RATING REPORT

Union Apparel (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 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. UAPL possess adequate information technology infrastructure utilizing SAP enterprise resource planning software which provides operational efficiency.

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, which entails installation of 12 electronic jacquard looms at weaving division along with 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 was expected to come online by end-FY22, however, it got delayed due to delay in electric connection by HESCO and concise rate approval from SSGC.

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)

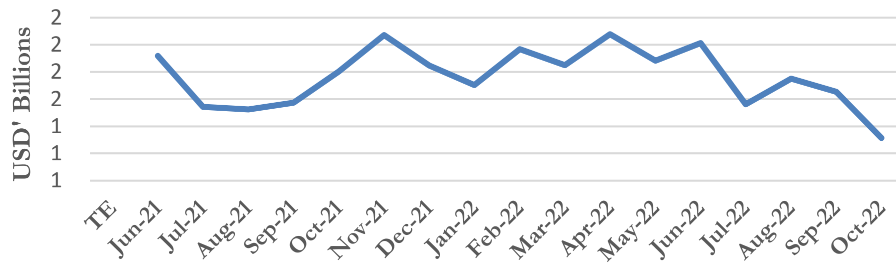
	FY20	FY21	FY22	1Q'FY22	1Q'FY23	FY20	FY21	FY22	1Q'FY22	1Q'FY22
High Value-Added Segment	**9,669**	**12,427**	**15,605**	**3,561**	**3,749**	**77.2%**	**80.7%**	**80.7%**	**80.6%**	**81.8%**
- Knitwear	2,794	3,815	5,121	1,145	1,321	22.3%	24.8%	26.5%	25.9%	28.8%
- Readymade Garments	2,552	3,033	3,905	861	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.

Key Rating Drivers

Growth in topline led by increased prices. Topline growth is expected to remain under pressure in FY23

- Sales of the Company posted an increase of 16.22% in FY22 mainly due to increase in prices. The Company, first time, registered an export sales during FY22. Management is focusing to continue their export sales going forward.

- Top ten client concentration make up 74.85% of the Company's local sales, whereby it stands on the higher side. Top 2 clients consist 55.2% of the total sales. Albeit client concentration draws comfort from the Management's long term association with reputed brands.

- With long term contracts undertaken with notable vendors like Khaadi, J. and Ideas, management envisages quantity to increase by 20% in FY23.

- Company has also initiated Nooriabad project whereby 2 units will be installed, of which 1 unit holds 48 looms each, thereby it may bolster its revenue. However, given the Country facing economic headwinds and market slowdown, revenue growth may remain under pressure, going forward.

Profitability margins have shown improvement, the same is to remain important from ratings perspective

- In FY22, the Company has recorded a favorable uptick in gross margins and operating margins which stood at 14.7% and 13.1% (FY21: 11.6% and 10.1%) respectively.

- However, net margins of the Company haven't witnessed an increase due to increased finance cost in FY22.
- Profitability metrics improved further in 1QFY23, with gross margins and net margins recorded at 17.6% and 7.0% respectively.
- Going forward, managing stability in the margins will remain important from the ratings perspective.

Liquidity profile has deteriorated in relation to the elevated debt levels. Given high debt drawdowns, liquidity profile is expected to remain tight

- FFO of the Company depicted a 27.78% decline in FY22. Subsequently, it rebounded and registered a growth of 10% in 1QFY23 in line with the net profit of the Company.
- Debt drawdowns have increased, which has adversely impacted the liquidity profile of the Company as cited by FFO in relation to total debt and long term debt which has plummeted to 0.04x and 0.07x in FY22 (FY21: 0.16x and 0.93x), albeit a slight improvement was noticed in 1QFY'23.
- Current ratio of the Company dropped below 1x to stand at 0.93 as at Sep'22 (Jun'22: 0.93x).
- Liquidity is expected to remain manageable subject to the cash flow coverage of the Company to meet its debt obligation, going forward.

At-end FY22, gearing ratio has increased as a result of increase in debt drawdowns, however, leverage ratio has shown a declining trend, albeit it remains high. Equity base has increased on the back of increased profitability and equity injection

- On the back of increased profitability and issuance of shares, equity base of the Company exhibited growth in FY22.
- Total debt of the Company has depicted a robust increase to Rs.3.0b in FY22 (FY21: Rs.1.1b) on account of financing expansion as well as to meeting working capital requirements. Wherein, LT debt has increased to Rs. 1.7b as at Sep'22 from Rs. 218m as at Jun'21. ST borrowings stands at Rs. 1.17b as at Sep'22 (Jun'21: Rs. 917.5m)
- Consequently, gearing ratio has increased to 1.73x as at Jun'22 (Jun'21: 1.31x) while leverage ratio improved to 3.34x as at Jun'22 (Jun'21: 3.56x). Subsequently as at Sep'23, leverage indicator further improved to 3.30x while gearing ratio improved to 1.59x.
- Going forward, the Company is not planning to mobilize any further debt. Capitalization indicators are expected to decline gradually during the rating horizon.

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
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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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
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. 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