

RATING REPORT

Union Fabrics (Private) Limited

REPORT DATE:

February 29, 2024

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	February 29, 2024		January 18, 2023	
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: Industrial Corporates

<https://docs.vis.com.pk/docs/CorporateMethodology.pdf>

APPLICABLE RATING SCALE(S)

VIS Issue/Issuer Rating Scale: <https://docs.vis.com.pk/docs/VISRatingScales.pdf>

Union Fabrics (Pvt) Limited

OVERVIEW OF THE INSTITUTION RATING RATIONALE

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

Company Profile

Union Fabrics (Pvt.) Limited (UFPL or the 'Company') deals in the weaving and finishing business of greige fabric and home textiles with around 80% of the sales geared towards the export market. UFPL possess necessary information technology infrastructure, utilizing SAP enterprise resource planning software which provides operational efficiency.

The position of CEO at UFPL is held by Mr. Mohammad Asif Siddiq, with Mr. Tufail Kasbati serving as the Chief Financial Officer. Mr. Mahmood Hussain acts as the Company's legal advisor. Additionally, the Company's auditor, Crowe Hussain Chaudhury & Co., is included in the State Bank of Pakistan's approved panel, holding an 'A' category, indicating professional competence and credibility.

Sector Update

Over the past decade (FY11-FY21), Pakistan's export proceeds have fluctuated within the range of USD 22 - 25 bn. The country's financial landscape, including forex reserves, inflation, debt to GDP ratio, fiscal and current account deficit, has faced challenges in the last two years. Textile exports, a significant component of the total exports, play a crucial role in the country's economic structure. The textile industry has faced multiple issues, including the adverse effects of the COVID-19 pandemic, disruptions in the global supply chain, devastating floods in 2022 impacting cotton crops, and an ongoing energy crisis posing a severe challenge to industry margins' sustainability and future growth.

Ad hoc measures like import freezes to stabilize foreign reserves, implemented by the government, have affected the industry's ability to cover shortfalls by importing raw materials. Beyond impacting profit margins, the higher pricing of raw materials is anticipated to increase working capital requirements, negatively affecting the liquidity profile of textile operators, especially spinners, weavers, and dyeing companies. The industry faces challenges such as the high cost of raising capital due to the policy rate hovering at 22%.

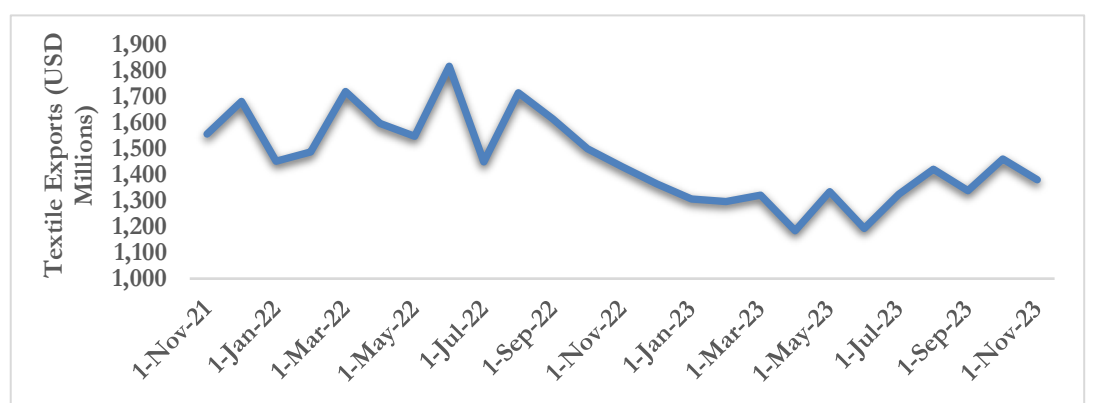


Figure 1: MoM Textile Exports (In USD Millions)
Source: SBP

Environment Management System for environmental performance, respectively.

In FY22, export revenues from the textile sector reached USD 19.30 bn, increasing from USD 15.40 bn in FY21, primarily attributed to subsidized COVID-19 pandemic-related financing programs like the Temporary Economic Refinance Facility (TERF). However, the figure declined by 15% to USD 16.50 bn in FY23. Textile exports accounted for 59.5% of the country's total goods exports in FY23, showing a minor decline from 60.9% in FY22. Specific sectors within textiles, such as cotton yarn exports, witnessed a 30% decline to USD 0.84 bn, while cotton fabric exports fell by 17% to reach USD 2.0 bn in FY23.

Global and domestic challenges, including a slowdown in export demand, particularly from North America and the European Union, have begun to manifest in Pakistan's monthly export proceeds. The recessionary trend, anticipated industrial gas load shedding in the country, and rising production costs due to inflation are expected to weigh on the business risk profile moving forward. These factors may lead to increased market pricing competition for exporters.

Key Rating Drivers

Topline declines on account of slowdown in demand in FY23; rupee depreciation boosts gross margin, yet elevated finance cost dent net margin

Sales of the Company mainly comprise of greige fabric and home textile. The Company's profitability profile is primarily supported by export sales, contributing ~81% towards sales revenue. In the period under review, home textile sales contributed 55% to the export sales revenue (FY22: 39%), serving as a primary source of income from exports for the Company.

During FY23, the Company's net revenue decreased by ~9.7% owing to reduced demand stemming from the temporary closure of a factory of a key export client, due to the Russo-Ukrainian war. With lower raw material prices and rupee depreciation during FY23, gross margin of the Company enhanced to 17.4% (FY22: 14.0%). The Company incurred increase in finance charges of ~81.8% compared to the previous year due to elevated monetary policy rate. Consequently, the net profit declined, while the net margin inched down to 2.9% (FY22: 3.54%).

In 1QFY24, the net sales rebounded, attributed to a strategic agreement signed in October 2022 for exporting value added products to one of the existing client. Pursuant to this agreement, the Company transitioned from supplying raw greige fabric to providing value-added bedsheets. Consequently, the initial decline in greige fabric sales was offset by increased volumes of value-added products. While gross margin slightly reduced to 16.6% (FY23: 17.4%), the net margin significantly improved to 7.8% (FY23: 2.9%), on account of lower finance costs with reduction in outstanding debt. Going forward, the management anticipates the rebound in sales to continue and margins to fall in line with the historical trend by the end of FY24.

Cash flows coverage indicators remained adequate

The liquidity profile of the Company remained adequate although the Funds from Operations (FFO) has declined by ~12.4% owing to a fall in profitability. Resultantly, the Debt-Service-Coverage-Ratio has reduced to 1.49x (FY22: 1.86x). The FFO/Total Debt ratio remained stable at 0.14x (FY22: 0.14x), while FFO/Long-term Debt ratio showed slight improvement, standing at 0.41x (FY22: 0.38x) due to the repayment of long-term debt.

The current ratio decreased to 0.98x (FY22: 1.00x), while the cash conversion cycle has improved to 128 days (FY22: 136 days) backed by higher days inventory and days payable outstanding.

During 1QFY24, the FFO improved compared to 1QFY23 on account of higher profitability. As a result, the DSCR improved to 2.05x (FY23: 1.49x) and both FFO/Total Debt and FFO/Long-term Debt ratios increased to 0.23x and 0.76x respectively (FY23: 0.14x and 0.41x). The current ratio showed minor improvement, standing at 1.00x (FY23: 0.98x), while the cash conversion cycle was reported to be 82 days (FY23: 123 days). Going forward, effective management of liquidity profile along with maintenance of debt-service coverage will remain important for the assigned ratings.

Capitalization profile posted slight improvement amid debt reduction in FY23

To save the bottom line from potential finance cost pressures, the Company reduced short-term debt and repaid long-term debt during FY23. As a result, short-term borrowings stood at Rs. 5.12 bn as at Jun'23 (Jun'22: 5.63 bn) and long-term debt reduced to Rs. 2.62 bn as at Jun'23 (Jun'22: Rs. 3.22 bn). The equity base of the Company increased on account of higher profit retention. Consequently, both gearing and leverage indicators have trended downwards to 1.58x and 2.26x (FY22: 1.96x and 2.72x) respectively.

During 1QFY24, both gearing and leverage ratios further improved to 1.46x and 2.25x respectively, indicating stability in the Company's capital structure. Going forward, maintenance of the same will remain a key rating factor.

REGULATORY DISCLOSURES		Appendix I			
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				
	29/02/2024	A-	A-2	Stable	Reaffirmed
	18/01/2023	A-	A-2	Stable	Reaffirmed
	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
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	06-Feb-2024		