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
07-May-2020	BBB+	A2	Negative	Maintain	YES
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 PET packaging sector mostly derives its demand from bottled water, Carbonated Soft Drink (CSD) industry, pharma and other consumables. The increase in consumer demand for CSD products and conversion from glass to plastic bottles in recent years brought significant growth in PET packaging industry. However, the industry remains exposed to seasonality as demand is higher in summer months. Lately, imposition of CNIC requirement on distributors and decline in consumer purchasing power due to high inflation has reduced demand for beverage and, in turn, industry products. The ratings reflect EcoPack's established position in PET Preform and PET Bottle segment and its strategic location in North. Volumetric decrease due to relatively lower demand has led to decline in the Company's top-line during the period. In recent years, the Company's sales mix has shifted towards preforms, which is a lower margin segment. Further, the Company's inability to pass higher costs on to customers in off-peak season has impacted margins. Furthermore, spiraling finance costs on the back of higher borrowings and benchmark rate have deteriorated the bottom-line. Lower inflation and decline in PET Resin prices due to falling crude oil prices internationally may reduce some pressure on margins in the short-run. The Company's capital structure remains moderately leveraged, though borrowings have shown rising trend over the years. The Company has utilized higher short term borrowings to manage working capital and other needs. This led to mismatch at trade level putting pressure on the financial profile. The recent measures announced by SBP, including principle deferment, and rate cut of 425bps is expected to provide some relief.
The 'Rating Watch' signifies uncertainty created by the COVID-19 outbreak in the prevailing challenging economic environment. The Company remains operational as it is exempted from shutdown, being related to food & allied sector. The demand may take time to recover amidst countrywide lockdown and closure of restaurants, banquet halls, and non-essential shops. The supply chain may also be impacted. PACRA will closely monitor the situation and take action accordingly.

The ratings are dependent on the Company's ability to sustain volumes and top-line in current scenario. Meanwhile, improving margins and reduction of asset liability mismatch remains critical. Prolonged lockdown, resulting in significant dip in demand and sustained losses 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.

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 500ml 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 the Jamil family (~32%). Mr. Hussain Jamil (owning 17.2% shares) is one of the largest shareholder of the Company. Of the remaining shares, 38% are held by acquaintances of the Sponsors. The remaining shareholding (~30%) 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 business since 1969 and is well versed with dynamics of the industry. Their acumen of the industry is reflected in EcoPack's growth over the decades as it became 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 Directors. The 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 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 and other members have diversified skill mix both in terms of qualifications and expertise, which bodes well for overall control.

Board Effectiveness The Board met four times in FY19 to carry out its duties, with majority members attending all four meetings. The Board has also formed two sub-committees, namely i) Audit Committee, and ii) Human Resource & Remuneration Committee. Both committees are chaired by Independent Directors. Audit Committee and HR & Remuneration 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 an 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 Director Technical and Commercial. All functional Heads report to the Company’s COO. However, finance and accounts function reports to the Company’s CFO. The CFO and COO report to the CEO.

Management Team The Company’s CEO, Mr. Hussain Jamil, has been associated with the Company since its 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 management has not established any management committees. This compromises the overall effectiveness, keeping in view the size of operations. Having cross-functional management committees would increase the efficiency of management as they are helpful in the inter-departmental coordination.

MIS The Company uses 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 is outsourced to BDO Ebrahim & Co., Chartered Accountants. EcoPack has setup a Quality Control and Assurance department that 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 ongoing lockdown implemented by the government to control the Covid-19 pandemic is expected to impact demand for beverages, and in turn, PET packaging. The recent reduction in international crude oil prices would subsequently lower the PET Resin prices since they are pegged to oil prices. This, coupled with lower production costs, may boost margins. Recent SBP measures and reduction in interest rates is expected to provide some respite.

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 favor of PET preform over bottles. Around 55% of the top-line is derived from sale of preform in FY19 (FY18: 48%) while rest came from sale of bottles. During 9MFY20, the Company's top-line declined significantly by ~24% and stood at PKR 1,875mln (9MFY19: PKR 2,479mln) due to a declining volumes as demand remained subdued (Preform: ~29%, Bottles: ~9%). This was mainly due to reduced demand for beverages from end consumers in the wake of increasing inflation and shift to larger bottles. The top-line is expected to remain depressed in FY20 due to impact of countrywide lockdown during peak season for the industry.

Margins During 9MFY20, the Company's gross profit margin decline to 1.3% (9MFY19: ~5%) due to significant increase in input costs. The Company was unable to pass on higher cost to customers during low demand season, while lower volumes (on YoY basis) exacerbating the situation further. Operating loss margin during 9MFY20 stood at -3.9% (9MFY19: Profit: ~1%) due to trickle-down effect of lower gross margin. Meanwhile, finance cost increased to PKR 117mln (9MFY19: PKR 74mln) due to higher benchmark rate and relatively higher total borrowings. The Company incurred losses of PKR 153mln (9MFY19: Loss PKR 48mln) with a net loss margin of ~8% (1HFY19: ~2%).

Sustainability The Company's production facility remains operational despite a widespread lockdown imposed by the Government to tackle the Coronavirus. The Company is exempt as it falls within the essential food and allied sector. However, the overall reduction in demand may impact volumes.

Financial Risk

Working Capital In 9MFY20, inventory days increased to 58 days (9MFY19: 36 days) on the back of lower sales during the period while the trade receivable days remained stable at 46 days (9MFY19: 48 days). As a result, gross working capital days swelled to 104 days (9MFY19: 83 days). Meanwhile, trade payable days remained stable at 18 days (9MFY19: 18 days) resulting in net working capital of 86 days (9MFY19: 65 days). The Company's short term trade leverage saw a steep decline to -44% (9MFY19: -10%). As a result, the Company has excess borrowing of PKR 321mln against its trade assets. This mismatch puts pressure on financial profile of the Company.

Coverages During 9MFY20, the Company's free cash flow from operations (FCFO) were depressed (9MFY20: PKR 19mln, 9MFY19: PKR 103mln) on the back of losses incurred during the period. Meanwhile, the Company's finance cost increased to PKR 117mln (9MFY19: 74mln) due to higher benchmark rate and rising total borrowings (9MFY20: PKR 1,255mln, 9MFY19: PKR 1,152mln). As a result, the interest coverage ratio declined to 0.2x (9MFY19: 1.9x) while the debt coverage ratio stood at 0.1x (9MFY19: 0.7x). The lower cashflows during the period reflect inherent seasonality of the Company's business although the impact is pronounced due to relatively lower revenue on YoY basis.

Capitalization EcoPack's leveraging ratio stands at ~63% indicating a highly leveraged capital structure. Going forward, leveraging is expected to remain stable as there are no plans for capital expenditure. Short term borrowings constitute ~75% of the Company's total borrowings.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

EcoPack Limited	Mar-20	Jun-19	Jun-18	Jun-17
Paper & Packaging	9M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	1,454	1,463	1,381	1,011
2 Investments	-	-	-	36
3 Related Party Exposure	-	-	-	-
4 Current Assets	1,002	1,103	999	655
a Inventories	*464*	*325*	*225*	*247*
b Trade Receivables	*230*	*403*	*455*	*149*
5 Total Assets	2,456	2,566	2,381	1,702
6 Current Liabilities	199	231	299	176
a Trade Payables	*110*	*132*	*222*	*121*
7 Borrowings	1,255	1,138	976	494
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	263	290	239	262
10 Net Assets	738	907	868	771
11 Shareholders' Equity	738	907	868	771
B INCOME STATEMENT				
1 Sales	1,875	4,075	3,312	2,205
a Cost of Good Sold	*(1,851)*	*(3,689)*	*(2,949)*	*(1,848)*
2 Gross Profit	24	386	363	357
a Operating Expenses	(97)	(132)	(112)	(135)
3 Operating Profit	(74)	254	251	223
a Non Operating Income or (Expense)	*(2)*	*(18)*	*(52)*	*(18)*
4 Profit or (Loss) before Interest and Tax	(75)	236	199	204
a Total Finance Cost	*(119)*	*(127)*	*(67)*	*(54)*
b Taxation	*41*	*(34)*	*(9)*	*(44)*
6 Net Income Or (Loss)	(153)	75	123	106
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*19*	*362*	*290*	*286*
b Net Cash from Operating Activities before Working Capital Changes	*(102)*	*292*	*225*	*235*
c Changes in Working Capital	*65*	*(222)*	*(180)*	*(1)*
1 Net Cash provided by Operating Activities	(38)	70	46	234
2 Net Cash (Used in) or Available From Investing Activities	(89)	(190)	(506)	(66)
3 Net Cash (Used in) or Available From Financing Activities	101	75	517	139
4 Net Cash generated or (Used) during the period	(26)	(44)	57	307
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	-38.6%	23.0%	50.2%	--
b Gross Profit Margin	1.3%	9.5%	11.0%	16.2%
c Net Profit Margin	-8.1%	1.8%	3.7%	4.8%
d Cash Conversion Efficiency (EBITDA/Sales)	2.5%	9.9%	12.0%	15.8%
e Return on Equity (ROE)	-24.7%	8.4%	15.0%	13.7%
2 Working Capital Management				
a Gross Working Capital (Average Days)	104	63	59	54
b Net Working Capital (Average Days)	86	47	40	34
c Current Ratio (Total Current Assets/Total Current Liabilities)	5.0	4.8	3.3	3.7
3 Coverages				
a EBITDA / Finance Cost	0.4	3.8	7.4	12.6
b FCFO / Finance Cost+CMLTB+Excess STB	0.1	1.4	1.3	2.2
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	-3.4	1.6	2.1	1.0
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	63.0%	55.6%	52.9%	39.0%
b Interest or Markup Payable (Days)	66.5	86.8	93.8	117.9
c Average Borrowing Rate	13.2%	10.1%	7.3%	5.6%

Rating Scale | Corporate

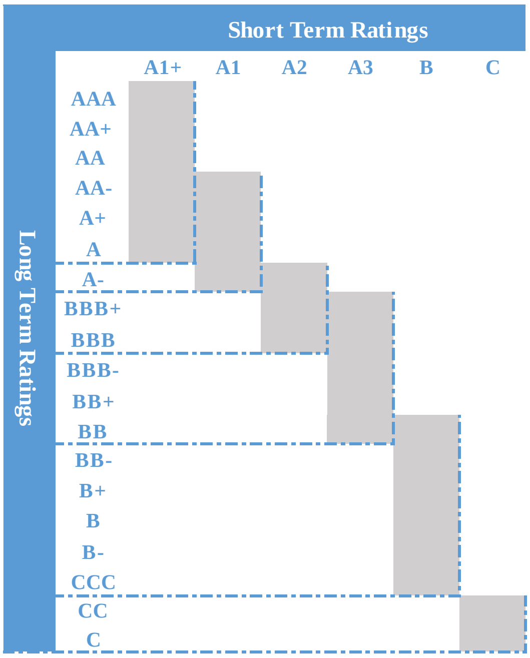
2019

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