RATING REPORT

Union Fabrics (Private) Limited

REPORT DATE:
December 07, 2021

RATING ANALYSTS:
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RATING DETAILS

	Latest Rating		Previous Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	A-	A-2	A-	A-2
Rating Date	*December 07, 2021*		*January 6, 2021*	
Rating Outlook	Stable		Stable	
Outlook Date	*December 07, 2021*		*January 6, 2021*	

COMPANY INFORMATION

Incorporated in 1992	**External auditors:** Crowe Hussain Chaudhury & Co.
Private Limited Company	**Chairman of the Board:** Mr. M Asif Siddiq
	Chief Executive Officer: Mr. M Asif Siddiq

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Corporates (August 2021)
https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

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 around four-fifth of the sales geared towards the export market. Capacity utilization levels of sizing, weaving, stitching and processing segments continued to report at maximum levels during the outgoing and ongoing fiscal year. UFPL possess adequate information technology infrastructure utilizing SAP enterprise resource planning software which provides operational efficiency. However, overall corporate governance framework depicts room for improvement given status of a private limited company.

Ongoing BMR activities in the processing unit together with the recovery in the industry post COVID-19 lockdown lends support to the business risk of the company.

As a part of the company's BMR plans, capacity of the processing unit will almost double benefiting the company of increased production and better margins. The project is expected to come online by end-FY22. This is additionally supported by the recovery in the textile sector that has scaled up production to pre-COVID level of full-capacity as a significant improvement in containment of the pandemic in the country led the world buyers to partially divert their orders to domestic manufacturers. The growth in production is backed by a big jump in the import of basic raw materials – cotton and man-made yarn – after the recent heavy rainfall and pest attack damaged notable portion of cotton crops in the fields to a multi-year low. Secondly, the industry recovered on a fast pace with the government's support in the shape of rationalizing energy price to a regional competitive level, the same included continued supply of raw material and subsidized financing for the expansion of production and setting up new units. Further, the textile exports have also largely recovered from the Covid-19 pandemic shocks and are still growing both in terms of their quantity and dollar value. The textile shipments have surged by 3.8% to $4.8 billion in 1QFY22 from $4.6bn in the corresponding period last year. The rise in the textile and clothing group has been slightly faster than the 0.6% growth in the overall export. The export recovery is most prominent in the knitwear, home textiles and denim segments.

Profitability indicators of the company improved significantly in FY21 largely owing to robust growth in sales volumes. Going forward, management envisages profitability to improve in the backdrop of higher margins emanating from the ongoing BMR in the processing unit.

Sales revenue of the company witnessed an increase of 47% during FY21. This significant escalation in topline was largely on account of higher volumetric growth in the home textile division. Country-wise sales mix depicts concentration in Europe and America. Given sufficient orders in hand, along with expected commencement of the BMR expansion, sales revenue is projected to depict growth in FY22. Gross profit margins were reported higher at 15.1% (FY20: 14.7%) during FY21 led by currency devaluation. Despite elevated debt levels, finance cost of the company was reported lower at Rs. 238.6m in FY21 as compared to the preceding year (FY20: Rs. 287.1m) due to reduction in overall policy rates. Overall profitability was supported by higher other income of Rs. 32m in FY21 (FY20: Rs. 1.3m) provided by one-off gain on sale of fixed assets and deferred grant income. Subsequently, net margins were reported higher at 8.2% (FY20: 5.1%) during the year end-FY21. Going forward, management envisages profitability to improve in the backdrop of higher sales revenue and margins emanating from the value added segment.

Liquidity profile of the company has improved on the back of elevated profitability indicators in FY21. However, liquidity coverages remained at prior year levels due to rise in debt portfolio. Going forward, with improving profitability, cash flow coverages are expected to remain adequate in relation to outstanding obligations.

In absolute terms, Funds from Operations (FFO) were reported significantly higher at Rs. 1.4b (FY20: Rs. 0.8b) in FY21 due to higher operating profit. Liquidity profile of the company has improved during FY21 with adequate coverage of cash flows in relation to outstanding obligations, manageable ageing of trade debts and sound debt servicing ability. Trade debts in relation to sales have depicted a noticeable rise during FY21 on account of higher dues receivable from the subsidiary-UAPL. Timely recovery of inter-company dues is considered important from a ratings perspective. Going forward, with improving profitability, cash flow coverages are expected to remain adequate in relation to outstanding obligations.

Equity base of the company witnessed an increase owing to profit retention. Leverage indicators increased in the outgoing year due to debt drawdown to finance BMR capex and working capital requirement. Given projected increase in profitability, consequent retention of the same in equity base, and limited debt drawn, capitalization indicators are expected to improve going forward.

Equity base of the company has increased on account of profit retention (FY21: Rs. 3.98b; FY20: 2.99b). During the outgoing year, long-term debt and short-term debt increased on account of purchase of new machinery in the processing unit and higher net working capital requirement, respectively. Gearing and leverage indicators remain on the higher side at 1.46x (FY20: 1.34x, FY19: 1.57x) and 1.93x (FY20: 1.89x, FY19: 1.96x), respectively at end-FY21 as compared to peers. During the ongoing year, Union Fabrics made a long-term investment of around Rs. 98.7m in UAPL. Given projected increase in profitability, consequent retention of the same in equity base, and limited debt drawn, capitalization indicators are expected to improve going forward.

Union Fabrics (Private) Limited — 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.

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	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	see table below

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
		RATING TYPE: ENTITY		
7/12/2021	A-	A-2	Stable	Reaffirmed
6/1/2021	A-	A-2	Stable	Maintained
24/4/2020	A-	A-2	Rating Watch-Developing	Maintained
17/12/2019	A-	A-2	Stable	Reaffirmed
26/12/2018	A-	A-2	Stable	Reaffirmed
21/11/2017	A-	A-2	Stable	Initial

Due Diligence Meetings

Name	Designation	Date
Mr. Amir Iqbal	CFO	1-Sept-2021
Mr. Salman Farooqui	Finance Manager	1-Sept-2021
Mr. Saqib Naseem	Senior Deputy Finance Manager	1-Sept-2021