RATING REPORT

Comfort Knitwears (Pvt.) Limited

REPORT DATE:
June 02, 2022

RATING ANALYSTS:

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RATING DETAILS		
Rating Category	**Initial Rating**	
	Long-term	**Short-term**
Entity	A-	A-2
Rating Outlook	*Stable*	
Rating Action	Initial	
Rating Date	*June 02, 2022*	

COMPANY INFORMATION

Incorporated in 1985	**External auditors:** Baker Tilly Mehmood Idrees Qamar Chartered Accountants.
Private Limited Company	**CEO:** Mr. Muhammad Asher Khurram
Key Shareholders (with stake 5% or more):	**Chairman:** Mr. Muhammad Ismail Khurram
Mr. Muhammad Asher Khurram – 35%	
Mr. Muhammad Imran Khurram – 35%	
Mr. Muhammad Ismail Khurram – 25%	
Mrs. Irshad Begum – 5%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Corporates (August 2021)
https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

Comfort Knitwears (Pvt.) Limited

OVERVIEW OF THE INSTITUTION

Comfort Knitwears (Pvt.) Limited was incorporated as Private Limited Company on September 22, 1985, under the repealed Companies Ordinance 1984 (now the Companies Act, 2017). It is principally engaged in manufacturing and sake of yarn, knitwear, and garments. Registered office of the company is located at 45-Industrial Estate, Township, Kot Lakhpat, Lahore.

Financial Snapshot

Tier-1 Equity: end-HY22: Rs. 2.56b; end-FY21: Rs. 2.31b; end-FY20: Rs. 2.12b.

Assets: end-HY22: Rs. 6.11b; end-FY21: Rs. 4.64b; end-FY20: Rs. 4.41b.

Profit After Tax: HY22: Rs. 252.9m; FY21: Rs. 188.0m; FY20: Rs. 89.9m

RATING RATIONALE

Comfort Knitwears (Pvt.) Limited (CKPL) is a vertically integrated knitwear apparel facility comprising spinning, knitting, dyeing and stitching facilities. Shareholding is vested within the family who are actively involved in day-to-day operations. The ratings incorporate extensive experience of sponsors in the textile industry and diversified exposure in pharmaceutical and transportation businesses. The company also has qualified and experienced management team and adequate internal control systems. Around two-third of the revenue emanated from knitted garments which are largely exported while yarn constituting nearly one-third of the product mix, is primarily sold in the local market. The ratings are supported by sound growth in revenues in line with Covid-led growth in textile industry of the country. Liquidity profile is underpinned by adequate current ratio and manageable net operating cycle. Debt service coverage has also remained adequate on a timeline basis. As no major capex is intended, capitalization indicators are projected to strengthen on the back of equity expansion in line with profit retention.

Whilst there is high cyclicality and competitive intensity for spinning industry along with volatility in cotton prices, overall business risk profile of the textile industry is supported by relatively stable demand and favorable regulatory regime. Being in the value-added export segment of the textile industry, the company is relatively less exposed to volatility in the business risk given the favorable approach by the government to increase exports. However, ongoing economic uncertainties in the domestic and international markets may impact the growth in the textile segment. The ratings, therefore, will remain sensitive to achieving projected growth in revenues and profitability while improving liquidity and leverage indicators, going forward.

Key Rating Drivers

Group's Introduction: The company is a part of 'Comfort Group' involved in diversified business interests primarily involving textile, pharmaceutical and transportation businesses. The shareholding of all the group companies is vested within the family. Zulfikar Knitting & Processing Mills (Pvt.) Limited (Z-KAP) is one of the group companies, which is a vertically integrated, export-oriented knitwear manufacturing unit. Major customers of Z-KAP includes renowned international brands namely, NEXT, Marc Ecko Enterprises, VF Corp, Sean John, Levi Strauss, and Liz Claiborne. Z-KAP manufacturing facility is situated in Lahore, within the immediate vicinity of CKPL. Asher Imran Spinning Mills (Pvt.) Limited (AISML) is a subsidiary company of CKPL with 99.98% equity stake. AISML consists of 4,432 autocoro rotors, producing 100% cotton & blended specialty yarns such as modal and viscose etc. AISML recorded an annual turnover of Rs.3.5b in FY21. Comfort Yarn Dyeing and Surgical Cotton Mills (Pvt.) Ltd. is primarily involved in yarn dyeing and processing facilities. The group also includes two pharmaceutical companies under the banners of Frontier Dextrose Limited (FDL) and Curatech Pharma (Pvt.) Limited (CPL), involved in manufacturing and sale of intravenous solutions in polypropylene packing and antibiotics, respectively. As per management, FDL is undergoing a major expansion plan and is a market leader in its related industry. ZAR Motors is an association of persons, which is relatively a new venture of Comfort Group, involved in manufacturing of first ever electric rickshaw/three-wheeler minicab and loader vehicles in Pakistan. The management expects total group turnover of around Rs. 16b in FY22.

Business model of CKPL: CKPL is a vertically integrated knitwear apparel facility comprising spinning, knitting, dyeing and stitching facilities. The company has three garments, one spinning, one yarn dyeing and one fabric dyeing units at different locations in Lahore. The company started its operations from a garments unit in 1987 and developed into a fully integrated facility over a period of around 25 years. The company also derives various synergies from its group companies in terms of material procurement and processing requirements. The spinning unit's installed capacity stands at 23,400 spindles with yarn manufacturing capacity of 9.55m Kgs (FY20 & FY19: 9.14m Kgs), after conversion into 20s count, in FY21. Capacity utilization has remained high at 96% (FY20: 91%; FY19: 95%). Business model of CKPL revolves around manufacturing cotton and blended yarn of various count ranging from 10s to 60s count. The company sells around three-fourth of the manufactured yarn to outside parties in the local market along with marginal export sales while rest of the yarn is utilized in-house to meet knitting requirements. Presently, knitting facility of the company comprised 44 circular and 20 flat knitting machines, garments facility comprised 697 stitching machines, 593 overlock machines, 364 flat lock machines and 354 garments finishing machines. CKPL's dyeing facility has an installed capacity of 1.5m Kgs. Overall capacity utilization of all business processes has remained optimal over the years while in FY21, knitting and dyeing production has increased notably in line with the demand dynamics. In addition, despite 70% increase in production capacity of garments division, its capacity utilization has remained at around 90% in FY21. Spinning division installed production capacity also increased due to BMR. Installed capacities of various processes, with actual production and capacity utilization are tabulated below:

	Installed Capacity per Annum			Actual Production per Annum			Capacity Utilization		
Process Name	**FY19**	**FY20**	**FY21**	**FY19**	**FY20**	**FY21**	**FY19**	**FY20**	**FY21**
Spinning –million Kgs	9,139.6	9,139.6	9,553.5	8,705.5	8,344.1	9,144.3	95%	91%	96%
Knitting –million Kgs	1,000	1,000	1,100	793.6	765.6	1,006.8	79%	77%	92%
Dyeing –million Kgs	1,500	1,500	1,500	1,159.0	1,189.7	1,389.1	77%	79%	93%
Stitching –million PCs	3,500	3,500	6,000	3,110.1	3,183.8	5,324.6	89%	91%	89%

Property, plant and equipment (PP&E) stood at Rs. 1.4b (FY21: Rs. 1.4b; FY20: Rs. 1.2b; FY19: Rs. 1.2b) at end-HY22. During FY21, the company made additions worth Rs. 156.4m in plant and machinery largely related to stitching machines and upgradation of spinning machinery while capital work in progress of Rs. 122.5m pertained to additions in dyeing machines and civil work on building. Given garments manufacturing is a highly labor-intensive process, the management contemplates to increase efficiency of its stitching unit by installation of barcode system in FY23. The said system has an estimated outlay of Rs. 100m and will enhance the productivity of the stitching division by around 50%. The barcode system is a network of hardware and software used in garments/apparel industry for better inventory management and lowering cost overheads by allowing precise tracking of the inventory.

Long-term investment in AISML stood at Rs. 249.9m (FY20 & FY21: Rs. 249.9m) by end-HY22. The company also hold TFCs of Rs. 10m (FY21 & FY20: Rs. 10m) of a bank while long-term investment amounting Rs. 9.9m (FY21: Rs. 19.9m; FY20: Nil) largely comprised equity investment in a cement manufacturing company. In addition, the company has provided interest free long-term loan of Rs. 184.3m (FY21: Rs. 184.3m; FY20: Rs. 60m) to its sister concerns, FDL and CPL for three years period.

Robust growth in topline driven by higher export orders: The company's sales have exhibited upward trajectory in line with covid led growth in textile industry of the country. During FY21, net sales were recorded higher at Rs. 6.5b (FY20: Rs. 3.9b; FY19: Rs. 4.5b). The export sales almost doubled to Rs. 3.7b (FY20: 1.8b; FY19: 1.9b) in the outgoing year, which largely constituted garments sales while garments proportion in the sales mix has increased to 57% (FY20: 46%; FY19: 42%). Increase in garments sales was the combined impact of higher volumetric sales and average selling prices. The contribution of yarn in the sales mix decreased to 33% (FY20: 45%; FY19: 49%) while in terms of value yarn sales were recorded higher at Rs. 2.2b (FY20: Rs.1 .7b; FY19: Rs. 2.2b). Volumetric sales of yarn posted increase while average selling price was slightly lower on account of change in the count mix during FY21. In order to diversify its geographic outreach, the company has been making efforts to strengthen its marketing team which has led to considerable improvement in concentration of export clients over time. The same is evident given around 98% of export sales were made to single client in FY19; meanwhile, in the following years top five clients accounted for 99% and 85%, respectively, in FY20 and FY21. Major clients of the company included Shok Activewear Ltd., T2T International Ltd., Bersheka, Innovative Clothing Ltd., Pull & Bear, Matrix Sourcing and Hummel.

The company recorded gross profit of Rs. 799.2m (FY20: Rs. 505.6m; FY19: Rs. 571.2m) while gross margins decreased to 12.2% (FY20: 13.1%; FY19: 12.7%). The slight variation in gross margins over the years has largely been a function of change in raw material cost, including stores, chemicals and dyes. The margins are also be impacted due to composition of export orders. Cost of sales increased to Rs. 5.7b (FY20: Rs. 3.4b; FY19: Rs. 3.9b) in FY21, mainly due to increase in raw material, stores, dyes and chemical consumed and other processing charges. Raw material consumed accounted for 52% (FY20: 57%; FY19: 55%) of the cost of goods manufactured (COGM) in the outgoing year. Around 64% of the yarn requirement (FY20: 65%; FY19: 36%) is met in-house while the rest is procured from local market. On the other hand, utilization of imported cotton has increased notably owing to quality issues and supply constraints in the local market; imported cotton accounted for about 20% (FY20: 6%; FY19: 3%) of the total procurement in FY21. Processing charges accounted for 12% (FY20 & FY19: 9%) of COGM; the company fulfills around three-fourth of its processing requirements through its associated undertaking, Z-KAP, while around 10% of the requirement is met in-house and the rest being outsourced. Salaries, wages and benefits have increased in line with higher average headcount and inflationary adjustments. Administrative expenses amounted to Rs. 109.9m (FY20: Rs. 98.2m; FY19: Rs. 99.5m). Distribution cost was recorded higher at 192.2m (FY20: Rs. 104.4m; FY19: Rs. 138.0m) due to higher freight expenses in line with surge in oil prices increasing transportation charges for Karachi bound shipments and container shortage globally, causing hike in ocean freight. Other income amounted to Rs. 20.3m (FY20: 10.7m; FY19: 1.6m) while other expenses of Rs. 61.1m (FY20: Rs. 13.4m; FY19: Rs. 38.8m) largely pertained to allowance for expected credit loss. Despite lower average markup rates, the company incurred Rs. 193.6m (FY20: Rs. 167.5m; FY19: Rs. 126.5m) in finance cost in line with higher average borrowings during FY21. Accounting for taxation, the company recorded higher net profits of Rs. 188.0m (FY20: Rs. 89.9m; FY19: Rs. 133.7m) with net margin of 2.9% (FY20: 2.3%; FY3.0%).

During HY22, net sales were recorded higher at Rs. 4.7b with gross margins of 12.3%. Gross margins have remained largely stagnant amidst increase in raw material cost, rupee depreciation and highly competitive export market. Administrative and distribution expenses were largely rationalized with scale of operations. Resultantly, the bottomline was recorded higher at Rs. 252.9m with notable increase in net margin to 5.4%. The management projects net revenue of Rs. 8.2b in FY22 which is lower than the annualized half yearly sales while gross margins are projected at 14.4% mainly due to economies of scale and the impact of lower cost inventory procured during the year. Topline is projected to grow at a CAGR of 16% over three years, meanwhile, being conservative, the management has projected slightly lower gross margins in FY23 and FY24.

Liquidity position is considered adequate in terms of cash flows in relation to outstanding obligations: The company generated Rs. 192.2m in funds from operations (FFO) (FY21: 262.2m FY20: Rs. 167.6m; FY19: Rs. 210.8) in HY22. Resultantly, annualized FFO to long-term debt increased to 1.32x (FY21: 0.66x; FY20: 1.58x; FY19: 3.75x). However, annualized FFO to total borrowings decreased marginally owing to sizeable short-term financing amidst higher working capital requirement in HY22. Debt service coverage ratio remained adequate at 1.43x (FY20: 1.75x; FY19: 2.78x).

Stock in trade increased notably to Rs. 2.9b (FY21: Rs. 1.05b; FY20: Rs.1.19b; FY19: Rs. 733.5m) by end-HY22 mainly on account of higher cotton procurement. The management procures cotton locally from August to December for the entire year while yarn inventory is maintained for 30-45 days. Trade debts amounted to Rs. 653.1m (FY20: Rs. 812.7m; FY19: 485.6m) at end-FY21 and as percentage of net sales stood at 10% (FY20: 21%; FY19: 11%) in FY21. Local yarn sales are made on 15 to 30 days credit whereas export sales are usually made on advance payment, usance and LC on site. Trade debts stood at Rs. 520.7m at end-HY21 while aging profile is considered satisfactory given 88% of the receivables were outstanding for less than a month, 10% fall due in 30-60 days credit bracket and 2% fall in 61-90 days. Trade and other payables stood at Rs. 518.3m (FY21: Rs. 437.2m; FY20: Rs. 518.9m; FY19: Rs. 285.2m), which included trade creditors amounting Rs. 305.7m (FY20: 229.2m; FY20: Rs. 298.4m; FY19: Rs. 139.2m) at end-HY22. Payments to yarn suppliers are made within 30 to 60 days period while cotton is majorly procured on advance basis. Net operating cycle of the company has remained manageable on a timeline basis due to better working capital management whereas some increase in net operating cycle during FY20 was on account of slower inventory turnover amidst pandemic. Current ratio remained adequate at 1.25x (FY21: 1.32x; FY20: 1.33x; FY19: 1.41x).

Coverage of short-term borrowings via stock in trade and trade debts was reported at 1.32x (FY21: 1.21x; FY20: 1.28x; FY19: 0.93x) at end-HY22. CKPL's liquidity position is expected to strengthen on the back of higher profitability and improvement in working capital management.

Low leveraged capital structure: Equity base has grown steadily to Rs. 2.6b (FY21: Rs. 2.3b; FY20: Rs. 2.1b) on account of internal capital generation. Debt profile of the company largely comprised short-term borrowings to meet working capital requirements. Long-term borrowings including current portion decreased to Rs. 291.9m (FY21: Rs. 397.7m; FY20: Rs. 106.4m) by end-HY22. Increase in long-term borrowings by end-FY21 was mainly due to loan amounting Rs. 146.9m obtained under SBP Temporary Economic Refinance Facility (TERF) to import machinery and SBP refinance scheme for payment of salaries and wages amounting Rs. 300m. Gearing and debt leverage have remained fairly comfortable at 0.78 (FY21: 0.79x; FY20: 0.67x) and 1.01x (FY21: 1.08x; FY20: 0.85x), respectively, by end-FY21 while the same have depicted some increase by end-HY22 owing to notable increase in short-term borrowings amidst higher working capital requirements and are expected to normalize by end-FY22. The management projects further improvement in capitalization indicators on account of profit retention and scheduled repayments of long-term borrowings.

Comfort Knitwears (Pvt.) Limited Annexure I

BALANCE SHEET	Jun 30, 2019	Jun 30, 2020	June 30, 2021	Dec 31, 2021
Property and Equipment	1,168	1,181	1,422	1,383
Long-Term Investments	250	260	280	270
Long-Term Loan to Related Party	-	60	184	184
Stock in Trade	734	1,195	1,053	2,913
Trade Debts	486	813	653	521
Loans, Advances, Deposits and Prepayments	811	667	706	591
Other Assets	170	147	175	166
Cash & Bank Balances	141	86	171	82
Total Assets	**3,759**	**4,408**	**4,644**	**6,109**
Trade and Other Payables	285	519	437	518
Short Term Borrowings	1,308	1,574	1,409	2,599
Long-Term Borrowings (incl. current maturity)	56	106	398	292
Total Interest-Bearing Debt	**1,364**	**1,681**	**1,807**	**2,890**
Other Liabilities	79	89	93	141
Total Liabilities	**1,729**	**2,288**	**2,337**	**3,550**
Paid Up Capital	100	100	100	100
Tier-1/ Total Equity	**2,030**	**2,119**	**2,307**	**2,560**

INCOME STATEMENT	Jun 30, 2019	Jun 30, 2020	Jun 30, 2021	Dec 31, 2021
Net Sales	4,505	3,866	6,541	4,676
Gross Profit	571	506	799	573
Operating Profit	334	303	497	380
Finance Cost	126	167	194	89
Profit Before Tax	170	133	263	305
Profit After Tax	134	90	188	253

RATIO ANALYSIS	Jun 30, 2019	Jun 30, 2020	Jun 30, 2021	Dec 31, 2021
Gross Margin (%)	12.7	13.1	12.2	12.3
Net Margins	3.0	2.3	2.9	5.4
Current Ratio	1.41	1.33	1.32	1.25
Net Working Capital	680	724	670	860
Funds from Operations (FFO)	211	168	262	N/A
FFO to Total Debt (x)	0.15	0.10	0.15	N/A
FFO to Long Term Debt (x)	3.75	1.58	0.66	N/A
Debt Leverage	0.85	1.08	1.01	1.39
Gearing	0.67	0.79	0.78	1.13
Debt Servicing Coverage Ratio (x)	2.78	1.75	1.43	N/A
ROAA (%)	3.6	2.2	4.2	9.4*
ROAE (%)	6.8	4.3	8.5	20.8*
Net Operating Cycle (Days)	89	122	82	90
(Stock in Trade+ Trade Debt) to Short-Term Borrowing (x)	0.93	1.28	1.21	1.32

**Annualized*

ISSUE/ISSUER RATING SCALE & DEFINITION Annexure II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

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: 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.vis.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.vis.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.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

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

'SD' Rating: An 'SD' rating is assigned when 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 — Annexure III

Name of Rated Entity	Comfort Knitwear (Pvt.) Limited
Sector	Textile
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings
Rating History	see table below
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 Meetings Conducted	see table below

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
02-June-22	A-	A-2	Stable	Initial

Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Muhammad Shuaib Khan	Manager Accounts	March 31, 2021
Mr. Muhammad Ismail Khurram	Chairman	May 18, 2022
Mr. Muhammad Asher Khurram	CEO	May 18, 2022
Mr. Saqib Naveed	CFO	May 18, 2022