



The Pakistan Credit Rating Agency Limited

**Rating Report**

**US Denim Mills (Pvt.) Limited**

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**Rating History**

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
20-Mar-2023	A	A1	Stable	Initial	-

**Rating Rationale and Key Rating Drivers**

US Denim Mills (Private) Limited (US Denim, The Company) is a prominent textile venture of US Group. The Group has a holding Company, named AJ Holding Limited, which also exists for managing investments in subsidiaries and associated companies. The sponsors are in charge of the individual enterprises, oversee the professional management, and are well-equipped and experienced. Strategic direction is meticulously worked out and rigorously followed once decided and finalized. The Company is principally engaged in the manufacturing and sale of denim fabric. The Company’s management has experienced professionals, aided by comprehensive reporting, where operations of the Company are supervised with complete autonomy. US Denim has a subsidiary Company with name Us Fashion Turkey Tekstil Ticaret Anonim Sirketi. US Fashion Turkey Tekstil Ticaret Anonim ?irketi was established on 31 January 2017 in Istanbul, Turkey. The Company’s income comprises domestic and export sales. The assigned ratings derive comfort from US Denim’s association with the US Group. The company reported a 33% increase in topline with marginal improvement in gross margins during FY22 on the back of higher volumetric sales and favorable prices. The major portion of the revenue base is derived from indirect exports (61%). The Company has also direct exports (38%) to Asia (Bangladesh, Srilanka), Africa (Morocco, Madagascar) & Europe (Turkey, Italy). US Denim continues to maintain a favorable capital structure and strong coverages signifying a robust financial profile. Going forward, the Company is planning CAPEX for vertical integration within the Group, which will be entirely funded from equity.

During 7MFY23, the textile exports of the country were valued at \$10.08bln compared to \$10.93bln, reflecting an 8% decline YoY – the declining trend has been recorded in the last few months. The decline in exports is driven by attrition in the demand pattern of export avenues.

The ratings are dependent on the Company’s ability to maintain a strong business profile amidst current circumstances. Preserving low-leveraged capital structure and sound coverages remain imperative.

**Disclosure**

<b>Name of Rated Entity</b>	US Denim Mills (Pvt.) Limited
<b>Type of Relationship</b>	Solicited
<b>Purpose of the Rating</b>	Entity Rating
<b>Applicable Criteria</b>	Methodology   Corporate Rating(Jun-22),Methodology   Correlation Between Long-term & Short-term Rating Scales(Jun-22),Methodology   Rating Modifiers(Jun-22)
<b>Related Research</b>	Sector Study   Weaving(Aug-22)
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## Profile

**Legal Structure** US Denim (Private) Limited (US Denim, The Company) was incorporated on January 18, 2005, as a private limited company.

**Background** The Company is a vital business venture of the US Group.

**Operations** US Denim is principally engaged in the manufacturing and sale of denim fabric. The Company's total energy requirement is 553,761 units and the sources to meet the requirement - captive (Coal, Gas, Furnace Oil), WAPDA etc. US Denim has also installed 1.9 M. W Solar Power Generation at full capacity.

## Ownership

**Ownership Structure** The Company is a wholly-owned subsidiary of AJ Holdings (Private) Limited. The holding company exercises its control over the company's board by virtue of its 100% stake in the Company.

**Stability** The Group ownership is divided between the two families Javed Arshad Bhatti & family & Mian Muhammad Ahsan & family. The Group's holding Company, AJ Holdings Limited, primarily manages investments in subsidiary and associated companies and this bodes fairly well for the stability of the overall structure.

**Business Acumen** US Group is one of the oldest business conglomerates in Pakistan with considerable interest in textiles. The group has developed quite good expertise in the textile garments sector, over the years, and enjoys long-term associations with several customers abroad. The group's presence has been limited to the textile sector but sustained volatility effectively over the years. Apart from the garment business, US Group also has a Denim weaving Mill namely, US Denim Mills Limited, engaged in weaving. This has assisted the Company in expanding its operations despite challenging market dynamics.

**Financial Strength** The presence of the holding company and details of the business profile and operations of almost all group companies reflects the strong financial strength of sponsors. This indicates sponsors' ability and willingness to support the flagship company of the group in case of need.

## Governance

**Board Structure** The Company has a ten-member board with the presence of sponsors and their families. The position of CEO is vested with Mr. M. Irfan Nazir Ahmed.

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

**Board Effectiveness** The board meetings are held regularly in which discussion on various aspects is also formally documented in minutes.

**Financial Transparency** KPMG Taseer Hadi & Co. Chartered Accountants, who are in the category 'A' of SBP and have a QCR rating by ICAP, are the external auditors of the company. They have expressed an unqualified opinion on the financial statements of the company for the year ending June 30th, 2022.

## Management

**Organizational Structure** The organizational structure of the company is divided into several functional departments, namely: (i) Finance, (ii) Marketing, (iii) Quality Assurance, (iv) Operations, (v) Information Technology, (vi) Supply Chain, and (vii) HR & Admin, and procurement functions. All departments report to respective GM(s) who are responsible to deliver the bottom line and agreed goals & targets. All the GMs report to CEO.

**Management Team** Mr. Irfan Nazir Ahmad, MBA by profession, with 24 years of experience in Textile & Apparel Industry in the areas of Sales & Marketing, General Management, Production Management, and Supply Chain with Reshi Textiles, Azgard 9 Ltd, US Denim and US Apparel. Mr. Farrukh, CFO of the Company, has been associated since the year 2001. He is a Chartered Management Accountant.

**Effectiveness** The management meetings are held periodically with follow-up points to resolve or proactively address operational issues, if any, eventually ensuring a smooth flow of operations. These meetings are headed by the CEO.

**MIS** The Company's daily and monthly MIS comprises comprehensive performance reports which are reviewed frequently by senior management. Recognizing the need for quality information systems to control and maintain the efficiency of operations, the company has implemented an Oracle-based ERP solution - Oracle E-business suite, Harmony version 4.

**Control Environment** US Denim utilizes management systems as its mechanism for ensuring control. There is clear evidence of these systems being audited and certified externally. Examples of this include ISO 14001, GOTS, C2C at the gold level, AWS, OCS, GRS, RCS, Higg FEM 3.0, SLCP, ICS Environment, BSCI, and Oeko-Tex.

## Business Risk

**Industry Dynamics** During 7MFY23, the textile exports were valued at \$10.08bln compared to \$10.93bln, reflecting an 8% decline YoY – the declining trend has been recorded in the last few months. The decline in exports is driven by attrition in the demand pattern of export avenues. The hike in cotton prices and low demand for yarn in international markets is also a challenge. The analysis of 5MFY23 reveals that 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 prevailing in textile demand amid burgeoning inflationary pressures in the exporting destinations, especially in the US and European countries. The demand pattern is expected to improve post-Jun-23.

**Relative Position** US Denim is principally engaged in the manufacturing & export of denim fabric. In Pakistan's denim segment, US Denim is one of the top exporters.

**Revenues** During FY22, the Company's top line has improved to PKR 23.1bln (FY21: PKR 17.4bln); an uptick of 33%YoY. The major portion of the revenue base is derived from indirect exports. The main customer of indirect export is US Apparel & Textile and Stylers International in FY22. The Company has also direct exports to Turkey, Bangladesh, Egypt, and other several destinations. During FY22, the Company's gross profits enhanced to PKR 2.7bln (FY21: PKR 1.8bln). Hence, the net profitability exhibited a sizeable growth and clocked at PKR 1.5bln (FY21: PKR 588mln).

**Margins** During FY22, the gross profit margin stood at 11.7% (FY21: 10.5%) attributable to the rationalization of cost structure and improved pricing. The management closely monitors operating expenses, translating into an improved operating profit margin of 7.9% (FY21: 5.8%). Hence, the net profit margin clocked at 6.4% (FY21: 3.4%).

**Sustainability** Going forward, the Company is planning CAPEX for vertical integration within the Group which will be entirely funded from equity. This will cater to the expansion of the revenue base and assist the business profile through backward integration of the Group.

## Financial Risk

**Working Capital** During FY22, the Company's net working capital cycle decreased to 36 days (end-Jun21: 45 days) attributable to the movement in Payable days (FY22: 65days; FY21: 52days) and a slight uptick in inventory days (FY22: 38days, FY21: 34days). The Company's net trade assets increased by 39% to clock in at PKR 8.7bln (FY21: PKR 6.2bln) which reflects a good cushion in trade assets.

**Coverages** Free Cash Flows from Operations (FCFO) increased in FY22 and clocked in at PKR 1.9bln on the back of higher EBITDA YoY. Hence, the coverage of the Company is very strong as the Company has no borrowings.

**Capitalization** The capital structure is reflecting a comfortable position. The Company has no on-balance sheet borrowing. The leveraging stems from the funded & non-funded facilities kept by the Company from different institutions. The equity base of the Company is at PKR 8bln (FY21: PKR 7bln). Further strengthening of the equity base shall improve risk absorption capacity, going forward.



US Denim Mills (Pvt.) Limited Weaving	Jun-22 12M	Jun-21 12M	Jun-20 12M
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**A BALANCE SHEET**

1 Non-Current Assets	5,285	5,284	5,216
2 Investments	-	-	-
3 Related Party Exposure	1	1	1
4 Current Assets	9,374	6,700	4,947
<i>a Inventories</i>	2,943	1,871	1,321
<i>b Trade Receivables</i>	4,630	3,424	2,688
5 Total Assets	14,661	11,985	10,164
6 Current Liabilities	5,267	3,556	1,907
<i>a Trade Payables</i>	5,025	3,248	1,742
7 Borrowings	-	-	-
8 Related Party Exposure	1,323	896	1,266
9 Non-Current Liabilities	69	44	64
10 Net Assets	8,003	7,490	6,926
11 Shareholders' Equity	8,003	7,490	6,926

**B INCOME STATEMENT**

1 Sales	23,120	17,376	14,072
<i>a Cost of Good Sold</i>	(20,413)	(15,547)	(12,152)
2 Gross Profit	2,707	1,828	1,920
<i>a Operating Expenses</i>	(885)	(818)	(731)
3 Operating Profit	1,822	1,010	1,189
<i>a Non Operating Income or (Expense)</i>	(114)	(283)	(240)
4 Profit or (Loss) before Interest and Tax	1,708	727	949
<i>a Total Finance Cost</i>	(26)	(22)	(15)
<i>b Taxation</i>	(194)	(117)	(97)
6 Net Income Or (Loss)	1,489	588	837

**C CASH FLOW STATEMENT**

<i>a Free Cash Flows from Operations (FCFO)</i>	1,909	922	1,155
<i>b Net Cash from Operating Activities before Working Capital Changes</i>	1,906	919	1,149
<i>c Changes in Working Capital</i>	(878)	(160)	80
1 Net Cash provided by Operating Activities	1,028	758	1,228
2 Net Cash (Used in) or Available From Investing Activities	(366)	(31)	(74)
3 Net Cash (Used in) or Available From Financing Activities	(546)	(777)	(983)
4 Net Cash generated or (Used) during the period	116	(50)	171

**D RATIO ANALYSIS**

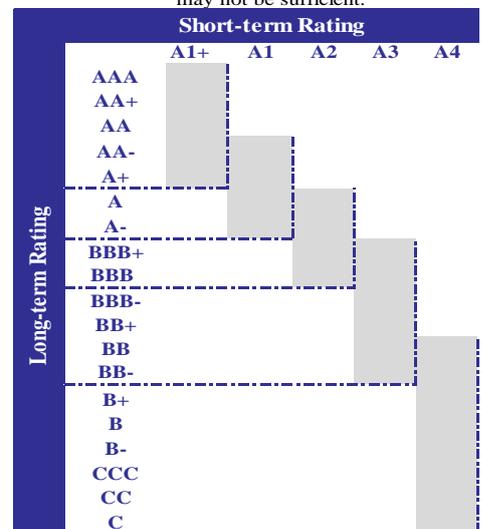
1 Performance			
<i>a Sales Growth (for the period)</i>	33.1%	23.5%	--
<i>b Gross Profit Margin</i>	11.7%	10.5%	13.6%
<i>c Net Profit Margin</i>	6.4%	3.4%	5.9%
<i>d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)</i>	4.5%	4.4%	8.8%
<i>e Return on Equity [ Net Profit Margin * Asset Turnover * (Total Assets/Shareholders' Equity) ]</i>	19.2%	8.2%	12.1%
2 Working Capital Management			
<i>a Gross Working Capital (Average Days)</i>	102	98	104
<i>b Net Working Capital (Average Days)</i>	36	45	59
<i>c Current Ratio (Current Assets / Current Liabilities)</i>	1.8	1.9	2.6
3 Coverages			
<i>a EBITDA / Finance Cost</i>	N/A	N/A	N/A
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	N/A	N/A	N/A
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>	0.7	1.0	1.1
4 Capital Structure			
<i>a Total Borrowings / (Total Borrowings+Shareholders' Equity)</i>	14.2%	10.7%	15.5%
<i>b Interest or Markup Payable (Days)</i>	N/A	N/A	N/A
<i>c Entity Average Borrowing Rate</i>	0.0%	0.0%	0.0%

### 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+	
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-	
BB+	
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-	
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	
CC	<b>Very high credit risk.</b> 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.
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)

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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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(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

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(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)

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