The Pakistan Credit Rating Agency Limited

Rating Report

Pakistan Synthetics Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
09-Aug-2019	BBB+	A2	Stable	Maintain	-
11-Feb-2019	BBB+	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Pakistan’s Polyethylene Terephthalate (PET) packaging sector mostly derives its demand from bottled water and carbonated beverage industry, while, edible oil sector has become an upcoming demand driver. The industry use variants of PET Resin to manufacture plastic caps (closures) and PET preforms. During FY18, PET Resin segment generated a total revenue of PKR 37bln. Having a capacity utilization of 70% - 72%, PET preforms segment is experiencing a volumetric growth and generated an estimated revenue of PKR 27bln. Plastic Closures had an estimated revenue of PKR 2.7bln in FY18.

The ratings reflect Pakistan Synthetics Limited's integrated position in PET industry. The Company entered the business arena by tapping in the PET Resin and Capping segments,. However, recently the Company has set up Preform manufacturing facility. This led the Company's topline to post a volumetric growth. Margins remain stable, however, are subject to volatility in raw material prices due to currency devaluation. Surged exchange loss, in line with high finance cost, stresses the Company's profitability.

The Company's leveraging remains high to fund the working capital requirements. This, coupled with the rising interest rate scenario could exert pressure on the financial profile of the Company. However, the management plans to streamline the debt mix. This, along with better cashflows, is expected to manage the financial risk.

The ratings are dependent on the management's ability to strengthen the relative positioning of the Company in the industry. Improvement in business margins and, in turn, profitability remains imperative. Any deterioration in the Company’s coverages would have negative impact on the ratings.

Disclosure

Name of Rated Entity	Pakistan Synthetics Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	PACRA_Methodology_Corporate_FY19(Jun-19),PACRA_Crtieria_LT ST Relationship_FY19(Jun-19),PACRA_Criteria_Rating Modifiers_FY19(Jun-19)
Related Research	Sector Study | Packaging(Oct-18)
Rating Analysts	Silwat Malik | silwat.malik@pacra.com | +92-42-35869504

Profile

Legal Structure Pakistan Synthetics Limited was incorporated as a private limited company in 1984. Later, in 1987, it was converted to a public limited company.

Background In 1984, Pakistan Synthetics Limited started commercial production of Polymer Staple Fibre. In 1987, the Company got listed on Pakistan Stock Exchange. Commercial operation of Plastic Caps (Closures) and Metal Crowns began in May'11. During 2015, due to depressed market dynamics of Polyester Fibre, the Company discontinued its operations and after making few amendments in the existing plant, it started to commercially manufacture PET Resin. In 2016, the Company integrated forwardly into PET Preforms segment.

Operations Pakistan Synthetics Limited provides a complete range of Plastic Closures and Metal Crowns at an installed capacity of ~559,000 cartons per annum. It also offers a wide range of PET Preforms for various products at an installed capacity of ~25,000 Octabins per annum. The Company also manufactures PET Resins at an installed capacity of 28,000 MT per annum. Pakistan Synthetics Limited's manufacturing facilities are located in Hub, Balochistan and Port Qasim, Karachi. While, the registered office is located in West Wharf, Karachi.

Ownership

Ownership Structure Pakistan Synthetic Limited is primarily owned by Haji Karim family ~ 73%. Financial Institution own 8% of the Company's shares. Remaining 19% of the stake resides with general public.

Stability Stability in the ownership structure is evident as majority shares resides with the sponsoring family, with a clear succession plan.

Business Acumen Pakistan Synthetics Limited is associated with the Group having strong experience in textile sector and PET industry. The Group is ranked among the leading industrial groups of the country with interests in textile, financial institutions, consumer product sectors.

Financial Strength Pakistan Synthetics Limited is owned by a strong business group. The Associated Companies, by virtue of common directorship, have prominent standing in financial and consumer sectors. Moreover, the total asset base of the Group Companies is around PKR 39bln supported by PKR 12bln of equity. These have generated a combined turnover of around PKR 30bln in FY18.

Governance

Board Structure Pakistan Synthetic Limited BoD comprises three Independent Directors, four Non-Executive Directors and one Executive Director. During 9MFY19, the Board appointed two independent directors - Mrs. Saeeda Fatima Naqvi and Mr. Faraz Bandoqchala. Apt size of the Board and presence of independent oversight on the Board indicates a well framed governance structure.

Members' Profile The BoD, with a diversified background and expertise, is a key source of guidance. During 9MFY19, Mr. Anwar Haji Karim has been appointed as the Board's Chairman. He is one of the founders of the Group and has an overall work experience of 35 years. He holds directorship of Bank Al-Habib Limited and Al-Karam Textile Mills (Pvt.) Limited.

Board Effectiveness The Board met three times during 9MFY19, with majority attendance to discuss pertinent matters. Minutes of the BoD meetings were well documented. To ensure effectiveness, the Board has formed Audit Committee and Human Resource and Remuneration Committee, comprising three members each. During 9MFY19, Audit Committee met three times with majority attendance. While, HR and Remuneration Committee met once with majority attendance.

Financial Transparency Pakistan Synthetic Limited's external auditors, M/s KPMG Taseer Hadi & Co., have expressed an unqualified opinion on the financial reports for FY18. The firm is QCR rated by ICAP and is in the A Category of SBP's panel of auditors.

Management

Organizational Structure Pakistan Synthetic Limited operates through six divisions; Plant, Sales and Marketing, Finance, Internal Audit, Human Resource and Information Technology. All Divisional Heads report to the Company's CEO, who then reports to the Board. However, Head of Internal Audit and Human Resource reports administratively to the CEO and functionally to the Board Audit Committee and Human Resource and Remuneration Committee, respectively.

Management Team The Company has a set of professional management having long association with it. During 9MFY19, Mr. Yaqoob Haji Karim, has been appointed as the CEO. He has been associated with the Company from over 25 years. He also serves on the Board of Al-Karam Textile Mills (Pvt.) Ltd. and Amna Industries (Pvt.) Ltd.

Effectiveness Keeping in view the size and operations of the Company, non existence of management committees indicates a room for improvement.

MIS Pakistan Synthetic Limited's both manufacturing facilities are connected with the Head Office through a Legacy System. However, the Company has installed SAP, to facilitate in generating operational reports required to monitor effectiveness and to improve operational efficiency.

Control Environment The Company's internal audit function provides support, guidance and monitoring of the internally placed SOPs along with conducting Gap Analysis for evaluating already placed policies and procedures.

Business Risk

Industry Dynamics Pakistan's Polyethylene Terephthalate (PET) packaging sector mostly derives its demand from bottled water and carbonated beverage industry, while, edible oil sectors have become an upcoming demand driver. The industry use variants of PET Resin to manufacture plastic caps (closures) and PET preforms. During FY18, PET Resin segment generated a total revenue of PKR 37bln. Having a capacity utilization of 70% - 72%, PET preforms segment is experiencing a volumetric growth and generated an estimated revenue of PKR 27bln. Plastic Closures had an estimated revenue of PKR 2.7bln in FY18.

Relative Position Pakistan Synthetic Limited holds a moderate market share of 10% in the PET Resin segment. While, in the Plastic Caps and Metal Crowns, the Company is a market leader with an estimated share of 45% and 40%, respectively.

Revenues The Company generates gross revenue from the sale of PET Resin in local and export markets, Plastic caps and Metal crowns, and PET Preforms. The Company make sales directly to B2B customer, with revenue concentration in the Central region of the country. In 9MFY19, the Company's topline showed a volumetric growth (~14%) and clocked in at PKR 4.5bln - net sales (FY18: PKR 5.3bln). Major increase was witnessed in the units sold by PET Resin segment (~9%), followed by Preforms segment. Whereas, units sold by Plastic closures and Metal crowns segment posted a dip (~8%).

Margins Pakistan Synthetics Limited manufactures PET Resin - a high margin segment, thus is among the price setters for the product. However, an increase was witnessed in the average import prices of raw materials. The Company was able to pass on the increased cost, thus maintaining the improved margins (gross: 9MFY19: 11%, FY18: 11%). By controlling the marketing and selling expenses, the Company was able to improve its operational margins (9MFY19: 9%,FY18: 8%).

Sustainability Going forward, demand for packaging sector is anticipated to grow. To meet this growth, fresh investment is expected by the Company. The management is eyeing on an annual CAPEX of PKR 650mln to either tap in the bottling segment or enhance its current production capacity of plastic closures, going forward. Keeping in view the rising interest rate situation and rupee devaluation the Company plans to streamline its debt structure.

Financial Risk

Working Capital During 9MFY19, the Company's inventory levels remain high leading to higher net working capital cycle (9MFY19: 105 days, FY18: 120 days). Receivable days showed a slight improvement, however, remained on the higher side as the integrated into Preform segment. The Company imports raw material with an option to pay within 70-80 days. To improve the its short term borrowing buffer, management plans to streamline its working capital management.

Coverages Increased in the Company's finance cost deteriorated the free cash flows from operations (9MFY19: PKR 305mln, FY18: PKR 364mln) and remained well below the current liabilities (9MFY19: 3bln, FY18: PKR 2.2bln). Thus, stressing the financial profile of the Company. Despite a decline, the Company's interest coverage remained above 1 (9MFY19: 1.5x, FY18: 2x), indicating the Company ability to timely pay off its liabilities. Core and Total Debt Coverage deteriorated (9MFY19: 0.4x, FY18: 1x) with an increase in short term debt.

Capitalization Pakistan Synthetic Limited has a highly leveraged capital structure (9MFY19: 71%, FY18: 66%) with a relatively small equity base. Significant increase in the total debt to PKR 3.3bln (Short Term Borrowing: PKR 2bln, Long Term Borrowing: PKR 1.1bln) in 9MFY19 supported the Company's operations. To improve the risk absorption capacity, the management has increased the Authorized Capital to PKR 1.4bln from PKR 700mln.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Pakistan Synthetics Limited	Mar-19	Dec-18	Jun-18	Jun-17	Jun-16
Packaging	9M	6M	12M	12M	12M
A BALANCE SHEET					
1 Non-Current Assets	2,195	2,276	2,313	1,567	1,713
2 Investments	-	-	-	-	-
3 Related Party Exposure	-	-	-	-	-
4 Current Assets	4,106	3,797	3,746	3,329	2,160
a Inventories	*2,492*	*2,456*	*2,251*	*1,899*	*948*
b Trade Receivables	*714*	*515*	*645*	*795*	*646*
5 Total Assets	6,301	6,073	6,060	4,896	3,874
6 Current Liabilities	1,677	1,583	1,543	1,135	601
a Trade Payables	*1,384*	*1,304*	*1,264*	*876*	*516*
7 Borrowings	3,280	3,220	2,585	2,522	1,973
8 Related Party Exposure	-	-	-	-	-
9 Non-Current Liabilities	29	27	596	17	60
10 Net Assets	1,316	1,244	1,336	1,222	1,240
11 Shareholders' Equity	1,316	1,244	1,336	1,222	1,240
B INCOME STATEMENT					
1 Sales	4,508	2,821	5,253	2,912	1,661
a Cost of Good Sold	*(4,031)*	*(2,560)*	*(4,683)*	*(2,643)*	*(1,207)*
2 Gross Profit	477	260	570	269	454
a Operating Expenses	(84)	(66)	(128)	(106)	(88)
3 Operating Profit	393	194	442	163	367
a Non Operating Income or (Expense)	*(188)*	*(176)*	*(153)*	*(3)*	*(31)*
4 Profit or (Loss) before Interest and Tax	205	19	289	160	336
a Total Finance Cost	*(233)*	*(145)*	*(205)*	*(143)*	*(114)*
b Taxation	*10*	*37*	*67*	*67*	*(20)*
6 Net Income Or (Loss)	(18)	(90)	151	84	201
C CASH FLOW STATEMENT					
a Free Cash Flows from Operations (FCFO)	*305*	*68*	*364*	*275*	*302*
b Net Cash from Operating Activities before Working Capital Changes	*75*	*(73)*	*172*	*127*	*188*
c Changes in Working Capital	*45*	*88*	*699*	*228*	*65*
1 Net Cash provided by Operating Activities	120	15	871	355	254
2 Net Cash (Used in) or Available From Investing Activities	(49)	(47)	(849)	(52)	(620)
3 Net Cash (Used in) or Available From Financing Activities	(53)	23	(284)	37	132
4 Net Cash generated or (Used) during the period	18	(9)	(261)	340	(234)
D RATIO ANALYSIS					
1 Performance					
a Sales Growth (for the period)	14.4%	7.4%	80.4%	75.3%	7.6%
b Gross Profit Margin	10.6%	9.2%	10.9%	9.2%	27.4%
c Net Profit Margin	-0.4%	-3.2%	2.9%	2.9%	12.1%
d Cash Conversion Efficiency (EBITDA/Sales)	8.5%	5.3%	8.5%	12.4%	24.9%
e Return on Equity (ROE)	-1.8%	-13.9%	11.8%	6.8%	16.2%
2 Working Capital Management					
a Gross Working Capital (Average Days)	185	190	194	269	333
b Net Working Capital (Average Days)	105	107	120	182	219
c Current Ratio (Total Current Assets/Total Current Liabilities)	2.4	2.4	2.4	2.9	3.6
3 Coverages					
a EBITDA / Finance Cost	1.8	1.1	2.4	2.6	3.6
b FCFO / Finance Cost+CMLTB+Excess STB	0.4	0.1	1.0	1.0	1.2
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	8.1	-9.2	3.2	3.1	3.0
4 Capital Structure (Total Debt/Total Debt+Equity)					
a Total Borrowings / Total Borrowings+Equity	71.4%	72.1%	65.9%	67.4%	61.4%
b Interest or Markup Payable (Days)	31.9	36.0	43.5	33.1	65.7
c Average Borrowing Rate	9.4%	8.9%	7.2%	6.1%	5.8%

Credit Rating Scale & Definitions

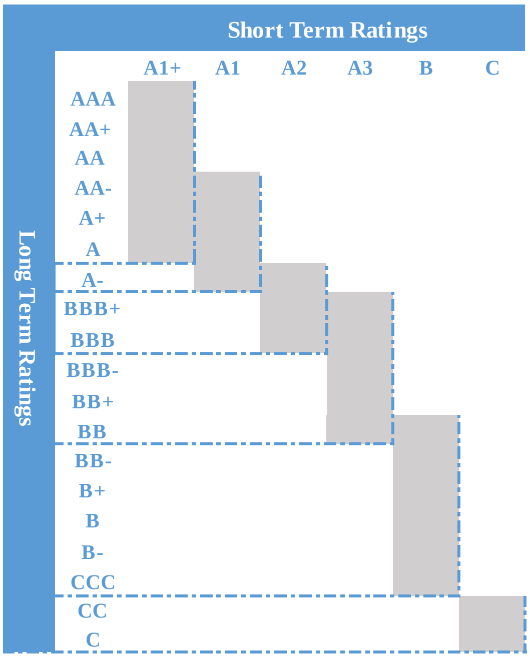
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings

AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short Term Ratings

A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
C	An inadequate capacity to ensure timely repayment.



Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Regulatory and Supplementary Disclosure

(Credit Rating Companies Regulations,2016)

Rating Team Statements

(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**

i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)

ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)

iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions

(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)

(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)

(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business

(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)

(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.

(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)

(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)

(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)

(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest

(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity

(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)

(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)

(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)

(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)

(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review

(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)

(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)

(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)

(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)

Probability of Default

(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)

Proprietary Information