RATING REPORT

Archroma Pakistan Limited (ARPL)

REPORT DATE:
January 07, 2022

RATING ANALYST:

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Rating Category	Latest Rating	
	Long-term	**Short-term**
Entity	AA	A-1
Rating Outlook	Stable	
Rating Date	January 07, 2022	
Rating Action	Initial	

COMPANY INFORMATION	
Incorporated in 1996	**External auditors:** KPMG Taseer Hadi & Co.
Public Limited Company	**CFO:** Irfan Chawala
Key Shareholders (with stake 5% or more):	**CEO:** Mujtaba Rahim
Archroma Textiles GmbH – 75%	**Chairman:** Mr. Veqar Arif

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria – Industrial Corporates (August 2021) **CorporateMethodology202108.pdf (vis.com.pk)**

Archroma Pakistan Limited (ARPL)

OVERVIEW OF THE ORGANIZATION

Archroma **Pakistan Limited** (ARPL) was incorporated in **2**013 as a public limited company. Head office of the company is situated in Karachi. Product portfolio of the company consists of chemicals for textile, construction, paper, and home care industries.

Profile of CEO

Mr. Mujtaba Rahim has been a part of the Board since 2004. He holds a Masters degree in Applied Chemistry from University of Karachi and has attended several local and international courses on leadership and strategic management. In 1982, he joined Sandoz where he worked his way up the career ladder and was appointed CEO in 2006, a position he continued to hold after the company's name was changed to Archroma.

Profile of CFO

Mr. Irfan Chawala is currently the Finance Lead for Cluster Pakistan & CFO of Archroma Pakistan Limited and was re-appointed on the Board of Directors in 2021 and is holding this position since April 2020. He is a Fellow Member of Institute of Chartered Accountants of Pakistan (ICAP) with over 25 years of

Archroma Pakistan Limited was formed in 2013 from the textiles, paper & emulsions business of Clariant. Clariant itself was formed in 1995 as a spin off from Sandoz, a chemical & pharmaceutical company incorporated in Pakistan and listed on PSX in 1963. Since its inception, i.e. Sandoz, Clariant and now Archroma has been primarily engaged in the manufacture and sales of chemicals, dyestuffs, coating, adhesive and sealants for the textile, paper, construction, and home care industries. Archroma is now a global, diversified provider of specialty chemicals operating in over 35 countries and with 26 production sites. Archroma Pakistan Limited is 75% owned by Archroma Textiles GmbH, Switzerland.

In the year 2015, Archroma also acquired textile chemical business of German chemical giant BASF Pakistan Private Limited and in 2016 a merger of wholly owned subsidiary Archroma Textiles Chemical Pakistan Private Limited (formerly BASF Pakistan Private Limited) into Archroma Pakistan limited took place with the approval of court.

The company has a diversified product portfolio, with its offerings catering to the requirements of different industrial segments in Pakistan and in the region. The Company is primarily engaged in the manufacture, import, indent and sale of chemicals, dyestuffs and coating, adhesive and sealants, catering to textile, construction, paper and home care industries. An extensive product range and long-term relationships with customers has enabled the entity to establish and maintains leadership position in the market for textile & performance specialties. In addition to that, the company also offers coatings, adhesives, sealants to construction industry, and dyes and chemicals to the paper industry. More recently, it has ventured into the home care industry and started manufacturing of Unsaturated Polyester Resins as well, which is expected to help the company to diversify its sales revenue base, going forward.

ARPL head office is based in Korangi, Karachi while production sites are located in Landhi, Karachi and Jamshoro, Sindh. The Korangi site also houses the Archroma Center of Excellence (ACE), a state-of-the-art facility which provides customer support and also leads in textile specialty chemicals' research. Total ARPL actual production in last year was 60,332 tons.. The installed capacity is indeterminable because of multi-product plans involving varying processes of manufacturing. At present, the power requirement of plants is fulfilled via gas based generators, but supply from grid is also available that acts a backup. In the next 3-5 years, the company plans to become self-reliant by looking into utilizing renewable sources of energy.

Rating Drivers

Assigned ratings draw support from the strength of the parent group

Assigned ratings of ARPL incorporate strong parent profile of Archroma Holdings Sarl, a global diversified provider of specialty chemicals serving the textiles, packaging and paper, coatings, adhesives and sealants markets with operations in over 35 countries and with over 26 production sites.

diverse working experience in different roles, industries & geographical markets.

Profile of Chairman

Mr. Veqar Arif joined the Board of directors in 2021. He is a fellow member of Institute of Chartered Accountants of Pakistan and Institute of Corporate Secretaries of Pakistan. He joined Sandoz in 1990 and has been associated with Clariant in Finance, Administration, and Audit functions for more than 30 years.

Diversified product portfolio, although revenues remain concentrated in one business segment

Archroma Pakistan sells a wide range of chemicals to industrial segments on a global scale. Product portfolio encompasses the following segments:

1. **Brand & Performance Textile Specialties**
   This segment contributes around 90% to the total sales revenue of the company. Archroma offers chemical products that are used across the textile value chain from fiber to finish and fashion to medical and home textiles. The products used enhances the properties of apparel such as crease resistance, moisture management, and repellency. In this segment, the company also offers dyes and chemicals for the textile and other sectors. Flagship product in this segment is Indigo which is supplied to denim products' manufacturers. Export sales account for 15% of total sales and are mainly to Turkey, Bangladesh, Vietnam, Singapore and Thailand.

2. **Coating, Adhesives & Sealants**
   This segment provides solutions to a wide range of applications including raw materials used in the paint and construction industries, synthetic latexes/polymer dispersions for paints, coatings, adhesives, and sealants.

3. **Packaging & Paper Specialties**
   This segment offers products for management of whiteness, coloration, special coatings, and strength that ultimately enhances both the optical and functional properties of paper.

4. **Personal & Home Care**
   In this segment, the company supplies hygiene products that are used in the hospital sector by patients and doctors. Archroma commenced manufacturing of alcohol-based hand sanitizers in the year 2020 to fight against the pandemic. The company also manufactures optical brighteners, dyes and additives used in laundry and house-hold care.

5. **Unsaturated Polyester Resins (UPR)**
   UPR is a new market identified which has a number of applications in daily life. This segment offers thermosetting Resins having international quality standards. The products offered acts as a substitute to wood and metal and increases useful life of the product with no rusting. In view of projected higher demand of this product line, management envisages further enhancement of UPR segments installed capacity which shall be financed by internal cash generation.

Over the years, a strong emphasis on R&D has enabled the entity to keep on introducing new products and explore new segments. Their new hygiene segment products have been well received in the market and likely to grow going forward mainly with the detergents industry. Pursuing such an approach in a sustainable manner will not only reduce dependence on certain product lines, but may also result in incremental revenues if market opportunities are capitalized in a successful manner.

Business Risk is considered moderate to low, although supply chain concerns remain elevated

Given major revenue contribution emanating from the textile segment, stable demand outlook and sizeable market presence depicts medium to low business risk profile. In addition, GoP's support package and increasing momentum of construction activity in the country bodes well for the business risk profile of the company. Players in the chemical industry are organized into two segments. The traditional segment is mostly represented by international players, while non-traditional segment includes fragmented small players who are mixers, formulators and traders. Archroma's competitive edge stems from its backward integrated process offering lower lead-time to import substituted products, which over the years has provided market leadership position to the company.

Being one of the leading environment friendly and compliant specialty chemicals producer allows the company to timely pass on the increasing input costs any currency impact. Also certain products' pricing is based in USD which also offsets the currency risk to a large extent. However, dependence on China and key global & regional players for raw material procurement is a material risk given challenging environment in sourcing raw materials. In the outgoing year, the company faced delay in raw material procurement along with higher costs and lead times mainly due to energy consumption controlling measures and environmental checks in China and non-availability of containers and vessels globally. Consequently, the company declared force-majure due to supply-chain constraints. Supply chain uncertainties also pose pricing challenges for the company. Resolution of supply chain challenges is considered important from a ratings perspective.

Long-term relationships with established players and distributors mitigates credit risk exposure to local textile industry.

With sales concentrated to local textile players, exposure to credit risk remains on the higher side. However, the company has over the years built strong relationships with some of the leading and established players in the industry which mitigates credit risk concerns. In addition, strong distribution partners with over 70 years of relationship also provides company with competitive strength.

Steady growth in topline, post COVID-19 coupled with efficiency improvement projects improved the overall profitability profile of the company.

Revenue of the company has grown at a CAGR of 12% over the past three years (FY19-FY21) and was reported at Rs.19.8b in FY21 (FY20: Rs. 15.0b, FY19: Rs. 17.4b) increase of which was a function of both volumetric growth and higher average selling prices. Growth in sales revenue was contributed by a 33% and 41% increase in Brand & Performance Textile Specialties and Coating Adhesive & Sealants business, respectively. Topline decreased during FY20 due to the advent of COVID-19 pandemic and consequent lock-downs across the globe. Proportions of local and export sales have remained at similar levels, with more than 80% revenue contributed by local customers. Top 15 local customers contributed around 43% of the total local sales revenue in FY21.

Gross margins have remained stable over the years with some improvements in FY21 due to have been reported at an average of 30% in the last four years with some improvements in FY21 due to higher average selling prices along with cost efficiency projects implemented by the company. Despite a noticeable rise in sales, administrative expenses remained in check and finance costs went down due to improved working capital cycle requiring lower utilization of short-term borrowings. Consequently, profit for the year increased to Rs. 2.3b (FY20: Rs.1.2b, FY19: Rs. 1.7b). Net Profit margin went up to 11.6%. (FY20: 7.8%, FY19: 9.9%) in FY21. Sensitivity of margins to change in input prices is on the lower side, as the entity is usually able to pass on higher raw material prices to its customers. Going forward, given increased focus towards value-added segments, margins and overall profitability of the company is projected to increase.

Modest equity growth on account of higher payouts.

Total equity of the company has grown at a CAGR of 7% over the past three years (FY19-FY21) despite healthy growth in profitability. Nevertheless, capitalization indicators have remained strong. Increase in equity along with timeline reduction in the quantum of debt has resulted in improved leverage indicators. At end-FY21, gearing and leverage ratios were reported at 0.33x (FY20: 0.61x, FY19: 0.60x) and 1.00x (FY20: 1.18x, FY19: 1.24x), respectively. Dividend payout levels remain on the higher side consistently.

Going forward, the company is also looking into installing solar/wind power plants to shift energy requirements on green energy at its Jamshoro plant. The company is also looking into further backward integration and production of certain raw materials required for manufacturing of dyes and chemicals. These projects are expected to require capital outlay, for which the company may draw down debt financing. However, despite higher projected debt levels, gearing and leverage indicators are expected to remain on the lower side and within manageable levels. Maintenance of capitalization indicators at current levels will be important for assigned ratings.

Healthy liquidity profile to meet outstanding obligations

Funds From Operations (FFO) surged to Rs. 2.5b in FY21 (FY20: Rs. 1.0b, FY19: Rs. 2.1b) owing to increasing profitability. Consequently, cash flow coverages experienced a substantial improvement, providing healthy debt servicing coverage. FFO to Total Debt, FFO to Long-term Debt, and Debt Servicing Coverage Ratios were reported at 133% (FY20: 38%, FY19: 70%), 577% (FY20: 172%, FY19: 1672%), and 9.74x (FY20: 4.26x, FY19: 9.54x), respectively.

Stock in trade and trade debts also provide a strong coverage for short-term debt and current ratio stands at 1.74x (FY20: 1.71x, FY19: 1.56x) at end-FY21. The credit period offered to customers is in the range of 0-90 days, however some of the large organizations make advance payments, which help to improve cash conversion cycle. Going forward, the projected increase in profits is expected to keep liquidity profile sufficient to cover outstanding obligations.

Sound corporate governance framework supported by a well-designed organizational structure, experienced management team and strong disposition towards transparency and disclosures

Archroma has instituted a well-designed organizational structure comprising separate departments for key functions. All divisions have independent management teams and organizational structure. Board composition is in line with best practices while effective oversight mechanism is in place through functioning board committees. Detailed annual report disclosures reflect strong disposition towards transparency and disclosures.

Overall corporate governance of the company is considered sound with Board of Directors comprising seven members. As per best practices, the company has two independent directors on the Board. Board meetings are deliberated on a quarterly basis and minutes are formally documented.

The company has a separate internal audit department that undertakes audit assignments related to financial, operational, and compliance related matters. Board audit committee meetings take place on a quarterly basis. The report prepared for the period is also shared with external auditors. At the end of each year, the audit plan is reviewed by the audit committee and any required changes are implemented from next year.

On the IT front, the department is mainly categorized in infrastructure and applications in use. There is 24/7 connectivity between all 5 sites of the organization. All the data is stored on Azure cloud servers, and the same are synced to global data centers in Spain. The disaster recovery site is located in Landhi which has a daily backup frequency. At present, the company is using BPCS ERP system, which offers complete integration of all functions. Going forward, the plan is to shift to SAP S/4 HANA in near future.

Archroma Pakistan Limited (ARPL) Appendix I

Financial Summary - Archroma Pakistan Limited (PKR m)				
BALANCE SHEET	**FY18**	**FY19**	**FY20**	**FY21**
Fixed Assets	1,953	1,914	1,977	1,865
Stock-in-Trade	2,695	3,056	3,090	2,653
Trade Debts	3,733	3,916	2,788	3,770
Cash & Bank Balances	532	599	269	1,268
Total Assets	10,961	11,463	9,828	11,710
Trade and Other Payables	3,293	3,028	2,174	3,772
Long Term Debt	125	127	605	441
Short Term Debt	2,490	2,920	2,143	1,476
Total Debt	2,615	3,047	2,748	1,916
Total Liabilities	6,156	6,345	5,348	5,863
Paid Up Capital	341	341	341	341
Total Equity (without revaluation surplus)	4,805	5,117	4,504	5,848
INCOME STATEMENT	**FY18**	**FY19**	**FY20**	**FY21**
Net Sales	14,290	17,353	15,039	19,872
Gross Profit	4,518	5,346	4,205	6,179
Profit Before Tax	1,944	2,150	1,536	3,189
Profit After Tax	1,536	1,722	1,169	2,309
RATIO ANALYSIS				
Gross Margin (%)	31.6%	30.8%	28.0%	31.1%
Net Margin	10.8%	9.9%	7.8%	11.6%
Net Working Capital	3,077.6	3,409.0	3,221.5	4,162.7
FFO	1,782.6	2,123.4	1,039.0	2,541.7
FFO to Total Debt (%)	68%	70%	38%	133%
FFO to Long Term Debt (%)	1420%	1672%	172%	577%
Current Ratio (x)	1.52	1.56	1.70	1.74
Debt Servicing Coverage Ratio (x)	5.52	9.54	4.26	9.74
Gearing (x)	0.54	0.60	0.61	0.33
Leverage (x)	1.28	1.24	1.19	1.00
Dividend payout	89%	89%	88%	132%
(Stock in Trade+Trade Debts)/STD	258%	239%	274%	435%
ROAA (%)	14%	15.4%	11.0%	21.4%
ROAE (%)	32%	34.7%	24.3%	44.6%

ISSUE/ISSUER RATING SCALE &DEFINITIONS Appendix II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.vis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details.www.vis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES					Appendix III
Name of Rated Entity	Archroma Pakistan Limited				
Sector	Chemicals				
Type of Relationship	Solicited				
Purpose of Rating	Entity Rating				
Rating History	**Rating Date**	**Medium to Long Term**	**Short Term**	**Rating Outlook**	**Rating Action**
	RATING TYPE: ENTITY				
	Jan-07-2022	AA	A-1	Stable	Initial
Instrument Structure	N/A				
Statement by the Rating Team	VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.				
Probability of Default	VIS ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.				
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. For conducting this assignment, analyst did not deem necessary to contact external auditors or creditors given the unqualified nature of audited accounts and diversified creditor profile. Copyright 2022 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.				
Due Diligence Meetings Conducted		**Name**	**Designation**	**Date**	
	1	Mr. Irfan Lakhani	Company Secretary	13-Dec-2021	
	2	Mr. Irfan Chawla	CFO	13-Dec-2021	
	3	Mr. Imran Younus	Head of Taxation	13- Dec-2021	
	3	Mr. Imran Tariq	Manager Finance	13-Dec-2021	
	3	Mr. Hadi Raza Lakhani	Head of Sales & Marketing	13-Dec-2021	
	4	Mr. Aslam	Head of IT	13-Dec-2021	