RATING REPORT

Novatex Limited

REPORT DATE:
July 29, 2021

RATING ANALYSTS:

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RATING DETAILS

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	*July 29, 2021*		*July 10, 2020*	
Rating Action	Reaffirmed		Upgrade	

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):	
Mr. Shabbir Diwan *Mr. Rizwan Diwan* *Mr. Saqib Haroon Bilwani*	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria *Industrial Corporates (May 2019)*
https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Corporate-Methodology-201904.pdf

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 seven decades with presence in various sectors including textile, plastic resin and power generation.

Shareholding of the company is held by G&T family..

Profile of CEO

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.

RATING RATIONALE

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 Preforms 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&T) of companies, which has been in existence for over seven decades with presence in various sectors including textile, plastic resin and power generation.

PET Resin: Novatex is the market leader in the local PET Resin market holding significant market share in terms of installed capacity. *Total local demand of PET Resin is approximately 100,000 MT per annum.* Capacity utilization of the segment has remained on the higher side with majority production comprising bottle grade chips; however, COVID-19 related disruptions in the economic activities led to a decrease in utilization levels during FY20 and the ongoing year. Around one-fourth of the resin produced is utilized in-house to manufacture Preforms and BOPET films.

Revenue from this segment depicted a decline in FY20 on account of COVID led slowdown in the economy. The decrease was largely attributable to lower average selling prices provided by diminishing international oil prices affecting overall prices of the petrochemical sector along with subdued volumetric sales. Revenue of the segment comprises a mix of local and export sales. Major export markets include USA and Canada. *The company owns a wholly owned subsidiary by the name of G-Pac, which has sales office in USA and Canada, along with two warehouses in Canada. Such arrangement allows Novatex to reduce delivery time for the clients, thereby providing a competitive advantage to the company.* Gross margins (GM) of the segment decreased in FY20 due to inventory losses and selling to clients in export markets at lower margins in order to build long-term relationships. However, GMs of the segment improved in 1HFY21 owing to inventory gains, and improvement in local and international margins. In view of the favorable demand outlook in key export markets, and removal of anti-dumping duties, sales revenue of the segment is expected to depict a growth momentum, going forward.

Management has installed a recycling plant (R-PET) in existing production facility of PET Resin, which will increase the total installed capacity of this segment. The cost of the project is estimated at around Rs. 2b and is expected to commence operations in the second half of CY2021.

PET Preform: 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. Novatex along with a group company – Gatron Industries holds a major market share in Pakistan's preform market. Capacity Utilization of the segment has been declining on a timeline basis owing to higher utilization of resin in the BOPET segment during FY20.

Sales of preform segment primarily caters to the local market. Segment sales have witnessed a decline during FY20 being affected the most during COVID-19 led lock-downs and lower utilization of bottles during the peak summer season given limitation on large gatherings. Consequently, proportion of the same in the total sales mix of the company decreased during FY20. Given sizeable capital investment incurred by leading beverage manufactures in Pakistan, demand outlook for preform is considered favorable; however risk of COVID-19 prevails.

In view of the above, the company has purchased land in Faisalabad and installed preform machines. Cost of the same was around Rs. 1.5b.

BoPET Films: These are flexible films primarily used in packaging and are produced by stretching PET resin. The company commands a majormarket share in BoPET films locally in terms of installed capacity. The other major local player in this segment is Ismail Industries Limited (Candyland). The installed capacity of this segment increased during FY19 with commencement of BoPET Line II. Given higher productivity in the outgoing year, capacity utilization witnessed an increase.

Revenues from this segment depicted healthy growth during FY20 with a mix of local and exports sales. Growth in sales revenue was a function of volumetric growth. Given sturdy revenue growth, contribution of the same in the total sales revenue of the company increased during FY20. Export segment will continue to remain the focus of the management due to healthy demand outlook. Gross Margins of the segment were reported higher led by higher sales revenue. Going forward, higher proportion of higher value added products is expected to translate to improvement in margins of this segment.

Over the next two years, the company plans to install BoPET Line III. Cost of the project will be financed in a mix of debt and equity. Competitive advantage of this line stems from being the longest BoPET production line in the world having a length of 10 meters. L/C for the same has been opened during the ongoing year.

Thalnova Power Thar (Private) Limited (TNPTL): 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 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 of the power plant was achieved on 30th, September 2020 and the Commercial Operations are expected to occur by September'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.

<u>Rating Drivers</u>

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.

- Business risk profile is also considered moderate given stable demand supported by end clients belonging to the FMCG (mainly food and beverages) and Pharmaceutical sectors and ability to pass on increase in raw material prices. Given the prevailing situation of COVID-19 pandemic, demand growth is expected to remain stable due to the sector's contribution in the supply chain of various important industries.
- 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.
- Ratings also incorporate strategic long-term supply contracts with major beverage manufacturers and limited risk of rupee devaluation due to sizeable exports in revenues and import parity pricing strategy pursued by the Company.

Sales revenue of the company was impacted due to decline in prices of oil and downstream petroleum products as well asslowdown of economic activities due to COVID-19. Sales revenue is projected to stabilize at prior year level by the end of the ongoing year given gradual improvement in international and domestic market dynamics.

Topline of the company was impacted by the slowdown of economic activities due to COVID19 which led to a downturn in local and export sales. Product mix of the company includes PET Resin, PET Preform and BoPET films. PET Resin segment continues to remain the largest revenue generating segment of Novatex.As per management, sales are projected to stabilize at prior year level by the end of FY21. Going forward, growth in sales revenue is expected to largely emanate from PET resin and BoPET films segments given timely materialization of expansion plans with increased focus on export market for BoPET films.

Overall profitability profile of the company was impacted due to higher cost raw material being converted into lower value of finished goods- inventory losses during FY20. During 9MFY21, margins of the company reflected an increase on account of better margins (international and local), inventory gains and operational efficiencies due to adoption of cost cutting measures. Going forward, margins are expected to report at historic levels once low priced inventory ends.

Gross margins of the company declined during FY20 largely on the back of inventory losses amidst COVID-19. Overall administrative and other operating expenses were reported higher in FY20, on account of re-measurement loss on short term investments. Other income was reported lower due to lower exchange gain as compared to preceding year. Finance charges were reported lower on account of reduced policy rate in FY20. Given reducing margins and inclining expenses, net margins were reported lower during the outgoing year.

During 9MFY21, gross and net margins of the company improved on the back of higher sales and inventory gains given revival in international oil prices and gradual improvement in demand dynamics. 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. Borrowings at concessionary rates also bodes well for the profitability profile of the company.

Liquidity indicators weakened in FY20 due to subdued profitability; however the same improved in 9MFY21 and are expected to remain in line with projected increase in overall profitability, going forward.

Cash flows have depicted a decrease in line with profitability of the company in FY20. However, liquidity profile is considered strong given healthy cash flow coverages in relation to outstanding borrowings, manageable aging profile of trade debts, and robust debt servicing ability. Liquidity profile is also supported by sizeable cash and bank balances and short term investments on the balance sheet at end-June'20 and Mar'21. FFO coverages witnessed improvement during the ongoing year in line with higher net margins. *Over the next two years, the company plans to incur capital expenditure of which will be financed through long term concessionary rate debt and the remaining will be financed through internal cash generation.* Going forward, liquidity indicators are expected to remain in line with projected increase in overall profitability.

Healthy capitalization indicators, despite elevated borrowings to finance expansions across all business segments

Equity base of the company increased by a meager 3% during FY20 on account of limited profit retention. Despite consistent capital expenditure on a timeline basis and increase in short term borrowings, leverage indicators of the company continue to remain on the lower side given sizeable equity base. Given projected debt drawdown to finance expansion plans, leverage indicators are expected to trend upwards, however the same shall remain on the lower side supported by higher equity base through profit retention, going forward.

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.

ISSUE/ISSUER RATING SCALE & DEFINITION Appendix I

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 II

Name of Rated Entity	Novatex 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				
29-07-2021	AA	A-1+	Stable	Reaffirmed
10-07-2020	AA	A-1+	Stable	Upgrade
05-12-2018	AA-	A-1	Positive	Maintained
25-09-2017	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 2021 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.

Due Diligence Meetings Conducted

S.No	Name	Designation	Date
1	Mr. Rizwan Diwan	Executive Director	May 31, 2021
2	Mr. Mustufa Bilwani	Deputy CFO	May 31, 2021
3	Mr. Kafeel Zehri	Senior Manager	May 31, 2021