RATING REPORT

Union Apparel (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 2016	**External auditors:** Crowe 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: Corporates (August 2021)
https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

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, Union Apparel (Private) Limited (UAPL) is a wholly-owned subsidiary of Union Fabrics (Private) Limited (UFPL), engaged in manufacture and sale of fabric to leading brands in the local market. The assigned ratings incorporate medium-size operations of the company, 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. Ratings are strongly dependent on improving gearing and leverage levels post commencement of the planned expansion.

In order to meet increasing demand of existing clientele, reduce dependence on outside purchases, and to improve lead time, the company has planned expansion in the weaving division with an estimated cost of Rs. 2.6b. Around 60% (Rs. 1.5b) of which shall be financed by long term financing facility (TERF) with the remaining being financed by internal cash flows and equity injection by the parent company- UFPL. The project entails installation of 132 Picanol air-jet looms with complete back process enhancing production capacity from 6m meters/annum to 24m meters/annum at Nooriabad, Karachi. The project is expected to come online by end-FY22.

Ongoing expansion plans in the weaving segment 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 expansion plans, capacity of the weaving unit will triple benefiting the company of increased production and better margins. 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.

Gross margins have depicted consistent improvement on the back of volumetric growth and cost-cutting efficiencies. High single client concentration in sales 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 expanded capacity levels.

UAPL's sales are entirely represented by local sales with sales revenue reporting a noticeable increase of 40% in FY21 attributable to both volumetric growth and higher average selling prices. Given capacity constraints, the company was majorly outsourcing its production. Client base of the company comprises reputed fashion and lifestyle brands with largest customer representing around one-half of the revenues. Orders that were historically outsourced are now expected to be sold through in-house functions post expansion. Moreover, given ongoing efforts to induct new customers, management expects to achieve further client diversification post-Dec'21. Ratings draw comfort from long term association of the parent company with reputed brands.

Gross margins have improved in FY21 to 11.4% (FY20: 11.2%; FY19: 8.9%) due to volumetric growth and cost-cutting efficiencies. Finance costs decreased on the back of decline in policy rates. Net margins were reported higher at 4.6% (FY20: 2.5%; FY19; 2.8%) during FY21 largely led by higher gross profitability. Going forward, profitability levels are projected to further strengthen due to large number of orders on hand, and higher projected sales post expanded capacity levels.

Healthy cash flow generation has resulted in strong liquidity profile. Despite projected elevation in debt levels, cash flow coverages are expected to remain within satisfactory levels supported by higher profitability.

Liquidity profile has improved in line with growth in profitability on a timeline basis. Funds from operations have registered sizeable growth during FY21. Despite significant short-term debt draw down to finance working capital requirements at end-FY21, 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 15.8% (FY20: 21%; FY19: 15.7%) and 80.2% (FY20: 62.4%; FY19: 40.3%), at end-FY21 respectively. Trade debts in relation to sales depicted a noticeable increase during FY21 on account of extended working capital cycle due to major sales incurring in the last quarter of the outgoing year. Recovery from dues will be 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.

At-end FY21, leverage indicators are elevated on account of larger debt base to finance working capital requirements. While VIS projects leverage indicators to increase owing to drawdown of debt to finance expansion, the same are expected to remain within manageable levels for the assigned ratings led by growth in equity base through profit retention and equity injection.

On account of higher profit retention and issuance of right shares (~Rs. 200m), net equity of the company was reported higher at Rs. 865.9m (FY20: Rs. 394.1m; FY19: Rs. 326.6m) at end-FY21. Total debt carried on balance sheet amounted to Rs. 1.14b (FY20: Rs. 514m) at end-June'21; where 80% of the total debt is short-term in nature. Moreover, the company also has an interest free short term sponsor loan to the tune of Rs. 50.3m at end-June'21. With a larger debt base, leverage indictors have escalated towards the higher side with gearing and debt leverage reported at 1.32x (FY20: 1.30x, FY19: 1.03x) and 3.56x (FY20: 3.43x, FY19: 3.97x) at end-FY21, respectively. Leverage indicators have trended upwards on account of noticeable additional debt drawdown to finance working capital needs. While VIS projects leverage indicators to increase owing to drawdown of debt to finance expansion, the same are expected to remain within manageable levels for the assigned ratings led by growth in equity base through profit retention and equity injection. Ratings are strongly dependent on improving gearing and leverage levels as per communicated benchmarks for the assigned ratings post commencement of the planned expansion.

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	see 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.
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. For conducting this assignment, analyst did not deem necessary to contact external auditors or creditors given the unqualified nature of audited accounts and diversified creditor profile.

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	Upgrade
24/4/2020	BBB	A-2	Rating Watch-Negative	Maintained
17-12-2019	BBB	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