RATING REPORT

Lucky Knits (Private) Limited

REPORT DATE:
October 04, 2022

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	*October 04, 2022*		*August 16, 2021*	
Rating Outlook	Stable		Stable	

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 Amdani – 49.98%	
Y.B.Holdings (Pvt) Ltd – 49.98%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria Methodology – Industrial Corporates (August 2021)
https://docs.vis.com.pk/docs/CorporateMethodology202108.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 Morinaga (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 (LKPL) 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 three-fifth of the sales are concentrated in the United States; other export market majorly includes the United Kingdom, Australia, Belgium, and other European countries. Most of the clients in the U.S.A and U.K. are managed through different buying agencies, while others are handled directly.

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 raw material procurement (around 97%) requirements are accommodated through a group concern- Gadoon Textile Mills Limited; while the rest of the raw material demand is catered through imports (comprising largely dyes and chemicals).

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 (YB Holdings) 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. Sponsor support is evident from a long-term (25 year) unsecured interest free loan from director and associated company (Lucky Energy (Private) Limited) for business operations in 2015. This loan was granted on present value mechanism and is amortized every year with no cash outflow. Continuity of sponsor support to the company in case need arises will be important for ratings. Moreover, no dividends were paid in FY22 as part of the company's legacy of reinvesting profitability for business expansion.

Textile and clothing exports registered a sizeable growth given the surge in demand on account of rerouting of orders to Pakistan. The ongoing energy crisis in the country poses a challenge to future growth of the sector.

Textile sector contributes nearly one-fourth to industrial value-added segment and 8.5% to the country's GDP, with an estimated market size of Rs. 3.8tr (FY20: Rs. 3.3tr) in FY21. Barring seasonal and cyclical fluctuations, textiles products have maintained an average share of about 60% in national exports. Export revenues from textile sector have increased significantly over the years (FY22: $19.3b FY21: $15.4b; FY20: $12.5b; FY19: $13.6b). Knitwear, Readymade and Bed wear segments continue to contribute higher than other segments, with a cumulative contribution of more than 60% in textile exports. While the growth was primarily driven by volume (excluding knitwear and cotton yarn), higher prices also boosted exports.

Figure: Textile Exports (as per PBS)

Segments	Value (US$ millions)		
	FY20	FY21	FY22
Knitwear products	2,785	3,816	5,121
Readymade Garments	2,549	3,033	3,905
Bed wear	2,149	2,772	3,293
Cotton Cloth	1,830	1,921	2,438
Cotton Yarn	987	1,017	1,207
Towels	711	938	1,111
Made-up Articles	591	756	849
Art, silk and synthetic textile	314	370	461
Tents, canvas and tarpaulin	98	110	110
Others	487	667	835
Total	**12,501**	**15,400**	**19,330**

Given the looming global recession, commodities super-cycle, rising inflation, and monetary tightening in major world economies, textile export orders growth in Pakistan is expected to slow down in the medium-term. This, combined with the country's ongoing energy crisis and rising production costs, poses a challenge to the sector's margin sustainability and future growth over the rating horizon.

Imposition of 1%-10% super tax may have a negative effect on profitability profile of high earning textile players. In addition, contractionary monetary policy and political uncertainties in the country are the present major business risk factors. In the long-run, improvement in value addition, investment in technology and optimization of energy cost would define the future of textile exports.

Capacity additions and operational efficiencies to cater to projected growth

Capacity Utilization	FY20	FY21	FY22
Knitting			
Installed (Kgs)	4,258,800	8,104,200	8,232,000
Actual Production (Kgs)	3,181,941	4,563,256	5,757,403
Capacity Utilization	75%	56%	70%
Stitching			
Installed (Kgs)	3,744,000	4,637,256	4,637,256
Actual Production (Kgs)	3,184,937	3,039,156	3,571,853
Capacity Utilization	85%	66%	77%
Dyeing			
Installed (Dz)	583,839	673,660	666,775
Actual Production (Dz)	587,102	393,833	380,696
Capacity Utilization	101%	58%	57%

During FY20 and FY21, the company incurred capex to the tune of Rs. 728m to enhance its capacity across all segments (knitting, stitching and dyeing) financed largely through debt financing. Post expansion, capacity utilization levels of the company have increased on a timeline basis and are reported on the higher side.

As a part of BMR initiative, the company further incurred a capital expenditure amounting to Rs. 81.8m during FY22 financed through debt and internal fund resources. No major capex is projected over the rating horizon, as per management other than routine BMR activities to enhance efficiency and production.

Profitability has improved in FY22 on the back of revenue growth, higher exchange gains and normalized distribution expenses

LKPL recorded net revenue of Rs. 5.7b during FY22 (FY21: Rs. 3.1b); depicting an 84% increase driven by incline in exports post ease in COVID-19 lockdown, capacity expansion, and successful transition to a new management team. The Company witnessed a broad-based increase in sales across all product categories with inclusion of a new category comprising fabric (primarily Jersey) sales. Revenue booked from this category pertains to a single client named 'Next Level Fabric' based in USA which has diverted its fabric requirements from China to Pakistan. A sizeable 36.5% of the total sales revenue is attributable to this category. Management expects sales revenue to remain sustainable from this customer over the next 1.5-2 years which is considered important from a ratings perspective to achieve projected growth.

Export sales continue to dominate the sales mix with Fabric, T-shirts and Hoodie constituting around 70% of the total sales in FY22. With addition of one client for fabric sales, top 10 client concentration increased significantly to around 86% of total sales in FY22. Excluding this one client, top-10 client concentration was reported at 46% (FY21: 40%) in FY22. As per management, diversification plans are on board with addition of new clients in their portfolio. Management of client concentration risk is considered crucial.

Sales Revenue (Rs. In m)	FY20		FY21		`FY22	
Exports Sales	3,454	96%	2,856	87%	5,456	95%
Local Sales	154	4%	424	13%	295	5%
Gross Sales	**3,608**		**3,280**		**5,751**	

Product-wise breakup of sales (USD)	FY21	%	FY22	%
T-Shirts	6,452,926	36%	3,841,549	13%
Hoodie	5,238,701	29%	6,511,773	21%
Sweat Shirt	2,234,384	13%	2,835,948	9%
Pants	1,301,135	7%	2,360,972	8%
Polo Shirts	1,246,325	7%	1,551,543	5%
Jackets	420,777	2%	404,837	1%
Shorts	525,212	3%	1,507,348	5%
Leggings	159,317	1%	234,914	1%
SMS	4,399	0%	-	0%
Mask	198,724	1%	-	0%
Fabric	-	0%	11,063,276	36%
Total	**17,781,899**		**30,312,160**	

Gross margins improved in FY22 to 7.0% (FY21: -6.4%) on account of higher quantum of exports yielding benefit of PKR devaluation. Gross margins of the company are projected to gradually improve in line with higher sales revenue and expected decline in yarn prices. Net margins were reported at 1.0% (FY21: -20.7%) in FY22. Recovery in the same was largely due to exchange gains and lower freight expense (one-time expense in FY21). Despite higher interest charges and taxation expense, net profit was reported at Rs. 127.9m (FY21: Loss of Rs. 604.5m) in the outgoing year. Slowdown in global economy is expected to impact customer purchasing power and therefore, may result in decline in quantum of exports in the near term. However, meeting operational efficiencies while maintaining topline growth going forward will be important from ratings perspective.

Cash flow coverage indicators improved during FY22 after weakening in the past two years due to COVID-19 and demise of supervisory personnel.

In absolute terms, Funds from Operations (FFO) amounted to Rs. 274.3m (FY21: Rs. -450.5m) increasing on account of higher overall profitability during FY22. Thus, in line with improvement in profitability during the same period, FFO/Total Debt improved to 12.3% (FY21: -27.1%), and FFO/Long term debt to 48.0% (FY21: -57.0%). Resultantly, debt servicing inclined to 1.33x during FY22 (FY21: -4.03x). However, debt servicing remained constrained in FY22 at 1.33x on account of higher finance charges. Inventory and trade debts provide satisfactory coverage for short-term debt obligations and current ratio was maintained at 1.1x at end-June'22. Further improvisation in liquidity indicators through projected higher profitability is considered important.

Elevated leverage profile on the back of higher short-term working capital requirements

After eroding equity base in FY21 due to losses incurred, equity base (including Loan from Directors & Associated company) of the company improved to Rs. 1.15b at end-FY22 (FY21: 1.09b) on the back of profit retention. Quantum of total debt increased to Rs. 2.10b (FY21: Rs. 1.35b) at end-June'22 to finance working capital requirements. Debt utilization mainly comprises of Export Refinancing Facility, Long-term Financing Facility and SBP Salary Refinancing Scheme. Sizeable increase in short-term borrowings was recorded at end-FY22 on account of high working capital requirements resulting from accumulation of orders in hands post ease in COVID19 lockdown. With subdued growth in equity base and elevated debt levels, gearing and leverage indicators stood higher at 1.82x (FY21: 1.42x) and 2.72x (FY21: 2.29x) respectively at end-FY22. Maintenance of leverage indicators at manageable levels is considered important from ratings perspective.

FINANCIAL SUMMARY *(amounts in PKR millions)* *Appendix I*				
BALANCE SHEET	**FY19**	**FY20**	**FY21**	**FY22**
Fixed Assets	1,004	1,270	1,458	1,473
Stock-in-Trade	445	574	566	770
Trade Debts	1,033	974	704	1,199
Cash & Bank Balances	143	635	197	279
Total Assets	3,196	4,014	3,570	4,286
Trade and Other Payables	628	590	758	838
Long Term Debt	234	620	478	439
Short Term Debt	460	1,076	874	1,657
Total Debt	694	1,696	1,352	2,096
Paid Up Capital	60	60	60	60
Total Equity (including loan from director and associated company)	1,710	1,684	1,086	1,151
INCOME STATEMENT	**FY19**	**FY20**	**FY21**	**FY22**
Net Sales	3,785	3,565	3,051	5,662
Gross Profit	295	215	(195)	394
Profit Before Tax	302	(49)	(604)	128
Profit After Tax	270	(65)	(637)	56
RATIO ANALYSIS	**FY19**	**FY20**	**FY21**	**FY22**
Gross Margin (%)	7.8%	6.0%	-6.4%	7.0%
Net Margin	7.1%	-1.8%	-20.9%	1.0%
FFO	433	143	(451)	274
FFO to Total Debt (%)	64%	9%	-29.3%	13.1%
FFO to Long Term Debt (%)	197%	30%	-67.6%	62.5%
Current Ratio (x)	1.9	1.6	1.1	1.1
(Stock+Trade Debts)/ Short term borrowing	321%	144%	145%	119%
Debt Servicing Coverage Ratio (x)	17.5	2.5	(4.03)	1.33
Gearing (x)	0.40	0.92	1.42	1.82
Leverage (x)	0.87	1.38	2.29	2.72
ROAA (%)	10%	-2%	-17%	1%
ROAE (%)	18%	-4%	-46%	5%

**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	**Rating Date**	**Medium to Long Term**	**Short Term**	**Rating Outlook**	**Rating Action**
	RATING TYPE: ENTITY				
	10/04/2022	A-	A-1	Stable	Reaffirmed
	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
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

	Name	Designation	Date
1	Mr. Abdul Muqeet	Chief Financial Officer	August 16, 2022
2	Mr. Mir Siraj	Head of Sales & Marketing	August 16, 2022