# RATING REPORT

# Lucky Knits (Private) Limited

**REPORT DATE:**
August 16, 2021

**RATING ANALYST:**
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| RATING DETAILS | | | | |
|---|---|---|---|---|
| | Latest Rating | | Previous Rating | |
| **Rating Category** | **Long-term** | **Short-term** | **Long-term** | **Short-term** |
| **Entity** | A- | A-1 | A- | A-1 |
| ***Rating Date*** | *August 16, 2021* | | *April 29, 2020* | |
| **Rating Outlook** | Stable | | Rating Watch-Developing | |

| 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 (April 2019)*** |
| ***https://docs.vis.com.pk/docs/Corporate-Methodology-201904.pdf*** |

## Lucky Knits (Private) Limited

| OVERVIEW OF THE INSTITUTION | RATING RATIONALE |
|---|---|

*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.*

**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 Moringa (Private) Limited. Furthermore, he serves as a CEO of Lucky Energy (Private) Limited, Gadoon Textile Mills Limited (GTML), 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 Limited.*

**Corporate Profile:** Incorporated in 2004; Lucky Knits (Private) Limited primarily involved in the manufacturing and exports of knitted apparel with product line mainly ranging from T-shirts, polo shirts, trousers, hoodies, and garments. More than half of the sales are concentrated in the United States; other export market majorly includes the United Kingdom, Australia, Belgium, and other European countries. Clients in the U.S.A and U.K. are managed through Fundamental Textile, a Manchester based firm, while others are handled mostly through direct agents.

Headquartered in Karachi; Lucky Knits (Private) Limited is a partly vertically-integrated entity with knitting, dyeing, and the stitching unit also located in Karachi. Majority of the procurement requirements are accommodated by an associated concern- Gadoon Textile; while the rest of the demand is catered through imports.

**Rating Drivers**

**Sponsor support remains a key rating driver**

The company is part of Yunus Brother Group (YBG), with shareholding equally vested between the ultimate parent company (YBG) and Mr. Muhammad Yusuf Amdani. The group has diversified presence across various sectors including textiles, real estate, power generation, building materials, chemicals, pharmaceuticals, food, and automotive industry. There were no changes in the shareholding pattern during FY20. However, the company underwent an overall change in the management with the sudden demise of the Chief Operating Officer (COO) due to COVID-19 leading to supervisory disturbances. The company has appointed Mr. Wahid Yusuf as the new COO, and the current management is working to achieve pre-COVID managerial environment. Furthermore; no dividends were paid as part of the company's legacy of reinvesting profitability in the business. Sponsor support to the company in case need arises will be important for ratings.

**Recovery in industry wide exports post ease in COVID-19 lockdown supports business risk profile of the company**

With the objective of enhancing exports to support the economy amid pandemic, the Government of Pakistan (GoP) provided incentives in the form of subsidized utility tariffs, low interest rates (Export Finance Scheme (EFS), Long Term Financing Facility (LTFF) and Temporary Economic Relief facility (TERF), and sales tax refund to the textile industry. Pakistan was able to benefit from diversion of orders from other regions that remained closed due to higher severity of pandemic. Textile exports posted recovery during FY21. During 11M'FY21; textile apparels posted double digit growth vis-à-vis last year, indicating industry's positive outlook. However, one of the factors is also the low-base of FY20 due to country-wide lockdown and export order cancellations. Going forward, most of the textile players indicate a strong order book; however the outcome of vaccination drive and opening up of export markets remains a risk factor.

**Capacity additions and operational efficiencies to cater to projected growth**

As part of BMR initiative; the company incurred a capital expenditure amounting to Rs. 422m during FY20 financed through debt. Going forward, management has planned to increase capacity in the knitting and stitching units during FY21 and FY22.

**Margins under pressure**

Company recorded net sales of Rs. 3.6b during FY20 (FY19: Rs. 3.8bn); recording a 6% decline driven by reduction in exports amid pandemic. Export sales continue to dominate the sales mix with T-shirts and Polo shirts constituting around half of the total sales. The current sales mix primarily includes T-shirts constituting more than half of the sales mix; followed by polo shirts, pants, and sweatshirts. Client concentration continued to remain on the higher side during H1'FY21 with top ten clients constituting more than 90% of total sales.

Gross margins improved in FY20 10.5% (FY19: 7.8%) on account of lower yarn prices. However, in FY21, yarn prices surged and are expected to keep gross margins subdued. Operating and net margins recorded a sizeable decline in FY20 largely due to higher freight charges. The increase was due to brief supervisory shortfall post sudden death of Chief Operating Officer resulting in fallout of production timelines causing the company to incur high air freight charges to meet order timelines. Other operating expenses contributing to lower margins included higher salaries, one-off repair and maintenance expenses, increased IT expenses; and financial charges owing to higher working capital utilization.

In order to retain customers, company had to continue to incur higher freight charges in FY21. As such margins are expected to remain under pressure and will continue to be a drag on profitability for FY21. However, transition to a new management team has been completed and all production timelines aligned. Going forward, recovery of operational efficiencies while maintaining topline growth will be important from ratings perspective.

**Cash flow coverage indicators declined during FY20; while liquidity profile continues to remain within satisfactory levels**

Funds from Operations fell to Rs. 330m during FY20 (FY19: 433m) on the back of lower profitability and high debt utilization. Cash flow coverage indicators thus regressed as FFO/Total Debt fell to 0.24 (FY19: 0.62), and FFO/Long term debt to 0.65 (FY19: 1.78). Resultantly; debt servicing to fell sharply to 4.82x during FY20 (FY19: 17.49x). Debt servicing is expected to remain constrained in FY21 on account of lower expected profitability.

Overall, liquidity profile remained satisfactory with current ratio of the company standing at 1.76x during FY20 (FY19: 1.94x). Going forward, liquidity profile is expected to show improvement on account of lower short term borrowings upon stabilization of inventory levels.

**Capitalization indicators are expected to increase, albeit remaining low.**

Equity base of the company rose to Rs. 1.7b during FY20 (FY19: 1.6b) on the back of profitability. Long term debt utilization increased more than 100% during FY20 vis-à-vis SPLY primarily on account of SBP Salary Refinancing Scheme and long term finance agreement availed by the company. Sizeable increase in short term borrowings was recorded on account of high working capital requirements resulting from COVID-19 slowdown. Gearing and leverage indicators thus increased; and stood at 0.76x (FY19: 0.41x) and 1.22 (FY19: 0.93) respectively. Capitalization indicators are expected to remain higher in the medium term on the back of capacity addition initiatives undertaken by the company, albeit remaining low.

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

## FINANCIAL SUMMARY
*(amounts in PKR millions)*

| BALANCE SHEET | FY18 | FY19 | FY20 | 1H'FY21 | 11M'FY21 | FY22(P) |
|---|---|---|---|---|---|---|
| Fixed Assets | 796.4 | 1,003.9 | 1,270.3 | 1,275.1 | | 1,905.4 |
| Stock-in-Trade | 353.2 | 444.7 | 569.2 | 740.0 | | 751.4 |
| Trade Debts | 467.6 | 1,033.4 | 924.6 | 819.2 | | 1,220.4 |
| Cash & Bank Balances | 22.5 | 143.4 | 635.3 | 78.2 | | 112.6 |
| Total Assets | 2,155.3 | 3,196.4 | 3,925.8 | 3,374.4 | | 4,490.5 |
| Trade and Other Payables | 260.8 | 628.1 | 563.6 | 477.4 | | 684.9 |
| Long Term Debt (including current maturity) | 50.7 | 243.3 | 510.2 | 661.9 | | 1,223.6 |
| Short Term Debt | 269.3 | 460.0 | 876.0 | 200.0 | | 500.0 |
| Paid up Capital | 60.0 | 60.0 | 60.0 | 60.0 | | 60.0 |
| Total Equity *(*Including loan from Directors & Associates)* | 1,750.3 | 1,710.4 | 1,822.2 | 1,832.7 | | 1,855.6 |

| INCOME STATEMENT | FY18 | FY19 | FY20 | 1H'FY21 | 11M'FY21 | FY22(P) |
|---|---|---|---|---|---|---|
| Net Sales | 2,766.0 | 3,784.9 | 3,565.4 | 1,521.2 | 2.9b | 4,706.3 |
| Gross Profit | 375.4 | 294.6 | 375.6 | 219.4 | 137m | 495.8 |
| Operating Profit/Loss | 186.4 | 57.0 | 25.5 | 49.9 | (252)m | 202.2 |
| Profit Before Tax | 358.7 | 302.1 | 89.2 | 22.5 | (277)m | 153.3 |
| Profit After Tax | 329.3 | 269.6 | 73.2 | 10.5 | (310)m | 92.2 |

| RATIO ANALYSIS | FY18 | FY19 | FY20 | 1H'FY21 | 11M'FY21 | FY22(P) |
|---|---|---|---|---|---|---|
| Gross Margin (%) | 13.6% | 7.8% | 10.5% | 14.4% | 4.7% | 10.5% |
| Operating Margin (%) | 6.7% | 1.5% | 0.7% | 3.3% | -8.7% | 4.3% |
| Net Margin (%) | 11.9% | 7.1% | 2.1% | 0.7% | -10.7% | 2.0% |
| Current Ratio (x) | 2.5 | 1.9 | 1.8 | 3.0 | | 2.2 |
| Net Working Capital | 810.4 | 1,050.5 | 1,133.3 | 1,389.6 | | 1,391.0 |
| FFO to Total Debt (x) | 1.33 | 0.62 | 0.24 | 0.27* | | 0.15 |
| FFO to Long Term Debt (x) | 8.41 | 1.78 | 0.65 | 0.35* | | 0.22 |
| Debt Servicing Coverage Ratio (x) | 17.2 | 17.5 | 4.82 | 2.87 | | 3.03 |
| ROAA (%) | 16.1% | 10.1% | 2.1% | 0.6%* | | 2.2% |
| ROAE (%) | 20.4% | 15.6% | 4.1% | 1.2%* | | 5.1% |
| Gearing | 0.18 | 0.41 | 0.76 | 0.47 | | 0.93 |
| Leverage | 0.48 | 0.93 | 1.22 | 0.90 | | 1.42 |
| (Stock + trade Debts)/Short term borrowings | 305% | 321% | 171% | 780% | | 394% |

*Annualized

## 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** | 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** | | | | |
| **8/16/2021** | A- | A-1 | Stable | Maintained |
| **4/29/2020** | A- | A-1 | Rating Watch-Developing | Maintained |
| **3/18/2019** | A- | A-1 | Stable | Initial |

**Due Diligence Meetings Conducted**

| | Name | Designation | Date |
|---|---|---|---|
| 1 | Farhan Moten | Chief Financial Officer | May 17, 2021 |