RATING REPORT

Universal Leather (Private) Limited

REPORT DATE:
October 2, 2020

RATING ANALYSTS:
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RATING DETAILS		
Rating Category	**Latest Rating**	**Previous Rating**
Entity	**BBB-/A-3**	**BBB-/A-3**
Rating Date	*October 1,'20*	*May 9,'19*
Rating Outlook	Negative	Stable
Outlook Date	*October 1,'20*	*May 9,'19*

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 for Corporates *http://www.vis.com.pk/kc-meth.aspx*

Universal Leather Private Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

OVERVIEW OF THE INSTITUTION

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.

RATING RATIONALE

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:

Global demand for leather will be adversely impacted by coronavirus outbreak
A large proportion of Pakistan's leather exports are directed to the countries most affected by the coronavirus —UK, US, France, Italy, Spain and Germany. This naturally suggests that the implications of the pandemic on Pakistan's leather exports are likely to be significant as its major export destinations struggle to cope with the crisis. In FY19, Pakistan's tanned leather exports decreased by 19% in volume terms and 24% in value terms compared to same period last year. Leather industry remains characterized by high competition due to presence of large number of small to medium sized players. Local firms have to compete not only with other domestic players, but also with Chinese, Indian and Bangladeshi manufacturers in the overseas market. The intense competition limits ability of companies to pass volatility of raw material prices and foreign exchange loss to customers entirely while pricing products. The domestic leather prices are dependent on availability of leather in the domestic market and are subject to significant volatility. However, as export realization is not linked to domestic leather prices, margins are susceptible to adverse price movements in export and domestic markets. Going forward, policies towards economic revival in countries affected by coronavirus will influence the pace at which demand for Pakistani leather products reaches pre-coronavirus levels.

Decline in topline during FY19 and 9MFY20; client and geographic risk is mitigated by long term association with top clients.
Sales revenue of the company decreased by 12% to Rs. 495m (FY18: Rs. 564m) in FY19. Sales further decreased by 20% (annualized compared to FY19) to Rs. 398m in 9MFY20. During 9MFY20, sales volumes declined by 28% while prices increased by 28% compared to 9MFY19. For full year FY20, management has provided sales estimate of around Rs. 406m. For FY21, sales are targeted at Rs. 500-550m. Exports represented around 99% of sales during 9MFY20. Local competition is getting lower as smaller players are closing operations. As per management, sales are targeted to be increased by 10-15% in FY20 while focus on cost efficiencies will continue. Geographic concentration on the exports front is considered to be high with top three markets contributing sizeable proportion in revenues. Europe continues to be an important market for ULPL but the company is also tapping Bangladesh and other Asian markets. Both client and country wise concentration in sales remains on the higher side which is partly mitigated by long-term association with most large clients. In terms of product development, the management is considering entering the area of shoe manufacturing; however, this will only be done once restructuring of tannery operations is complete.

With recovery in gross margins in FY19, the company turned profitable.
Gross Margins (GMs) improved during FY19 to 19.3% (FY18: 3.8%). Improvement in GM is a function of better selling prices, declining raw material prices, and certain cost saving initiatives undertaken by the management. Raw material is 100% local. As a result, the company reported profit after tax of Rs. 33m (FY18: Loss of Rs. 38m). The Company's strategy is focused on margins, rather than sales volumes. The company is undertaking efficiency improvements in the areas of infrastructure and human resources. Going forward, profitability will remain dependent on achieving projected sales volumes and efficient management of expenses.

Liquidity profile improved with better cash flows. Trade debts and stocks provide sufficient coverage to short term borrowings.
Liquidity profile of the company improved during FY19 due to better GMs as compared to the preceding

year and higher cash flows. Inventory levels of the company were stagnant in FY19 but decreased moderately during 9MFY20; the same remain lower than high levels observed in FY15-17). The management remains focused on reducing stock-in-trade. Borrowings (Bank+Directors) amounted to Rs. 375m (FY18: Rs. 367m; FY17: Rs. 405m) at end-FY19 and increased to Rs. 404.5mand are short term in nature. Liquidity profile is supported with sufficient coverage (221%) of short term borrowings through stock in trade and trade debts. Aging profile of trade debts signifies that majority receivables are due within 90 days. (Bank borrowing FY-20 Rs. 269, FY-19 Rs. 286m, FY-18 Rs. 302m, FY-17 Rs, 355m)

Improvement in capitalization indicators due to better profitability.
Equity (Equity+Directors' loan) base of the company witnessed increase during FY19 and amounted to Rs. 320m (FY18: Rs. 263m; FY17: Rs. 286m, FY16: Rs. 385m). With a slight increase in short term borrowings, gearing remained around prior year levels at 1.17x (FY18: 1.15x; FY17: 1.24x) at end-FY19 whereas leverage remained around prior year levels at 2.2x at end-FY19.

Universal Leather Private Limited Appendix I

Financial Summary (Rs. In millions)			
BALANCE SHEET	**FY18**	**FY19**	**9MFY20**
Fixed Assets	67	70	70
Long term Investments	122	122	122
Stock-in-Trade	499	498	563
Trade Debts	61	112	43
Cash & Bank Balances	24	8	14
Total Assets	889	940	936
Trade and Other Payables	280	291	262
Long Term Debt	-	-	-
Short Term Debt	367	375	405
Total Debt	367	375	405
Paid up capital	33.9	33.9	33.9
Total Equity (Including Loan from Directors)	263	320	238
INCOME STATEMENT			
Net Sales	564	495	299
Gross Profit	20	95	56
Admin Expenses	(30)	(20)	(10)
Selling Expenses	(38)	(19)	(20)
Financial Cost	(33)	(18)	(17)
Operating Profit	(14)	55	26
Profit before tax	(32)	(38)	8.7
Profit After Tax	(38)	33	5.7
RATIO ANALYSIS			
Gross Margin (%)	3.6%	19.3%	18.7%
Net Margin	-6.7%	6.7%	1.8%
Trade debts/Sales	11%	23%	10.2%
FFO	(34)	41	n/a
FFO to Total Debt (%)	-13%	11%	n/a
FFO to Long Term Debt (%)	NA	NA	NA
Current Ratio (x)	1.1	1.0	1.09
(Stock+Trade Debts)/ Short term borrowing	153%	163%	150%
Debt Servicing Coverage Ratio (x)	(1.0)	3	n/a
Gearing (x)	1.39	1.17	1.70
Leverage (x)	2.62	2.22	2.93
ROA (%)	-4.2%	3.5%	0.6%

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	Universal Leather Private Limited			
Sector	Tanneries and Leather Products			
Type of Relationship	Solicited			
Purpose of Rating	Entity Rating			
Rating History	**Rating Date**	**Medium to Long Term**	**Rating Outlook**	**Rating Action**
	RATING TYPE: ENTITY			
	10/1/2020	BBB-/A-3	Negative	Maintained
	05/09/2019	BBB-/A-3	Stable	Downgrade
	10/16/2017	BBB/A-3	Negative	Downgrade
	05/20/2016	BBB+/A-3	Stable	Reaffirmed
	05/04/2015	BBB+/A-3	Stable	Reaffirmed
	04/09/2014	BBB+/A-3	Stable	Reaffirmed
	04/08/2013	BBB+/A-3	Stable	Reaffirmed
	02/13/2012	BBB+/A-3	Stable	Reaffirmed
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 with	13 July 2020: Kashif Rasool - Manager Accounts			