The Pakistan Credit Rating Agency Limited

Rating Report

Cherat Packaging Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
23-Dec-2022	A	A1	Positive	Maintain	-
24-Dec-2021	A	A1	Positive	Maintain	-
23-Dec-2020	A	A1	Stable	Maintain	-
24-Dec-2019	A	A1	Stable	Maintain	-
28-Jun-2019	A	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect Cherat Packaging Limited's ("CPPL" or the "Company") established position as one of the leading players in packaging sector (kraft paper sacks, polypropylene bags and flexible packaging). The Company is focusing on strengthening its position in export segment (PP Bags) and managed to increase its exports by 37.7% (FY21: PKR 366mln). Over the years, the Company has built a strong business profile and setting footprints in flexible packaging industry as well. As per management representation, the Company succeeded to maintain its market share in bags manufacturing segment at ~30%. The long-term prospects of the Company are linked with demand in local and foreign cement industries and flexible packaging businesses. The Company has managed to earn positive cash flows during FY'22 and 1QFY23. The profit margins of the Company decreased due to diminished growth in cement sector amid recent flood devastations. Further strategic relationships with international suppliers helped the Company in reaping benefits of high demand and effective inventory management. The Company installed new PP line IV in Feb'22, contributing a production capacity of 65mln bags/annum and taking the total production capacity to 260mln PP bags per annum. The Company has availed the Temporary Economic Refinance Facility (TERF) from SBP amounting to PKR 655mln, to finance this project.
Financial leveraging elevated at end of FY'22 and 1QFY23 attributable to inventory buildup in anticipation of higher future prices and raw material availability concerns, which resulted in elevated short-term borrowings, lower coverages and higher finance costs. The Company has moderately leveraged capital structure where the increase in short-term debt is attributable to recent supply chain management. Strong liquidity position of the Company is also evident from its current ratio of 4.8 times at end Sep'22 (FY22: 4.6 times; FY:21: 5.3 times).
The Company's association with Ghulam Faruque Group bodes well for the ratings. Going forward, the Company should focus on increasing the foreign sales to gain exchange rate advantages and lack of management committees in organizational structure can be focus of further improvement.

The ratings are dependent upon the management's ability to improve margins while sustaining its market share. Prudent management of the working capital, maintaining sufficient cash flows and coverages is imperative for the ratings. Materialization of management's strategy of diversification through flexible packaging into better margins and profitability is important. Any significant decrease in margins and/or coverages will impact the ratings.

Disclosure

Name of Rated Entity	Cherat Packaging Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating(Jun-22),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jun-22),Methodology | Rating Modifiers(Jun-22)
Related Research	Sector Study | Paper and Packaging(Nov-22)
Rating Analysts	Muhammad Azmat Shaheen | azmat.shaheen@pacra.com | +92-42-35869504

Profile

Legal Structure Cherat Packaging Limited ("CPPL" or the "Company") was incorporated as a public limited company in 1989. The Company got listed on PSX in 1991.

Background In 1992 CPPL started its production of paper sacks and diversified its business with manufacturing of polypropylene bags in 2012 and was the first company to be recognized as the leading manufacturer of premium quality cement sacks. In 2017, the Company decided to enter into the segment of flexible packaging.

Operations The main business activities are manufacturing, marketing and sale of paper sacks, polypropylene bags and flexible packaging material. The plant has an annual production capacity of 660 million bags (kraft paper and polypropylene combined) and 12.6 mln Kgs of flexo and roto printing. The Company also exports cement bags.

Ownership

Ownership Structure Cherat Packaging is part of the Ghulam Faruque Group. Faruque (Pvt.) Ltd holds 10.3% stake in Cherat Packaging Limited, followed by Cherat Cement Company Limited (7.4%), Greaves Pakistan Private Limited (5%), Mirpurkhas Sugar Mills Limited (5%). The group & directors holds 32% stake of the company while the remaining stake is held by general public and other financial and non-financial institutions.

Stability Since inception, Ghulam Faruque Group has continuously strengthened and diversified its lines of businesses.

Business Acumen The sponsors have strong business acumen emanating from the groups established presence in cement, sugar, chemical, paper, industrial air conditioning and engineering sector. The diversified business lines provide a strong sense of stability as a group.

Financial Strength Cherat Cement Company Limited net assets stood at ~PKR 18.8bln with a turnover of ~PKR 9.0bln during 1QFY23 represents a sound support for the Company when needed. The overall group's asset stood at over PKR ~80bln with revenue of PKR ~43bln during FY 2021.

Governance

Board Structure CPPL’s Board of Directors (BoD) comprises 9 members which include 3 independent directors including a female representation, 2 executive directors, and 4 non-executive directors on the board. The board is currently chaired by Mr. Akbarali Pesnani, a non-executive director, bring an external viewpoint to effectively carry out oversight function of the board.

Members’ Profile All the directors are highly qualified and have extensive experience in the fields of accounting, auditing, banking, manufacturing and financial services. There is a good mix of professional skills and qualifications possessed by the board members.

Board Effectiveness During the year, five meetings of the Board of Directors were convened. The quality of discussion as captured in meeting minutes reflects high involvement of the board members in business activities. The two board committees namely: i)Audit Committee & ii) Human Recourse and Remuneration Committee provide assistance to the board on important matters.

Financial Transparency EY Ford Rhodes Chartered Accountants are the external auditors of the Company. They have expressed an unqualified opinion on the financial statements for the period ending June 22. The Company has an in-house internal audit department, which reports to the Audit Committee.

Management

Organizational Structure The Company has a well-developed organizational structure. The Company operates through two regional offices, located in Lahore and Islamabad, while its manufacturing facility is in Gadoon and a registered office located in Peshawar, reporting to the Head Office in Karachi. All the functional Heads report to the Company’s COO. The CFO and COO report to the CEO of the Company.

Management Team Mr. Amer Faruque is the CEO of the company. He is a Bachelor of Science (BS) graduate in Business Administration majoring in Management/Marketing from Drake University, USA. All functional departments are headed by seasoned professionals.

Effectiveness Management’s effectiveness and efficiency can be ensured through the presence of management committees. There are no management committees in place, which indicates a room for improvement.

MIS CPPL’s manufacturing division is in KPK. The head office in Karachi, regional offices and manufacturing facility are integrated through single ERP platform. The Company uses SAP and customized software to generate various types of operational reports as required by the management in order to monitor the activities effectively.

Control Environment The Company has an effective mechanism for identification, assessment and reporting of all types of risk arising out of the business operations.To ensure operational efficiency, the Company has an in-house internal audit department. The audit committee reviews the internal audit department report and planned activities.

Business Risk

Industry Dynamics Pakistan’s packaging industry consists of three major segments: paper, plastic, and tinplate. Pakistan’s paper and plastic industry has an approximate size of PKR 64bln at end CY22. The second largest segment within the local industry is paper and board which occupies ~34% of the market. The segment’s direct costs consist largely of imported raw materials (75%). Therefore, volatility in exchange rates and international price trends has a major impact on costs. Demand in this segment remained relatively. The demand for cement bags is directly linked with the packaging industry and post flood demand for cement has seen a decrease of ~25%, reflecting the same decrease in demand for paper and packaging industry, consistent as it is part of supply chain of essential products. The market for paper packaging is anticipated to expand at a CAGR of 3.87% from FY21 to FY26.

Relative Position There are five players including CPPL, producing Paper bags and seven players, including CPPL, producing PP bags. Major players in Paper bags are Nishat paper, Thal limited and Lahore Poly Industries. In PP bags are Ultra Packaging, Nova Synpac, Lahore Poly Industries and Syntronics. In Flexible packaging category, the key players are Packages Ltd, Kompass Pvt. Ltd, Kamil Packaging and Hamza Flexible. CPPL is the largest player in the industry representing ~30% of total market share in bags manufacturing segment.

Revenues The operations are segmented in two main Divisions, i) bags manufacturing division (paper bags and polyproplylene bags manufacturing) ii) flexible packaging division (extrusion, flexo graphic and rotogravure printing). The Company’s topline has shown an increase of 22.8% during 1QFY23, the revenue stood at PKR 3.8bln (1QFY22: PKR 3.1bln). The paperbag manufacturing division has the largest share in revenue during FY22.

Margins The gross margins stood during 1QFY23 at 15.8% (1QFY22: 18.3%). The operating margins also decreased with the same pace as gross margins. The net profit margin decreased to 4.3% in 1QFY23 vs 8.8% in 1QFY22 due to significant increase in financing cost to PKR 250.5mln during (1QFY22: PKR 92.5mln) and recent flood devastation.

Sustainability The revival of construction sector along with increase in cement demand will have a positive effect on the revenue of the Company. Further, the margins are expected to increase from current level with decrease in dollar value. There is strong competition in the industry due to price sensitivity. Amid the recent flood devastation in 1QFY23, there is a sizeable decline in cement demand of around 25%. The diminished demand for cement will translate into lower revenue in kraft paper packaging providers as well.

Financial Risk

Working Capital The cash cycle has increase to 189days during 1QFY23 from 163days during FY22 and 153days during FY21, which is mainly triggered by increase in inventory days. The inventories are buildup recently due to anticipated increase in raw material prices. Majority of the Company’s sales are on credit as it’s the industry practice.

Coverages Total borrowings of the Company witnessed an increase with short term borrowings comprising a significant portion of debt. Free cash flows (FCFO) of the Company stood at PKR 278mln for first quarter of 2023 (FY22: PKR 1,429mln; FY21: PKR 1,263mln).

Capitalization The capital structure of CPPL is moderately leveraged. The leveraging stood at 53.6% at the end of Sep'22 (FY22: 49%; FY21: 43.9%). The significant increase in short term borrowing over the year end 2022 and first quarter 2023 is attributable to higher capitalization ratio.

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Financial Summary
PKR mln

Cherat Packaging Ltd Paper and Packaging	Sep-22 3M	Jun-22 12M	Jun-21 12M	Jun-20 12M
A BALANCE SHEET				
1 Non-Current Assets	5,711	5,561	5,029	5,111
2 Investments	-	-	-	-
3 Related Party Exposure	620	500	950	469
4 Current Assets	10,700	8,860	6,608	5,580
a Inventories	*6,215*	*4,661*	*3,152*	*2,622*
b Trade Receivables	*3,193*	*2,841*	*2,255*	*1,967*
5 Total Assets	17,032	14,922	12,587	11,161
6 Current Liabilities	2,222	1,929	1,245	723
a Trade Payables	*618*	*543*	*335*	*229*
7 Borrowings	7,539	6,005	4,731	5,437
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	733	733	572	227
10 Net Assets	6,538	6,256	6,040	4,774
11 Shareholders' Equity	6,538	6,256	6,040	4,774
B INCOME STATEMENT				
1 Sales	3,803	13,503	11,255	9,436
a Cost of Good Sold	*(3,201)*	*(11,188)*	*(9,318)*	*(8,262)*
2 Gross Profit	602	2,315	1,938	1,174
a Operating Expenses	(105)	(401)	(304)	(260)
3 Operating Profit	497	1,914	1,634	914
a Non Operating Income or (Expense)	*(6)*	*(33)*	*(50)*	*(32)*
4 Profit or (Loss) before Interest and Tax	491	1,881	1,583	882
a Total Finance Cost	*(250)*	*(485)*	*(385)*	*(784)*
b Taxation	*(79)*	*(510)*	*(343)*	*(28)*
6 Net Income Or (Loss)	162	886	855	70
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*278*	*1,429*	*1,263*	*1,160*
b Net Cash from Operating Activities before Working Capital Changes	*529*	*1,914*	*1,647*	*364*
c Changes in Working Capital	*(1,620)*	*(1,671)*	*(148)*	*412*
1 Net Cash provided by Operating Activities	(1,091)	243	1,500	776
2 Net Cash (Used in) or Available From Investing Activities	(243)	(882)	(236)	(279)
3 Net Cash (Used in) or Available From Financing Activities	1,335	(679)	(570)	(495)
4 Net Cash generated or (Used) during the period	1	(1,318)	693	2
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	12.7%	20.0%	19.3%	16.6%
b Gross Profit Margin	15.8%	17.1%	17.2%	12.4%
c Net Profit Margin	4.3%	6.6%	7.6%	0.7%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	-35.3%	-1.8%	9.9%	16.7%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sl*	10.6%	15.4%	15.0%	1.5%
2 Working Capital Management				
a Gross Working Capital (Average Days)	1429	174	162	180
b Net Working Capital (Average Days)	189	163	153	173
c Current Ratio (Current Assets / Current Liabilities)	4.8	4.6	5.3	7.7
3 Coverages				
a EBITDA / Finance Cost	1.3	3.7	4.2	1.6
b FCFO / Finance Cost+CMLTB+Excess STB	0.7	1.3	1.2	1.2
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	23.1	2.8	3.1	7.3
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	53.6%	49.0%	43.9%	53.2%
b Interest or Markup Payable (Days)	70.1	114.8	89.6	83.6
c Entity Average Borrowing Rate	17.1%	8.8%	7.3%	13.4%

Credit Rating

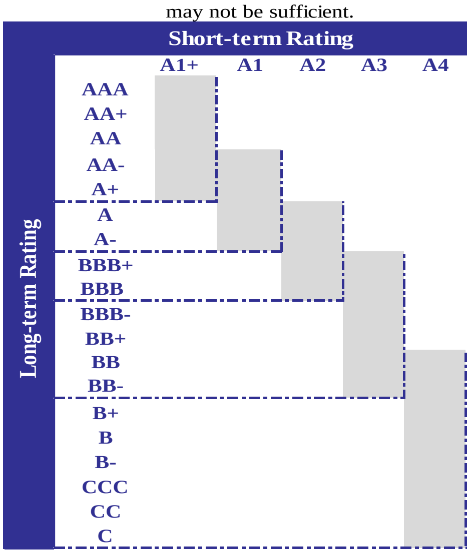
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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.



**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):

a) Broker Entity Rating
b) Corporate Rating
c) Debt Instrument Rating
d) Financial Institution Rating
e) Holding Company Rating
f) Independent Power Producer Rating
g) Microfinance Institution Rating
h) Non-Banking Finance Companies 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 | Clause 11-(A)(p).

(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)

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