RATING REPORT

Utopia Industries (Private) Limited

REPORT DATE:
June 05, 2023

RATING ANALYSTS:
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RATING DETAILS		
Rating Category	**Initial Rating**	
	Long-term	**Short-term**
Entity	A-	A-2
Rating Outlook	Stable	
Rating Action	Initial	
Rating Date	*June 05, 2023*	

COMPANY INFORMATION	
Incorporated in 2018	**External Auditors:** Clarkson Hyde Saud Ansari Chartered Accountants
Private Limited Company	**CEO:** Mr. Jabran Niaz
Key Shareholders (with stake 5% or more):	
Mr. Jabran Niaz ~ 50%	
Mr. Adnan Niaz ~ 50%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: Industrial Corporates (May 2023) *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*

Utopia Industries (Private) Limited

OVERVIEW OF THE INSTITUTION

Utopia Industries (Private) Limited (UIPL) was incorporated on April 6 2018, as a private limited company. Registered office is situated at S.I.T.E, Super Highway, Karachi.

Profile of CEO

Mr. Jabran Niaz is the CEO of Utopia deals, Utopia Industries and Utopia Fulfillment. He also previously worked as a Vice president in Bank of America. He holds Bachelor of Software Engineering from Fast University. Karachi

RATING RATIONALE

Corporate Profile

Utopia Industries (Private) Limited (UIPL), a division of Utopia Group, operates under the ownership and active participation of two Pakistani brothers. UIPL, recognized as the 27th largest exporter in Pakistan, specializes in the manufacturing and export of a diverse range of products such as terry towels, pillows, comforters, mattress toppers, mattress encasements, and protectors, bed sheets, cookware, plastic products, and personal care items. With a global presence, the company has a workforce of over 4,000 employees.

Brief History

With its roots tracing back to 2002, Utopia Sourcing (formerly Rafaqat Textile) specialized in manufacturing high-quality towels for local and international markets. Expanding its reach in 2011, it began exporting products to Utopia Towels Incorporation in the US, operating under the brand name Utopia Deals for direct customer sales. Recognizing the significance of competitive pricing for sustainability and profitability in the e-commerce business, sponsors formed UIPL in 2018, focusing on in-house manufacturing for export products.

Utopia Deals began with sales of $0.2m in its first year and achieved an average annual growth rate of 150%, reaching over $440m in 2022. Today, it stands as one of the top 5 sellers on Amazon. Additionally, leased warehouses in USA, Canada, UK and Spain facilitate seamless product dispatch to Amazon warehouses via Utopia Fulfillment, ensuring cost-effective operations. Around 80% of the products are sourced from Pakistan through UIPL, with the rest shared by China.

Table: Utopia Towels Inc. & Affiliates (USD in millions)

	Dec 31, 2022
Revenue	441.2
Gross Profit/(Loss)	261.9
Gross Margin	***59.4%***
Net Profit/(Loss)	6.9
Net Margin	***1.6%***
Inventories	60.8
Cash & Bank Balance	5.0
Total Assets	**79.8**
Trade Payables	6.7
Dues to related party	23.9
Borrowings & Lease Liabilities (*Incl. current portion*)	25.2
Total Liabilities	**58.9**
Retained Earnings	18.6
Total Equity	**20.9**
Funds Flow from Operations (FFO)	**9.9**
Gearing	***1.21***
Leverage	***2.81***
Debt Service Coverage Ratio (DSCR)	***3.23***

Operational Performance & Expansion Plans
UIPL, headquartered in Superhighway Scheme 33 - Karachi, operates six production units spanning a total of 27 acres of land. These units are dedicated to various processes including weaving, knitting, dyeing, processing, stitching, and cut-to-pack operations.

- **Unit 1:** Home textile made-ups including bed, table, toilet and kitchen linen
- **Unit 2 & 3:** Weaving and finishing divisions along with warehouse
- **Unit 4:** Plastic ware including plastic molding and cookware
- **Unit 5:** Other textile products such as quilts, eiderdowns, cushions, pouffes, pillows, sleeping bags etc.
- **Unit 6:** Manufacturing of other textiles
- **Unit 7:** Under construction

Installed capacity for the home textile division experienced a substantial growth of ~76% in FY22 and ~22% in the current fiscal year, while the plasticware and kitchenware segments recently commenced operations. Additionally, production levels across all divisions have been on the rise, as reflected in the utilization ratios.

Table: Capacity & Production Data (Units in millions)

	FY20	FY21	FY22	6M'FY23
Home Textile				
Installed Capacity (kgs)	15.7	15.7	27.6	33.7
Actual Production (kgs)	1.2	11.4	26.7	32.4
Capacity Utilization	***7%***	***72%***	***96%***	***96%***
Plastic Ware				
Installed Capacity (lbs)	-	-	3.9	4.6
Actual Production (lbs)	-	-	3.4	4.1
Capacity Utilization	-	-	***86%***	***90%***
Kitchen Ware				
Installed Capacity (kgs)	-	-	0.05	1.1
Actual Production (kgs)	-	-	0.04	1.0
Capacity Utilization	-	-	***88%***	***95%***

Key Rating Drivers

Business risk profile is constrained by current weak macroeconomic environment both globally and locally, demand slowdown, high interest rate situation, inflationary pressures and recent floods adversely affecting cotton crop while ongoing energy crisis in the country pose a challenge to margins sustainability and future growth.
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. Textile sector contributes nearly one-fourth to industrial value-added segment and 8.5% to the country's GDP, with an estimated market size of around Rs. 4.0tr. Barring seasonal and cyclical fluctuations, textiles sector has maintained an average share of about 60% in national exports.

Table: Pakistan Export Statistics (in USD millions)

	FY20	FY21	FY22		9M'FY22	9M'FY23
Pakistan Total Exports	22,536	25,639	32,450		23,706	21,088
Textile Exports	12,851	14,492	18,525		13,577	12,992
PKR/USD Average rate	158.0	160.0	177.5		171.5	235.5

Source: SBP

Export revenues from textile sector have noted sizeable growth over the years (FY22: $19.3b FY21: $15.4b; FY20: $12.5b; FY19: $13.6b). Knitwear, Readymade and Bed wear segments continue to contribute higher than other segments, with a cumulative contribution of more than 60% in textile exports. While the growth was primarily driven by volume (excluding knitwear and cotton yarn), higher prices also boosted exports.

Table: Textile Export Details (in USD millions)

	FY20	FY21	FY22		9M'FY22	9M'FY23
High Value-Added Segment	**9,669**	**12,427**	**15,605**		**11,482**	**10,318**
- Knitwear	2,794	3,815	5,121		3,730	3,390
- Readymade Garments	2,552	3,033	3,905		2,864	2,657
- Bed wear	2,151	2,772	3,293		2,449	2,032
- Towels	711	938	1,111		820	745
- Made-up Artides	591	756	849		627	535
- Art, Silk & Synthetic Textile	315	370	460		344	309
- Others	555	743	866		650	650
Low to medium Value-Added Segment	**2,858**	**2,972**	**3,717**		**2,760**	**2,158**
- Cotton Cloth	1,830	1,921	2,438		1,795	1,538
- Cotton Yarn	984	1,017	1,207		908	573
- Others	43	34	72		56	47
Total	**12,527**	**15,399**	**19,332**		**14,243**	**12,476**

Source: PBS

Cotton prices rose to a new 12-year high of ~Rs. 22,935/maund as of Sept'22, as a result of the shortage of cotton due to recent floods in the country. Cotton imports were also up 19.8%, in USD terms, for FY22 vis-à-vis preceding year.

Table: Cotton Prices Trend (In Rs.)

	FY19	FY20	FY21	FY22	9M'FY23
Per Maund	8,770	8,860	13,000	17,380	18,935
YoY % Change	26%	1%	32%	34%	n/a

Floods in Sindh and Southern Punjab during recent monsoon season have caused significant damage to the cotton crop. According to industry estimates, ~45% of the crop has been washed, worth more than $2.5b, resulting in significant price increases. The government has announced facilitation for raw materials imports to compensate for domestic shortages. Nonetheless, in addition to affecting profit margins, higher raw material pricing is expected to increase the working capital requirements, which is likely to have a negative impact on the liquidity profile of textile operators, particularly spinners, weavers and dying companies.

Global and domestic challenges, such as slowdown in export demand (primarily from North America and the EU, which has begun to materialize in Pakistan's monthly export proceeds) due to recessionary trend, industrial gas load shedding expected in the country, and rising production costs due to inflation, will weigh on the business risk profile going forward. These factors may result in competitive market pricing for exporters.

Competitive advantage from e-commerce retail sales drive revenue growth through increased capacities and volume; future growth expected from ongoing capacity additions.
UIPL achieved robust revenue growth in FY22, surpassing the Rs. 26b mark primarily fueled by increased sales volume aligned with higher production capacities while further supported by an uptick in prices denominated in dollars and rupee depreciation impact. This positive trend has continued in 9M'FY23, with sales amounting to Rs. 27b while projected full-year revenue for FY23 is Rs. 35b, as per management. The ongoing capacity expansion is expected to drive further sales growth in the future.

Almost entire sales emanate from exports to a related party, Utopia Towels, which sells the products on Amazon as Utopia Deals. Management indicated that the return rate for online orders is less than 1%. Product-wise, towels, bedsheets, comforters, mattress protectors, and pillows contribute to nearly four-fifth of the revenue mix followed by knit garments, plastics, kitchenware, and others. Geographic sales mix depicts concentration as the majority of exports are directed toward USA followed by Europe, UK, and Canada.

Gross margins remained healthy over time, but significant jump in administrative overheads and foreign exchange losses led to a declining trend in net margins.
Gross margins, after a sizeable one-time increase in FY22, returned to normal levels in the current fiscal year due to the reallocation of freight charges in distribution expenses. Home textile production heavily relies on imported yarn from China, while fabric procurement involves a mix of local and imported sources. Moreover, imported to local procurement ratio of remaining raw materials is 60:40. Adequate inventory is maintained to meet projected sales for the next three to four months.

Operating overheads increased in line with inflation, while financial charges remained low due to limited debt on the balance sheet. However, significant foreign exchange losses are a drag on profitability. Additionally, rising raw material, salary, fuel, and power costs contributed to a declining trend in net margins.

Healthy cash flow generation aligns with profitability, while debt coverage metrics remain strong. However, cash conversion cycle is elevated due to high inventory holding days.
Improved earnings have led to a positive trend in funds flow from operations (FFO) on a timeline, reaching Rs. 3.2b (FY21: Rs. 1.2b) in FY22. However, increased debt levels led to a slight decline in debt coverage metrics as reflected from FFO to total debt of 0.45x (FY22: 0.55x) and FFO to long-term debt of 2.21x (FY22: 2.51x) at end-6M'FY23. Similarly, tdebt servicing coverage ratio also declined to 11.46x (FY22: 19.07x).

Current ratio is consistently reported above 1.0x and coverage of short-term borrowings in relation to trade debts and inventory remains sufficient, indicating a satisfactory liquidity profile. However, cash conversion cycle is elevated, reporting above 170 days over time owing to high inventory holding days. Ageing profile of trade debts is sound as all receivables are settled within 90 days.

Growing capitalization levels; high leverage metrics projected to trend downwards as indicated by management.
The equity base has more than doubled in the last 18 months, reaching Rs. 4.1b by end-6M'FY23. The divestment of personal property held by the CEO will contribute an additional Rs. 2b in equity, as stated by management.

Debt profile has increased to Rs. 8.2b (FY22: Rs. 5.7b), with a mix of short-term and long-term borrowings; ~80% represents short-term debt entirely being the ERF/EFS facilities. Utopia Towels has provided a foreign currency loan of $18m (Rs. 4.1b at end-6M'FY23). The loan is interest-free, unsecured, and repayable based on 10% of monthly exports or as demanded by the lender. Management stated that repayment will occur gradually until FY25. Additionally, loan from director stand at Rs. 921.1m. Leverage ratios are anticipated to trend downward with growing earnings and capitalization levels.

IT infrastructure is adequate, featuring an in-house ERP system and data backup maintenance.

The company utilizes an in-house ERP system that seamlessly integrates all business operations, enabling real-time insights and streamlined decision-making. It optimizes operations, enhances efficiency, and drives profitability and growth by managing inventory, procurement, payroll, employee benefits, and financial transactions. A data backup system embedded in an ERP solution ensures data security, availability, and business continuity with minimal downtime.

Utopia Industries (Priavte) Limited — Appendix I

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**FY20**	**FY21**	**FY22**	**6M'FY23**
Fixed Assets	990.8	4,001.7	6,312.5	6,348.9
Stock-in-Trade	650.3	3,629.4	7,299.9	6,024.9
Trade Debts	16.8	19.0	714.6	8,075.3
Cash and Bank Balance	173.8	349.9	223.4	166.0
Total Assets	**2,157.3**	**8,999.3**	**16,315.0**	**22,241.8**
Trade and Other Payables	228.0	1,431.7	3,003.9	4,927.7
Long-Term Borrowings *(Incl. current maturity)*	-	148.0	1,260.7	1,650.4
Short-Term Borrowings	-	-	4,453.1	6,526.2
Total Debt	-	148.0	5,713.8	8,176.6
Loan from Associate		2,853.0	3,546.7	4,068.7
Total Liabilities	**2,072.1**	**7,802.6**	**13,196.8**	**18,102.6**
Paid-up Capital	1.0	1.0	1.0	1.0
Total Equity	**85.2**	**1,196.6**	**3,118.2**	**4,139.3**
INCOME STATEMENT				
Net Sales	813.2	7,985.9	26,151.1	19,942.0
Gross Profit	145.3	1,598.4	8,949.6	5,054.5
Operating Profit	123.7	1,180.4	3,451.1	2,007.6
Profit Before Tax	**87.0**	**1,188.1**	**2,176.7**	**1,219.1**
Profit After Tax	**79.6**	**1,111.4**	**1,921.6**	**1,021.1**
RATIO ANALYSIS				
Gross Margin (%)	17.9%	20.0%	34.2%	25.3%
Net Margin (%)	9.8%	13.9%	7.3%	5.1%
Current Ratio	0.54	1.23	1.28	1.32
FFO	97.5	1,172.7	3,158.9	1,821.8
FFO to Long-Term Debt (x)	-	7.93	2.51	2.21*
FFO to Total Debt (x)	-	7.93	0.55	0.45*
DSCR (x)	14.76	32.61	19.07	11.46*
Gearing (x)	-	0.12	1.83	1.98
Debt Leverage (x)	24.31	6.52	4.23	4.37
Inventory + Receivable/Short-term Borrowings (x)	-	-	1.80	2.16
ROAA (%)	7.2%	19.9%	15.2%	10.6%*
ROAE (%)	174.6%	173.4%	89.1%	56.3%*

**Annualized*

REGULATORY DISCLOSURES Appendix II

Name of Rated Entity	Utopia Industries (Private) Limited
Sector	Textile
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings
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.
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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
Rating Type: Entity				
05-06-2023	A-	A-2	Stable	Initial

Due Diligence Meeting Conducted

Name	Designation	Date
Mr. Rashid Bhatti	Head of Finance	April 17, 2023
Mr. Abdul Hannan	Senior Manager – Financial Reporting	
Mr. Shahid Mahfooz	Finance Manger - Treasury	