

## RATING REPORT

### Novatex Limited

**REPORT DATE:**

July 10, 2020

**RATING ANALYSTS:**

Narendar Shankar Lal

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#### RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
<b>Entity</b>	AA	A-1+	AA-	A-1
<b>Rating Outlook</b>	Stable		Positive	
<b>Rating Date</b>	July 10, 2020		December 05, 2018	
<b>Rating Action</b>	Upgrade		Maintained	

#### 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)

**VIS Entity Rating Criteria** *Industrial Corporates (May 2019)*

<https://s3-us-west-2.amazonaws.com/backupsqvis/docs/Corporate-Methodology-201904.pdf>

**Novatex Limited**

OVERVIEW OF THE INSTITUTION	RATING RATIONALE
<p>Novatex Limited operates as an unlisted public limited company under the G&amp;T group of companies; the group has been in existence for over six decades with presence in various sectors including textile, plastic resin and power generation.</p> <p>Shareholding of the company is held by G&amp;T family with remaining shares by Gatron Industries.</p> <p><b><u>Profile of CEO</u></b></p> <p>Mr. Diwan is a seasoned industrialist with over 46 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.</p>	<p>Novatex Limited (Novatex) is a public unlisted company incorporated in 1991. The company is principally engaged in manufacturing and sale of PET Resin and other types of Resin, PET Preform and BOPET films. Novatex is also pursuing diversification by venturing in the power segment through investment in Thalnova Power Thar (Private) Limited (TNPTL) ((through a wholly owned subsidiary Nova Powergen Limited). Novatex is a part of the Gani and Tayub group (G&amp;T) of companies, which has been in existence for over six decades with presence in various sectors including textile, plastic resin and power generation.</p> <p><b>PET Resin:</b> Novatex is the local market leader in PET Resin. The company has significant market share of the total local demand of PET Resin. PET Resin segment continues to remain the largest revenue generating segment of Novatex, comprising approximately three fourth of the company’s topline in FY19. Capacity utilization of the segment has been increasing on a timeline basis with majority production comprising bottle grade chips. Around one-fourth of the resin produced is utilized in-house to manufacture preforms and BOPET films. Revenue from this segment comprises a mix of local and export sales. Growth in export sales was primary driver of increase in revenues during the outgoing year. Volumetric growth in sales along with higher selling prices contributed to revenue growth. In view of the favorable demand outlook in key export markets, removal of anti-dumping duties, and continuation of duty free status under GSP Programs, growth momentum is expected to continue, going forward.</p> <p><b>PET Preform:</b> PET preforms are test tube shaped un-inflated bottles, which Novatex manufactures in-house by using PET Resin. The company produces preforms for water, beverage and pharmaceutical companies and has long-term supply contracts in place with major bottlers.</p> <p>Sales of preform segment primarily cater to the local market. Considerable growth has been observed in the sales of this segment, which was a function of increase in sales volumes and higher average selling prices. Capacity utilization remains at moderate level in this segment as management incurred sizeable capex to enhance capacity of this segment during the past few years. In view of the sizeable capital investment undertaken by leading beverage manufactures in Pakistan, demand outlook for preform is considered favorable.</p> <p><b>BoPET Films:</b> These are flexible films primarily used in packaging and are produced by stretching PET resin. The company commands major market share in BoPET films locally in terms of installed capacity. The installed capacity of this segment doubled during the outgoing year with induction of BoPET Film line II in March 2019. Due to limited timeframe post addition of this new capacity, capacity utilization remained modest in FY19. No further capacity expansion is expected in this segment. Revenues from this segment depicted healthy growth during FY19. Growth in sales was a function of increase in volumes and higher average selling price. Around two third revenue of this segment comprises local sales; however, exports registered considerable growth during the outgoing year. Export segment will continue to remain the focus of the management due to healthy demand outlook. Going forward, higher proportion of higher value added products is expected to translate to improvement in margins of this segment.</p> <p><b>Thalnova Power Thar (Private) Limited (TNPTL):</b> Novatex is also undertaking diversification in the power sector through investment in TNPTL. Novatex has established Nova Powergen Limited (NPL) as a special entity for the purpose of routing its investment in TNPTL. TNPTL is a joint venture between NPL, Thal Power (Pvt.) Limited (a</p>

subsidiary of Thal Limited), Hub Power Company Limited, Descon Engineering Limited and CMEC to set up a 330 MW mine mouth coal-fired power generation plant located at Thar, Sindh. The regulator has granted generation license for 30 years. Moreover, an unconditional acceptance of the upfront (fixed) tariff has been given to TNPTL. The financial close is expected in Q3 of 2020 and the Commercial Operations in Q1 of 2022. Total project cost is estimated at around \$530m. Novatex's equity contribution (24.7%) for the project will primarily be funded through internal cash flows.

### **Rating Drivers**

#### **Leading market position in all segments**

The ratings assigned to Novatex incorporate the company's leading market position in all three business segments in which it operates. The company continues to remain the market leader in the PET Resin segment; Novatex along with another G&T group company enjoys leading market share in PET Preform and BOPET Films segment.

#### **Business risk profile derives support from diversified local and international operations (three business segments and exports to 45 countries), healthy growth outlook of end consumer industries, significant pricing power and favorable demand-supply dynamics in key export markets**

- Novatex primarily caters to consumer packaged goods, mainly food and beverages, and pharmaceutical industries, which have experienced relatively stable demand during various economic cycles historically. Growth outlook for these industries continues to remain robust, going forward. Changing consumer preference towards packaged food is also facilitating in market growth. Moreover, the company is also undertaking environment friendly initiatives
- 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. However, business risk profile draws support from favorable medium term demand dynamics of key export markets and substantial share in the local market. The assigned ratings incorporate strong ability to pass through costs to customers avoiding material impacts on operating margins.
- Given the technology and capital intensive nature of the business, significant investment is required on the part of any new entrants; such characteristic of this industry acts as strong barrier to entry. Moreover, high switch over costs for clients also reduce competitive pressure. Focus on service quality and innovation & product development enable the company to form strong client relationships and differentiate itself from its competitors.
- 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**

Financial profile of the company is considered strong given the sizeable and consistent improvement in profitability on a timeline basis. Improvement in profitability during FY19 was a function of increase in sales volumes along with considerable one time exchange gain. Margins were reported lower in FY19 due to greater increase in costs vis-à-vis the increase in selling prices. Going forward, profitability is expected to depict healthy growth over the rating horizon due to favorable demand supply dynamics, addition of value added products and cost saving initiatives (developing in-house fleet of transportation vehicles) undertaken

by the management. Fixed rate borrowing at low rates also bodes well for the profitability profile of the company.

**Liquidity profile draws support from sizeable internal cash flows and strong debt servicing ability**

Cash flows have depicted improvement in line with profitability of the company. Overall liquidity profile is considered strong given healthy cash flows in relation to outstanding obligations, manageable aging profile of trade debts, and robust debt servicing ability. Fund Flow from Operations (FFO) in relation to adjusted total debt amounted to 120% (FY18: 154%) in FY19. Liquidity profile is also supported by lower projected outflow for capital expenditure in relation to internally generated cash flows over the rating horizon which will result in healthy cash accumulation.

**Healthy capitalization indicators and conservative financial policy**

Equity base of the company increased by 29% in FY19 on account of profit retention. Despite sizeable capital expenditure and increase in short term borrowings, leverage indicators of the company continue to remain on the lower side given the sizeable equity base. Adjusted gearing ratio stood at 0.31x (FY18: 0.27x). Company's conservative financial policy of low dividend payouts and 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 is considered comprehensive as the department covers all the head office and factory areas. Risk based audit methodology is implemented, with adequate planning and follow up mechanism in place. Going forward, management will continue to focus on enhancing overall control framework and target improvement in Information Technology infrastructure.

**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](http://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](http://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](http://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 II	
<b>Name of Rated Entity</b>	Novatex Limited				
<b>Sector</b>	Chemicals				
<b>Type of Relationship</b>	Solicited				
<b>Purpose of Rating</b>	Entity Rating				
<b>Rating History</b>	<b>Rating Date</b>	<b>Medium to Long Term</b>	<b>Short Term</b>	<b>Rating Outlook</b>	<b>Rating Action</b>
	<b>RATING TYPE: ENTITY</b>				
	10-06-2020	AA	A-1+	Stable	Upgrade
	05-12-2018	AA-	A-1	Positive	Maintained
	25-09-2017	AA-	A-1	Stable	Initial
<b>Instrument Structure</b>	N/A				
<b>Statement by the Rating Team</b>	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.				
<b>Probability of Default</b>	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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<b>Due Diligence Meetings Conducted</b>	<b>S.No</b>	<b>Name</b>	<b>Designation</b>	<b>Date</b>	
	1	Mr. Rizwan Diwan	Executive Director	Dec 03, 2019	
	2	Mr. Mustufa Bilwani	Deputy CFO	Dec 03, 2019	