



The Pakistan Credit Rating Agency Limited

Rating Report

Pakistan Synthetics Limited

Report Contents

1. Rating Analysis
2. Financial Information
3. Rating Scale
4. Regulatory and Supplementary Disclosure

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
07-Feb-2020	BBB+	A2	Stable	Maintain	-
09-Aug-2019	BBB+	A2	Stable	Maintain	-
11-Feb-2019	BBB+	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Pakistan's PET packaging industry derives its demand from the country's beverage industry, which has been negatively impacted due to the reduced purchasing power of end consumers. This, in turn, has reduced the demand for the PET packaging industry's products. The ratings reflect Pakistan Synthetics Limited's (Pakistan Synthetics or 'the Company') established presence in the PET packaging industry through the provision of an integrated packaging solution to its customers. Pakistan Synthetics witnessed top-line growth on the back of volumetric increase in sales as the Company continued to establish its new Preform segment. The Company's margins declined due to increased cost of imported raw material, putting pressure on margins. The increased finance cost and significant exchange loss eroded the Company's bottom-line as it suffered a net loss in FY19. Although margins did not improve, stable rupee provided some relief as the Company returned to profitability, albeit modest. The Company's financial profile remains under pressure due to asset liability mismatch at trade level, declining coverages and high leveraging. The Company has recently received capital through right issue, increasing its equity base and providing cushion for repayment. The ratings draw strength from the Company's association with a strong business group and sponsor's demonstrated ability to provide support.

The ratings are dependent on the management's ability to strengthen the Company's position in the industry and continued revenue growth. Improvement in margins and reducing the asset liability mismatch remains imperative. Significant decline in coverages may have a negative impact on ratings.

Disclosure

Name of Rated Entity	Pakistan Synthetics Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Corporate Ratings(Jun-19),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria Rating Modifier(Jun-19)
Related Research	Sector Study Paper and Packaging(Nov-19)
Rating Analysts	Ateeb Riaz ateeb.riaz@pacra.com +92-42-35869504



Profile

Legal Structure Pakistan Synthetics Limited (Pakistan Synthetics or 'the Company') is incorporated as a public limited company and is listed on the PSX.

Background Pakistan Synthetics was founded as a private limited company in 1984 and converted to a public limited company in 1987. The Company currently produces PET Resin, PET Preform, Plastic Caps and Metal Crowns. Initially, the Company also produced Polymer Staple Fibre. However, its production was discontinued in 2015.

Operations The Company produces Plastic Closures, Metal Crowns, PET Resin and PET Preforms with respective capacities of ~559,000 cartons per annum, 28,000MT per annum and ~25,000 octabins per annum. The Company's manufacturing facilities are located in Hub, Balochistan and Port Qasim, Karachi. The registered office is located in West Wharf, Karachi.

Ownership

Ownership Structure Majority stake of Pakistan Synthetics lies with the Haji Karim family, who own ~73% of total shares. Mr. Anis Yaqoob (~10%) and Mr. Fawad Anwar (~9%) are the two largest stakeholders of the Company. Approximately ~17% of the stake resides with general public.

Stability The ownership structure is stable as the Haji Karim family holds majority shares since inception. They have vast experience of the textile and plastic packaging industry.

Business Acumen Pakistan Synthetics is a successful venture of Al-Karam Group. The Group is ranked amongst the leading industrial groups of the country with interests in textile, financial institutions, consumables and consumer product sectors. The flagship company of the group is Al-Karam Textile.

Financial Strength Pakistan Synthetics is owned by a strong business group. The sponsors have recently made an equity injection through participation in the right issue. The contribution by sponsoring family amounted to PKR 371mln out of the total equity injection of PKR 504mln. This shows willingness of the sponsors to provide financial support to the Company.

Governance

Board Structure The Company's board is dominated by members of the Haji Karim family. The BoD comprises three Independent Directors, four Non-Executive Directors and two Executive Directors, including the CEO. Presence of independent oversight on the Board indicates a well framed governance structure.

Members' Profile The Board's Chairman Mr. Anwar Haji Karim is a graduate of the University of Karachi and has been associated with the Company for over 25 years. He also serves on the Boards of Bank Al-Habib Limited and Al-Karam Textile Mills (Pvt.) Limited. The directors have diversified backgrounds and expertise which enables them to provide effective oversight and guidance to the management.

Board Effectiveness The Board met five times during FY19, with majority attendance to discuss pertinent matters. The minutes of these BoD meetings were well documented. To ensure effective governance, the Board has formed two committees, namely, (i) Audit Committee, and (ii) HR and Remuneration Committee.

Financial Transparency The Company's external auditors, M/s KPMG Taseer Hadi & Co. Chartered Accountants, have expressed an unqualified opinion on the financial reports for FY19.

Management

Organizational Structure The Company has a well defined organizational structure developed according to operational needs. There are seven departments, which include Plant, Finance, Sales and Marketing among others.

Management Team The Company's CEO, Mr. Yakoob Haji Karim, has been associated with the Company for over 25 years. He also serves on the boards of Al-Karam Textile Mills (Pvt.) Limited and Amna Industries (Pvt.) Limited. All members of the senior management are experienced and have long associations with the Company, which bodes well for operational efficiency.

Effectiveness Management committees help improve effectiveness and efficiency by streamlining communication between various department heads. There are no management committees in place, indicating room for improvement.

MIS The Company has recently installed SAP in order to improve the flow of information and facilitate generation of reports required by management. Implementation of various modules is ongoing.

Control Environment The Company has an internal audit function in place, which provides an effective mechanism for identification, assessment and reporting of all types of operational risks. The Company has various quality certifications including ISO 9001 and Halal certification, indicating compliance with high quality standards.

Business Risk

Industry Dynamics Demand for Pakistan's PET packaging industry is seasonal in nature as it mostly drives its demand from country's beverage sector. Additionally, conversion from glass to plastic bottles drives demand. The reduced purchasing power of end consumers and imposition of CNIC requirement has had a negative impact on the food and beverage segment. This, in turn, has impacted demand for the country's PET industry.

Relative Position Pakistan Synthetics holds a moderate market share of ~8% in the PET Resin segment. Whereas, in the Plastic Caps and Metal Crowns, the Company is a market leader with an estimated share of 45% and 40%, respectively.

Revenues In FY19, the Company's top-line grew by ~34% and clocked in at PKR 7,039mln (FY18: PKR 5,257mln). The growth was due to volumetric increase in sales of PET Resin and Preform segments. The Company generated ~70% of its total revenue from the sale of PET Resin. The Company's top ten customers constituted 60% of total revenue indicating high level of concentration. The Company's revenues mainly originate (~74%) from the Central region where major beverage players are located. In 1QFY20, the Company's revenue grew by ~14% YoY and clocked in at PKR 1,695mln (1QFY19: PKR 1,493mln) due to higher PET Preform sales.

Margins In FY19, the Company's gross margin declined to ~9.5% (FY18: ~11%) due to higher cost of raw material imports on the back of rupee devaluation. Operating margin were stable at ~7.5% (FY18: ~7.5%) as the Company increased operational efficiency, absorbing the trickle down effect of lower gross margins. The Company suffered a significant exchange loss of PKR 353mln (FY18: PKR 171mln) due to sudden currency depreciation. Finance cost increased to PKR 329mln (FY18: PKR 205mln) on the back of higher benchmark rate and increase in borrowings. As a result, the Company suffered a net loss of PKR 124mln (FY18: Net Profit: PKR 117mln). In 1QFY20, the gross margin remained stable at ~9.4% while the operating margin stood at ~7%. The net profit clocked in at PKR 34mln with a net margin of ~2%.

Sustainability Going forward, the Company plans to invest in BMR activities to improve operational efficiency and maintain market position. Additionally, the management is focused on consolidating its position in the industry and increasing capacity utilization of newly established PET Preform segment.

Financial Risk

Working Capital The Company's inventory days were reduced to 107 days in FY19 (FY18: 144 days) as Preform inventory that had been held up while awaiting approval from customers was sold. Trade receivable days remained stable (FY19: 41 days, FY18: 50 days) reflecting the agreed payment terms with customers. Trade payable days declined to 56 (FY18: 74 days) as the Company shifted from Usance LC to Sight LC, in order to reduce exposure from fluctuating exchange rates. As a result, the Company's net working capital days stood at 92 days in FY19 (FY18: 120 days). The Company's short term trade leverage stood at -19.2% as the Company incurred excess short term borrowing of PKR 543mln. In 1QFY20, the Company's net working capital days remained stable at 91 days.

Coverages In FY19, the Company's free cash flows increased to PKR 554mln (FY18: 364mln). Meanwhile, finance cost increased to PKR 329mln (FY18: PKR 205mln). The Company's interest coverage ratio remained stable at 1.9x (FY18: 2.0x). The debt coverage ratio declined to 0.4x (FY18: 1.0x) as the Company had upcoming repayment of long-term debt of PKR 1,012mln (FY18: PKR 702mln). During 1QFY20, the Company's free cash flows stood at PKR 191mln (1QFY19: PKR 166mln) and finance cost stood at PKR 102mln (FY18: PKR 68mln). The Company's coverages improved slightly as the interest coverage ratio stood at 2.1x and the debt coverage ratio stood at 0.6x. The recent right issue is expected to supplement coverages as it will be used to reduce borrowings.

Capitalization Pakistan Synthetics had a highly leveraged capital structure as demonstrated by a debt to equity ratio of ~75% in FY19 (FY18: ~66%). The Company's short term borrowings constitute nearly 68% of total borrowings. In order to relieve some of the pressure on the financial profile, the Company has recently received an equity injection of PKR 504mln. This amount will be used primarily to pay back short term borrowings. In 1QFY20, the Company's leverage ratio declined to ~72%.



The Pakistan Credit Rating Agency Limited

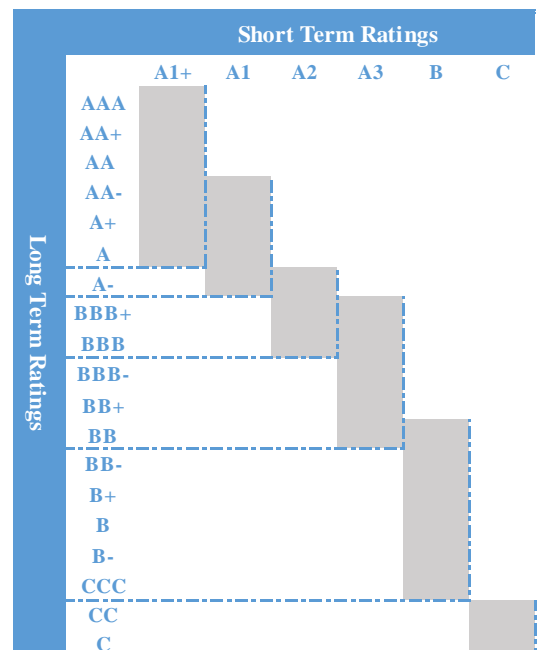
Financial Summary
PKR mln

Pakistan Synthetics Limited Paper & Packaging	Sep-19 3M	Jun-19 12M	Jun-18 12M	Jun-17 12M
A BALANCE SHEET				
1 Non-Current Assets	2,354	2,363	2,313	1,567
2 Investments	-	-	-	-
3 Related Party Exposure	-	-	-	-
4 Current Assets	3,030	3,571	3,746	3,329
a Inventories	1,605	1,866	2,251	1,899
b Trade Receivables	698	951	645	795
5 Total Assets	5,384	5,934	6,060	4,896
6 Current Liabilities	1,035	1,137	1,543	1,135
a Trade Payables	830	907	1,264	876
7 Borrowings	3,086	3,570	2,585	2,522
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	32	31	596	17
10 Net Assets	1,230	1,196	1,336	1,222
11 Shareholders' Equity	1,230	1,196	1,336	1,222
B INCOME STATEMENT				
1 Sales	1,695	7,039	5,257	2,919
a Cost of Good Sold	(1,535)	(6,367)	(4,686)	(2,653)
2 Gross Profit	160	672	570	267
a Operating Expenses	(42)	(141)	(177)	(153)
3 Operating Profit	118	531	394	114
a Non Operating Income or (Expense)	31	(352)	(151)	(1)
4 Profit or (Loss) before Interest and Tax	150	179	242	112
a Total Finance Cost	(102)	(329)	(205)	(143)
b Taxation	(14)	26	80	69
6 Net Income Or (Loss)	34	(124)	117	39
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	191	554	364	275
b Net Cash from Operating Activities before Working Capital Changes	82	230	172	127
c Changes in Working Capital	(201)	(418)	699	228
1 Net Cash provided by Operating Activities	(119)	(188)	871	355
2 Net Cash (Used in) or Available From Investing Activities	(37)	(199)	(849)	(52)
3 Net Cash (Used in) or Available From Financing Activities	125	364	30	152
4 Net Cash generated or (Used) during the period	(31)	(23)	53	456
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	-3.7%	33.9%	80.1%	75.7%
b Gross Profit Margin	9.4%	9.5%	10.8%	9.1%
c Net Profit Margin	2.0%	-1.8%	2.2%	1.3%
d Cash Conversion Efficiency (EBITDA/Sales)	12.3%	8.6%	8.5%	12.4%
e Return on Equity (ROE)	11.1%	-9.8%	9.2%	3.1%
2 Working Capital Management				
a Gross Working Capital (Average Days)	138	148	194	346
b Net Working Capital (Average Days)	91	92	120	259
c Current Ratio (Total Current Assets/Total Current Liabilities)	2.9	3.1	2.4	2.9
3 Coverages				
a EBITDA / Finance Cost	2.3	2.0	2.4	2.6
b FCFO / Finance Cost+CMLTB+Excess STB	0.6	0.4	1.0	1.0
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	2.8	4.4	3.2	3.1
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	71.5%	74.9%	65.9%	67.4%
b Interest or Markup Payable (Days)	14.7	27.1	43.5	33.1
c Average Borrowing Rate	11.0%	9.6%	7.2%	6.1%

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		Short Term Ratings	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
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.	A1	A strong capacity for timely repayment.
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.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial 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.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
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.	C	An inadequate capacity to ensure timely repayment.
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.		



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 surveil the opinion due to lack of requisite information.

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

Disclaimer: PACRA's ratings are an assessment of the credit standing of entities/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA's opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security's market price or suitability for a particular investor.

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

(23) All information contained herein is considered proprietary by PACRA. Hence, none of the information in this document can be copied or, otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without PACRA's prior written consent