RATING REPORT

Union Fabrics (Private) Limited

REPORT DATE:
January 18, 2023

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	*January 18, 2023*		*December 07, 2021*	
Rating Outlook	Stable		Stable	
Rating Action	Reaffirmed		Reaffirmed	

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.

Sector Update

- Pakistan's export growth came in at 14% and 27% in FY21 and FY22 respectively. Pakistan's export proceeds have oscillated in the range of USD 22-25b during the past decade (FY11-FY21), however, in FY22 exports finally broke the threshold, coming in at USD 32.4b.

- As illustrated in the table below, the composition of textile exports has depicted improvement in, with contribution from higher value added segment increasing from 77.2% in FY20 to 80.8% in FY22 of aggregate textile exports.

Table 2: Segment-wise textile Exports (All Figures in USD' Millions, except for percentages)

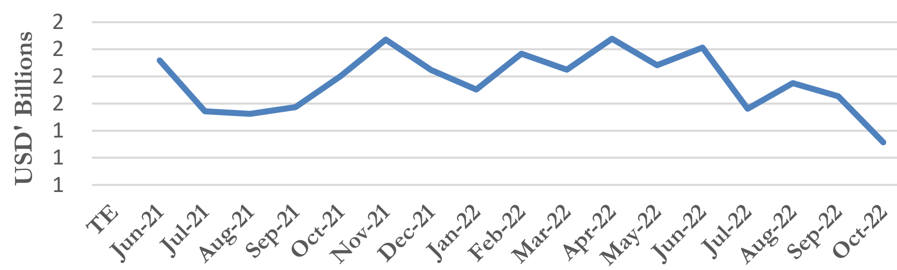
	FY20	FY21	FY22	1Q'FY22	1Q'FY23	FY20	FY21	FY22	1Q'FY22	1Q'FY23
High Value-Added Segment	**9,669**	**12,427**	**15,605**	**3,561**	**3,749**	**77.2%**	**80.7%**	**80.7%**	**80.6%**	**81.8%**
- Knitwear	2,794	3,815	5,121	1,145	1,321	22.3%	24.8%	26.5%	25.9%	28.8%
- Readymade Garments	2,552	3,033	3,905	861	912	20.4%	19.7%	20.2%	19.5%	19.9%
- Bed wear	2,151	2,772	3,293	803	780	17.2%	18.0%	17.0%	18.2%	17.0%
- Towels	711	938	1,111	241	237	5.7%	6.1%	5.8%	5.5%	5.2%
- Made-up Articles (Excl. towels & bed wear)	591	756	849	197	180	4.7%	4.9%	4.4%	4.5%	3.9%
- Art, Silk & Synthetic Textile	315	370	460	108	108	2.5%	2.4%	2.4%	2.4%	2.4%
- Others	555	743	866	206	211	4.4%	4.8%	4.5%	4.7%	4.6%
Low to Medium Value-added Segment	**2,858**	**2,972**	**3,717**	**860**	**835**	**22.8%**	**19.3%**	**19.2%**	**19.4%**	**18.2%**
- Cotton Cloth	1,830	1,921	2,438	557	581	14.6%	12.5%	12.6%	12.6%	12.7%
- Cotton Yarn	984	1,017	1,207	289	236	7.9%	6.6%	6.2%	6.5%	5.2%
- Others	43	34	72	14	18	0.3%	0.2%	0.4%	0.3%	0.4%
Total	**12,527**	**15,399**	**19,332**	**4,421**	**4,584**					
Source: PBS										

- After posting windfall margins in FY21 and H1'FY22, margins of textile operators, particularly spinners, weavers and dying units, have came under pressure during the period

Jan-Sep'2022, mainly on account of higher input costs and recessionary trend in export markets.

- The recessionary trend in Pakistan's major export textile export markets, mainly North America and EU, has started to materialize in Pakistan's MoM export proceeds, with receipts for October 2022 (at USD 1.36b) being lower by 11% and 15% vis-à-vis preceding month and corresponding period last year respectively, as also illustrated in the table below.

Figure 1: MoM Textile Exports (TE) (In USD' Billions)



- Given expected industrial gas load shedding during the period Dec-Feb'22, and prevailing recession in major export markets and peak inventory levels, textile export proceeds are expected to fall by ~10% in FY23. Furthermore, profitability margins of textile operators, particularly spinners, weavers and dying companies, are expected to remain under pressure given higher input and financial costs.

<u>Key Rating Drivers</u>

Growth in topline mainly stemmed by higher selling prices amid currency devaluation

- Company has recorded an increase of 24% in sales revenue in FY22. The increase is a result of an increase in sales volume coupled with higher average selling price as well as currency devaluation. Capex in previous year has also contributed towards the revenue growth. Sales of the Company comprise of Greige Fabric, ROT, and Home textile.

- Sales mix of the Company shows concentration in America, Italy, and Germany, accounting for 56.8% of the exports in these markets. Top ten client concentration stands on the higher side, making up 67% of the total sales.

- During 1QFY'23, sales revenue of the Company recorded 8% growth compared to 1QFY22. Going forward, given the exports market depicting a recessionary trend, topline may have an impact. However, management envisages sales to remain in these levels due to high prices in dollar terms.

Profitability margins contracted owing to supply chain constraints reflected by an increase in shipping costs along with higher finance charges

- Despite rupee depreciation during the period under review, gross margins of the Company registered a slight drop to come in at 14% in FY22 (FY21: 15.1%) mainly on the back of increase in shipping costs due to supply chain issues. 1QFY23 gross margin clocked in at 14.2%.

- Apart from increase in short term debt, finance cost has also shown an increase due to increase in debt levels and interest rates.

- Consequently, net profit of the Company has declined by 31.26% in FY22. Similarly, net margins has also shown a contraction to 3.5% during FY22. 1QFY23 net margins remain intact at 3.5%.

- Management is expecting margins to improve during the rating horizon with the change in product mix of the Company.

Cash flow coverages have come under stress in FY22 and 1QFY'23 on the back of lower profitability reported in these periods coupled with elevated debt levels

- With FFO having shown an increasing trend till FY21, it has shown a decline of 14.3% in FY22 due to shrink in profitability.

- Apart from fall in FFO, liquidity profile has further deteriorated owing to an increase in the debt levels of the Company in FY22 which is reflected by FFO to total debt ratio of 0.14x (FY21: 0.24x) and FFO to long term debt of 0.38x (FY21: 0.5x). Debt servicing ratio decreased to 1.86x (FY21: 4.26x). Liquidity profile further deteriorated in 1QFY23.

- Current ratio of the Company stands at 1.00x and 1.02x as at Jun'22 and Sep'22, depicting room for improvement.

- Going forward, effective management of liquidity profile along with adequate debt service coverage will remain important from the ratings perspective.

Equity base of the company witnessed a slight increase. Gearing and leverage indicators have elevated on the back of increase in the total borrowings to finance Capex and meet working capital requirements of the Company

- Equity base of the Company stood higher at Rs.4.6b as at Sep'22 (Jun'21: Rs.4.0b).

- Total debt of the Company has increased significantly to Rs.8.8b (FY21: Rs.5.8b). The increase is attributable to financing Capex as well higher working capital requirement as cited by low cash conversion cycle due to slowdown in the market.

- Separately, Short term borrowings increased to Rs. 5.3b as at Sep'22 compared to Rs. 2.9b as at Jun'21. Short term borrowings is a mix of ERF and credits from financial institutions.

- Long term borrowings increased to Rs. 3.4b as at Sep'22 from Rs. 2.8b as at Jun'21. Management is planning to pay off its all KIBOR based debt (LT+ST) as at Mar'23.

- Increased debt levels have construed into higher leverage and gearing ratios to 2.72x and 1.96x as at Jun'22. (Jun'21: 1.93x and 1.46x) respectively.

- In 1QFY'23, Capitalization indicators remained within the same level. Going forward, management does not expect any debt drawdowns in view of the prevailing market conditions.

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

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
		RATING TYPE: ENTITY		
18/1/2023	A-	A-2	Stable	Reaffirmed
12/7/2021	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

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

Name	Designation	Date
Mr. Tufail Kasbati	CFO	27-Dec-2022
Mr. Salman Farooqui	Senior Finance Manager	27-Dec-2022
Mr. Saqib Naseem	Senior Deputy Finance Manager	27-Dec-2022