The Pakistan Credit Rating Agency Limited

Rating Report

Pakistan Synthetics Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
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 provision of an integrated packaging solution to its customers. Pakistan's PET packaging industry derives its demand from the country's beverage industry, which has been impacted due to inflation round and spread of COVID-19 pandemic in the country and subsequent imposition of countrywide lockdown in March 20. The demand for the PET packaging industry's products as beverage industry saw lower up lift of stock. Resultantly, the industry is faced challenges including low demand, build-up of inventory and receivables and lower capacity utilization. The Company largely maintained its top-line in 9MFY20 and improved its profitability due to higher margins and as effect of exchange losses diminished. The revenues are expected to remain low due to COVID-19 outbreak and its impact in 4QFY20. The situation improved recently with up lift of lockdown in majority areas and start of peak season. The Company's margins are expected to remain intact due to reduced price of raw materials on the back of decrease in international oil prices. The utilization level of the new Preform segment improved but remained below optimal levels. The Company's financial profile is characterized by a leveraged capital structure. The leveraging reduced on YoY basis as sponsors injected equity through right issue. The coverages improved on the back of better cashflows. The working capital remains stressed due to asset liability mismatch at trade level. The ratings incorporate strong sponsor support as demonstrated in the past.
The 'Rating Watch' signifies uncertainty created by the COVID-19 outbreak 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 food & allied sector. However, production in the metal crowns segment was suspended due to low demand. PACRA will closely monitor the situation and take 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. Significant decline in profitability and/or coverages may have a negative 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 Ratings(Jun-20),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria | Rating Modifier(Jun-20)
Related Research	Sector Study | Paper and Packaging(Nov-19)
Rating Analysts	Ateeb Riaz | ateeb.riaz@pacra.com | +92-42-35869504

Profile

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

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

Operations The Company produces Plastic Closures, Metal Crowns, PET Resin and PET Preforms with respective capacities of ~559,000 cartons per annum, 28,000MT per annum and ~31,000 octabins per annum. The Company's manufacturing facilities are located in Hub, Balochistan and Port Qasim, Karachi. The registered office is located in West Wharf, Karachi.

Ownership

Ownership Structure Majority stake of Pakistan Synthetics lies with the Haji Karim family, who own ~75% of total shares. Mr. Yaqoob Haji Karim (~17%) and Mr. Anis Yaqoob (~14%) are two of the largest stakeholders of the Company. Approximately ~15% of the stake resides with general public.

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

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

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

Governance

Board Structure The Company's board is dominated by members of the Haji Karim family. The BoD comprised three Independent Directors, four Non-Executive Directors and two Executive Directors, including the CEO. Two BoD members have resigned recently and will be replaced in due course.

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

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

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

Management

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

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

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

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

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

Business Risk

Industry Dynamics Demand for Pakistan's PET packaging industry is seasonal in nature and is derived from the country's beverage sector. The reduced purchasing power of end consumers due to higher inflation has had a negative impact on the food and beverage segment and thus hampered demand for the PET packaging industry. Additionally, the closure of markets and restaurants to control the Covid-19 pandemic has had a detrimental impact. The reduction in international crude oil prices due to lower demand amid COVID-19 have lowered the price of raw material, boosting profitability in short-term. Recent SBP measures and reduction in interest rates is expected to provide some relief to cashflows.

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

Revenues 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 9MFY19, the Company's top-line clocked in at PKR 4,253mln (9MFY19: PKR 4,522mln). The decline of ~6% YoY was due to the reduced customer purchasing power as well as the closure of markets and restaurants during the COVID-19 lockdown period which coincided with the start of peak season.

Margins In 9MFY20, the gross margin improved to 11.4% (9MFY19: 10.6%) on the back of lower raw material prices and increased share of preform in the Company's sales mix. The operating margin increased slightly to ~9% (9MFY19: 8.7%) as the trickle down effect of gross margin was partially negated by the increase in operating costs. The Company's finance cost increased to PKR 315mln (9MFY19: PKR 233mln) due to higher benchmark rate. However, the net margin improved to 1.4% (9MFY19: -0.4%) and net profit clocked in at PKR 58mln (9MFY19: PKR -19mln) as the Company avoided incurring significant exchange loss during the period.

Sustainability The Company's production of the metal crowns segment was suspended for a period of 2 weeks in the initial stages of the spread of COVID-19. Operations were able to resume once lockdown restrictions were gradually eased. Going forward, management is focused on consolidating its position in the industry and increasing capacity utilization of newly established PET Preform segment.

Financial Risk

Working Capital The Company's inventory days were reduced to 125 days in 9MFY20 (9MFY19: 144 days) as Preform inventory that had been held up while awaiting approval from customers was sold. Trade receivable days increased to 59 days (9MFY19: 41 days) due to slower recoveries as a result of lockdown. Trade payable days declined to 65 (9MFY19: 80 days) as the Company shifted from Usance LC to Sight LC, in order to reduce exposure from fluctuating exchange rates. As a result, the Company's net working capital days stood at 119 days in 9MFY20 (9MFY19: 105 days). The Company's short term trade leverage stood at -28% as the Company incurred excess short term borrowing of PKR 807mln.

Coverages In 9MFY20, the Company's free cash flows increased to PKR 539mln (9MFY19: 306mln) on the back of improved profitability. Meanwhile, finance cost increased to PKR 315mln (9MFY19: PKR 233mln) due to higher benchmark rate. As a result, the Company's interest coverage ratio remained stable at 1.9x (9MFY19: 1.9x). Meanwhile, the debt coverage ratio improved to 1.0x (9MFY19: 0.4x) as the Company repaid its current maturity of long-term debt (9MFY20: PKR 184mln, 9MFY19: PKR 790mln). The recent right issue is expected to supplement coverages as it will be used to reduce borrowings.

Capitalization During the period, Pakistan Synthetics' leveraging reduced to ~62% (FY19: ~75%) due to the equity injection of PKR 504mln. The equity injection is expected to be used to repay short term borrowings. The Company's short term borrowings constitute ~88% of total borrowings. Going forward, leveraging is expected to remain stable as the Company does not have plans for capital expenditure.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

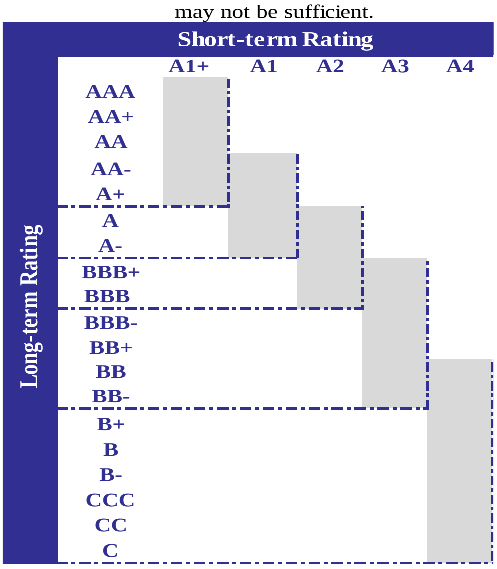
Pakistan Synthetics Limited Paper & Packaging	Mar-20 9M	Jun-19 12M	Jun-18 12M	Jun-17 12M
A BALANCE SHEET				
1 Non-Current Assets	2,325	2,363	2,313	1,567
2 Investments	1	-	-	-
3 Related Party Exposure	-	-	-	-
4 Current Assets	3,777	3,571	3,746	3,329
a Inventories	*2,018*	*1,866*	*2,251*	*1,899*
b Trade Receivables	*888*	*951*	*645*	*795*
5 Total Assets	6,103	5,934	6,060	4,896
6 Current Liabilities	1,396	1,137	1,543	1,135
a Trade Payables	*1,121*	*907*	*1,264*	*876*
7 Borrowings	2,914	3,570	2,585	2,522
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	34	31	596	17
10 Net Assets	1,759	1,196	1,336	1,222
11 Shareholders' Equity	1,759	1,196	1,336	1,222
B INCOME STATEMENT				
1 Sales	4,253	7,039	5,257	2,919
a Cost of Good Sold	*(3,769)*	*(6,367)*	*(4,686)*	*(2,653)*
2 Gross Profit	483	672	570	267
a Operating Expenses	(105)	(141)	(177)	(153)
3 Operating Profit	378	531	394	114
a Non Operating Income or (Expense)	*34*	*(352)*	*(151)*	*(1)*
4 Profit or (Loss) before Interest and Tax	412	179	242	112
a Total Finance Cost	*(315)*	*(329)*	*(205)*	*(143)*
b Taxation	*(39)*	*26*	*80*	*69*
6 Net Income Or (Loss)	58	(124)	117	39
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*539*	*554*	*364*	*275*
b Net Cash from Operating Activities before Working Capital Changes	*223*	*230*	*172*	*127*
c Changes in Working Capital	*17*	*(418)*	*699*	*228*
1 Net Cash provided by Operating Activities	240	(188)	871	355
2 Net Cash (Used in) or Available From Investing Activities	(84)	(199)	(849)	(52)
3 Net Cash (Used in) or Available From Financing Activities	(169)	364	30	152
4 Net Cash generated or (Used) during the period	(13)	(23)	53	456
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	-19.4%	33.9%	80.1%	75.7%
b Gross Profit Margin	11.4%	9.5%	10.8%	9.1%
c Net Profit Margin	1.4%	-1.8%	2.2%	1.3%
d Cash Conversion Efficiency (EBITDA/Sales)	13.7%	8.6%	8.5%	12.4%
e Return on Equity (ROE)	5.3%	-9.8%	9.2%	3.1%
2 Working Capital Management				
a Gross Working Capital (Average Days)	184	148	194	346
b Net Working Capital (Average Days)	119	92	120	259
c Current Ratio (Total Current Assets/Total Current Liabilities)	2.7	3.1	2.4	2.9
3 Coverages				
a EBITDA / Finance Cost	2.1	2.0	2.4	2.6
b FCFO / Finance Cost+CMLTB+Excess STB	1.0	0.4	1.0	1.0
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	1.6	4.4	3.2	3.1
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	62.4%	74.9%	65.9%	67.4%
b Interest or Markup Payable (Days)	18.4	27.1	43.5	33.1
c Average Borrowing Rate	11.6%	9.6%	7.2%	6.1%

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):

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