RATING REPORT

Lucky Knits (Private) Limited

REPORT DATE:
March 22, 2019

RATING ANALYST:

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RATING DETAILS		
	Initial Rating	
Rating Category	**Long-term**	**Short-term**
Entity	A-	A-1
Rating Outlook	Stable	
Rating Date	*18 March 2019*	

COMPANY INFORMATION	
Incorporated in November, 2004	**External auditors:** M/s Deloitte Yousuf Adil, Chartered Accountants
Private Limited Company	**Chairman & CEO:** Mr. Sohail Tabba
Key Shareholders (with stake 5% or more):	
Muhammad Yousuf – 49.98%	
Y.B.Holdings (Pvt) Ltd – 49.98%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria *Industrial Corporates (May 2016)*
http://www.vis.com.pk/docs/Corporate-Methodology-201605.pdf

Lucky Knits (Private) Limited

OVERVIEW OF THE INSTITUTION

Lucky Knits was incorporated in Nov, 2004 as a Private Limited Company Under Companies Ordinance, 1984.The principal activities of the company involve knitting, dyeing, cutting, printing, stitching and packing.

Financial Statements of the company for FY18 were audited by M/s Deloitte Yousuf Adil, Chartered Accountants. Auditors belong to category 'A' on the approved list of auditors published by the State Bank of Pakistan (SBP).

Profile of Chairman & CEO

Mr. Muhammad Sohail Tabba is a seasoned businessman with extensive experience in manufacturing, energy, real estate and cement sectors. Mr. Sohail is a chairman of ICI Pakistan Limited and NutriCo Morinaga (Private) Limited. Furthermore, he serves as a CEO of Lucky Energy (Private) Limited, Yunus Energy Limited and LuckyOne (Private) Limited. He is the Chairman of Lucky Paragon Readymix Concrete and a Director on the Board of Lucky Cement Limited and Kia Lucky Motors Pakistan

RATING RATIONALE

Lucky Knits (Private) Limited (LKPL) is part of Yunus Brother Group (YBG). The group has presence in diversified sectors including textiles, building materials, real estate, power generation, chemicals, pharmaceuticals, food and automotive sectors. The group has an annual turnover of nearly Rs. 160b while annual profitability of the group was in excess of Rs. 26b in 2017. LKPL is primarily involved in the manufacturing and exports of knitted apparel with product line ranging from T- shirts, polo shirts, hoodies, trousers and undergarments. International clients in UK and US are managed by a Manchester based firm, Fundamental Textile while other European markets are catered largely through direct agents. Until FY16, undergarments were the major contributor in revenue base; however, the management has now shifted its focus toward higher value added products. Shareholding of the company is equally vested between Muhammad Yousuf and Y.B.Holdings (Pvt) Ltd. Mr. Yousuf is a seasoned businessman with over two decades of experience in the manufacturing and real estate sectors. He also owns Grupo Karim in Honduras; a US based firm operating in real estate and textile industry.

Operations of the company are carried out through four production units (two cut to pack, one knitting and one dyeing unit) located in Karachi, Sindh. Power requirements of the organisation are met by Lucky Energy (YB Group company) which is a gas based power plant and provides competitive edge to the Company. LKPL's operations encompasses the following three divisions:

Knitting: The company begins its operational process with the third process of textile value chain. Yarn as a raw material for the same is procured primarily from a related party. At end-HY19, monthly installed capacity of knitting operations based on average production of different types of articles at 50% efficiency was reported at 249,750 Kg (Annual Capacity – 2,997,000 Kg) with around 100 in house machines. Capacity utilization has remained on the higher side. Knitting unit is located at Kathore, Karachi.

***Dyeing*:** In the next stage, the company adds value to knitted fabric by means of dyeing. A separate dyeing facility is located at Deh Khanto, Landhi, Karachi. Based on production of 40% white and 60% dyed, installed capacity at end-HY19 stood at 299,000 Kg per month (Annual Capacity – 3,588,000 Kg) with 25 dyeing machines installed. Capacity utilization of the segment has remained on the higher side.

Stitching: In the last process of value chain, dyed fabric is cut, printed and stitched with different sewing techniques as per the requirements of customers. Moreover, pressing and packaging processes are also carried out in the stitching division. LKPL has two production units situated at Kathore and F.B. Industrial Area equipped with total 1,177 sewing machines. Capacity utilization of the segment was reported at 94% (FY18: 90%) during 1HFY19.

Capacity Enhancement Plans: Going forward, management plans capex of Rs. 394.8m for capacity and efficiency enhancement in all three divisions. Planned capex for FY19 mostly pertains to installation of new machinery and up-gradation of the IT (SAP) system. Capex planned will enhance operational efficiency & reduce cost of production funded through debt financing (LTFF). Moreover, given the high utilization levels in all three divisions and expected increase in client base, management may consider further capacity expansion projects in the coming period.

Key Rating Drivers:

Business risk profile is supported by government's favourable policy towards textile sector. Significant rupee devaluation compliments export oriented sectors.

Total textile exports depicted strong growth of 14% during FY18 with exports of knit wear amounting to

Limited.

Financial Snapshot

Net Equity: *Dec'18: Rs. 1.5b, June'18: Rs. 1.4b*

Net Revenue: *HY19: Rs. 1.6b, FY18: Rs. 2.8b*

Rs. 298.4b (recording growth of 21% in FY18). The growth witnessed was on account of increase in value added exports. Moreover, increased focus of Government of Pakistan (GoP) on enhancing exports (through reducing cost of doing business and commitment for timely release of refunds and rebates) and sizeable currency devaluation bodes well for textile exports. While pace of growth in textile exports has slowed down in the ongoing year, VIS expects double digit growth in textile exports over the medium term as impact of planned and ongoing capacity expansion along with supportive government policies kicks in. Nonetheless, business risk profile remains exposed to slow-down in major markets, inability to pass on increase in input cost and competition from other regional countries.

Top line primarily comprises sales of T-shirts/ Polo followed by Hoodies and Trousers. Product-wise sales distribution has witnessed change over time. Client-wise concentration risk is higher; however, it is mitigated in view of long term association with customers.

LKPL is primarily an export-oriented company. Sales have depicted healthy growth of 21.7% and 24.3% during FY18 and 1HFY19, respectively. During FY18, net sales increased to Rs. 2.8b (FY17: Rs. 2.3b) in FY18. Post FY16, given shift in the sales mix from low value added to high value added products, contribution of T Shirts/Polo segment in export sales has increased considerably, constituting around one-half of total sales. 'Hoodies' is the second largest contributor in revenue base. Previously, undergarments for a major customer used to constitute the bulk of sales. Given the exit of the said customer from the Pakistani market, geographical concentration in sales has reduced. Major export markets include USA, UK and Germany with large multinational hypermarket chain as main customers. Overall client and geographical concentration in sales continues to remain on the higher side. With tapping of new clients and increasing penetration in new European markets, diversification in sales in projected to further improve. Going forward, net sales are projected to increase at a CAGR of 20% during FY19 to FY21 and will be facilitated by enhancement in capacity and addition of new clients.

Improvement in profitability margins on the back of change in sales mix, currency devaluation and higher per unit price.

Over the last two fiscal years, gross margins have witnessed significant improvement to 12.8% (FY18: 13.6%; FY17: 4.2%; FY16: 6.5%) during HY19. Improvement in gross margins vis-à-vis FY17 levels is attributable to shift in strategy towards higher value added products, significant rupee devaluation and increase in in-house production resulting in reduction in contractual charges. Overall profitability was also supported by duty drawback and export rebate received by the Government, amounting to Rs. 213.1m (FY17: Rs. 122.4m) during FY18. During HY19, the company posted profit after tax (PAT) of Rs. 105.5m (1HFY18: Rs. 53.6m). Going forward, increase in profitability will be a function of higher revenues while margins are projected to remain at around FY18 levels.

Liquidity profile is supported by increasing cash flows on timeline basis and adequate debt servicing ability.

With improving earning profile and strong debt servicing ability, liquidity position of the company has improved. Funds flow from operations (FFO) increased to Rs. 426.3m (FY17: Rs. 101.2m) in FY18. Resultantly, Debt Service Coverage Ratio (DSCR) and FFO/Long-Term Debt remain strong. Current ratio has also exhibited improvement on a timeline basis. Short term borrowings have been mobilized for working capital requirements. Stock in trade and trade debts at 467% at end-1HFY19 are well in excess of short term borrowings. Trade debts aging profile remains with in manageable levels.

Low leverage indicators and conservative financial policy

Equity base of the Company has increased on a timeline basis on account of profit retention. LKPL's debt profile is largely short term in nature; Rs. 54.8m of long term loan was acquired during FY18. Additional long term loan (LTFF) is planned be acquired in future to finance the expansion plans. During HY19, gearing and leverage ratios were reported at 0.15x (FY18: 0.18x; FY17: 0.33x) and 0.6x (FY18: 0.48; FY17:

0.6x), respectively. Given expansion plans, leverage indictors are projected to increase slightly but remain at manageable levels. With staggered debt repayments of LTFF, financial flexibility is on the higher side given the limited quantum of debt repayments over the rating horizon.

Adequate corporate governance framework and internal controls. An integrated IT platform is currently being implemented.

Overall control framework is considered adequate with LKPL in the process of implementation of an integrated SAP (S4 HANA) platform. The upgraded IT system will improve transparency, audit ability and operational efficiency of the back office and business processes. An in-house internal audit & compliance function staffed with 5 resources is in place to ensure effective oversight. However, board level governance may be further strengthened through induction of independent directors, formation of board level committees and segregation of Chairman of the board and CEO positions. External auditors of the company are Deloitte Yousuf Adil, Chartered Accountants. Auditors belong to category 'A' on the approved list of auditors published by the State Bank of Pakistan. Senior management team comprises experienced personnel.

Lucky Knits (Private) Limited **Appendix I**

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**FY16**	**FY17**	**FY18**	**HY19**
Fixed Assets	837.7	861.3	796.4	780.7
Stock-in-Trade	417.3	370.7	353.2	447.8
Trade Debts	128.5	211.9	467.6	590.1
Cash & Bank Balances	2.5	5.5	22.5	29.8
Total Assets	1,745.0	1,929.4	2,155.3	2,528.8
Trade and Other Payables	229.5	205.2	260.8	555.8
Long Term Debt	-	-	50.7	48.0
Short Term Debt	308.7	490.4	269.3	222.3
Total Equity *(*Including loan from Directors & Associates)*	1,469.3	1,481.4	1,750.3	1,855.8
INCOME STATEMENT				
Net Sales	2,382.1	2,273.1	2,766.0	1,592.4
Gross Profit	154.2	94.7	375.4	204.3
Operating Profit/Loss	13.6	(81.2)	186.4	90.1
Profit After Tax	17.4	19.5	329.3	105.5
RATIO ANALYSIS				
Gross Margin (%)	6.5%	4.2%	13.6%	12.8%
Net Working Capital	366.7	370.7	810.4	965.6
FFO to Total Debt (%)	0.23	0.21	1.33	1.47
FFO to Long Term Debt (%)	-	-	8.41	8.29
Debt Servicing Coverage Ratio (x)	-	7.43	17.21	19.10
ROAA (%)	1.0%	1.1%	16.1%	9.0%
ROAE (%)	1.2%	1.3%	20.4%	11.7%
Gearing	0.21	0.33	0.18	0.15
Leverage	0.48	0.60	0.48	0.60

ISSUE/ISSUER RATING SCALE &DEFINITIONS Appendix 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					Appendix III
Name of Rated Entity	Lucky Knits (Private) Limited				
Sector	Textiles				
Type of Relationship	Solicited				
Purpose of Rating	Entity Rating				
Rating History	**Rating Date**	**Medium to Long Term**	**Short Term**	**Rating Outlook**	**Rating Action**
	RATING TYPE: ENTITY				
	3/18/2019	A-	A-1	Stable	Initial
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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