RATING REPORT

Archroma Pakistan Limited

REPORT DATE:
January 31, 2023

RATING ANALYSTS:
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Rating Category	Latest Rating		Previous Rating	
	Long-term	**Short-term**	**Long-term**	**Short-term**
Entity	AA	A-1	AA	A-1
Rating Outlook	Stable		Stable	
Rating Date	January 31, 2023		January 07, 2022	
Rating Action	Reaffirmed		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: Corporate Rating Methodology (August, 2021)   **https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf**

Archroma Pakistan Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

Archroma Pakistan Limited was incorporated in 2013 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 Master's 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 diverse working experience in different roles, industries & geographical markets.

Profile of Chairman

Archroma Pakistan Limited ('Archroma' or 'the Company') 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 31 countries and with 25 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 maintain 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, the Company has ventured into the home care industry, construction chemicals (admixtures & Super Plasticizers) and started manufacturing Unsaturated Polyester Resins (UPR) as well, which is expected to support the Company to diversify its sales revenue base, going forward. At present, segment diversification is limited with 90% of the revenue emanating from Brand & Performance Textiles (BPT) Segment.

Archroma's 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. At present, the power requirement of plants is fulfilled via gas-based generators, but supply from grid is also available as backup. In the next 2-3 years, the Company plans to become self-reliant by moving towards renewable sources of energy.

Product Portfolio

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

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.

- **Brand & Performance Textile (BPT):** Majority (~90%) of sales emanate from this category. Archroma offers chemical products that are used across the textile value chain from fiber to finish. 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, main consumers of which are denim producers.

- **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, sealants also for Packaging, stationery and certain other industries.

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

- **Personal & Home Care:** In this segment, the Company supplies hygiene products that are used in the health care sector by patients and doctors. Archroma commenced manufacturing alcohol-based hand sanitizers in 2020, as demand for these grew exponentially during the pandemic. This segment also includes sales of molecules used in laundry and cleaning products.

- **Unsaturated Polyester Resins (UPR):** 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.

Business Update – Archroma

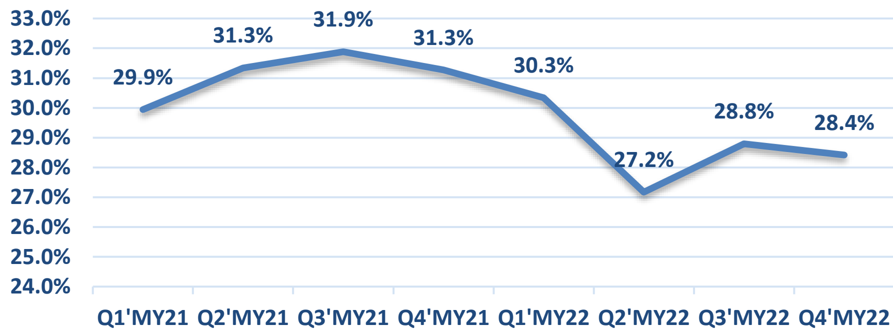
Sales & Operations

Table 1: P&L (extract)

	MY20	MY21	MY22
NET SALES (PKR MILLION)	15,039	19,872	25,154
GROSS MARGIN (%)	28.0%	31.1%	28.7%
NET MARGIN (%)	7.8%	11.6%	7.5%

- Archroma posted strong growth (26.6%) in topline during MY22 (MY21: 32.1%). Growth was particularly elevated in Q1'MY22 and subsequently both topline and gross margin has depicted contraction QoQ, the latter clearly illustrated in the figure below.

Figure 1: Gross Margins (QoQ)



- Majority (~90%) of the sales for Archroma emanate from BPT segment, wherein consumers are major textile operators in Pakistan and overseas. The textile sector slowdown being noted in major export markets is the major reason behind the QoQ contractionary trend in sales revenue; this trend is likely to change in MY23.
- Archroma's revenues comprise export sales, which contribute ~30% of the revenue base, being solely derived from BPT segment. The Company's major export destination is Europe & Asia.
- The contraction in gross margin during MY22 is mainly attributable to high raw material cost owing to the devaluation of PKR during the period. Despite the dip in margins, these remain within threshold for the assigned rating.
- The Company's net margin has contracted during the period and is viewed to be lower than peers. As per the management, reasoning behind the drop in net margin was lower gross margins and higher taxation, mainly as the Company has made provisions for super tax in MY23, which translate into effective tax rate of 39.9% (MY21: 27.6%).
- The Company's sales does depict customer concentration, as 29.3% of the gross sales emanated from largest two distributors in MY22 (MY21: 24.5%), while about half of the trade receivables are outstanding against 5 clients. As per management, 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 provide the Company with competitive strength.

Cash Flow Coverages

Table 2: Cash Flow Coverage Indicators

	MY20	MY21	MY22
FFO (MN.) (PKR MILLION)	1,039	2,542	2,558
FFO TO TOTAL DEBT (X)	0.38	1.33	1.11
FFO TO LONG TERM DEBT (X)	1.72	5.77	7.71
DEBT SERVICING COVERAGE RATIO (X)	4.26	9.74	7.94
CURRENT RATIO	1.70	1.74	1.25
(STOCK IN TRADE + TRADE DEBTS)/STD	2.74	4.35	4.46

- The Company's cash flow coverage indicators contracted slightly during MY23, albeit are considered to be adequately high.
- Current ratio declined significantly during MY22, however, it remained adequately high.
- The assigned short term rating is further supported by adequate coverage of short term borrowings by stock of trade debts and inventory. Furthermore, cash conversion cycle (CCC) has also declined, given that inventory days have been rationalized. The CCC for MY22 is viewed as superior to peers.

Table 3: Cash Conversion Cycle

	MY20	MY21	MY22
CASH CONVERSION CYCLE	**97**	**58**	**33**
- DIO	104	77	68
- DSO	81	60	62
- DPO	88	79	97

- An adverse trend in aging of trade receivables has been noted, albeit it was mainly visible in the up to 30 day past due bucket. Overall credit risk profile of trade receivables remains sound.

Capitalization

Table 4: Balance Sheet (Extract) (all figures stated in PKR' Millions, unless stated otherwise)

	SEPT'20	SEPT21	SEPT'22
TOTAL ASSETS	9,828	11,710	12,396
TOTAL LIABILITIES	5,348	5,863	8,624
TOTAL EQUITY	4,504	5,848	3,772
TOTAL DEBT	2,748	1,916	2,309
- LONG TERM DEBT	605	441	332
- SHORT TERM DEBT	2,143	1,476	1,977
LEVERAGE (X)	1.19	1.00	2.29
GEARING (X)	0.61	0.33	0.61

- Archroma's equity base contracted YoY, as the Company maintained a high payout ratio during MY22 (MY22: 81%; MY21: 133%).
- Given the increase in debt and contractionary trend in equity, gearing has trended up during MY22 and viewed to be slightly higher than the peer median. Incorporating additional debt mobilization plans of Rs. 1.5b in MY23-24, the Company's gearing is expected to depict slight increase, albeit it is expected to remain below 0.75x through the rating horizon.

Key Rating Drivers

Assigned ratings draws support from the strength of the parent group

Assigned ratings of Archroma 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.

Topline remains concentrated in one business segment, which has been incorporated into the business risk profile of Archroma; supply chain challenges and customer concentration pose added concerns

With majority (~90%) of its offtake emanating from the BPT segment, the Company's revenue depicts significant sensitivity to changes in its downstream industry i.e. textile. Cognizant of this concentration, the Company's management is working towards diversification. On a YoY basis, we have not noted any change in proportion of revenue contribution from non-BPT segment. However, as per management as new projects commercialize, the diversification is expected to improve through the rating horizon.

The Company's high dependence on China for raw materials is a pertinent risk given potential procurement challenges. In addition, the Company is also facing import related challenges, given import curtailment measures undertaken by Government of Pakistan (GoP). The Company does benefit from the Exports and so far has been able to manage its import needs accordingly and also has stock buffer for the next quarter i.e. Q2'MY23. However, any escalation in the aforementioned business challenges may trigger a rating review.

Business risk profile incorporates customer concentration, as a result of which 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 provide the company with competitive strength.

Assigned rating incorporates adequate cash flow coverage of debt, albeit financial risk profile leaves room for improvement

Archroma's cash flow coverage indicators remain adequately strong. However, overall financial risk profile is affected by a consistently high payout ratio and increasing trend in gearing, which has exceeded the peer median as of end-MY22. As per management, the payout ratio will be managed with increased profit retention, if need be and gearing is likely to remain limited. Incorporating additional debt mobilization plans of Rs. 1.5b in MY23-24, VIS expects gearing to depict slight increase, albeit it is expected to remain below 0.75x through the rating horizon.

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 disclosure.

Archroma Pakistan Limited (ARPL) **Appendix I**

FINANCIAL SUMMARY			*(amounts in PKR millions)*
BALANCE SHEET	**SEPT'20**	**SEPT'21**	**SEPT'22**
Fixed Assets	1,977	1,865	1,930
Stock-in-Trade	3,090	2,653	3,986
Trade Debts	2,788	3,770	4,827
Cash & Bank Balances	269	1,268	96
Total Assets	9,828	11,710	12,396
Trade and Other Payables	2,174	3,772	5,750
Long Term Debt	605	441	332
Short Term Debt	2,143	1,476	1,977
Total Debt	2,748	1,916	2,309
Total Liabilities	5,348	5,863	8,624
Paid Up Capital	341	341	341
Total Equity (without revaluation surplus)	4,504	5,848	3,772
INCOME STATEMENT	**MY20**	**MY21**	**MY22**
Net Sales	15,039	19,872	25,154
Gross Profit	4,205	6,179	7,220
Profit Before Tax	1,536	3,189	3,137
Profit After Tax	1,169	2,309	1,885
RATIO ANALYSIS	**MY20**	**MY21**	**MY22**
Gross Margin (%)	28.0%	31.1%	28.7%
Net Margin	7.8%	11.6%	7.5%
Net Working Capital	3,246	4,163	2,095
FFO	1,039	2,542	2,558
FFO to Total Debt (%)	37.8%	132.6%	110.8%
FFO to Long Term Debt (%)	171.6%	576.8%	771.2%
Current Ratio (x)	1.70	1.74	1.25
Debt Servicing Coverage Ratio (x)	4.26	9.74	7.94
Gearing (x)	0.61	0.33	0.61
Leverage (x)	1.19	1.00	2.29
(Stock in Trade + Trade Debts)/STD	274.3%	435.2%	445.6%
ROAA (%)	11.0%	21.5%	15.6%
ROAE (%)	24.3%	44.6%	39.2%
**Annualized*			

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 TYPE: ENTITY** **01-31-2023 AA A-1 Stable Reaffirmed** **01-07-2022 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.
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Due Diligence Meetings Conducted	**Name** / **Designation** / **Date** **Mr. Irfan Chawla** – CFO – December 29, 2022 **Mr. Imran Younus** – Head of Taxation – December 29, 2022 **Mr. Imran Tariq** – Manager Finance – December 29, 2022