The Pakistan Credit Rating Agency Limited

Rating Report

Pakistan Synthetics Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
06-Aug-2021	BBB+	A2	Stable	Maintain	-
07-Aug-2020	BBB+	A2	Stable	Maintain	Yes
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

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. PSL is one of the market leaders in the caps and closures with a market share of ~40%-45%. Pakistan's PET packaging industry derives its demand from the country's beverage industry, which has been impacted due to the inflation round and spread of the COVID-19 pandemic in the country. However, the demand for the PET packaging industry's products has increased as the beverage industry saw an improved uplift of stock. The industry is faced with challenges including low demand, build-up of inventory and receivables and lower capacity utilization however, the Company largely maintained its top-line in 3QFY21 and improved its profitability due to higher margins. Preventive measures have been started throughout the country by the relevant authorities which will gradually improve the COVID related uncertainty. The Government is continuously countering the fourth wave through a smart lockdown instead of overall shutdowns. Amid the COVID pandemic, steps taken by the SBP on slashing the discount rates to 7%, refinance scheme on salaries and wages, and ITERF, has significantly reduced the finance cost of the Company, resultantly the profits have also improved. The revenues are expected to improve and its impact can be seen in 3QFY21. The Company recently went into expansion and has started a new product line of 500ml PET bottles, previously it was manufacturing 1000ml and 1500ml. The Company's gross margin is expected to suffer on the back of an increase in the international oil prices, however, the net margin is expected to remain intact due to the decrease in markup on borrowings. The utilization level of the new Preform segment improved but remained below optimal levels. The coverages improved on the back of better cashflows and profitability. The working capital remains stressed due to asset-liability mismatch at the trade level. The ratings incorporate strong sponsor support as demonstrated in the past.
The removal of 'Rating Watch' signifies the company's ability to cope up with the changes in the prevailing challenging economic environment. The demand for industry products has recovered recently although it may take time to reach pre-COVID levels. The Company remained operational as it was exempted from shutdown, being related to the food & allied sector. Although the production in the metal crowns segment was suspended due to low demand in FY20, the company has regained its pace and achieved 67% production in the metal crowns segment in 3QFY21. PACRA closely monitored the situation and took action accordingly.

The ratings are dependent on the management's ability to strengthen the Company's position in the industry, sustain optimal production and margins. The reduction of the asset-liability mismatch remains imperative. The increase in profitability and/or coverages may have a positive impact on ratings. Sponsor support will remain important.

Disclosure

Name of Rated Entity	Pakistan Synthetics Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating(Jun-21),Criteria | Correlation Between Long-term & Short-term Rating Scales(Jun-21),Criteria | Rating Modifiers(Jun-21)
Related Research	Sector Study | Paper and Packaging(Nov-20)
Rating Analysts	Timnat Thomas | timnat.thomas@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 ~558,570 cartons per annum, 28,000MT per annum and ~31,000 octa bins per annum. The Company's manufacturing facilities are located in Hub, Baluchistan and Port Qasim, Karachi. The registered office is located in West Wharf, Karachi.

Ownership

Ownership Structure The majority stake of Pakistan Synthetics lies with the Haji Karim family, who owns ~73% of total shares. Mr Yaqoob Haji Karim (~20%) and Mr Noman Yaqoob (~21%) are two of the company's largest stakeholders. Approximately ~15% of the stake resides with the general public.

Stability The ownership structure is stable as the Haji Karim family holds majority shares since inception. They have vast experience in 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 the sponsoring family amounted to PKR 371mln out of the total equity injection of PKR 505mln. This shows the willingness of the sponsors to provide financial support to the Company in time of need.

Governance

Board Structure The Company’s board is comprised of 8 members and is dominated by Haji Karim family. There are three Independent Directors, three Non-Executive Directors and two Executive Directors, including the CEO on the board.

Members’ Profile The Board’s Chairman Mr Khurshid Akhtar is a Non-Executive Director and was appointed during the period to fill the vacancy of Mr Anwar Haji Karim who resigned from directorship in July 2020. All directors have diversified backgrounds and expertise which enables them to provide effective oversight and guidance to the management.

Board Effectiveness The Board met six times during FY21, 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 FY20.

Management

Organizational Structure The Company has a well-defined organizational structure developed according to operational needs. There are seven departments, which include Plant Operations, 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 installed SAP in order to improve the flow of information and facilitate the generation of reports required by management. Implementation of various modules remains in process with the need base.

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 The size of the PET bottle segment is estimated to be PKR~36,567mln in FY21 as compared to PKR~33,028mln in FY20. YoY growth is ~10% attributable to two main factors 1) increase in demand from beverage industry (food & allied segment has had some of the highest growth in all large scale manufacturing sectors and because FY20 had a low base partly due to COVID) and 2) higher PET resin prices. The price of major raw materials in the plastic segment is correlated to international oil prices and therefore, volatility in oil prices and exchange rates is a significant source of risk. Going forward, the business environment is likely to remain challenging owing to the potential adverse implications of the COVID pandemic on the industry.

Relative Position Pakistan Synthetics holds a moderate market share of ~10% - 12% 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%.

Revenues The Company generates its revenue through the sale of PET Resin, PET Preform, Plastic Caps and Metal Crowns with the largest contribution coming from PET Resin during the period 3QFY21. During 3QFY21, the Company's top-line clocked in at PKR 4,277mln (3QFY20: PKR 4,253mln). The improvement of ~6% YoY was due to the increased customer purchasing power as well as the increase in demand post-pandemic.

Margins During 3QFY21, the gross margin improved to 16.7% (3QFY20: 11.4%) on the back of lower raw material prices and increased share of Crown and Plastic Caps, Preform and PET Resin in the Company's sales mix. The operating margin increased to ~12.4% (3QFY20: 8.9%) as the trickledown effect of gross margin was partially negated by the increase in operating costs. The Company's finance cost decreased sharply to PKR 144mln during 3QFY21 (3QFY20: PKR 315mln) due to a decrease in policy rates, and because the Company has also paid its old borrowings. The net margin improved to 7.6% (3QFY20: 1.4%) with net profit clocked in at PKR 324mln (3QFY20: PKR 58mln).The trickledown effect of lower raw material cost along with less volatile exchange rates and lower financing cost translated into better net income.

Sustainability Going forward, management is focused on consolidating its position in the industry and increasing capacity utilization of the PET Preform segment.

Financial Risk

Working Capital The Company’s inventory days were reduced to 106 days during 3QFY21 (3QFY20: 125 days) as Preform inventory that had been held up while awaiting approval from customers was sold. Trade receivable days showed a meagre increase to 64 days (3QFY20: 59 days) due to slower recoveries as a result of lockdown. Meanwhile, Trade payable days increased to 75 during 3QFY21 (3QFY20: 65 days) to take the benefit of stable exchange rates by adopting sight L/C payments. As a result, the Company’s net working capital days stood at 94 days during 3QFY20 (3QFY20: 119 days). The Company’s short term trade leverage stood at -8.1% as the Company incurred short term borrowing of PKR 320mln.

Coverages During 3QFY21, the Company’s free cash flows increased to PKR 845mln (3QFY20: 539mln) on the back of improved profitability. Meanwhile, finance cost decreased to PKR 144mln (3QFY20: PKR 315mln) due to a lower benchmark rate along with decreased short term borrowings of PKR 2,109mln (3QFY20: PKR 2,567mln). As a result, the Company’s interest coverage ratio improved significantly and stood at 5.9x during 3QFY21 (3QFY20: 2.1x). Meanwhile, the debt coverage ratio improved to 2.6x (3QFY20: 1.0x) as the Company repaid its current maturity of long-term debt.

Capitalization During the period, Pakistan Synthetics' leveraging reduced to ~8.1% (3QFY20: ~13% & FY20: ~61%) due to the equity injection of PKR 505mln during 2QFY20. The equity injection was used mainly to repay short term borrowings. The Company's short term borrowings constitute ~78% of total borrowings. Going forward, leveraging is expected to remain stable as the Company does not have plans for capital expenditure.

PKR mln

Pakistan Synthetic Ltd Packaging	Mar-21 9M	Dec-20 6M	Jun-20 12M	Jun-19 12M	Jun-18 12M
A BALANCE SHEET					
1 Non-Current Assets	2,204	2,139	2,124	2,363	2,313
2 Investments	1	1	1	-	-
3 Related Party Exposure	-	-	-	-	-
4 Current Assets	4,193	3,096	2,975	3,571	3,746
a Inventories	*2,150*	*1,686*	*1,149*	*1,866*	*2,251*
b Trade Receivables	*1,130*	*500*	*877*	*951*	*645*
5 Total Assets	6,397	5,236	5,100	5,934	6,060
6 Current Liabilities	1,737	1,151	1,297	1,137	1,543
a Trade Payables	*1,386*	*915*	*971*	*907*	*1,264*
7 Borrowings	2,696	2,337	2,165	3,570	2,585
8 Related Party Exposure	-	-	-	-	-
9 Non-Current Liabilities	38	38	36	31	596
10 Net Assets	1,926	1,710	1,602	1,196	1,336
11 Shareholders' Equity	1,926	1,710	1,602	1,196	1,336
B INCOME STATEMENT					
1 Sales	4,277	2,369	6,587	7,039	5,257
a Cost of Good Sold	*(3,561)*	*(2,050)*	*(6,127)*	*(6,367)*	*(4,686)*
2 Gross Profit	716	319	461	672	570
a Operating Expenses	(186)	(104)	(176)	(141)	(177)
3 Operating Profit	530	215	284	531	394
a Non Operating Income or (Expense)	*74*	*32*	*6*	*(352)*	*(151)*
4 Profit or (Loss) before Interest and Tax	604	247	290	179	242
a Total Finance Cost	*(144)*	*(92)*	*(389)*	*(329)*	*(205)*
b Taxation	*(136)*	*(47)*	*0*	*26*	*80*
6 Net Income Or (Loss)	324	108	(99)	(124)	117
C CASH FLOW STATEMENT					
a Free Cash Flows from Operations (FCFO)	*845*	*438*	*500*	*554*	*364*
b Net Cash from Operating Activities before Working Capital Changes	*689*	*333*	*116*	*230*	*172*
c Changes in Working Capital	*(947)*	*(356)*	*301*	*(418)*	*699*
1 Net Cash provided by Operating Activities	(258)	(23)	416	(188)	871
2 Net Cash (Used in) or Available From Investing Activities	(239)	(101)	(122)	(199)	(849)
3 Net Cash (Used in) or Available From Financing Activities	501	457	(472)	364	30
4 Net Cash generated or (Used) during the period	4	333	(177)	(23)	53
D RATIO ANALYSIS					
1 Performance					
a Sales Growth (for the period)	-13.4%	-28.1%	-6.4%	33.9%	80.1%
b Gross Profit Margin	16.7%	13.5%	7.0%	9.5%	10.8%
c Net Profit Margin	7.6%	4.6%	-1.5%	-1.8%	2.2%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	-2.4%	3.4%	12.1%	1.9%	20.2%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	24.9%	12.8%	-5.7%	-10.2%	9.7%
2 Working Capital Management					
a Gross Working Capital (Average Days)	170	162	134	148	194
b Net Working Capital (Average Days)	94	90	82	92	120
c Current Ratio (Current Assets / Current Liabilities)	2.4	2.7	2.3	3.1	2.4
3 Coverages					
a EBITDA / Finance Cost	5.9	4.3	1.5	2.0	2.4
b FCFO / Finance Cost+CMLTB+Excess STB	2.6	2.1	0.9	0.4	1.0
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.6	0.7	3.6	4.4	3.2
4 Capital Structure					
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	58.3%	57.7%	57.5%	74.9%	65.9%
b Interest or Markup Payable (Days)	20.2	20.6	24.7	27.1	43.5
c Entity Average Borrowing Rate	7.4%	6.9%	12.3%	9.3%	7.0%

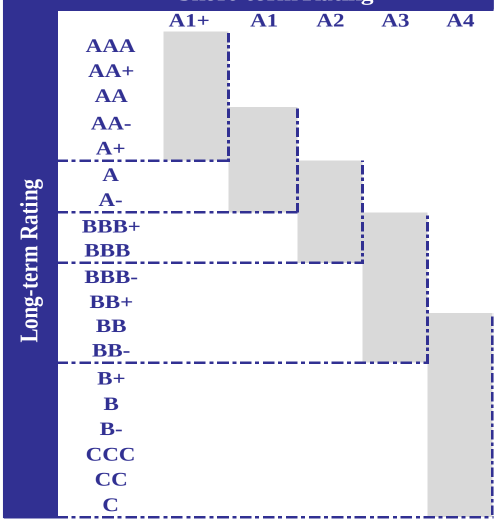
Credit Rating

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 Rating	
Scale	**Definition**
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 Rating	
Scale	**Definition**
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
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.

Short-term Rating



The correlation shown is indicative and, in certain cases, may not hold.

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 some material identifiable event with indeterminable rating implications. 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 rating 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) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) 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.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

Entities

a) Broker Entity Rating
b) Corporate Rating
c) Financial Institution Rating
d) Holding Company Rating
e) Independent Power Producer Rating
f) Microfinance Institution Rating
g) Non-Banking Finance Companies (NBFCs) Rating

Instruments

a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk Rating

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