



The Pakistan Credit Rating Agency Limited

**Rating Report**

<b>Denim-E (Pvt.) Limited</b>	<b>Report Contents</b>
	<ol style="list-style-type: none"> <li>1. Rating Analysis</li> <li>2. Financial Information</li> <li>3. Rating Scale</li> <li>4. Regulatory and Supplementary Disclosure</li> </ol>

<b>Rating History</b>					
Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
07-Feb-2024	BBB-	A2	Stable	Maintain	-
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 up gradation of machinery to remain competitive. Healthy topline growth has been recorded over the last few years which improved to PKR 3.5bln in FY23 (FY22: PKR 2.4bln); a result of increased capacity levels and the positive impact of exchange rate gains from dollar-denominated earnings. The sales mix represents the contribution from the export market. The Company’s customer base is spread across several export destinations including Central Europe. Assigned ratings incorporate elevated business risk in the textile sector, stemming from a weak macroeconomic environment, high interest rates, inflationary pressures, escalating raw material costs, ongoing energy crisis, and a global demand slump. Despite the industry's historical significance, these factors pose challenges to margin sustainability and future growth. The Company's liquidity profile continues to provide adequate support to assigned ratings. Going forward, the planned CAPEX is expected to bring efficiency to the business process and improve margins.

During FY23, textile exports were valued at \$16.5 billion as against \$19.33 billion, reflecting a 15% year-on-year decline – a downward trend seen since the beginning of FY23. Exports declined due to higher energy prices, cotton shortages, and uncertainty in foreign exchange rates. Taming the demand represented by export routes was also a challenge. During FY23, value-added products such as knitwear, bedwear, towels, and ready-made garments saw an annual decline of 13 percent. Basic textiles, including raw cotton, cotton yarn, and cotton fabrics, declined by 21 percent year-on-year. During the month of June 2023, cotton yarn exports increased by 7% MoM. Value-added exports reported volume growth of 16 percent on a month-on-month basis.

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.

<b>Disclosure</b>	
<b>Name of Rated Entity</b>	Denim-E (Pvt.) Limited
<b>Type of Relationship</b>	Solicited
<b>Purpose of the Rating</b>	Entity Rating
<b>Applicable Criteria</b>	Methodology   Corporate Rating(Jul-23),Methodology   Correlation Between Long-term & Short-term Rating Scales(Jul-23),Methodology   Rating Modifiers(Apr-23)
<b>Related Research</b>	Sector Study   Composite and Garments(Dec-23)
<b>Rating Analysts</b>	Iram Shahzadi   iram.shahzadi@pacra.com   +92-42-35869504

## 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 apparel. The Company has cut to pack capacity of 11,500 Pieces/day which accumulates to 300,000 per month and 3.6mln Pieces annually. The Company's total energy requirement is 381,735 units. The requirement is met through various sources captive (Coal, Gas, Furnace Oil), WAPDA, etc and in housed deployed Solar Panel as well.

## 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, 2023.

## 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** The Company is using Odoo ERP a Belgian based business management software purchased user license from Odoo S.A.

**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 FY23, textile exports were valued at \$16.5 billion as against \$19.33 billion, reflecting a 15% year-on-year decline – a downward trend seen since the beginning of FY23. Exports declined due to higher energy prices, cotton shortages, and uncertainty in foreign exchange rates. Taming the demand represented by export routes was also a challenge. During FY23, value-added products such as knitwear, bedwear, towels, and ready-made garments saw an annual decline of 13 percent. Basic textiles, including raw cotton, cotton yarn, and cotton fabrics, declined by 21 percent year-on-year. During the month of June 2023, cotton yarn exports increased by 7% MoM. Value-added exports reported volume growth of 16 percent on a month-on-month basis.

**Relative Position** Many textile companies had a transition to move from conventional to sustainable practices. 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 analysis of the last three years reveals that the company's revenues have been growing sizably. in FY23, the Company's top line has an improvement to PKR 3,457mln (FY22: PKR 2,315mln). While the Company's gross profits increased to PKR 532mln (FY22: PKR 434mln). Attributable to favorable pricing of product slate. 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 PKR 122mln (FY22: PKR 78mln) as a result of higher average markup rates. Hence, the net profitability clocked in at PKR 112mln (FY22: PKR 72mln).

**Margins** The increased raw material costs and high inflationary pressure contributed to reduced gross and operating margins. The gross profit margin stood at 15.4% (FY22: 18.8%). Operating margin also had a slight dip to 1.1% (FY22: 2.2%). While the net profit margin reflected a marginal increase and clocked at 3.2% (FY22: 3.1%).

**Sustainability** The Company is planning to increase to 400,000 in 2024 The Company's existing capacity is 300,000 pcs per month. Now the Company is planning CAPEX of 400,000 Pcs till 2024 and 500,000 till 2025. The Company has rented a new unit that can easily cater to the plan for capacity increase till 2024. New stitching and washing machinery will be purchased in line with the extension plan and also plan ETP Plant installation. This will cater to the expansion of the revenue base and strengthen the business profile of the company. The Company is also planning to increase its penetration in the USA, Canada, Australia, and the Middle Eastern Markets by attracting more orders from existing buyers and targeting some new buyers.

## Financial Risk

**Working Capital** During FY23, the Company's gross working capital cycle recorded a marginal increase to 84 days (FY22: 83 days) attributable to the attrition in receivable days (FY22: 19 days, FY21: 37 days). The Company's net trade assets increased and clocked at PKR 1,040mln (FY22: PKR 952mln).

**Coverages** Free Cash Flows from Operations (FCFO) increased in FY23 and clocked in at PKR 318mln on the back of higher EBITDA YoY. The interest coverage ratio declined to 2.8x in FY22 from 3.1x in FY22. The core coverage was recorded at 0.7x (FY22: 1.2x), primarily due to a surge in the finance cost from higher interest rates, despite the reduction in short-term borrowings.

**Capitalization** The financial matrix of the company portrays a good picture. Equity of the Company is at PKR 385mln (FY22: PKR 272mln). During FY23, leveraging increased to 55.8% (FY22: 52.8%). Short-term borrowings comprise 43% (FY22: 72%) of the total borrowings.



Denim- E (Pvt.) Limited Composite and Garments	Jun-23 12M	Jun-22 12M	Jun-21 12M
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#### A BALANCE SHEET

1 Non-Current Assets	878	564	352
2 Investments	-	-	-
3 Related Party Exposure	75	-	-
4 Current Assets	1,217	996	419
a Inventories	788	454	123
b Trade Receivables	3	306	120
<b>5 Total Assets</b>	<b>2,170</b>	<b>1,560</b>	<b>771</b>
6 Current Liabilities	1,300	828	501
a Trade Payables	1,006	776	329
7 Borrowings	482	456	79
8 Related Party Exposure	4	4	4
9 Non-Current Liabilities	-	-	8
<b>10 Net Assets</b>	<b>385</b>	<b>272</b>	<b>179</b>
<b>11 Shareholders' Equity</b>	<b>385</b>	<b>272</b>	<b>179</b>

#### B INCOME STATEMENT

1 Sales	3,457	2,306	1,096
a Cost of Good Sold	(2,925)	(1,872)	(893)
<b>2 Gross Profit</b>	<b>532</b>	<b>434</b>	<b>203</b>
a Operating Expenses	(493)	(384)	(164)
<b>3 Operating Profit</b>	<b>39</b>	<b>50</b>	<b>39</b>
a Non Operating Income or (Expense)	238	120	45
<b>4 Profit or (Loss) before Interest and Tax</b>	<b>277</b>	<b>170</b>	<b>84</b>
a Total Finance Cost	(122)	(78)	(33)
b Taxation	(43)	(21)	(10)
<b>6 Net Income Or (Loss)</b>	<b>112</b>	<b>72</b>	<b>42</b>

#### C CASH FLOW STATEMENT

a Free Cash Flows from Operations (FCFO)	318	198	106
b Net Cash from Operating Activities before Working Capital	232	130	74
c Changes in Working Capital	259	(122)	41
<b>1 Net Cash provided by Operating Activities</b>	<b>491</b>	<b>8</b>	<b>114</b>
<b>2 Net Cash (Used in) or Available From Investing Activities</b>	<b>(397)</b>	<b>(136)</b>	<b>(170)</b>
<b>3 Net Cash (Used in) or Available From Financing Activities</b>	<b>(10)</b>	<b>118</b>	<b>103</b>
<b>4 Net Cash generated or (Used) during the period</b>	<b>84</b>	<b>(10)</b>	<b>47</b>

#### D RATIO ANALYSIS

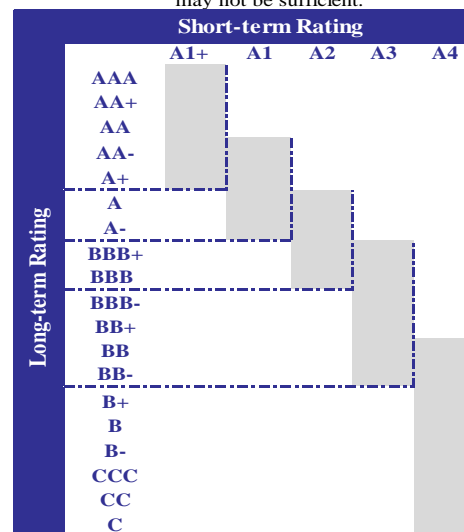
<b>1 Performance</b>			
a Sales Growth (for the period)	50.0%	110.4%	69.6%
b Gross Profit Margin	15.4%	18.8%	18.5%
c Net Profit Margin	3.2%	3.1%	3.8%
d Cash Conversion Efficiency (FCFO adjusted for Working C	16.7%	3.3%	13.4%
e Return on Equity [ Net Profit Margin * Asset Turnover * (T	34.2%	32.0%	26.5%
<b>2 Working Capital Management</b>			
a Gross Working Capital (Average Days)	82	79	81
b Net Working Capital (Average Days)	-12	-8	-9
c Current Ratio (Current Assets / Current Liabilities)	0.9	1.2	0.8
<b>3 Coverages</b>			
a EBITDA / Finance Cost	3.2	3.4	4.1
b FCFO / Finance Cost+CMLTB+Excess STB	0.7	1.2	0.7
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Fi	2.8	2.2	2.1
<b>4 Capital Structure</b>			
a Total Borrowings / (Total Borrowings+Shareholders' Equit	55.8%	62.8%	31.7%
b Interest or Markup Payable (Days)	0.0	0.0	0.0
c Entity Average Borrowing Rate	27.6%	23.4%	33.4%

### 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.

Scale	Long-term Rating Definition
AAA	<b>Highest credit quality.</b> Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+	
AA	<b>Very high credit quality.</b> 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.
AA-	
A+	
A	<b>High credit quality.</b> 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.
A-	
BBB+	<b>Good credit quality.</b> 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.
BBB	
BBB-	
BB+	<b>Moderate risk.</b> 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.
BB	
BB-	
B+	
B	<b>High credit risk.</b> 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.
B-	
CCC	<b>Very high credit risk.</b> Substantial credit risk "CCC" Default is a real possibility.
CC	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.
C	
D	Obligations are currently in default.

Scale	Short-term Rating 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 conditions.
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 surveil 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

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(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

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- (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)
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- (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)
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- (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)
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- (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 | 17-(a)
- (19) PACRA reviews all the outstanding ratings periodically, on annual basis; Provided that public dissemination of annual review and, in an instance of change in rating will be made; | Chapter III | 17-(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 | 17-(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 | 17-(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 | 14-3(f)(vii)

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