RATING REPORT

Universal Leather (Private) Limited

REPORT DATE:
November 18, 2021

RATING ANALYSTS:
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RATING DETAILS		
Rating Category	**Latest Rating**	**Previous Rating**
Entity	**BBB-/A-3**	**BBB-/A-3**
Rating Date	*November 18,'21*	*October 02,'20*
Rating Outlook	Positive	Negative

COMPANY INFORMATION	
Incorporated in 1968	**External auditors:** Mushtaq & Co 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. Shakil Ahmed - 19.24%	
Mr. S.M. Saleem – 10.00%	
Mr. S.M. Naseem - 10.00%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria *Industrial Corporates (August 2021)*
https://docs.vis.com.pk/docs/CorporateMethodology202108.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 cow and buffalo animals with facilities present in Karachi and Lahore.

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. The company has long term investments in associated companies worth Rs. 122m, representing 16.3% of the total asset base. The associate companies include MIMA Leather and MIMA Knit.

Key Rating Drivers:

Recovery observed in Pakistan's leather export post ease in COVID-19 led lockdowns.

The leather sector of Pakistan is predominantly export-oriented, contributing around 3-4% share in the total exports of the country. The major export markets are USA, Europe and Far East. During the past five years, the aggregate leather exports have depicted a declining trend albeit posting recovery during FY21. Overall leather exports improved to USD 833.2m (FY20: USD 765.3m) during FY21. Value added segment posted growth of 15.4% while tanned leather export continued downward trend and declined by 12.1% to USD 161.9m (FY20: USD 184.2m) during FY21. The reason for declining trend especially within tanned leather has been the overall contraction in global leather demand (with availability of faux leather), further aggravated by the onset of COVID-19 as well as challenges faced by the domestic industry in terms of product diversification, technological up-gradation and strong competition from regional countries. However, tanned leather segment is expected to recover modestly on account of better demand prospects arising from European countries. Going forward, leather sector's outlook is expected to stay stable in the medium term, posting a modest growth on account of opening up of economies post vaccination drive.

Leather Exports breakup in USDmn

	FY19	FY20	FY21
Tanned leather	252.2	184.2	161.9
Leather garments	256.3	250.9	286.1
Leather gloves	217.9	212.8	260.1
Leather footwear	106.4	107.2	108.4
Others	11.4	10.3	16.5
Total	**844.3**	**765.3**	**833.2**

Source: Pakistan Bureau of Statistics

Modest growth recorded in topline.

Sales revenue of the company increased by 8.5% to Rs. 420.0m (FY20: Rs. 386.9m) in FY21. Increase in sales was a result of better prices for cow skin achieved in the export market. Exports continue to dominate the sales mix, representing around 96% of the sales. Europe continues to remain important market for ULPL as the cold weather complements the use of leather products. Geographic concentration on the exports front is considered to be high with top two markets (namely Germany and Austria) contributing sizeable proportion, of around ~71%, in revenue. . Client concentration also remains high with top 10 customers accounting for 90% of sales; however this is partly mitigated by long-term association with most clients. Going forward, management focus will remain on the export market. As per management, collection issues in the local market have restrained them from targeting the local market.

For FY22, management expects improvement in sales since removal of travel restrictions will provide greater opportunities to market their products through participation in trade fairs and exhibitions. Additionally, the company over the last year has achieved two major certifications namely, ISO 14001 and Leather Working Group certification which are expected to support export sales in the future. The company has also installed sewage treatment plant and water saving plant to efficiently treat waste water and prudently utilize water in tanning process.

Significant uptick in margins

Gross margins recorded significant improvement in FY21 to 16.3% (FY20: 1.9%). Improvement in gross margins was as a result of better selling prices, reduced raw material prices, and certain cost saving initiatives undertaken by the management. Along with higher gross margins, overall profitability was further supported by one-off other income – (reversal of creditor payment due to supply of low quality raw material) and lower finance cost given low interest rate regime. As a result, net profit increased to Rs. 25.6m (FY20: loss of Rs.48.9m) during FY21. Going forward, gross margins are likely to stay stable on account of expected lower prices of key input i.e. animal skin which is in abundant supply and measures undertaken by the Company to improve product quality and enhance productivity through up gradation in machinery and tanning processes, however margins of the company remain exposed to volatility.

Liquidity profile remains constrained

FFO improved in line with the profitability of the company. With company posting profit in FY21 as compared to loss in preceding year, FFO turned positive amounting to Rs. 27m (FY20: Rs.(61m)) however overall liquidity profile remains constrained. Current ratio stands at 1.04x. The Company's working capital management is a function of high inventories and payables Whereas prudent management of debtors is observed. The management aims to reduce the average inventory days holding, going forward. Hence, efficient management of working capital cycle is considered important.

Improvement in capitalization indicators on a timeline basis, albeit remaining high

Equity base of the company increased to Rs. 207.9m (FY20: Rs. 182.3m) during FY21 on account of profit retention. The overall debt profile of the company is short term in nature with short term borrowing slightly declining to Rs. 241.6m (FY20: Rs. 268.5m) during FY21. The sponsors have provided interest free loan of Rs. 111.4m repayable on demand and therefore not accounted in equity. Gearing and leverage indicators have declined on a timeline basis to 1.16x (FY20: 1.47x) and 2.6x (FY20: 3.53x), respectively, during FY21, although remaining higher given the cyclicality in the industry. Going forward, management aims to further reduce borrowing levels and bring gearing level to below 1x mark.

Universal Leather Private Limited **Appendix I**

BALANCE SHEET	FY19	FY20	FY21
Fixed Assets	70.0	71.0	76.5
LT Investments	122.2	122.2	122.2
Stock-in-Trade	497.9	468.3	373.6
Trade Debts	112.1	37.5	58.1
Cash & Bank Balances	7.6	1.8	2.3
Total Assets	940.3	827.0	747.6
Trade and Other Payables	291.2	257.2	168.8
Short Term Debt	286.4	268.5	241.6
Loan from Directors	88.5	94.5	111.5
Paid up Capital	33.9	33.9	33.9
Total Equity (Without surplus revaluation)	231.3	182.4	207.9
INCOME STATEMENT	FY19	FY20	FY21
Net Sales	495.1	386.9	420.0
Gross Profit	102.3	7.5	68.5
Loss/Profit Before Tax	37.6	-44.0	29.9
Loss/Profit After Tax	33.0	-48.9	25.6
RATIO ANALYSIS	FY19	FY20	FY21
Gross Margin (%)	19.3%	1.9%	16.3%
Net Margin	7.2%	-12.6%	6.1%
FFO	40.7	-60.7	27.3
FFO to Total Debt (%)	10.8%	-22.6%	11.3%
Current Ratio (x)	0.98	1.01	1.04
(Stock+ Trade Debts)/ Short-term Debt	1.63	1.88	1.79
Gearing (x)	1.62	1.47	1.16
Leverage (x)	3.45	3.53	2.60
ROAA (%)	3.6%	-5.5%	3.3%
ROAE (%)	15.4%	-23.5%	13.1%

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	see below
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	see below

Rating History

Rating Date	Medium to Long Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY			
11/18/2021	BBB-/A-3	Positive	Maintained
10/01/2020	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

Due Diligence Meeting Conducted

S.No	Name	Designation	Date
1	Mr. Waqas Shakil	Chief Financial Officer	11th Oct 2021
2	Mr. M. Khalid	Manager – Finance	11th Oct 2021