RATING REPORT

Novatex Limited

REPORT DATE:
December 05, 2018

RATING ANALYSTS:

Talha Iqbal
talha.iqbal@jcrvis.com.pk

Asfia Aziz
asfia.aziz@jcrvis.com.pk

RATING DETAILS				
	Latest Rating		**Previous Rating**	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	AA-	A-1	AA-	A-1
Rating Outlook	Positive		Stable	
Rating Date	*December 05, 2018*		*September 25, 2017*	

COMPANY INFORMATION	
Incorporated in 1997	**External auditors:** Kreston Hyder Bhimji & Co. Chartered Accountants, Karachi
	Chief Executive Officer: Abdul Razak Diwan
Key Shareholders (with stake 5% or more):	
Gatron Industries Limited	

APPLICABLE METHODOLOGY(IES)
Applicable Rating Criteria: Industrial Corporates (May, 2016) ***http://www.jcrvis.com.pk/kc-meth.aspx***

Novatex Limited

OVERVIEW OF THE INSTITUTION

Novatex Limited operates as an unlisted public limited company under the G&T group of companies; the group has been in existence for over five decades with presence in various sectors including textile, plastic resin and power generation.

Shareholding of the company is held by G&T family with remaining shares by Gatron Industries.

Profile of CEO

Mr. Diwan is a seasoned industrialist with over 45 years of experience. He has been associated with the company since its inception. Mr. Diwan has also been involved in philanthropic activities in the education and health care sector.

RATING RATIONALE

Novatex Limited (Novatex) operates as an unlisted public limited company under the Gani and Tayub (G&T) group of companies; the group has been in existence for over five decades with presence in various sectors including textile, plastic resin and power generation. The Company commenced operations in 1998 and operates in three business segments namely PET Resin, PET Preforms and BOPET Films. Novatex (through a wholly owned subsidiary Nova Powergen Limited) is also in the process of diversification in the power segment through investment in Thalnova Power Thar (Private) Limited (TNPTL).

PET Resin: Novatex is a market leader in the segment. PET resin segment continues to be the major contributor to the Company's revenues and represents over two-third of Novatex's topline. Capacity utilization of the segment has been increasing on a timeline basis with majority production comprising bottle grade chips. A sizeable portion of the resin production is utilized in-house to manufacture preforms and BOPET films. Revenue from this segment witnessed significant growth during FY18 and comprises a mix of local and export sales. Volumetric growth in sales along with higher selling prices contributed to revenue growth. Given the favorable demand-supply outlook in key export markets and removal of anti-dumping duties in US, growth momentum is expected to continue, going forward.

PET Preform: PET preforms are produced using in-house developed PET resin. The company produces preforms for water, beverage and pharmaceutical companies. Novatex along with Gatron Industries (group company) enjoy major market share in Pakistan's preform market. Capacity utilization of the segment is a function of seasonal nature of demand for beverages in the country. Over the last two years, management has enhanced capacity through induction of new injection molding machines and replacement of old machines. Revenues primarily comprise domestic sales and increased during FY18. The growth was a function of increase in sales volumes and higher average selling price. During FY18, management has successfully diversified in the pharmaceutical and juice segment which are expected to be growth drivers in future. Given the significant capital investment being undertaken by leading beverage manufacturers and favorable demographics, demand for preforms is projected to grow.

BoPET Films: These are flexible films primarily used in packaging and are produced by stretching PET resin. In terms of installed capacity, Novatex enjoys more than 60% market share in the segment. Over the last three years, capacity utilization of the segment has remained on the higher side. Substantial portion of the BoPET sales revenue comprise domestic sales while remaining comprise exports. The management is currently undertaking expansion in the BOPET segment which would double the existing capacity. Commercial production from the new line is projected to commence in January'2019. As per management, the company is well positioned to cater to growing local demand where higher value added products along with favorable demand-supply dynamics will result in improvement in margins. With increase in capacity, export sales are also projected to witness growth in view of healthy demand outlook.

Thalnova Power Thar (Private) Limited: Novatex is also undertaking diversification in the power sector through investment in TNPTL, a joint venture between Thal Limited and Novatex. TNPTL has been incorporated to set up a 330MW coal fired power plant at Thar coal mine mouth Sindh. The regulator has granted generation license for 30 years. Moreover, an unconditional acceptance of the upfront (fixed) tariff has been given to TNPTL. Financial close for the project is targeted in first half of CY19 and it is expected to start commercial operations in mid-2021. Total project cost is estimated at around $500m while Novatex's equity contribution for the project will primarily be funded through internal cash flows.

Rating Drivers

Leading Market Position
The ratings assigned to Novatex reflect the company's dominant market position in all three business segments. The company continues to enjoy leading market position in the PET Resin segment; Novatex along with G&T group enjoys leading market share in PET Preform and BOPET Films segment.

Business risk profile is supported by diversified local and international operations (three business segments and exports to 45 countries), healthy growth outlook for fast moving consumer goods and pharmaceutical sector (recently diversified), strong pricing power and favorable demand-supply dynamics in key export markets.

- Novatex operates in the relatively stable consumer packaged goods end markets, mainly food and beverages. All three segments have witnessed double digit compound annual growth rate over the last 5 years. Growth outlook for the fast moving consumer goods and pharmaceutical sector which are catered by Novatex remains robust going forward. Changing consumer preference towards packaged food is also facilitating in market growth.
- The Company is particularly exposed to changes in PET resin prices which are subject to a degree of volatility resulting from temporary supply and demand imbalances due to lumpy capacity additions. However, business risk profile draws support from favorable medium term demand dynamics of key export markets and strong pricing power in the local market. The assigned ratings incorporate strong ability to pass through costs to customers avoiding material impact on operating margins.
- Significant barriers to entry given the capital and technology intensive nature of operations and high switch over cost for clients. Focus on service quality, innovation & product development resulting in strong client relationships.
- Strategic long-term supply contracts with major beverage manufacturers.
- Diversified local and international operations; three business segments along with expansion in the power sector and exports to 45 countries.
- Risk of rupee depreciation is limited due to sizeable exports in revenues and import parity pricing strategy pursued by the Company.

Significant growth in profitability on the back of increase in sales volumes, sizeable jump in gross margins and efficient cost management
Financial risk profile of the company is considered strong given sizeable improvement in profitability. Profitability witnessed significant growth during FY18 on the back of increase in sales volumes, sizeable jump in gross margins and efficient cost management. Management has focused on controlling overheads through efficiency initiatives (WHRS installation, investment in gas gensets and focus on reducing power consumption in the backdrop of rising gas prices) and maintaining head count despite expansions being undertaken. Despite increase in interest rates, growth in financing cost is expected to remain limited due to fixed rate concessional borrowing.

Liquidity profile supported by sizeable jump in cash flows and strong debt servicing ability
With improving profitability, liquidity profile of the company is considered strong given healthy cash flows in relation to outstanding obligations, aging of profile of trade debts which remain within manageable levels and robust debt servicing ability. Liquidity profile is also supported by lower than projected outflow for capital investments which will result in healthy cash accumulation over the rating horizon.

Healthy capitalization indicators and conservative financial policy

Equity base of the company has grown over the last 5 years. Despite debt drawdown for expansion plans, gearing and leverage levels continue to be on the lower side given growth in equity base on the back of profit retention. Company's conservative financial policy of primarily undertaking future capital investments from internal sources is also a positive rating driver.

Adequate corporate governance framework

Overall control framework is adequate with Novatex using an Oracle based ERP system with satisfactory backup and network security arrangement. Scope of internal audit function includes all head office and factory areas with adequate planning and follow-up mechanism in place. Going forward, management will continue to focus on enhancing overall control and governance infrastructure.

RATING SCALE & DEFINITION — Appendix I

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: JCR-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.jcrvis.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.jcrvis.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.

'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.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-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	Novatex Limited
Sector	Chemicals
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see table below
Instrument Structure	N/A
Statement by the Rating Team	JCR-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	JCR-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, JCR-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. JCR-VIS is not an NRSRO and its ratings are not NRSRO credit ratings. Copyright 2018 JCR-VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to JCR-VIS.

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
05-12-2018	AA-	A-1	Positive	Maintained
25-09-2017	AA-	A-1	Stable	Initial