The Pakistan Credit Rating Agency Limited

Rating Report

Denim-E (Pvt.) Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
07-Feb-2023	BBB-	A2	Stable	Maintain	-
07-Feb-2022	BBB-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings of Denim-E (Pvt.) Limited incorporates progressive growth of the Company in the initial years. The Company is a family-owned business. Apart from this company, the sponsor family is involved in real estate and Biogas businesses. Denim-E is principally engaged in the manufacturing and export of garments/made-up, clothing, knitwear, and the weaving of apparel. The Company's management is cognizant of the textile industry's volatility and has planned phase-wise gradation of machinery to remain competitive. Healthy growth has been recorded over the last three years. The Company's topline has reflected improvement to PKR 2.3bln (FY21: PKR 1.1bln); a result of higher capacity utilization accompanied by better prices. The sales mix represents the contribution from the export market. The Company enjoys a customer base with several export destinations where various retailers are also on board. The net profitability also observed improvement while margins observed slight improvement. Ratings incorporate sound financial risk manifested by significant improvement in coverage YoY. The Company has an adequate financial profile characterized by adequate coverages, low-leveraged capital structure, and improving working capital management. Going forward, the planned CAPEX is expected to bring in efficiency and improve margins.
During 5MFY23, textile exports were valued at $7.44bln compared to $7.76bln, reflecting a 4% dip YoY – the declining trend recorded in the last two months. The fall in export value has mainly come from volumetric decline as prices of almost all categories have either increased or stayed flat. This has taken a fiscal year to date exports into negative with a 1.4% decline in the first four months (July – October) FY23. Among value-added items, bedwear has witnessed the largest decline of 19% (on an MoM basis), down to $217 million. Knitwear remained on the downward path in October 2022 and declined by 10% to $392 million. Among non-value-added items, cotton yarn has shown the largest decline of 35%. Moreover, a slowdown is expected in textile demand amid burgeoning inflationary pressures in the exporting destinations, especially in the US and European countries. The import of raw materials has become a challenge, to manage which is quite essential for continued operations.

The ratings are dependent on the management's ability to uphold the entity's growing performance trend. Meanwhile, maintaining strong margins and coverages to fulfill financial obligations will remain critical. The company is expected to adhere to conservative financial discipline, which would be crucial to ratings.

Disclosure

Name of Rated Entity	Denim-E (Pvt.) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Correlation Between Long-term & Short-term Rating Scales(Jun-22),Methodology | Rating Modifiers(Jun-22)
Related Research	Sector Study | Composite and Garments(Dec-22)
Rating Analysts	Iram Shahzadi | iram.shahzadi@pacra.com | +92-42-35869504

Composite and Garments

Profile

Legal Structure Denim-E (Private) Limited (Denim-E) was incorporated on August 13, 2018 as a private limited company. The registered office of the Company is situated at Plot 100, Sector 27 Korangi Industrial Area, Karachi.

Background Denim-E (Private) Limited is a family-owned Private Company. Apart from Denim-E, sponsoring family is engaged in real estate and Biogas businesses.

Operations The Company is principally engaged in the manufacturing and export of garments/made-up, clothing, knitwear and weaving of apparels. The Company have cut to pack capacity of 6,700 Pieces/day which accumulates to 200,000 per month and 2.4mln Pieces annually. The Company's total energy requirement are 265,228 units. The requirement is met through various sources captive (Coal, Gas, Furnace Oil), WAPDA, etc.

Ownership

Ownership Structure The ownership of the Company rests with the family of Mr. Khalid including his son, nephew and brothers. The major shareholding of the Company is owned by Mr. Azhar Khalid.

Stability The considerable positions in the Company are held by Mr. Khalid's Family. The distribution of shareholding among family members portrays a structured line of succession. In the foreseeable future, after incorporating a few changes, the shareholding of the company will vest with Mr. Azhar Khalid and his family.

Business Acumen Mr. Azhar Khalid - BSC (hons) from Textile Institute of Pakistan (TIP) - is the son of Khalid Farooq. He has an experience of more than ten years in the textile industry, developing credential expertise over time which provides sufficient business acumen, to sustain any upcoming challenges.

Financial Strength The sponsor family is engaged in multiple businesses with over more than 20 years. The holding group is currently engaged in real estate and biogas businesses. This indicates sponsors' ability to provide support if need arises.

Governance

Board Structure The Company has three-member board with presence of sponsors and their families. The position of CEO is vested with Mr M. Azhar. The Chairman of the Company is Mr Khalid Farooq.

Members' Profile The members of the board have relevant stature and extensive experience of around three decades of the textile industry. Currently, there are no independent directors on the board.

Board Effectiveness BoD meetings are held regularly in which discussion on various aspect is recorded in minutes and decision or action is referred to CEO, Mr. Azhar Khalid.

Financial Transparency Grant Thornton Anjum Rahman Chartered Accountants, who are in category 'A' of SBP and have a QCR rating by ICAP, are the external auditors of the company. They have expressed unqualified opinion on the financial statements of the company for the year ended June 30th, 2022.

Management

Organizational Structure The organizational structure of the company is divided into several functional departments, namely: (i) Production, (ii) Marketing, (iii) Admin, Information Technology, Utilities & Maintenance, (iv) Finance & Audit, (v) HR & Compliance, (vi) Import/Export & Logistics, (vii) Procurement and (viii) Quality external. All HODs report directly to the CEO.

Management Team Mr. Azhar Khalid is the CEO of the Company. He carries fifteen years of professional experience and holds BSC (hons) from Textile Institute of Pakistan (TIP). He has been engaged with the company since 2018.

Effectiveness The management meetings are held periodically with follow-up points to resolve or pro-actively address operational issues, if any, eventually ensuring a smooth flow of operations.

MIS Denim E has dedicated IT team which includes System engineers, System analyst, Developers and network engineers. The company is using customised ERP, purchased from AK Solutions. The agreement is renewed annually and includes timely support, trouble shooting and development of new reports. This software is the primary system and platform for driving information for strategic and operational decision making. The MIS reports are updated on a real-time basis to be available to senior management all the time. The reports are shared and discussed with the CEO regularly to ensure timely decision making and smooth flow of operations.

Control Environment Denim-E utilize management systems as their mechanism for ensuring control. There is clear evidence of these systems being audited and certified externally. Examples of this include RCS (Recycled Claim Standard), BSCI, GOTS, OekoTex, GRS, WRAP, C-TPAT & OCS certifications.

Business Risk

Industry Dynamics During 5MFY23, textile exports were valued at $7.44bln compared to $7.76bln, reflecting a 4% dip YoY – the declining trend recorded in the last two months. The fall in export value has mainly come from volumetric decline as prices of almost all categories have either increased or stayed flat. This has taken a fiscal year to date exports into negative with a 1.4% decline in the first four months (July – October) FY23. Among value-added items, bedwear has witnessed the largest decline of 19% (on an MoM basis), down to $217 million. Knitwear remained on the downward path in October 2022 and declined by 10% to $392 million. Among non-value-added items, the cotton yarn has shown the largest decline of 35%. Moreover, a slowdown is expected in textile demand amid burgeoning inflationary pressures in the exporting destinations, especially in the US and European countries.

Relative Position Denim-E was formed with one vision in mind and that was to be the first denim manufacturing Company in Pakistan to be fully sustainable from its very inception. The Company's plan of enhancing current capacity will assist in strengthening its footprint, going forward.

Revenues The major portion of the revenue base is derived from exports. The main export destinations in FY22 were North America and European countries. The analysis of the last three years reveals that the company's revenues have been growing sizably. During FY22, the Company's top line has a massive improvement to PKR 2,315mln (FY21: PKR 1,082mln). During FY22, the Company's gross profits enhanced to PKR 449mln (FY21: PKR 189mln), attributable to favorable pricing of product slate. Finance costs, increased YoY, due to increased key policy rate. This is due to enhanced short-term borrowing which are requirement of course of business. Net profitability clocked in at PKR 91mln (FY21: PKR 63mln).

Margins Gross profit margin improved and stood at 19.4% (FY21: 17.5%). Operating margin slight incline to 3.0% (FY20: 2.3%), on the back of 132% increase in operating expenses to PKR 380mln (FY21: PKR 164mln). While the net profit margin clocked at 3.9% (FY21: 5.8%).

Sustainability The Company is planning CAPEX of 300,000 pcs per month till 2024 and 400,000 Pcs till 2025. The Company has rented new unit which can easily cater the plan for capacity increase till 2024. New stitching and washing machinery will be purchased in line with extension plan and also plan ETP Plant installation. This will cater to expansion in revenue base and strengthening business profile the company.

Financial Risk

Working Capital During FY22, the Company's gross working capital cycle recorded a marginal increase to 83 days (FY21: 78 days) attributable to an increase in receivable days (FY22: 37 days, FY21: 31 days). The Company's net trade assets increased and clocked at PKR 952mln (FY21: PKR 340mln).

Coverages Free Cash Flows from Operations (FCFO) increased in FY22 and clocked in at PKR 198mln on the back of higher EBITDA YoY. The interest coverage ratio inclined to 6.7x in FY22 from 4.8x in FY21. While the core coverage also improved and recorded at 1.5x (FY21: 1.0x).

Capitalization The financial matrix of the company portrays a good picture. Equity of the Company is at PKR 291mln (FY21: PKR 200mln). During FY22, leveraging increased to 52.8% (FY21: 50.1%). Short-term borrowings comprise 72% (FY21: 42%) of the total borrowings. Going forward, the company is expected to adhere to conservative financial discipline.

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Denim-E (Pvt.) Limited Composite & Garments	Jun-22 12M	Jun-21 12M	Jun-20 12M
A BALANCE SHEET			
1 Non-Current Assets	448	352	212
2 Investments	-	-	-
3 Related Party Exposure	-	-	-
4 Current Assets	1,042	440	335
a Inventories	*454*	*123*	*158*
b Trade Receivables	*352*	*120*	*62*
5 Total Assets	1,491	792	547
6 Current Liabilities	874	384	310
a Trade Payables	*776*	*329*	*215*
7 Borrowings	322	197	88
8 Related Party Exposure	4	4	0
9 Non-Current Liabilities	-	8	13
10 Net Assets	291	200	137
11 Shareholders' Equity	291	200	137
B INCOME STATEMENT			
1 Sales	2,315	1,082	646
a Cost of Good Sold	*(1,866)*	*(893)*	*(479)*
2 Gross Profit	449	189	167
a Operating Expenses	(380)	(164)	(112)
3 Operating Profit	69	25	55
a Non Operating Income or (Expense)	*111*	*80*	*25*
4 Profit or (Loss) before Interest and Tax	180	105	80
a Total Finance Cost	*(68)*	*(33)*	*(10)*
b Taxation	*(21)*	*(10)*	*(6)*
6 Net Income Or (Loss)	91	63	64
C CASH FLOW STATEMENT			
a Free Cash Flows from Operations (FCFO)	*198*	*127*	*86*
b Net Cash from Operating Activities before Working Capital Changes	*130*	*95*	*76*
c Changes in Working Capital	*(122)*	*41*	*(11)*
1 Net Cash provided by Operating Activities	8	135	65
2 Net Cash (Used in) or Available From Investing Activities	(136)	(170)	(84)
3 Net Cash (Used in) or Available From Financing Activities	118	82	60
4 Net Cash generated or (Used) during the period	(10)	47	41
D RATIO ANALYSIS			
1 Performance			
a Sales Growth (for the period)	113.9%	67.5%	634.6%
b Gross Profit Margin	19.4%	17.5%	25.8%
c Net Profit Margin	3.9%	5.8%	9.9%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	3.3%	15.5%	11.6%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Shareholders' Equity)]*	37.1%	37.5%	60.9%
2 Working Capital Management			
a Gross Working Capital (Average Days)	83	78	76
b Net Working Capital (Average Days)	-4	-13	15
c Current Ratio (Current Assets / Current Liabilities)	1.2	1.1	1.1
3 Coverages			
a EBITDA / Finance Cost	4.0	4.8	10.5
b FCFO / Finance Cost+CMLTB+Excess STB	1.3	1.0	3.3
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	1.1	1.5	1.0
4 Capital Structure			
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	52.8%	50.1%	39.1%
b Interest or Markup Payable (Days)	0.0	0.0	0.0
c Entity Average Borrowing Rate	20.5%	19.8%	12.7%

Corporate Rating Criteria

Scale

Credit Rating

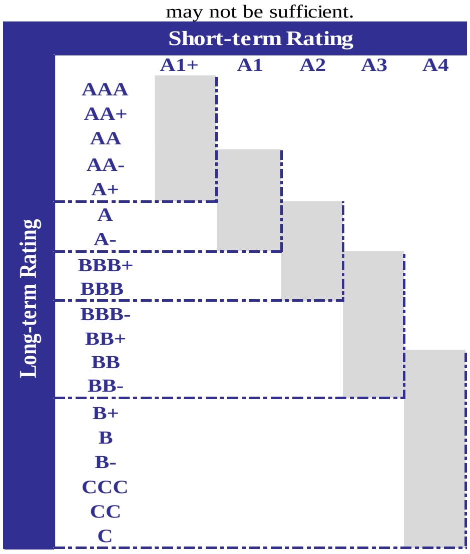
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short-term Rating

Scale	Definition
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

a) Broker Entity Rating
b) Corporate Rating
c) Debt Instrument Rating
d) Financial Institution Rating
e) Holding Company Rating
f) Independent Power Producer Rating
g) Microfinance Institution Rating
h) Non-Banking Finance Companies Rating

Regulatory and Supplementary Disclosure
(Credit Rating Companies Regulations,2016)

Rating Team Statements
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report | Clause 11-(A)(p).
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest
(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)
Probability of Default
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)
Proprietary Information