RATING REPORT

Union Fabrics (Private) Limited

REPORT DATE:
March 20, 2025

RATING ANALYSTS:

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RATING DETAILS

	Latest Rating		Previous Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	A-	A2	A-	A2
Rating Date	*March 20, 2025*		*February 29, 2024*	
Rating Watch/ Outlook	Rating Watch – Developing		Stable	
Rating Action	Maintained		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

RATING RATIONALE

Company Profile

Union Fabrics (Pvt.) Limited (UFPL or the 'Company') commenced operations as a small weaving unit in 1992 and has since evolved into a leading exporter of high-quality home textile fabrics and made-ups. Company provides a diverse range of fabrics to various industries, including bedding, mattress ticking, and furnishing, available in greige (loom-state), bleached, and finished forms. Approximately half of these fabrics are further processed into finished goods such as sheets, pillows, shams, duvets, drapes, and kitchen linens, for both retail and institutional buyers.

The position of CEO at UFPL is held by Mr. Muhammad Asif Siddiq, with Mr. Tufail Kasbati serving as the Director Finance/ Chief Financial Officer and Mr. Mahmood Hussain as the Company's legal advisor. Additionally, the Company's auditor, Crowe Hussain Chaudhury & Co., is included in the SBP's approved panel, holding an 'A' category and appears in the QCR list of auditors.

Merger Plan

The company plans to consolidate Union Apparel (Pvt) Limited with and into its parent entity, Union Fabrics (Pvt) Limited. This consolidation is driven by the recent changes in the tax regime for export-oriented companies, which will allow the combined entity to benefit from various incentives. These include a larger asset base, enhanced synergies, increased risk absorption capacity, reduced administrative costs, streamlined corporate and tax reporting, better leverage of assets, improved tax efficiencies, and optimized legal structure. Additionally, the consolidation is expected to result in significant cost savings and operational rationalization

Consequently, the management has decided to merge Union Apparel with and into Union Fabrics, with Union Fabrics being the surviving entity. The consolidation is expected to take effect from the FY25 results, as all NOCs have been obtained from the Company's existing lenders to proceed with the Amalgamation and a petition has been filed with the High Court of Sindh.

As per the Transaction support letter issued by the Company's Auditors, the swap consideration is as follows:

'In consideration of the shared common control in the share capital between both companies i.e., resulting from UAPL being a wholly owned subsidiary of UFPL, the corresponding share capital and investments will be offset accordingly. In light of the same, in respect of the proposed Amalgamation, no shares of any kind are required to be issued by UFPL, as there will be no change in the relationship between the shareholders of UFPL. The investment in UAPL which is appearing in the books of UFPL will be canceled, along with the shares held by its nominees, and the difference between the Assets and Liabilities of UAPL will be credited to the books of the merged entity (i.e., UFPL) as a 'Capital Reserve' or 'Merger Reserve'. As a consequence of the Amalgamation, there will be no changed in the existing and future pattern of shareholding of UFPL – i.e., in the post-approval scenario of the Scheme.'

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.

<u>Sector Update</u>

The growth of textile sector exports has remained largely constrained since FY23 due to energy shortages, elevated financing costs, and a slowdown in the global economy. In FY24, Pakistan's textile and clothing exports recorded a modest YoY growth of 0.9%, reaching USD 16.65Bn, a slight increase from USD 16.50Bn in FY23, as per data from the Pakistan Bureau of Statistics. This limited growth was primarily attributed to higher taxation measures and escalating energy costs, which also led to a decline in the import of textile machinery—an indication of reduced industry investment in expansion and modernization.

During the same period, exports of made-up textiles (excluding bed wear and towels) experienced a 3.3% YoY increase, reaching USD 715Mn. This reflects the sector's resilience despite prevailing challenges. Demand for home textiles, kitchen linens, and other finished textile products remained robust, particularly in key markets such as the United States, the European Union, and the Middle East.

In USD Million	FY20	FY21	FY22	FY23	FY24
Textile Exports	12,527	15,399	19,330	16,502	16,656
Made-up textile exports	591	756	849	693	715

Source: PBS

The beginning of FY25, however, has shown positive developments, with textile exports increasing by 4.86% during Jul-Sept compared to the same period last year. This growth has been largely attributed to the relocation of global textile orders to competing markets, including Pakistan, following political and economic instability due to the change of government in Bangladesh. According to industry sources, this shift has contributed approximately USD 100Mn in additional high-value-added textile exports since June 2024. However, the sustainability of this growth remains to be seen as Bangladesh stabilizes under the new set-up.

Despite these improvements, the textile sector continues to face significant challenges, including increased taxation following the annual budget announced in June 2024 and rising energy costs due to recent changes in power tariffs.

<u>Financial Risks</u>

Capital Structure

Short-term borrowings increased by 41% YoY in FY24, reflecting the incremental working capital requirements to support higher sales. Meanwhile, long-term debt declined by 20% YoY as at end-FY24 supported by loan repayments. The equity base strengthened by 18% due to higher profit retention and by a further 5% in 1QFY25. However, despite the improvement in equity, gearing and leverage ratios remained elevated at 1.64x and 2.17x, respectively (FY23: 1.58x and 2.26x). During 1QFY25, both ratios further deteriorated to 1.81x and 2.41x, respectively, indicating room for improvement in the Company's capital structure.

The Company is currently undergoing routine Balancing, Modernization and replacement (BMR), including the installation of new advanced machinery aimed at improving efficiency. These upgrades are expected to significantly reduce energy and material costs. Additionally, the Company is addressing production bottlenecks with the procurement of a specialized machine to improve processing capacity. The new equipment is anticipated to increase speed and output, contributing to overall operational efficiency. For the current year, the Company has allocated significant funds for these upgrades, with the financing split between debt and equity.

Furthermore, the Company is working on establishing renewable energy projects, including 6.5MW wind Turbine, to enhance energy cost efficiency. The total investment in these projects is substantial, with a significant portion financed through debt. The renewable energy initiatives are expected to be completed by September 2025, further improving the Company's cost structure and sustainability. Consequently, the Company's capitalization profile is expected to remain constrained.

Profitability

The Company's sales are primarily driven by the export of finished home-textile goods in major markets in Europe. Export sales accounted for 85% of total sales, while the remaining portion was attributed to local services (pertaining to printing and processing services), mainly provided to the Company's subsidiary, Union Apparel (Pvt.) Ltd, and other leading export houses.

During FY23, a 10% YoY decline in topline was reported due to factory closure of export clients all over Europe following the Russia-Ukraine war. However, with this closure of factories, demand for greige fabrics (which is a semi-finished good) has been replaced by finished goods from 60-70% of European clients, reflecting a rebound in sales as topline registered a 43% YoY growth during FY24. Management foresees this demand for finished goods from Europe to remain sustained for next 3-4 years.

Although the gross margin (FY24: 15.6%) has declined compared to FY23 (17.4%), this was primarily due to a relatively stable exchange rate during the period and increase in gas prices. Nevertheless, the net margin demonstrated a notable improvement, rising from 2.93% in FY23 to 4.94% in FY24, driven by a decline in finance costs and a lower effective tax rate, continuing into 1QFY25 with net margin reaching 5.14%

Liquidity and Debt Coverage

The liquidity profile of the Company showed slight improvement, with Funds from Operations (FFO) recovering by 45% as a result of increased profitability. Consequently, the Debt-Service Coverage Ratio (DSCR) improved to 1.81x (FY23: 1.35x). The FFO/Total Debt ratio rose to 0.17x (FY23: 0.14x), while the FFO/Long-Term Debt ratio improved even further, reaching 0.73x (FY23: 0.43x), supported by the repayment of long-term loans. The current ratio remained mainly stable at 1.00x (FY23: 0.98x), although the cash conversion cycle weakened to 144 days (FY23: 128 days), primarily due to a reduction in payable days.

For 1QFY25, annualized FFO declined by 25% YoY but remained consistent with prior level. As a result, the DSCR stood at 1.66x, while FFO/Total Debt and FFO/Long-Term Debt ratios declined to 0.11x and 0.55x, respectively (FY24: 0.17x and 0.73x). The current ratio clocked at 0.99x (FY24: 1.00x), while the cash conversion cycle further deteriorated to 149 days (FY24: 144 days).

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				
20/03/2025	A-	A-2	Rating Watch - Developing	Maintained
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	Director Finance	19-Feb-2025
Mr. Saim Sher	Manager Treasury	
Mr. Muhammad Fahim	Deputy Manager – Treasury	