RATING REPORT

Universal Leather (Private) Limited

REPORT DATE:
May 9, 2019

RATING ANALYSTS:
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RATING DETAILS		
Rating Category	**Latest Rating**	**Previous Rating**
Entity	**BBB-/A-3**	**BBB/A-3**
Rating Date	*May 9,'19*	*October 16,'17*
Rating Outlook	Stable	Negative
Outlook Date	*May 9,'19*	*October 16,'17*

COMPANY INFORMATION	
Incorporated in 1968	**External auditors:** Deloitte Yousuf Adil Chartered Accountants
Private Limited Company	**Chairman of the Board:** Mr. Shakil Ahmed
Key Shareholders (with stake 10% or more):	**Chief Executive Officer:** Mr. Shakil Ahmed
Mr. Farrukh Hussain Sheikh - 10.76%	
Mr. Shahid Hussain - 11.97%	
Mr. S.M. Saleem - 10.00%	
Mr. S.M. Naseem - 10.00%	
Mr. Daniyal Ahmed Sheikh-10.04%	

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

Universal Leather Private Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

Incorporated in 1968 as a public listed company, ULPL was then converted into a private limited company in 2004. ULPL's primary business focus is leather tanning of bovine animals with facilities present in Karachi and Lahore. The financial statements for FY18 were audited by Deloitte Yousuf Adil Chartered Accountants.

Universal Leather (Private) Limited (ULPL) specializes in leather produced from cow/buffalo skins. ULPL belongs to the MIMA Group of Companies constituting MIMA Knit (socks), MIMA Leather (leather from goat and sheep skins), MIMA Apparel (clothing), HUB Leather, and HUB retail stores. The group sponsors possess extensive experience in the leather industry with shareholding held by various family members.

Key Rating Drivers:

Slowdown in European markets has impacted demand outlook for leather exports. High regional competition in the industry limits pricing power of exporters. Management has made concerted efforts to tap new markets in order to enhance sales volumes.

Competition in the leather sector extends to regional players in the international market such as China, India, Bangladesh and Turkey. Consequently, competition limits bargaining power of local players as they are unable to pass on volatility in raw material prices to customers. Over the last four fiscal years, leather exports from Pakistan have declined by ~40% owing to slowdown in demand from European countries. Moreover, a shift in leather demand has been observed from Europe to Asia (the former imported US$ 753.9m and the latter imported US$ 965.7m worth of leather in FY17). Despite declining finished leather exports, PKR depreciation against US$ and Euro in FY18 and the ongoing year has provided support to revenues and margins of Pakistani tanneries.

Growth in topline attributable to currency devaluation but volumetric growth remains limited due to subdued demand from key markets; client and geographic risk is mitigated by long term association with top clients.

Sales revenue of the company manifested an increase of 13% during FY18 and amounted to Rs. 564m (FY17: Rs. 499m) primarily on account of higher average selling prices. Proportion of exports in the topline was 97% (FY17: 96%) during FY18. Geographic concentration risk on the exports front is considered to be on the higher side with top three markets (Germany, Austria and Spain) contributing more than 85% in revenues. Europe continues to remain an important market for ULPL with management expecting orders to emanate from newer markets, particularly from Asian countries. Both client and country wise concentration in sales remains on the higher side which is partly mitigated given the long-term association with most large clients.

Reduction in quantum of losses during FY18 on the back of higher revenues and implementation of cost control measures. Profitability profile has witnessed some improvement in the ongoing year with company posting operating profits in 9MFY19.

Gross Margins (GMs) improved during FY18 to 3.6% while further accretion in gross margins has been noted in the ongoing year. Improvement in GM is a function of better selling prices and certain cost saving initiatives undertaken by the management. During the outgoing year, Inability of the margins to cover operating expenses led to loss before tax of Rs. 32m (FY17: Rs. 144m) in FY18. However, quantum of losses has reduced as compared to the preceding two years. Going forward, profitability will remain dependent on achieving projected sales volumes and efficient management of expenses.

Weak liquidity profile given low cash flow generation. Trade debts and stocks provide sufficient coverage to short term borrowings.

Liquidity profile of the company improved during FY18 due to better GMs as compared to the preceding year, however the same remain weak with negative fund from operations (FFO) in FY18. Inventory levels of the company have depicted noticeable decline on a timeline basis (FY18: Rs. 499m, FY17: Rs. 615m, FY16: Rs. 891m, FY15: Rs. 1,264m) but continue to represent around one year sales. The management remains focused on aggressively reducing stock-in-trade. Borrowings amounted to Rs. 302m (FY17: Rs. 355m) at end-FY18 and are short term in nature. Liquidity profile is supported with sufficient coverage

(185%) of short term borrowings through stock in trade and trade debts. Aging profile of trade debts signifies that all receivables are due within 90 days.

Weakening in capitalization indicators due to consistent losses.
Equity base of the company witnessed further attrition during FY18 and amounted to Rs. 263m (FY17: Rs. 286m, FY16: Rs. 385m). With a slight decline in short term borrowings, gearing decreased to 1.15x (FY17: 1.24x) at end-FY18 whereas leverage remained around prior year levels at 2.4x at end-FY18.

ISSUE/ISSUER RATING SCALE &DEFINITIONS Appendix I

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.

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<tr><td>Name of Rated Entity</td><td>Universal Leather Private Limited</td></tr>
<tr><td>Sector</td><td>Tanneries and Leather Products</td></tr>
<tr><td>Type of Relationship</td><td>Solicited</td></tr>
<tr><td>Purpose of Rating</td><td>Entity Rating</td></tr>
<tr><td>Rating History</td><td>
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<tr><th>Rating Date</th><th>Medium to Long Term</th><th>Rating Outlook</th><th>Rating Action</th></tr>
<tr><td colspan="4">RATING TYPE: ENTITY</td></tr>
<tr><td>05/09/2018</td><td>BBB-/A-3</td><td>Stable</td><td>Downgrade</td></tr>
<tr><td>10/16/2017</td><td>BBB/A-3</td><td>Negative</td><td>Downgrade</td></tr>
<tr><td>05/20/2016</td><td>BBB+/A-3</td><td>Stable</td><td>Reaffirmed</td></tr>
<tr><td>05/04/2015</td><td>BBB+/A-3</td><td>Stable</td><td>Reaffirmed</td></tr>
<tr><td>04/09/2014</td><td>BBB+/A-3</td><td>Stable</td><td>Reaffirmed</td></tr>
<tr><td>04/08/2013</td><td>BBB+/A-3</td><td>Stable</td><td>Reaffirmed</td></tr>
<tr><td>02/13/2012</td><td>BBB+/A-3</td><td>Stable</td><td>Reaffirmed</td></tr>
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</td></tr>
<tr><td>Instrument Structure</td><td>N/A</td></tr>
<tr><td>Statement by the Rating Team</td><td>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.</td></tr>
<tr><td>Probability of Default</td><td>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.</td></tr>
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