pace with rapid changes in fashion trends and diversification is considered important. JCR-VIS expects demand for denim products to remain stable over the medium term. Other key business risk factors include efficient procurement of cotton and weakening in law and order.

Profitability

Apart from the ongoing fiscal year, CAGR growth in revenues of the company has remained low over the past three years. ADML reported sales revenue of Rs. 6.9b (FY16: Rs. 6.5b) during FY17, an increase of 7% as compared to the previous year. Increase in sales was attributable to the garment division of the company. Growth in sales is primarily attributable to volumetric increase while average prices witnessed a declining trend. Export sales represent the major portion of company's revenues with garment segment contributing around half of the company's topline during FY17. During FY17, gross margins of the company slightly declined to 10.71% (FY16: 10.89%; FY15: 16.8%) on account of lower sales prices and rising cotton prices, wages & depreciation. During 1HFY18, sales revenue witnessed a sizeable jump on account of volumetric growth in fabric and garment exports. Going forward, gross margins are expected to remain under pressure on account of pressure on prices (due to significant capacities coming online) and increasing cost due to sustainability related investment that the company has to incur to comply with client requirements.

Liquidity

Despite decline in fund flow from operations on a timeline basis (FFO: FY17: Rs. 627m; FY16: Rs. 699m; FY15: Rs. 1b), overall liquidity profile is considered adequate in view of strong debt servicing coverage (FY17: 8.14(x); FY16: 6.17(x)) and satisfactory FFO/Total debt ratios (FY17: 25%; FY16: 36%). Going forward, cash flows will also be supported by receipt of rebates announced by the government under the textile policy. Given the company's working capital cycle requires utilization of short-term borrowing, the same represents around two-third of total outstanding borrowings at end-FY17. Stock in trade and trade debts represent around 171% of short-term borrowings while cash flows provide significant coverage of outstanding long-term debt at 74% (FY16: 121%). Trade debts represented 21% of total sales with most receivables against LCs apart from few large garment brands that have a track record of timely payments. Aging profile of trade debts is considered satisfactory. With current assets being greater than current liabilities, current ratio of ADML was reported greater than 1 at end Dec'17.

Capitalization and Funding

At end Dec'2017, equity base of the company amounted to Rs. 5.84b (FY17: Rs. 5.76b) at end-1HFY18. Equity base of the company has grown at a 3-yr CAGR of 6% with dividend payout ratio averaging 43% over the last 3 years. With increase in debt being higher than growth in equity base, leverage indicators have trended upwards. Given the company's expansion plans (BMR), leverage indictors are projected to increase slightly but are expected to remain in line with benchmarks for the assigned ratings.

Corporate Governance

Given the company's status as the only listed company in the denim sector, transparency and disclosures compare favorably vis-à-vis other peers in the denim sector. However, board composition has room for improvement through inclusion of additional independent directors on the board. The company uses Microsoft Dynamics alongwith other in-house developed modules for its IT related needs. Progress against planned initiatives on the IT front will be tracked by JCR-VIS.

Artistic Denim Mills Limited **Appendix I**

FINANCIAL SUMMARY *(amounts in PKR millions)*

BALANCE SHEET	FY15	FY16	FY17	1HFY18*
Fixed Assets	4,695	5,340	5,458	5,351
Long term Investments	-	-	-	-
Stock-in-Trade	1,033	1,335	1,361	2,045
Trade Debts	1,116	1,034	1,496	1,744
Cash & Bank Balances	27	61	63	40
Total Assets	7,587	8,611	9,470	10,332
Trade and Other Payables	632	1,001	1,174	1,354
Long Term Debt	182	578	852	847
Short Term Debt	1,189	1,380	1,670	2,265
Total Debt	1,371	1,958	2,522	3,112
Total Equity	5,457	5,497	5,759	5,836
INCOME STATEMENT				
Net Sales	6,999	6,462	6,907	8,387
Gross Profit	1,178	703	740	821
Operating Profit	898	472	534	658
Profit After Tax	744	378	429	508
RATIO ANALYSIS				
Gross Margin (%)	16.8%	10.9%	10.7%	9.8%
Net Margin (%)	10.6%	5.8%	6.2%	6.1%
Net Working Capital	996	865	1,102	1,267
Trade debts/Sales	16%	16%	22%	21%
FFO	1,001	699	627	949
FFO to Total Debt (%)	73%	36%	25%	30%
FFO to Long Term Debt (%)	550%	121%	74%	112%
Debt Servicing Coverage Ratio (x)	4.20	6.17	8.14	8.27
Leverage (x)	0.39	0.57	0.64	0.77
Gearing (x)	0.25	0.36	0.44	0.53
ROAA (%)	10%	5%	5%	5%
ROAE (%)	14%	7%	8%	9%

**Annualized*

ISSUE/ISSUER RATING SCALE & DEFINITION — Appendix II

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: JCR-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.jcrvis.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.jcrvis.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.

'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.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-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	Appendix III
Name of Rated Entity	Artistic Denim Mills Limited
Sector	Textile Industry
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see table below
Instrument Structure	N/A
Statement by the Rating Team	JCR-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	JCR-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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Rating History:

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
May 7, 2018	A-	A-1	Stable	Initial