# RATING REPORT

# Archroma Pakistan Limited (APL)

**REPORT DATE:**
September 03rd, 2024

**RATING ANALYSTS:**
Muhammad Subhan
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| RATING DETAILS | | | | |
|---|---|---|---|---|
| Rating Category | Latest Rating | | Previous Ratings | |
| | Long-term | Short-term | Long-term | Short-term |
| **Entity** | AA | A-1 | AA | A-1 |
| ***Rating Date*** | *September 03, 2024* | | *January 31, 2023* | |
| **Rating Outlook/Rating Watch** | Negative | | Stable | |
| **Rating Action** | Maintained | | Reaffirmed | |

| COMPANY INFORMATION | |
|---|---|
| **Incorporated in 2013** | **External Auditors:** KPMG Taseer Hadi & Co. Chartered Accountants |
| **Public Listed Company** | **Chairman of the Board:** Dr. Lalarukh |
| **Key Shareholders (with stake 5% or more):** | **Chief Executive Officer (CEO):** Mr. Mujtaba Rahim |
| Archroma Textiles GmbH – 75.0% | |

| APPLICABLE RATING SCALE(S) |
|---|
| **VIS Issue/Issuer Rating Scale:** *https://docs.vis.com.pk/docs/VISRatingScales.pdf* |

| APPLICABLE METHODOLOGY |
|---|
| **VIS Entity Rating Criteria: Corporates** ***https://docs.vis.com.pk/docs/CorporateMethodology.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 coating industries.*

***Profile of the 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.*

**Corporate Profile**

Archroma Pakistan Limited ("APL" or "the Company") was incorporated and domiciled in Pakistan as a limited liability company. The registered office of the Company is located at Korangi, Karachi, Pakistan. It is publicly listed on the Pakistan Stock Exchange Limited (PSX). APL operates as a subsidiary of Archroma Textiles GmbH, headquartered in Pratteln, Switzerland, which owns 75% of the Company's share capital.

The Company is principally involved in the manufacturing, importing, and distribution of chemicals, dyestuffs, coatings, adhesives, sealants for textile, paints, paper, coating, and construction industries and operates as an indenting agent. Its manufacturing facilities are located at Petaro Road, Jamshoro and Landhi Industrial Area, Karachi while sales offices are located at Thokar Niaz Baig, Lahore and Amin Town, Faisalabad.

**Background Of APL:**

APL's heritage traces back to when Kern & Sandoz was established in 1886 in Basel to produce textile dyes. In 1995, Clariant was formed, as a spin-off from Sandoz, and in 1997 acquired the specialty chemicals business of Hoechst. APL came into existence in 2013 September when SK Capital acquired the then textile chemicals, paper specialties, and emulsions businesses from Clariant Corporation. The three divisions were combined into an integrated, market-focused, and collaborative company and renamed Archroma upon becoming an independent entity namely Archroma Pakistan Limited.

**Business Segments:**

**Textile Effect (TE):** APL's TE division produces chemicals for pretreatment, dyeing, printing, and finishing textiles, including applications for high fashion, home textiles, and technical textiles. Competitors include global players like DyStar and suppliers from China. APL holds a market share of 20-25% overall, with higher share in denim which contributed approximately 84.5% (MY23: 85.2%, MY22: 90.1%) to total sales in 1HMY24.

**Paper, Packaging, & Coatings (PPC):** APL's PPC division offers chemical applications for whitening, coloration, coatings, and strength enhancement across various sectors including packaging & paper, paint, adhesive, and construction. The segment contributed around 15.5% (MY23: 11.8%, MY22: 9.9%) to the total sales in 1HMY24.

**Merger of Archroma Chemicals Pakistan (Pvt.) Limited (ACPL) (formerly Huntsman Textile Effects Pakistan) with APL:**

APL has entered into a merger with ACPL, renowned for its expertise in producing novocron dyes, holding a significant market share. This positions APL as the exclusive marketer of novocron, a development expected to support its revenue streams moving forward. The merger reflects APL's strategic shift towards insourcing, driven by robust considerations for product integration and market synergies. The merger has been effective from October 1st, 2023. The salient features of the Scheme Of Arrangement (SOA) are as follows:

- The Company shall allot and issue an aggregate of 445,460 Company's shares to the shareholders of Archroma Chemicals Pakistan (Private) Limited (formerly Huntsman Textile Effects Pakistan) on the basis of the swap ratio of approximately 0.0455 shares of the Company for every one share of Huntsman. Currently, SOA is pending for issuance of sanction order by the Honorable High Court of Sindh.

**Key Rating Drivers:**

**Strong parent profile**

Assigned ratings of APL incorporate strong parent profile of Archroma Holdings Gmbh, 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.

**Medium to high business risk profile**

APL's business risk profile is classified as medium to high, influenced by cyclicality, moderate competitive intensity, and reliance on imported raw materials.

Demand for chemicals in Pakistan primarily stems from industries such as plastics, paints, paper, leather, soaps, detergents, shampoos, and textiles. This demand is sensitive to economic fluctuations, including changes in interest rates, import regulations, currency fluctuations, liquidity constraints, and cost variations. These economic factors, combined with the industry's cyclicality, impact consumer demand and, consequently, sectoral demand.

The capital-intensive nature of the chemical industry presents a barrier to entry for new entrants, limiting competition and supporting existing market players like APL. However, the Company faces competitive pressures from substitute imports, particularly from China, which at times create challenges for APL to adjust prices in response to rising production costs. Additionally, APL is exposed to exchange rate risks due to its reliance on imported raw materials, with approximately 80% of its input sourced internationally. Nonetheless, APL's significant market share in the chemicals sector provides a degree of stability to its overall business risk profile.

**Despite topline growth, margins depict weakening and bottom-line reports loss**

In MY23, APL's sales composition included 79.1% (MY22: 80.2%) from local sales and 20.9% (MY22: 18.2%) from exports. The company reported a 19.3% increase in its revenue to PKR 30 bln (MY22: PKR 25.2 billion), driven by higher sales in both TE and PP&C segments. This higher sale was on account of Company's strategy to maximize its engagement with its customers and consumption markets and maintaining its market share and position in all segments. Despite the revenue growth in MY23, gross profit only rose by 3.4% to PKR 7.5 bln (MY22: PKR 7.2 bln), resulting in a decline in gross margin to 25% (MY22: 28.7%). The pressure on gross margins across all segments persisted due to challenges in passing on increased costs stemming from the steep devaluation of PKR against major currencies and inflating raw material import costs. Elevated borrowing expenses, foreign exchange losses, and higher taxation rates for registered and corporate businesses during MY23 further impacted APL's bottom-line and profitability, which decreased to PKR 1.2 bln (MY22: PKR 1.9 bln), and a lower net margin of 4.1% (MY22: 7.5%).

In the 1HMY24, the Company recorded sales of PKR 14.3 bln and a gross profit of PKR 2.7 bln, reflecting further lowering of gross margin to 18.8%. Moreover, elevated selling and administration costs, coupled with exceptionally high borrowing expenses and taxation rates, significantly impacted the Company's bottom-line performance. As a result, the Company reported a net loss of PKR 178 mln for its 1HMY23.

Looking ahead, while the proceeds from the sales of novocron chemicals in the last quarter of MY24 are expected to contribute to revenue growth, the Company anticipates a negative impact on profitability in full year MY24. Management forecasts a net loss for the upcoming financial year due to higher cost of sales and finance, reflecting challenges that may offset potential revenue gains from novocron sales.

**Weakening in the coverage profile**

In MY23, the Company experienced a pressure in its coverage profile, as evidenced by a debt service coverage ratio (DSCR) of 1.5x (MY22: 3.3x). This decline in DSCR was primarily driven by a 40.1% reduction in APL's funds flow from operations (FFO), amounting to PKR 1.5 bln (MY22: PKR 2.6 bln). The decrease in FFO was primarily attributed to higher payments towards finance costs and income tax obligations during the year.

In the 1HMY24, the Company's DSCR remained under pressure at 0.7x. This decline is primarily attributed to reduction in FFO to PKR 75.7 mln, driven by lower profitability and increased finance costs. Moving forward, the Company's coverage profile is anticipated to deteriorate further due to management's expectation of a net loss for the year.

**Gearing sustained while leverage remains elevated**

Despite an increase in the equity base in MY23 to PKR 4.3 bln (MY22: PKR 3.8 bln) attributable to the unappropriated profit, the Company reported a deterioration in its capitalization metrics. Specifically, its gearing ratio weakened to 1.1x (MY22: 0.6x) and leverage ratio elevated to 3.7x (MY22: 2.3x). This weakening in APL's capital structure in MY23 was driven by higher short-term debt of PKR 4.4 bln (MY22: PKR 2 bln) necessitated by increasing working capital requirements, alongside a higher volume of creditors of PKR1.3 bln (MY22: 890.8 mln).

In the 1HMY24, the Company maintained a conservative capitalization profile, with its gearing ratio further elevating to 1.6x while leverage slightly improved to 3.6x. The elevation in the gearing ratio was driven by further procurement of short-term debt to PKR 6.6 bln to meet growing working capital requirements. Concurrently, leverage saw a slight improvement due to a reduction in other liabilities and an increase in the equity base to PKR 4.4 bln resulting from the amalgamation reserve following the merger.

**Adequate liquidity profile**

In MY23, the Company's liquidity profile experienced a decline, with its current ratio slightly decreasing to 1.2x (MY22: 1.3x) and short-term debt (STD) coverage declining to 3.6x (MY22: 4.2x). This deterioration in liquidity was attributed to higher procurement of STD during the year. In 1HMY24, the current ratio remained unchanged, but the STD coverage further weakened to 2.4x due to ongoing drawdown of short-term debt to meet the increasing working capital needs of the Company.

**Sound corporate governance framework**

APL 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.

**Key Rating Considerations:**

Going forward, the ratings will remain sensitive to the Company's profitability and coverage profile.

**Archroma Pakistan Limited** **Appendix I**

**Financial Summary** PKR Mlns

| **Balance Sheet** (PKR Millions) | MY18A | MY19A | MY20A | MY21A | MY22A | MY23A | 1HMY24 |
|---|---|---|---|---|---|---|---|
| Property, plant and equipment | 1,952.68 | 1,914.47 | 1,976.82 | 1,865.03 | 1,929.53 | 1,901.91 | 1,871.66 |
| Stock-in-trade | 2,694.53 | 3,056.05 | 3,089.90 | 2,652.65 | 3,985.98 | 6,756.10 | 6,720.99 |
| Trade debts | 3,733.32 | 3,916.35 | 2,788.16 | 3,769.71 | 4,826.63 | 9,312.87 | 9,102.71 |
| Cash & Bank Balances | 532.11 | 598.96 | 269.24 | 1,267.87 | 96.03 | 315.38 | 209.40 |
| Other Assets | 2,048.39 | 1,976.98 | 1,673.02 | 2,155.08 | 1,557.33 | 2,160.14 | 1,983.76 |
| Total Assets | 10,961.03 | 11,462.81 | 9,797.14 | 11,710.34 | 12,395.50 | 20,446.40 | 19,888.52 |
| Creditors | 476.64 | 518.84 | 477.68 | 862.59 | 890.80 | 1,265.82 | 5,596.50 |
| Long-term Debt (incl. current portion) | 125.52 | 126.97 | 611.20 | 381.62 | 331.70 | 333.18 | 338.13 |
| Short-Term Borrowings | 2,489.70 | 2,920.07 | 2,143.05 | 1,475.61 | 1,977.49 | 4,370.65 | 6,597.84 |
| Total Debt | 2,615.22 | 3,047.04 | 2,754.25 | 1,857.23 | 2,309.19 | 4,703.83 | 6,935.97 |
| Other Liabilities | 3,063.98 | 2,779.47 | 2,161.34 | 3,142.94 | 5,423.70 | 10,142.60 | 3,000.37 |
| Total Liabilities | 6,155.84 | 6,345.35 | 5,393.27 | 5,862.76 | 8,623.69 | 16,112.25 | 15,532.84 |
| Paid up Capital | 341.18 | 341.18 | 241.18 | 341.13 | 341.18 | 341.18 | 345.63 |
| Equity (excl. Revaluation Surplus) | 4,805.21 | 5,117.44 | 4,403.86 | 5,847.54 | 3,771.81 | 4,334.13 | 4,355.66 |

| **Income Statement** (PKR Millions) | MY18A | MY19A | MY20A | MY21A | MY22A | MY23A | 1HMY24 |
|---|---|---|---|---|---|---|---|
| Net Sales | 14,290.10 | 17,353.05 | 15,038.94 | 19,872.25 | 25,154 | 30,012.73 | 14,281.58 |
| Gross Profit | 3,944.70 | 5,346.15 | 4,204.72 | 6,179.32 | 7,220.47 | 7,467.77 | 2,678.66 |
| Operating Profit | 2,373.92 | 2,830.28 | 1,975.73 | 3,461.06 | 3,830.39 | 3,503.26 | 645.16 |
| Finance Costs | 429.94 | 680.27 | 439.24 | 271.66 | 693.01 | 1,262.28 | 592.16 |
| Profit Before Tax | 1,943.98 | 2,150.01 | 1,536.49 | 3,189.40 | 3,137.38 | 2,240.98 | 53.00 |
| Profit After Tax | 1,536.28 | 1,722.37 | 1,169.26 | 2,309.37 | 1,885.06 | 1,244.38 | -125.18 |

| **Ratio Analysis** | MY18A | MY19A | MY20A | MY21A | MY22A | MY23A | 1HMY24 |
|---|---|---|---|---|---|---|---|
| Gross Margin (%) | 27.60% | 30.81% | 27.96% | 31.10% | 28.71% | 24.88% | 18.8% |
| Operating Margin (%) | 16.61% | 16.31% | 13.14% | 17.42% | 15.2% | 11.7% | 4.52% |
| Net Margin (%) | 10.75% | 9.93% | 7.77% | 11.62% | 7.5% | 4.1% | -0.88% |
| Funds from Operation (FFO) (PKR Millions) | 1,779.92 | 2,122.41 | 1,217.76 | 2,551.85 | 2,572.14 | 1,540.51 | 75.7 |
| FFO to Total Debt* (%) | 68.06% | 69.65% | 44.21% | 137.40% | 111.39% | 32.75% | 2.18% |
| FFO to Long Term Debt* (%) | 1418.04% | 1671.58% | 199.24% | 668.69% | 775.44% | 462.37% | 44.75% |
| Gearing (x) | 0.54 | 0.60 | 0.63 | 0.32 | 0.6 | 1.1 | 1.6 |
| Leverage (x) | 1.28 | 1.24 | 1.22 | 1.00 | 2.3 | 3.7 | 3.6 |
| Debt Servicing Coverage Ratio* (x) | 4.61 | 3.26 | 2.31 | 5.18 | 3.32 | 1.5 | 0.7 |
| Current Ratio (x) | 1.52 | 1.56 | 1.71 | 1.74 | 1.3 | 1.2 | 1.2 |
| (Stock in trade + trade debts) / STD (x) | 2.57 | 2.38 | 2.53 | 3.80 | 4.2 | 3.6 | 2.4 |
| Return on Average Assets* (%) | 14.83% | 15.36% | 11.00% | 21.48% | 15.64% | 7.58% | -1.24% |
| Return on Average Equity* (%) | 31.28% | 34.72% | 24.56% | 45.05% | 39.19% | 30.70% | -5.76% |
| Cash Conversion Cycle (days) | 134.38 | 126.79 | 140.41 | 96.17 | 93.58 | 134.64 | 150.80 |

**Annualized, if required*

A - Actual Accounts

P - Projected Accounts

M - Management Accounts

## REGULATORY DISCLOSURES — Appendix II

| | |
|---|---|
| **Name of Rated Entity** | Archroma Pakistan Limited |
| **Sector** | Chemical |
| **Type of Relationship** | Solicited |
| **Purpose of Rating** | Entity Ratings |

**Rating History**

| Rating Date | Medium to Long Term | Short Term | Rating Outlook/Rating Watch | Rating Action |
|---|---|---|---|---|
| **RATING TYPE: ENTITY** | | | | |
| **09/03/2024** | **AA** | **A-1** | **Negative** | **Maintained** |
| 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. Altaf Jamal | Financial Controller | 20th May 2024 |
| Mr. Imran Younus | Head Of Taxation & Payables | |
| Mr. Imran Tariq | Manager - Finance | |