RATING REPORT

Novatex Limited

REPORT DATE:
Dec 30, 2022

RATING ANALYSTS:

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RATING DETAILS

Rating Category	Latest Rating Long-term	Latest Rating Short-term	Previous Rating Long-term	Previous Rating Short-term
Entity	AA	A-1+	AA	A-1+
Rating Outlook	Stable		Stable	
Rating Date	*Dec 30, 2022*		*July 29, 2021*	
Rating Action	Reaffirmed		Reaffirmed	

COMPANY INFORMATION

Incorporated in 1991	**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 *Corporates (August 2021)*
https://docs.vis.com.pk/docs/CorporateMethodology202108.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' or 'the Company') 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. Recently, the company further enhanced its product portfolio to PET Flakes and Recycled PET (R PET). The plants is located at Landhi, Karachi while the Corporate office is situated at G&T Tower, Beaumont road, Civil lines, Karachi. Additionally, the Company has installed molding machines in Faisalabad, increasing the capacity of PET Preforms and also building a BoPET Film line III at Sheikhupura, Punjab.

Novatex is also pursuing diversification by venturing in the power segment through investment in Thalnova Power Thar (Private) Limited (TNPTL) (through its 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 packaging 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 (FY22: 78%, FY21: 75%) with majority production comprising bottle grade chips. As per the management, utilization level has further increase during 1QFY23. Around one-fourth of the resin produced is utilized in-house to manufacture Preforms and BoPET Films.

Revenue from this segment has depicted an increase in FY22 mainly because of increase in effective prices due to rupee devaluation, however, local prices of bottle grade chips has also increased. While the overall offtake of the same has witnessed a drop of 7% Y/Y. PET Resin remained the highest contributor in sales in FY22. Revenue of the segment comprises a mix of local and export sales. Going forward, sale of PET Resin mainly BGC is forecasted to stay subdued with the expectation of volumes to remain intact on the back of weak global macro-economic conditions.

Management has installed a recycling plant (R-PET) in existing production facility of PET Resin. R-PET is also in demand in export market which also contributed in export revenue in FY22.

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. The Company's new Preform line (molding) at Faisalabad came online during the year taking the total capacity to 103,140 MT during FY22 from 85,355 MT in FY21. Despite increase in capacity, utilization of the segment remained intact with the increased number of production levels.

Sales of preform caters to the local market while exports are negligible. Segments sales have witnessed a notable increase on the back of both increase in prices and volumes.. Given sizeable capital investment incurred by leading beverage manufactures in Pakistan, demand outlook for preform is considered stable, although macroeconomic conditions including higher inflation may impact demand to some extent.

BoPET Films: These are flexible films primarily used in packaging and are produced by stretching PET resin. The company commands a major market share in BoPET films locally in terms of installed capacity. The other major local player in this segment is Ismail Industries Limited. The installed capacity of this segment will increase further with the commencement of BoPET Film Line III at Sheikhupura. Capacity utilization remained intact during FY22.

Revenue from this segment depicted growth due to rupee depreciation while the volumes marginally declined. The revenue mix of this segment has changed notably due to increase in export proportion during FY22 as compared to FY21. Export segment will continue to remain the focus of the management. Going forward, higher proportion of higher value added products is expected to translate to improvement in margins of this segment.

The Company is installing BoPET Film Line III encompassing capacity of 40,000 taking installed capacity to 100,000 MT. The project is expected to start production in 3QFY23.

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 now expected to occur in 3QFY23 (Previously 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.

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).

- 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 weak global macro-economic condition growth is expected to remain suppressed amid expected demand pressure.

- 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.

Topline increased due to rupee depreciation and increase in prices while the volumetric offtake inched down in FY22. Overall volumes are expected to remain intact in the on-going year. Newly enhanced capacity of PET Preforms and addition of RPet in product portfolio also supported the topline. Going forward, enhanced capacity and product portfolio including upcoming BoPET Film Line III and long term investment in power segment will further support profitability profile.

Net sales of the Company depicted a notable increase in FY22. This is because of the impact of rupee depreciation during FY22 while the overall volumes dropped by meagre 0.43% Y/Y. 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. Going forward, management is focusing on increasing the exports of PET resin and BoPET films while the enhanced capacity of Preforms, addition of RPET and upcoming BoPET Film line III will further support the revenue. The proportion of local vs export sales remain intact during FY22.

Gross margins of the Company has improved during FY22 due to rupee depreciation, increase in product prices and inventory gains. Operating expenses displayed a significant increase due to notable increase in distribution and selling. Other income of the Company grew in FY22 on the back of exchange gain. With the increased topline and margins, profit after tax of the Company has increased in FY22. In line with the same, net margins also improved during FY22. Going forward, margins are expected to rationalize with relative stability in USD/PKR parity and drop in prices in line with the decrease in global commodities prices.

Liquidity indicators remained strong during FY22

Cash flows have depicted an increase in line with profitability of the Company in FY22.

However, liquidity profile is considered strong given healthy cash flow coverages in relation to outstanding borrowings, manageable aging profile of trade debts, and robust servicing ability. Fund Flow from Operations (FFO) in relation to total debt amounted to 1.5x (FY21: 1.6x) in FY22. Liquidity profile is also supported by sizeable cash and bank balances and short term investments on balance sheet as at Jun'22. FFO coverages witnessed improvement during the ongoing year in line with higher net margins. Going forward, liquidity indicators are projected to remain strong during the rating horizon.

Healthy capitalization indicators, despite elevated borrowing to finance expansions

Equity base of the Company increased notably in the last two fiscal years. Leverage and Gearing ratios stand at 0.77x and 0.32 (Jun'21: 0.72x & 0.23x) as at Jun'22. Despite consistent capital expenditure on a timeline basis and increase in short term borrowings, capitalization indicators of the Company continue to remain on the lower side amid continuous growth in equity base. Despite the expected increase in long term debt, capitalization indicators are expected to stay in the same range in FY23 due to healthy internal cash generation.

Adequate corporate governance framework

The Company has further strengthened its overall control framework by switching form Oracle based ERP system to SAP completely including all the functions 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. However, room for improvement exists in governance framework and disclosure levels.

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				
30-12-2022	AA	A-1+	Stable	Reaffirmed
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.
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Due Diligence Meetings Conducted

S.No	Name	Designation	Date
1	Mr. Rizwan Diwan	Executive Director	December 21, 2022
2	Mr. Mustufa Bilwani	Deputy CFO	December 21, 2022
3	Mr. Kafeel Zehri	Group Head – Financial Planning	December 21, 2022