RATING REPORT

Union Apparel (Private) Limited

REPORT DATE:
January 6, 2021

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	BBB	A-2
Rating Date	*January 6, 2021*		*Apr 24, 2020*	
Rating Outlook	Stable		Rating Watch-Negative	
Outlook Date	*January 6, 2021*		*Apr 24, 2020*	

COMPANY INFORMATION

Incorporated in 2016	**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. Khurram Arif
Union Fabrics (Private) Limited – 100%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria *Industrial Corporates (May 2019)*
http://vis.com.pk/kc-meth.aspx

Union Apparel (Private) Limited

OVERVIEW OF THE INSTITUTION

Incorporated in 2016, Union Apparel (Private) Limited (UAPL) is a wholly-owned subsidiary of Union Fabrics (Private) Limited (UFPL). UAPL is engaged in manufacture and sale of fabric to the domestic market.

Chairman of the Company- Mr. Asif Siddiq 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.

The management team of the company is spearheaded by one of the directors of the parent company- Mr. Khurram Arif. He has been associated with Union fabrics since the past 18 years. Mr. Khurram holds a degree in Mechanical Engineering from England.

RATING RATIONALE

Setup in 2016, UAPL is a wholly-owned subsidiary of Union Fabrics (Private) Limited (UAPL), engaged in manufacture and sale of fabric to leading brands in the local market. The assigned ratings incorporate medium-size operations of the company with manageable gearing indicators, adequate margins and sufficient cash flow position in relation to outstanding debt. Ratings also factor in UAPL's satisfactory order book position which provides adequate revenue visibility in the medium term. In lieu of increasing demand, the company has planned expansion in the weaving division with an estimated cost of Rs. 1.5b, two-third of which shall be financed by long term financing facility with the remaining being financed by internal cash flows and equity injection by the parent company.

Favorable government policies for enhancing exports and improving country's perception and law & order situation bode well for the textile sector. Key risk factor include rising cost of doing business (increasing electricity and gas tariff and rising local cotton prices). Even though implications of Covid-19's second wave remain elevated, we expect the order book for the industry to remain strong in the ongoing year, easing our business risk concerns.

Textile exports depicted growth of 9.3% during FY20 driven largely by sizeable currency devaluation in the outgoing year. Overall growth emanated from the value added segment. Favorable government policies for enhancing exports and improving country's perception and law & order situation bode well for the textile sector. Conversely, increasing cost of doing business and reduction in rebate rates may impact margins for select players. Even though implications of Covid-19's second wave remain elevated, we expect the order book for the industry to remain strong in the ongoing year, easing our business risk concerns.

Gross margins have depicted consistent improvement on the back of volumetric growth and higher pricing of value-added products. Single client concentration has witnessed improvement on a timeline basis, however the same is considered to be on the higher side. Ratings draw comfort from long term association of the parent company with reputed brands. Going forward, profitability levels are projected to further strengthen due to large number of orders on hand and higher projected sales post expansion.

UAPL's sales are entirely represented by local sales with sales revenue reporting an increase of 7% in FY20. Client base of the company comprises reputed fashion and lifestyle brands with largest customer representing more than 60% of revenues. Given ongoing efforts to induct new customers, management has managed to achieve client diversification in FY20. Consequently, single client concentration has witnessed improvement on a timeline basis, however the same is considered to be on the higher side. Ratings draw comfort from long term association of the parent company with reputed brands.

Gross margins have significantly improved in FY20 and the ongoing year due to volumetric growth and higher pricing of value added products. Gross margins were reported at 17.1% (FY20: 11.2%; FY19: 8.9%) during 4MFY21. Finance costs depicted a jump on the back of increase in quantum of funds borrowed to meet working capital requirements. Net margins were reported at 9.2% (FY20: 2.5%; FY19; 2.8%) during 4MFY21. The improvement in net margins was a result of higher volume of orders and value-added pricing. Going forward, profitability levels are expected to improve due to number of orders in hand and the high projected revenue followed by UAPL expansion plans.

Adequate liquidity profile bolstered by sufficient cash flow coverages against outstanding obligations

Liquidity profile has improved in line with growth in profitability on a timeline basis. Funds from operations have registered sizeable growth during FY20. Despite debt draw down to finance working capital requirements, cash flow coverage metrics of the company are considered satisfactory. FFO in relation to total debt and FFO in relation to Long term debt were reported at 22.0% (FY20: 32.5%; FY19: 15.7%) and 128% (FY20: 96.8%; FY19: 40.3%), at end-Oct'20 respectively. Trade debts in relation to sales depicted a noticeable increase during FY20 and 4MFY21 on account of extension in credit terms amidst COVID-19. Recovery from dues is back on historical track, as per management. Debt servicing coverage ratio is considered adequate. Given company's plan to drawdown long term debt to finance expansion, maintaining cash flow coverage in relation to borrowings is considered important from a ratings perspective.

Leverage indicators are expected to improve on the back of profit retention and equity injection expected from the parent company over the next two years. Despite expansion plans set in order, management expects leverage levels to remain within manageable levels in support with improved profitability profile.

Equity base has increased on a timeline basis on account of profit retention. Gearing and leverage ratios of the company stood at 1.48x (FY20: 1.30x, FY19: 1.03x) and 2.74x (FY20: 3.43x, FY19: 3.97x) at end-Oct'20. With expansion plans set in order, UAPL's management expects an interest free sponsor loan from the parent company over the next two years. Given projected increase in debt levels, gearing and leverage levels are expected to increase. However the same are expected to remain within manageable levels in support with improved profitability profile and equity injection from the parent company.

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 Apparel (Private) Limited
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				
6/1/2021	A-	A-2	Stable	Upgrade
24/4/2020	BBB	A-2	Rating Watch-Negative	Maintained
17-12-2019	BBB	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
Tufail Kasbati	CFO	16-Dec-2020
M. Asif Siddiq	CEO	16-Dec-2020