The Pakistan Credit Rating Agency Limited

Rating Report

EcoPack Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
06-Nov-2019	BBB+	A2	Stable	Maintain	-
07-May-2019	BBB+	A2	Stable	Maintain	-
05-Nov-2018	BBB+	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect EcoPack's established position in PET Preform and PET Bottle segments. PET packaging sector mostly derives its demand from bottled water, Carbonated/other Soft Drink (CSD) industry and strategic location. The increase in consumer demand for CSD products over the years and conversion to plastic bottles from glass brought significant growth in PET packaging industry. However, the industry remains exposed to seasonality as demand is higher in summer months. The overall growth in demand is reflected in the top-line of EcoPack as it maintained its market share in the industry. The Company was unable to translate this growth in gross profit as sales mix shifted to greater preform sales, a lower margin product. The growth in bottling segment was limited as most CSD industry players have in-house bottling plants. The margins were also lower as imported raw material and other input costs increased and could not be passed onto customers entirely. This led to lower profitability. The Company's leveraging increased during the year but remains moderate with adequate coverages. The Company utilized higher short-term borrowings to manage its working capital needs. This led to exhaustion of borrowing cushion at trade level.

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

Disclosure	
Name of Rated Entity	EcoPack 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 EcoPack Limited (EcoPack or 'the Company') was incorporated as a Public Limited Company in 1992 and is listed on the Pakistan Stock Exchange (Formerly Karachi Stock Exchange).

Background The Company started commercial production in 1993. Over the years, the Company enhanced its production capacity of both PET Preforms and Bottles. The Company has been on the forefront of innovation and product development. EcoPack introduced 1 piece bottle for Carbonated Soft Drink (CSD) industry and successfully introduced the first 500mln bottle in the market.

Operations The Company has two product lines, namely i) PET Preforms, and ii) PET Bottles. The production capacities of PET preforms division and bottling division are 797mln and 304mln units per annum, respectively. The production facility of EcoPack is located in Hattar Industrial Area, KPK, while its head office is in Rawalpindi.

Ownership

Ownership Structure Majority of EcoPack's ownership resides with Jamil family (~32%). Mr. Hussain Jamil (owning 17.2% shares) is one of the largest shareholder of the Company. Of the remaining 68% portion of the shares, 38% are held by acquaintances of the Sponsors. The remaining shareholding vests with general public.

Stability Ownership of the business is seen as stable as the major ownership vests with Jamil family.

Business Acumen Jamil family has been associated with the plastic packaging since 1969 and is well versed with dynamics of the industry. Their acumen of the industry is reflected in the multi-fold growth of EcoPack over the decades. EcoPack is now one of the leading players in the industry.

Financial Strength EcoPack is a stable business entity. The Sponsors have adequate financial strength to support the Company in case need arises.

Governance

Board Structure EcoPack’s BoD comprises two Independent Directors, three Non-Executive Directors and two Executive Director. Jamil family dominates the Board with five directors representing the family. Apt size of the Board and presence of independent oversight indicates well framed governance structure.

Members’ Profile The BoD members have diversified skill mix both in terms of qualifications and expertise. Board’s Chairman, Mr. Amar Zafar Khan, is a Chartered Accountant having over 30 years of multi-functional experience at international financial institutions. The Executive Directors have strong knowledge of the plastic industry, which bodes well for overall control. Other members bring different perspective to the Board, based on their background and expertise.

Board Effectiveness The Board has met four times in FY19 to discharge its duties, with majority members attending all four meetings. The Board has also formed two sub-committees, namely i) Audit Committee, and Human Resource and Remuneration Committee (HR&R). Both committees are chaired by Independent Directors. Audit committee and HR&R committee met four and five times in FY19, respectively. The meeting minutes are well documented.

Financial Transparency M/s KPMG Taseer Hadi & Co., Chartered Accountants are the external auditors of the Company. They have expressed unqualified opinion on the financial statements for FY19.

Management

Organizational Structure EcoPack's production function is divided into two divisions, namely i) PET Preforms, and ii) PET Bottles. Each division is headed by its respective Divisional Head, who reports to the Director Technical and Commercial. All functional Heads report to the Company’s COO. However, finance and accounts function reports to the Company’s CFO. Both, CFO and COO, report to the CEO.

Management Team The Company’s CEO, Mr. Hussain Jamil has been associated with the Company since inception. He is a seasoned businessman and carries over 40 years of experience. All senior management has long association with the Company, which bodes well for operational efficiency.

Effectiveness The cross-functional management committees increase the efficiency of management as they are helpful in the inter-departmental coordination. However, the management has not established any functional committees. This compromises the overall effectiveness, keeping in view the size of operations.

MIS The Company has installed SAP ERP, installed by Sidat Hyder Financials, to manage flow of information. EcoPack’s Plant, Head Office, and Regional Offices are all connected through this ERP system. The SAP is capable of generating various reports, which are submitted to the management for monitoring purposes.

Control Environment The Company has established an internal audit function, which has been outsourced to BDO Ebrahim & Co., Chartered Accountants. EcoPack has setup a Quality Control and Assurance department, which conducts regular inspections to ensure product quality. Furthermore, the Company is ISO 9001:2008 and ISO 22000:2005 certified, reflecting strong control environment.

Business Risk

Industry Dynamics PET packaging sector derives demand from bottled water and carbonated Soft Drink (CSD) industry, while pharmaceutical and edible oil segments have become an upcoming demand driver. The industry is seasonal in nature with summer season having the greatest demand. Strong consumer demand for beverages remains pivotal to the overall packaging industry's growth. The recent macroeconomic stabilization measures taken by government have eroded the purchasing power of consumers to an extent. This has affected the demand for CSD products, impacting PET packaging industry's volumes. The industry's raw material is pegged with crude oil prices. Recent devaluation of PKR has increased the cost of raw material.

Relative Position EcoPack holds a moderate market share of 10% in the Preform segment, whereas in the Bottle segment, the Company has a market share of 30%.

Revenues The sales mix of the Company has changed over the years in the favor of PET preform over bottles. The top-line of the Company grew by ~23% in FY19 and clocked in at PKR 4,074mln (FY18: PKR 3,312mln). Around 55% of the top-line is derived from sale of preform in FY19 (FY18: 48%, FY17: 34%, FY16: 33%), while rest came from sale of bottles. The growth mainly came from volumetric increase in sales of preforms after capacity expansion. During 1QFY20, the top-line of the Company clocked at ~PKR 781mln, posting a decline of ~29%. The decline is mainly attributable to lower volumetric sales of preforms due to lower demand from beverage industry amid lower consumer demand and shift to bigger volume bottle.

Margins The gross margins of EcoPack stood at ~9.5% during FY19 (FY18: ~11%). The gross margins declined due to higher share of preform, a lower margin segment, and increasing input costs. The gross margin of the preform division stood at ~7% in FY19 (FY18: ~7.8%), while that of the bottling division clocked in at ~12.5% (FY18: ~14%). On the back of better cost controls at operating level, the operating margin clocked in at ~6.2% in FY19 (FY18: ~7.7%). The net profit margin dropped to ~2% in FY19 (FY18: ~4%) as interest cost increased substantially. The Company posted net profit of PKR 75mln in FY19 (FY18: PKR 123mln). The gross margins of EcoPack declined to ~3.3% in 1QFY20. The gross margins declined due to increasing input costs and the inability of the Company to pass these costs to its customers entirely in the off-peak season. The Company incurred a net loss of PKR 30mln in 1QFY20 (1QFY19: PKR 14mln Loss).

Sustainability EcoPack regularly incurs Capex to enhance and optimize its production capacity. The Company has increased PET production capacity in FY19 and has also completed installation of plant for manufacturing large PET bottles to cater to increasing demand from bottled water. Further, in order to remain competitive in the high inflation environment, the Company is incurring capital expenditure in FY20 for manufacturing lower weight preforms.

Financial Risk

Working Capital During FY19, the gross working capital days increased to 63 days (FY18: 59 days), mainly due to higher trade receivables, while the net working capital days increased to 47 days (FY18: 40 days). This was financed through higher borrowings, which clocked in at PKR 719mln (FY18: PKR 485mln). The short-term trade leverage of EcoPack turned negative 2% in FY19, showing no room for further borrowings. In 1QFY20, the gross and net working capital days increased to 69 days and 56 days, respectively.

Coverages The FCFO improved to PKR 362mln in FY19 (FY18: PKR 292mln). The finance cost increased in FY19 by ~90% and clocked in at PKR 127mln (FY18: PKR 67mln) due to greater reliance on short-term borrowings and higher benchmark rate. On this backdrop, the interest coverage ratio declined to 3.4x in FY19 (FY18: 5.5x), while the debt coverage ratio stood at 1.4x (FY18: 1.6x). During 1QFY20, the interest coverage and debt coverage ratios clocked in at 0.7x and 0.4x, respectively.

Capitalization The capital structure of EcoPack is moderately leveraged. The leveraging stood at ~56% during FY19 (FY18: ~48%). The long-term borrowings of the Company increased to PKR 419mln (FY18: PKR 326mln), while short-term borrowings recorded at PKR 719mln during FY19 (FY18: PKR 485mln). In 1QFY20, the leveraging decreased to 50%, as the Company repaid part of its short-term borrowings after peak demand season.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

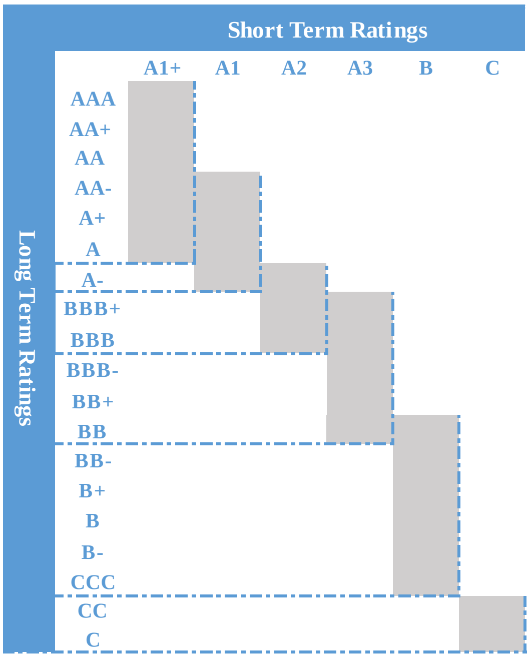
EcoPack Limited	Sep-19	Jun-19	Jun-18	Jun-17
Packaging	3M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	1,477	1,463	1,381	1,011
2 Investments	-	-	-	36
3 Related Party Exposure	-	-	-	-
4 Current Assets	737	1,103	999	655
a Inventories	*261*	*325*	*225*	*247*
b Trade Receivables	*193*	*403*	*455*	*149*
5 Total Assets	2,214	2,566	2,381	1,702
6 Current Liabilities	173	231	299	176
a Trade Payables	*99*	*132*	*222*	*121*
7 Borrowings	879	1,138	976	494
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	284	290	239	262
10 Net Assets	878	907	868	771
11 Shareholders' Equity	878	907	868	771
B INCOME STATEMENT				
1 Sales	781	4,075	3,312	2,205
a Cost of Good Sold	*(755)*	*(3,689)*	*(2,949)*	*(1,848)*
2 Gross Profit	26	386	363	357
a Operating Expenses	(30)	(132)	(112)	(135)
3 Operating Profit	(4)	254	251	223
a Non Operating Income or (Expense)	*1*	*(18)*	*(52)*	*(18)*
4 Profit or (Loss) before Interest and Tax	(3)	236	199	204
a Total Finance Cost	*(38)*	*(127)*	*(67)*	*(54)*
b Taxation	*11*	*(34)*	*(9)*	*(44)*
6 Net Income Or (Loss)	(30)	75	123	106
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*28*	*362*	*290*	*286*
b Net Cash from Operating Activities before Working Capital Changes	*(2)*	*292*	*225*	*235*
c Changes in Working Capital	*315*	*(222)*	*(180)*	*(1)*
1 Net Cash provided by Operating Activities	313	70	46	234
2 Net Cash (Used in) or Available From Investing Activities	(45)	(190)	(506)	(66)
3 Net Cash (Used in) or Available From Financing Activities	(273)	75	515	139
4 Net Cash generated or (Used) during the period	(5)	(44)	55	307
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	-29.0%	23.0%	50.2%	5.2%
b Gross Profit Margin	3.3%	9.5%	11.0%	16.2%
c Net Profit Margin	-3.8%	1.8%	3.7%	4.8%
d Cash Conversion Efficiency (EBITDA/Sales)	4.6%	9.9%	12.0%	15.8%
e Return on Equity (ROE)	-13.3%	8.4%	15.0%	15.0%
2 Working Capital Management				
a Gross Working Capital (Average Days)	69	63	59	78
b Net Working Capital (Average Days)	56	47	40	59
c Current Ratio (Total Current Assets/Total Current Liabilities)	4.3	4.8	3.3	3.7
3 Coverages				
a EBITDA / Finance Cost	0.9	3.8	7.4	12.6
b FCFO / Finance Cost+CMLTB+Excess STB	0.4	1.4	1.3	2.2
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	-8.9	1.6	2.1	1.0
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	50.0%	55.6%	52.9%	39.0%
b Interest or Markup Payable (Days)	45.7	86.8	93.8	117.9
c Average Borrowing Rate	15.0%	10.1%	7.3%	4.8%

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