RATING REPORT

Lucky Textile Mills Limited

REPORT DATE:
November 20, 2023

RATING ANALYSTS:
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RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	**Short-term**	**Long-term**	**Short-term**
Entity	AA-	A-1	AA-	A-1
Rating Outlook	Stable		Stable	
Rating Action	Reaffirmed		*Reaffirmed*	
Rating Date	*20 November, 2023*		*December 19, 2022*	

COMPANY INFORMATION

Converted from AOP to Company in 2011	**External Auditors:** Yousuf Adil & Co., Chartered Accountant
Public Unlisted Company	**Board Chairman:** Mr. Imran Yunus Tabba
Key Shareholders (with stake 10% or more):	**Chief Executive Officer:** Mr. Jawed Yunus Tabba
Y.B. Holdings (Pvt) Ltd – 99.99%	

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 Textile Mills Limited

OVERVIEW OF THE INSTITUTION

Lucky Textile Mills Limited (LTML) was incorporated in December 2011 as a Public Unlisted Company. The Company had taken over the assets and liabilities of Lucky Textile Mills which operated as a partnership firm registered in the year 1983 under the Partnership Act, 1932. The principal activity of the company includes manufacturing and export of fabric, home textiles, and apparel products.

Profile of Chairman:
Mr. Imran Yunus Tabba has vast experience in the Textile Sector and he is the Executive Director and key decision-maker of the LTML. He manages the operational and administrative functions of the company's units located in various parts of Karachi. Mr. Imran Tabba has contributed significantly to the performance of the companies where he serves as a Director on the Board. Mr. Imran Yunus Tabba is also involved in the Aziz Tabba Foundation, which is the Yunus Brother Group's foundation for philanthropy.

Profile of the CEO:
Mr. Jawed Yunus Tabba has rich experience in the Textile industry and is

RATING RATIONALE

Corporate Profile
Converted from AOP to a public unlisted company in 2011. Lucky Textile Mills Limited ('LTML' or 'the Company') is a part of the Yunus Brother Group (YBG), a wholly owned subsidiary of YB Holdings (Pvt.) Limited. LTML is a fully integrated textile company engaged in the spinning, weaving, processing, and stitching of various kinds of textile products. Sales of the company can be classified into three categories: home textiles, garments, and fabric.

Diversified Strategic Investment Portfolio:
LTML boasts a diverse investment portfolio and includes stakes in subsidiaries, associates, and listed entities as listed below:

Table 1: Investment Portfolio

Equity Investment in Associated Companies	
	Ownership
Lucky Core Industries Limited (LCIL)	6.2%
Lucky Holding Limited (LHL)	1.0%
Yunus Energy Limited (YEL)	20.0%
Lucky Motors Corporation Limited (LMCL)	7.6%
Investment in listed company	
Feroze 1888 Mills Limited (FML)	1.6%
Investment in subsidiary	
Lucky Wind Power Limited	100.0%
Lucky Entertainment (Pvt) Ltd	100.0%
Lucky Renewables (Pvt) Ltd	51.0%
Investment in listed company	
Interloop Limited	0.017%

LTML to convert investment in Lucky One project into share capital for dividend stream
Lucky Textile Mills Limited is a key investor in Lucky Landmark Private Limited (LLPL). LLPL consists of the Lucky One Project, encompassing both a mall and residential towers.

Recent backward integration in spinning unit
As a part of the company's strategic backward integration initiative, the company has set up a spinning unit. The project entails a production capacity of 42m lbs of yarn annually. The total cost of the project is estimated at Rs. 10.7b with a debt-to-equity mix of 36:64. This project is advancing through three phases with Phase 1 having been successfully completed in Jan'23, and Phase 2 successfully completed in Jul'23. The final phase, Phase 3, will bring the entire project to its completion, with the installation of 6 more MVS machines.

The Company pioneering investment in alternative energy to bolster profit margins
In addition to its investment in the spinning unit, the company is also making substantial investments towards the development of alternative energy sources with the primary objective of maintaining the profit margins.

currently the Chief Executive and Director of a renowned textile mill. He has been instrumental in managing the textile concerns of the Yunus Brothers Group and has transformed LTML into one of the premiere Textile Companies in Pakistan.

Environmental, Social, & Governance (ESG) Initiatives

In addition to the solar project, the company has also invested in two wind power project of 50 MW namely M/S Yunus Energy Limited and Lucky Renewables Pvt. Ltd. The projects are located in Jhimpir, Sindh Province, and has been in operation since 2021 and 2016 respectively. Moreover, the factory has its own wastewater treatment plant.

The company has also obtained the following certification for sustainable textile production: Standard 100 and STeP by OEKA-TEX, Gold Compliance Certificates, certification in compliance with ISO/IEC 17025:2017, ISO 9001:2015, ISO 14001:2015, Gold Organic Standards (GOTS), Organic Content Standard (OCS) (Version 3.0), Global Recycled Standard (GRS) (Version 4.0), and Recycled Claim Standard (RCS) (Version 2.0)

Operational Performance

Since the commencement of phase one of the spinning unit in Jan'23, capacity utilization has been adequate with further room for improvement. While the installed capacity remains unchanged, utilization levels have dipped for weaving and processing segments in FY23 due to decreased demand amid the ongoing recessionary trend.

Table: Capacity & Production Data

	FY21	FY22	FY23
Spinning			
Total Spindles	-	-	4,224
Installed Capacity – (lbs) millions*	-	-	25
Actual Production – (lbs) millions*	-	-	20.6
Capacity Utilization	***-***	***-***	***82%***
Weaving			
Total number of looms installed	833	833	833
Total number of looms worked	833	833	656
Installed Capacity – (mtr) millions	79.2	79.2	79.2
Actual Production – (mtr) millions	77.5	73.1	59.1
Capacity Utilization	***98%***	***92%***	***75%***
Processing			
Installed Capacity – (mtr) millions	78.0	96.0	96.0
Actual Production – (mtr) millions	75.6	80.5	63.6
Capacity Utilization	***97%***	***84%***	***66%***

* Numbers have been annualized since spinning phase 1 was operational from Jan'23

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.

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

Table 2: 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 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 compare 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.

Rupee devaluation spurred growth in topline amid tumbling export volumes

Over the 6-year span (FY17-23), the company's offtake achieved a CAGR of ~21.5% while in FY23, net sales uptick by ~17.5%, reaching Rs. 43.5b mark (FY22: Rs. 37.0b). The increase is primarily attributed to rupee devaluation during the period. Going forward, due to improving volumes in textile export, the management is optimistic that net sales will surpass Rs. 53.9b in FY24 against which Rs. 14.0b sales have already been registered in Q1'FY24.

The majority of the sales are generated through exports, with a small portion of the local sales comprising wastage sales. The concentration of top-ten clients remains on the higher side. However, client concentration risk is mitigated by the long-standing relationship with major clientele.

Historic high margins achieved on the back of Rupee devaluation, backward integration and minimal reliance on imported cotton

In FY23, margins (both gross and net) reached historic highs of 29.9% and 24.5% respectively, surpassing peer averages which is attributed to the positive impact of PKR devaluation, backward integration with the addition of spinning unit, and a reduced dependence on imported cotton. However, according to the management's projection, a modest decline in both gross and net margins to ~28.0% and ~20.3% respectively is anticipated in FY24.

The increase in administrative overheads corresponds with the inflation and sales trends, while distribution expenses have marginally been reduced this fiscal year. The company's bottom line is additionally bolstered by the dividends received from investments in associates and mutual funds. Albeit, finance charges have increased owing to elevated benchmark interest rates.

Strong profitability profile translates into improved cash-flow coverage while DSCR weakened yet remains above peers; liquidity profile is supported by dividends received from short term investments.

On the back of strong bottom-line performance, substantial growth of 73.5% in the funds from operations (FFO) was achieved, reaching Rs. 10.5b (FY22: Rs. 6.1b) in FY23. Consequently, improvement in FFO led to an increase of the cash-flow coverage indicators as depicted by FFO to total debt and FFO to long-term debt ratios to 0.91x (FY22: 0.42x) and 1.44x (FY22: 0.86x) in FY23. However, despite the upsurge in FFO, the debt servicing coverage ratio (DSCR) has declined to 9.09x (FY22: 12.27x) during FY23 as a result of higher loan repayments during the period. Nonetheless, the same remains favorably positioned in comparison to industry peers.

The liquidity profile remains strong, supported by improvement in the current ratio and short-term debt coverage with trade debts and inventory. Moreover, the net cash cycle has exhibited notable improvements during the review period, driven by lower receivable days and extended payable days. Liquidity is further supported by investments in money market mutual funds and TDRs, increasing to Rs. 6.2b (FY22: 1.7b) in FY23.

Leverage improves on the accounts of strong profitability profile, high-profit retention and lower debt level

Excluding the revaluation surplus, the equity base surged by ~31.4 % in the last fiscal year, hitting Rs. 41.8b at end-FY23, primarily driven by strong earnings and high-profit retention. In line with the dividend payout policy, the company paid interim dividends amounting to Rs. 600m (FY22: 600m) with a payout ratio of ~5.6% (FY22: 10.6%) in FY23. Debt profile is a blend of short-term and long-term debt, with total interest-bearing liabilities decreasing to Rs. 11.6b (June'22: Rs. 14.5b) as of Jun'23; ~37.2% constituted short-term debt. Both gearing and leverage depicted improvement in FY23 and remain below peers over the timeline.

Lucky Textile Mills Limited Appendix I

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**FY20**	**FY21**	**FY22**	**FY23**
Total Assets	**36,949.1**	**43,829.0**	**57,711.8**	**65,487.0**
Long Term Debt *(including current maturity)*	3,540.0	3,908.7	6,984.1	7,251.8
Short Term Debt	4,700.0	5,025.0	7,519.5	4,309.3
Total Equity (without surplus revaluation)	**22,098.5**	**26,481.6**	**31,811.3**	**41,797.3**
INCOME STATEMENT				
Net Sales	**24,623.9**	**27,009.4**	**37,018.5**	**43,509.3**
RATIO ANALYSIS				
Current Ratio (x)	1.78	1.91	1.73	2.22
Adjusted FFO	4,438.2	4,927.6	6,058.1	10,512.3
FFO to Total Debt (%)	53.5%	54.8%	41.6%	90.5%
FFO to Long Term Debt (%)	123.6%	124.5%	86.1%	144.0%
Debt Servicing Coverage Ratio (x)	12.11	9.40	12.27	9.09
Gearing (x)	0.38	0.34	0.46	0.28
Leverage (x)	0.65	0.63	0.80	0.56

REGULATORY DISCLOSURES — Appendix II

Name of Rated Entity	Lucky Textile Mills Limited
Sector	Textile
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
20-11-2023	AA-	A-1	Stable	Reaffirmed
19-12-2022	AA-	A-1	Stable	Reaffirmed
28-12-2021	AA-	A-1	Stable	Reaffirmed
10-11-2020	AA-	A-1	Stable	Reaffirmed
18-11-2019	AA-	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 Meeting Conducted

Name	Designation	Date
Mr. Adnan Arif	CFO	October 16, 2023