

RATING REPORT

Universal Leather (Private) Limited

REPORT DATE:

May 20, 2016

RATING ANALYSTS:

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RATING DETAILS

	Latest Rating	Previous Rating
Rating Category	Long-term	Long-term
Entity	BBB+	BBB+
Rating Date	<i>May 20, '16</i>	<i>May 4, '15</i>
Rating Outlook	Stable	Stable
Outlook Date	<i>May 20, '16</i>	<i>May 4, '15</i>

COMPANY INFORMATION

Incorporated in 1972	External auditors: M/s M. Yousuf Adil Saleem & Co. Chartered Accountants
Private Limited Company	Chairman of the Board: Mr. S. M. Saleem
Key Shareholders (with stake 10% or more):	Chief Executive Officer: Mr. Shakil Ahmed
Mr. Farrukh Hussain Sheikh-11.07%	
Mr. Shahid Hussain-10.43%	
Mr. S.M. Saleem-10.31%	
Mr. S.M. Naseem-10.31%	

APPLICABLE METHODOLOGY(IES)

JCR-VIS Entity Rating Criteria <http://www.jcrvis.com.pk/images/methodology.pdf>

Universal Leather Private Limited

OVERVIEW OF THE INSTITUTION

Incorporated in 1968 as a public listed company, ULPL was then converted into a private limited company in 2004. ULPL's primary business focus is leather tanning of bovine animals with facilities present in Karachi and Lahore. The financial statements for FY15 were audited by M. Yousuf Adil Saleem & Co.

RATING RATIONALE

Universal Leather (Private) Limited (ULPL) is a private limited company involved in the business of converting cow hides to finished leather. The company is amongst the large tanneries in the country and has over 4 decades of experience in the leather sector. Shareholding of the company is held by various family members. The rating of ULPL derives strength from track record of sponsors who have extensive experience in the leather industry.

The global trade of leather products is subject to cyclical demand patterns while the gross margins in the business have also seen notable volatility. Leather industry in Pakistan is largely export-oriented with third largest contribution (4.5%) to the country's total exports, after textile (54%) and rice (9%). However, Pakistan's share in global leather exports is limited to around 1%. According to the Pakistan Tanner Association (PTA); leather contributes 5% to GDP and 5.4% to the country's foreign exchange earnings. Leather industry is currently facing a challenging operating environment with significant pressure on sales and margins. Given the slowdown in Eurozone & China and significant depreciation of Euro against PKR (18% depreciation), leather exports have witnessed a significant decline. Given the current sector dynamics, financial profile of ULPL has weakened on a timeline basis.

Major portion (around 95%) of net sales of the company comprise export sales with a significant decline witnessed in the outgoing year; management expects proportion of local sales to increase going forward. Sales to Eurozone represent around 83% of total sales. Both client and country wise concentration in sales is on the higher side. Around two-third of total sales are generated through top 5 clients. Moreover, top three countries generate around 73% of the total sales. Concentration in sales is partly mitigated given the long-term association with most large clients. While prices of raw material have declined at a faster pace vis-à-vis dip in average selling prices, gross margins reduced due to significantly lower sales and higher purchases made during FY15. During 1H16, revenues have witnessed a decline by 29% vis-à-vis corresponding period last year. Decline in gross profits along with limited reduction in operating expenses and higher finance cost translated into a sizeable loss before tax of Rs. 69.2m during FY15. Going forward, profitability is expected to remain under pressure given the high closing stock carried on balance sheet at end-FY15 which will be charged to profit and loss in the ongoing year.

Liquidity profile of the company has weakened on a timeline basis with negative cash flows & an increase in cash conversion cycle. On account of unfavorable working capital cycle, utilization of short-term borrowings increased at end-FY15. Borrowings are utilized to fund inventory carried on the balance sheet and are entirely short term in nature. Short term borrowing amounted to Rs. 657.1m (FY15: Rs. 678.5m; FY14: Rs. 574.4m) at end-December'2015.

The management has enhanced focus on reducing inventory levels (1H16: Rs. 940m; FY15: Rs. 1.26b; FY14: Rs. 1.07b) on account of which purchases (1H16: Rs. 180m; FY15: Rs. 867.8m, FY14: Rs. 1,177.2m) have been curtailed in the ongoing year. Stock-in-trade represented 143% (FY15: 186%; FY14: 187%) of borrowings at end-Dec'2015.

Total equity (including loan from directors) of ULPL fell significantly to 575.9m (FY14:Rs. 626.3m) due to the loss incurred in the outgoing year. Resultantly, gearing stood higher at 1.1x (FY14: 0.9x) at end-FY15. Adjusted for investment and loans in associated companies, debt leverage and gearing increased to 2.6x (FY14: 2.2x) and 1.4x (FY14: 1.1x), respectively at end-FY15. ULPL's management plans to inject equity of Rs. 175m during FY16. Equity injection is considered necessary to improve risk profile of the institution and will facilitate in improving liquidity profile and reducing leverage indicators.

ISSUE/ISSUER RATING SCALE & DEFINITIONS

Appendix I

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: JCR-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.jcrvis.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.jcrvis.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.

'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.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-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.

JCR-VIS Credit Rating Company Limited

Technical Partner – IIRA, Bahrain | JV Partner – CRISL, Bangladesh

REGULATORY DISCLOSURES		Appendix II		
Name of Rated Entity	Universal Leather Private Limited			
Sector	Tanneries and Leather Products			
Type of Relationship	Solicited			
Purpose of Rating	Entity Rating			
Rating History	Rating Date	Medium to Long Term	Rating Outlook	Rating Action
	RATING TYPE: ENTITY			
	05/20/2016	BBB+	Stable	Reaffirmed
	05/04/2015	BBB+	Stable	Reaffirmed
	04/09/2014	BBB+	Stable	Reaffirmed
	04/08/2013	BBB+	Stable	Reaffirmed
02/13/2012	BBB+	Stable	Reaffirmed	
Instrument Structure	N/A			
Statement by the Rating Team	JCR-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	JCR-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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