RATING REPORT

Lucky Knits (Private) Limited

REPORT DATE:
November 17, 2023

RATING ANALYST:
Muhammad Amin Hamdani
amin.hamdani@vis.com.pk

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	*November 17, 2023*		*October 04, 2022*	
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: Industrial Corporates (May 2023) *https://docs.vis.com.pk/docs/CorporateMethodology.pdf*

APPLICABLE RATING SCALE(S)
VIS Issue/Issuer Rating Scale: *https://docs.vis.com.pk/docs/VISRatingScales.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.

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, Lucky Cement 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 Chairman of the Board of Kia Lucky Motors Pakistan Limited.

RATING RATIONALE

Corporate Profile

Incorporated in 2004; Lucky Knits (Private) Limited (LKPL) is primarily involved in the manufacturing and exports of knitted apparel with product lines mainly ranging from T-shirts, polo shirts, trousers, hoodies, and garments.

Headquartered in Karachi; Lucky Knits (Private) Limited is a partly vertically integrated manufacturing facility housing knitting, dyeing, and stitching units in Karachi at different locations. Cotton/blended yarn is the main raw material, which is procured from a group concern- Gadoon Textile Mills Limited. The requirement for the rest of the raw materials, largely comprised of dyes and chemicals, is met through imports.

Rating Drivers

Business risk remain elevated amid weak macroeconomic environment, high-interest rates, inflationary pressures, rising raw material costs, ongoing energy crisis in the country, and a global slump in demand. All these factors pose a challenge to the sector in terms of margins sustainability and future growth.

Pakistan's export proceeds have oscillated in the range of USD 22-25b during the past decade (FY11-FY21), however, in FY22 exports broke the threshold, clocking in at USD 32.4b. Textile sector contributes nearly one-fourth to industrial value-added segment and provides employment to about 40% of the industrial labor force[1]. Contributing around 8.5% to the country's gross domestic product (GDP), with an estimated market size of around Rs. 4.0tr, textile sector has maintained an average share of about 60% in national exports over the years.

Table 1: Pakistan Export Statistics (USD in Millions)

	FY20	FY21	FY22	FY23
PAKISTAN TOTAL EXPORTS	22,536	25,639	32,450	27,911
TEXTILE EXPORTS	12,851	14,492	18,525	16,710
PKR/USD AVERAGE RATE	158.0	160.0	177.5	248.0

Source: SBP

The lingering effects of Covid-19 pandemic continue to shape the Pakistan's textile industry. Initially, as lockdowns lifted, the industry capitalized on opportunities, securing production contracts with western countries. This redirection of substantial volumes to Pakistan, was complemented by government import tax reductions and subsidized covid-related financing programs such Temporary Economic Refinance Facility (TERF), spurred robust export growth during FY22. However, a subsequent phase presented new challenges. Global interest rate hikes aimed at curbing post-pandemic inflation, coupled with geopolitical unrest such as the Ukraine conflict, led to supply chain disruptions and energy crisis. These factors led to a global demand slowdown in major textile economies, reflected in a 10% year-on-year decline in Pakistan's textile exports in FY23, totaling USD 16.7b (FY22: USD 18.5b). As per the data from Pakistan Bureau of

[1] https://www.brecorder.com/news/40179021

Statistics (PBS), High Value-Added Segments made up over 82.2% (FY22: 80.7%) of the total textile exports in FY23.

Flash floods in Sindh and Southern Punjab monsoon wreaked havoc on the cotton crop last year. This catastrophe led to a historic low production level of 4 million bales of cotton in 2022, compared to a 12 million bales annual demand. Consequently, local cotton prices reached 12-year high of over Rs. 22,000 per 40kg during the year as well as import of raw cotton rose by ~20% in USD terms during FY22, as compared to the preceding year. This situation led to higher working capital requirements, adversely affecting profit margins and liquidity profile of textile entities, particularly spinners, weavers, and dyeing companies. Supported by favorable weather and timely government intervention, cotton production in the country is estimated to increase to 12.7 million bales during the current season (FY24). 4.0 million bales have already been produced during Q1FY24, marking an impressive 80.0% increase compared to the same period last year.

The industry is facing business risk due to weak macroeconomic environment both globally and locally, high-interest rates, inflationary pressures, rising raw material costs, ongoing energy crisis in the country, and a global slump in demand, primarily from North America and Europe.

Previously, the sector also enjoyed incentives provided by the government through a five-year textile policy (2020-25), including preferential energy rates, low-interest financing schemes, and timely payments of various refunds, easing liquidity constraints for local players. However, the prevailing economic instability along with advisory from the IMF led to the reduction or withdrawal of many of these fiscal supports. This along with contractionary monetary policy and political uncertainties in the country are the key business risk factors facing by the industry. In the long run, improvement in value addition, investment in technology and optimization of energy cost would define the future prospects of textile exports.

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 a diversified presence across various sectors including textile, building materials, real estate, power generation, chemicals, pharmaceuticals, FMCG, philanthropy, automotive, and mobile assembling. Sponsor support is evident from a long-term (25-year) unsecured interest-free loan from the director and associated company (Lucky Energy (Private) Limited) for business operations in 2015. This loan was granted on the present value mechanism and is amortized every year with no cash outflow. Continuity of sponsor support to the company in case the need arises will be important for ratings.

Continued capacity enhancement to cater projected growth

Table 2: Utilization Levels

	FY21	FY22	FY23
	Knitting		
Installed (Kgs)	8,104,200	8,232,000	8,615,520
Actual Production (Kgs)	4,563,256	5,757,403	6,886,353
Capacity Utilization	56%	70%	80%
	Dyeing		
Installed (Kgs)	4,637,256	4,637,256	4,637,256

Actual Production (Kgs)	3,039,156	3,571,853	2,959,375
Capacity Utilization	66%	77%	64%
	Stitching		
Installed (Dz)	673,660	666,775	1,303,639
Actual Production (Dz)	393,833	380,696	738,507
Capacity Utilization	58%	57%	57%

During FY23, the Company incurred CAPEX to the tune of Rs. 103m compared to Rs. 128m in FY22 for enhancement of knitting and stitching capacities. Despite the capacity enhancement, utilization levels of both segments witnessed an increase, though, dyeing segment utilization levels registered a decrease in FY23. As per the management, no major CAPEX is planned during the next 2-3 years other than routine BMR activities to enhance operational efficiency.

Growth in topline and higher exchange gain with enhanced focus on exports resulted in better profitability during FY23

LKPL registered a net sales of Rs. 8.2b in FY23 (FY22: 5.7b), depicting an increase of 44% Y/Y. This growth is achieved through higher production on the back of enhanced capacities, improved operational efficiency, and new management; while the rupee depreciation also boosted export proceeds. The company continued its efforts to increase export sales, which climbed up to 97.2% of total sales in FY23 (FY22: 94.8%).

Table 3: Export vs Local

	FY21	%	FY22	%	FY23	%
Export	2,693.0	88.3%	5,380.4	94.8%	7,937.6	97.2%
Local	357.9	11.7%	295.0	5.2%	225.6	2.8%
Total	3,050.9		5,675.4		8,163.1	

On a product-wise basis, LKPL has recorded an absolute increase in $ terms in all product categories including newly added Tank Top and Boxer during FY23. T-shirts came out as a major segment consisting of around 40% (FY22: 17%) of the total $ sales followed by Fabric at 32% (FY22: 28%). During FY23, the geographic concentration of sales to the USA has increased to 62.5% compared to 38.8% a year earlier. It is worth mentioning here that the USA sales are mainly based on a single client named 'Next level' wherein the client concentration is also 61.9% (FY22: 36.5%) to the Top 1 client. According to the management, there are plans on board for the addition of new clients in order to reduce the client-wise concentration of sales. Management of client concentration risk is considered crucial.

Table 4: Product wise (Sales value in USD)

Product	FY22	%	FY23	%
Fabric	11,063,276	*36%*	10,512,884	*32%*
Hoodie	6,511,773	*21%*	3,836,719	*12%*
Jacket	404,837	*1%*	171,418	*1%*
Pants	2,360,972	*8%*	1,612,013	*5%*
Polo	1,551,543	*5%*	994,496	*3%*
Shorts	1,507,348	*5%*	1,073,139	*3%*

Sweat Shirt	2,835,948	*9%*	897,721	*3%*
Leggings	234,914	*1%*	-	*NA*
Tank Top	-	-	85,570	*0%*
T-Shirt	3,841,549	*13%*	13,076,958	*40%*
Boxer	-	-	533,978	*2%*
Total	**30,312,160**	***100%***	**32,794,896**	***100%***

With the significant increase in topline, the gross margin has improved to 17.7% (FY22: 6.7%) on the back of achieving better economies of scale and increased operating efficiency. The increase in operating expenses remains in line with the increase in inflation, however, distribution costs decreased during FY23 amid the normalization of freight issues prevailed in FY22. Other income has increased mainly on the back of higher exchange gains and dividend income from mutual fund investments. Finance costs registered an uptick given the high-interest rates environment. Consequently, the net margins of the Company have improved to 14.1% (FY22: 1.0%) in FY23.

Going forward, management expects to maintain its topline with the addition of new customers starting from 2HFY24. VIS expects margins to stay in check due to lower exchange gain and increased cost pressures. However, maintaining topline growth with sustainable margins will be important from the ratings perspective.

Improved cash flow coverages while liquidity indicators remained adequate

In absolute terms, Funds from Operations (FFO) increased to Rs. 1.4b (FY22: Rs. 283.2m) on account of higher overall profitability during FY23. Thus, in line with the improvement in profitability during the same period, FFO/Total Debt improved to 0.77x (FY22: 0.14x) and FFO/Long Term Debt to 3.5x (FY22: 0.5x). Resultantly, the Debt Service Coverage Ratio (DSCR) notably improved to 5.9x (FY22: 1.4x), despite higher finance costs. Inventory and trade debts provide satisfactory coverage for short-term debt obligations while the current ratio inched up to 1.6x (FY22: 1.1x) as of Jun'23. Further improvement in liquidity indicators amid projected higher profitability is considered important.

Capitalization profile further strengthened due to higher internal cash generation in FY23

LKPL's equity grew to Rs. 2.2b (Jun'22: 1.0b) as of Jun'23 amid healthy growth in profitability. Simultaneously, the quantum of total debt also registered a marginal decline to Rs. 1.8b (Jun'22: 2.1) as at Jun'23, wherein both LT debt and ST debt decreased to Rs. 394m (Jun'22: Rs. 544m) and Rs. 1.4b (Rs. 1.5b) as at Jun'23. Consequently, Gearing and Leverage indicators declined to 0.8x (Jun'22: 2.0x) and 1.6x (Jun'22: 3.2x) as at Jun'23. It is pertinent to mention here that both long-term and short-term debts enjoy subsidized interest rates through various schemes provided by the State Bank of Pakistan. Going forward, the maintenance of capitalization indicators will remain a key rating driver.

Lucky Knits (Private) Limited — Appendix I

FINANCIAL SUMMARY (PKR Millions)					
BALANCE SHEET	**FY19A**	**FY20A**	**FY21A**	**FY22A**	**FY23A**
Property, plant and equipment	1,003.9	1,270.3	1,458.0	1,473.8	1,417.7
Stock-in-trade	444.7	569.2	565.8	775.7	705.3
Trade debts	1,033.4	924.6	704.2	1,199.4	1,729.1
Cash & Bank Balances	143.4	635.3	197.5	79.6	11.9
Total Assets	3,196.4	3,925.8	3,570.0	4,325.5	5,610.5
Trade and Other Payables	628.1	563.6	757.7	860.7	1,149.5
Long-term Debt (incl. current portion and lease liability)	220.0	469.9	666.0	543.9	393.8
Short-term Debt	460.0	876.0	874.0	1,550.5	1,385.8
Total Debt	680.0	1,345.9	1,540.0	2,094.4	1,779.7
Total Liabilities	1,593.7	2,219.2	2,607.7	3,305.1	3,441.6
Paid up Capital	60.0	60.0	60.0	60.0	60.0
Equity (excl. Revaluation Surplus)	1,602.6	1,706.6	962.3	1,020.4	2,168.9
INCOME STATEMENT	**FY19A**	**FY20A**	**FY21A**	**FY22A**	**FY23A**
Net Sales	3,784.9	3,565.4	3,050.9	5,675.4	8,163.1
Gross Profit	294.6	375.6	-195.3	382.5	1,443.9
Operating Profit	8.4	-75.0	-658.9	-115.0	856.7
Finance Costs	27.8	69.8	76.4	90.6	210.4
Profit Before Tax	302.1	89.2	-604.5	106.8	1,283.7
Profit After Tax	269.6	73.2	-637.4	57.3	1,154.7
RATIO ANALYSIS	**FY19A**	**FY20A**	**FY21A**	**FY22A**	**FY23A**
Gross Margin (%)	7.8%	10.5%	-6.4%	6.7%	17.7%
Net Margin (%)	7.1%	2.1%	-20.9%	1.0%	14.1%
Funds from Operation (FFO)	432.7	142.7	-450.5	283.2	1,368.5
FFO to Total Debt* (%)	63.6%	10.6%	-29.3%	13.5%	76.9%
FFO to Long Term Debt* (%)	196.7%	30.4%	-67.6%	52.1%	347.5%
Gearing (x)	0.42	0.79	1.60	2.05	0.82
Leverage (x)	0.99	1.30	2.71	3.24	1.59
Debt Servicing Coverage Ratio* (x)	16.51	2.15	-3.44	1.21	4.27
Current Ratio	1.94	1.76	1.14	1.11	1.56
(Stock in trade + trade debts) / STD (x)	3.21	1.71	1.45	1.27	1.76
Return on Average Assets (%)	10.1%	2.1%	-17.0%	1.5%	23.2%
Return on Average Equity (%)	18.5%	4.4%	-47.8%	5.8%	72.4%

REGULATORY DISCLOSURES					Appendix II
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				
	11/17/2023	A-	A-1	Stable	Reaffirmed
	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.				
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. For conducting this assignment, analyst did not deem necessary to contact external auditors or creditors given the unqualified nature of audited accounts and diversified creditor profile. Copyright 2023 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.				

Due Diligence Meetings Conducted		**Name**	**Designation**	**Date**
	1	Mr. Abdul Muqeet	CFO	6th October, 2023
	2	Mr. Mohammad Tahir	Manager Finance	