RATING REPORT

Union Fabrics (Pvt) Limited

REPORT DATE:
December 26, 2018

RATING ANALYSTS:
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RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A-	A-2	A-	A-2
Rating Date	*December 26, 2018*		*November 21, 2017*	
Rating Outlook	Stable		Stable	
Outlook Date	*December 26, 2018*		*November 21, 2017*	

COMPANY INFORMATION

Incorporated in 1992	**External auditors:** Horwath Hussain Chaudhury & Co.
Private Limited Company	**Chairman of the Board:** Mr. M Asif Siddiq
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. M Asif Siddiq
Mr. M. Asif Siddiq (30.56%)	
Mr. Faisal Amin (13.09%)	
Mr. Khurram Arif (10.90%)	
Mr. Ahmed Amin (10.30%)	
Ms. Sana Ali Shah (8.89%)	
Ms. Sania Khalid (5.45%)	
Mr. M. Amin Siddiq (5.41%)	

APPLICABLE METHODOLOGY(IES)

Applicable Rating Criteria: Industrial Corporates (May, 2016) ***http://www.jcrvis.com.pk/kc-meth.aspx***

Union Fabrics (Pvt) Limited

OVERVIEW OF THE INSTITUTION

Union Fabrics (Pvt) Limited (UFPL) commenced operations in 1992 as a small scale weaving unit and currently operates in the home textiles, processing and value added business lines in addition to weaving of greige fabric.

The company has 5 plants situated in S.I.T.E area. The company's greige fabric product and various home textile products form a significant part of its export sales.

The management team of the company is spearheaded by the sponsor- Mr. Asif Siddiq himself. Mr. Asif holds a Bachelor's degree in Electrical & Electronics Engineering from University of Florida and an MBA degree in Finance and MIS from University of South Florida.

Certifications held by UFPL include GOTS (Global Organic Textile Standard), OEKO-TEX (Class I and II) which is an international testing and certification system for textiles for limiting use of hazardous chemicals and substances in the textile product, and ISO 9001:2008 and ISO 14001:2004 relating to Quality Management Systems for customer satisfaction and Environment Management System for environmental performance, respectively.

RATING RATIONALE

Union Fabrics (Pvt) Limited (UFPL) deals in the weaving and finishing business segment of greige fabric and home textile product line with more than four-fifth of the sales geared towards the export market. Given increased focus towards value added products, the company completed its expansion in the processing division in March'2017.

Union Apparel (Private) Limited

Union Apparel (Private) Limited (UAPL) is a wholly owned subsidiary of UFPL which is a trading concern that purchases greige and finished fabric from its parent company and other industry players and sells it in the local market. During FY18, sales revenue of UAPL substantially increased to Rs. 1.3b (FY17: Rs. 111.6m). Going forward, UFPL's management plans to convert UAPL into a manufacturing concern through transferring one of its facility. Furthermore, UFPL will inject equity (financed from internal cash generation) in UAPL to fund expansion which entails addition of new looms with higher efficiency vis-à-vis existing looms.

Rating Drivers

Industry Dynamics

Textile exports depicted healthy growth of 14% during FY18 driven by increase in value added segment exports with knit and bed wear segment reporting growth of 21% and 11%, respectively. Growth in value added exports has been driven by incentives under the textile package: 1) increased rebates on total FOB exports value of processed fabric (5%) and garments (7%); 2) removal of sales tax on imports of cotton and textile machinery; and 3) elimination of custom duty on man-made fiber. Moreover, cotton cloth and cotton yarn exports also depicted growth of 8% and 15%, respectively. Going forward, recent rupee depreciation and increased focus of the government on enhancing exports (through reducing cost of doing business and commitment for timely release of refunds and rebates) bodes well for competitiveness of textile exports. Conversely, reduction in rebate rates, increase in cotton prices and rising interest rates may dampen profitability.

Operations

Utilization levels of sizing and weaving unit remained on the higher side and were reported at 82% and 92%, respectively. The management remained focus on production of finer quality fabric manufacturing and high-end product finishing using reactive printing technology. Enhanced focus of the management towards value added segment is further evident from increasing utilization levels of the processing mill reported at 63% during FY18; however the same segment is operating at over 90% utilization during the ongoing year. Going forward, capacity utilization of all segments is expected to remain on the higher side.

Sales

Sales revenue of the company increased by 21% during FY18 with the growth emanating from higher local as well as export sales. More than one-half of the local sales were directed towards the subsidiary company- UAPL owing to higher demand in the domestic market where the company caters to leading brands. Proportion of exports sales still constitutes the bulk of the revenues at around 80%. On a timeline basis, sales of home textiles in sales mix has increased with the same expected to further increase, going forward. Management expects home textiles to constitute around half of sales mix over the medium term. Given the company's current capacity and better prices, European markets remain key area of focus with growth expected to emanate from brands in France and Germany. Given the orders in hand, increase in average selling prices (due to increase in value added sales and rupee depreciation) and higher utilization of the processing mill, consolidated sales (UAPL and UFPL) are projected to depict strong double digit growth in 2019.

Profitability

Gross Margins (GMs) of the company marginally declined to 11.7% (FY17: 11.9%) during FY18 largely on account of higher depreciation charge due to recent expansion. Adjusting for impact of incremental depreciation charge, UFPL's GMs were reported on the higher side in FY18 as compared to preceding year.

Despite higher financial charges as compared to preceding year due to enhanced debt levels and higher provisions for WWF and WPPF, net profit after tax increased by 11% during FY18. Going forward, management foresees that greater sales from value-added segment and local currency devaluation shall more than off-set the impact of rising yarn prices and finance costs, consequently improving profitability.

Liquidity

Liquidity profile of the company has improved during FY18 with adequate coverage of cash flows in relation to outstanding obligations, manageable ageing of trade debts and sound debt servicing ability. Going forward, with improving profitability and limited additional long-term debt drawdown, liquidity profile is expected to strengthen.

Capitalization

Equity base of the company has grown at a 2 year CAGR of 19% on account of profit retention and issuance of right shares for expansion. Total debt on the balance sheet enhanced to Rs. 3.2b (FY17: Rs. 2.9b) at end-June'2018 largely on account of higher short term borrowings to fund working capital requirements. While improving on a timeline basis, gearing and leverage indicators remain on the higher side at 1.62x (FY17: 1.70x) and 1.97x (FY17: 2.05x), respectively at end-FY18. Given projected increase in profitability and limited additional long-term debt drawdown, capitalization indicators are expected to improve going forward.

Corporate Governance

Overall board composition and oversight has room for improvement through inclusion of independent directors. Furthermore, in line with best practices, positions of the CEO and chairman may be segregated. External auditors of the company lie in category A on the SBP panel of auditors. Moreover, UFPL employs a self-developed ERP system which includes HR, production, inventory and finance modules.

ISSUE/ISSUER RATING SCALE & DEFINITION Appendix I

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: JCR-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.jcrvis.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.jcrvis.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.

'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.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-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 II
Name of Rated Entity	Union Fabrics (Pvt) Ltd
Sector	Textile
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	(see table below)
Instrument Structure	N/A
Statement by the Rating Team	JCR-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.
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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
26/12/2018	A-	A-2	Stable	Reaffirmed
21/11/2017	A-	A-2	Stable	Initial