

RATING REPORT

Novatex Limited (Novatex)

REPORT DATE:

February 22, 2024

RATING ANALYSTS:

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RATING DETAILS

Rating Category	Latest Rating	Previous Rating
Entity	AA/A-1+	AA/A-1+
<i>Rating Date</i>	<i>February 22, 2024</i>	<i>December 30, 2022</i>
Rating Outlook	<i>Positive</i>	<i>Stable</i>
Rating Action	Maintained	Reaffirmed

COMPANY INFORMATION

Incorporated in 1991

External auditors: Kreston Hyder Bhimji & Co. Chartered Accountants, Karachi

Public Limited Company

Chief Executive Officer: Mr. Rizwan Diwan

Key Stakeholders (with stake 5% or more):

Mr. Shabbir Diwan

Mr. Rizwan Diwan

Mr. Saqib Haroon Bilwani

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria Methodology – Industrial Corporates

<https://docs.vis.com.pk/docs/CorporateMethodology.pdf>

APPLICABLE RATING SCALE(S)

VIS Issue/Issuer Rating Scale:

<https://docs.vis.com.pk/docs/VISRatingScales.pdf>

Novatex Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE
<p>Novatex Limited (Novatex) operates as an unlisted public limited company under the Gani & Tayub group of companies. The Company is principally engaged in manufacturing and sale of PET Resin and other types of Resin, PET Preforms and BoPET Films. The G&T family holds the shares of the Company.</p> <p>Gani & Tayub Group (G&T Group) has been in existence for over seven decades with presence in various sectors including textile, plastic resin and power generation. Companies such as Mustaqim Dyeing & Printing Industries, Gatron Industries, and Krystalite Products Limited are part of the business group.</p> <p>CEO Profile: Mr. Rizwan Diwan has been associated with the Company since its inception in 1991. He is a specialized industrialist with over 33 years of experience.</p>	<p>Corporate Profile</p> <p>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. Last year, the Company further enhanced its product portfolio to PET Flakes and Recycled PET (R PET). The plant is located at Landhi, Karachi while the corporate office is situated at G&T Tower, Beaumont Road, Civil lines, Karachi. Additionally, the Company has Preform operations in Faisalabad and is building a BoPET Film line III at Sheikhpura, Punjab.</p> <p>Novatex has also pursued diversification by venturing in the power segment through investment in Thalnova Power Thar (Private) Limited (TNPTL), via 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, pharmaceuticals, warehousing, automobiles, and power generation.</p> <p>Major customers of the Company include Packages Convertors, Vision Foods & Packaging, Gatron Industries, Coca Cola Beverages Pakistan, Pak Pet etc.</p> <p>Demerger of Novatex and Nova Frontier into separate entities</p> <p>In May 2023, the Company underwent a demerger, resulting in the emergence of two distinct entities: Novatex and Nova Frontier. Novatex specializes in the existing chemical industry, while Nova Frontier will explore and undertake other investment opportunities. As part of this demerger process, a specific allocation of capital and cash was transferred to Nova Frontier, facilitating the separation of these two entities.</p> <p>Business Segments</p> <p>PET Resin: Novatex holds a prominent position in the PET Resin market, characterized by a significant share in terms of installed capacity. Over 25% of the resin produced is utilized internally for the production of Preforms and BoPET Films.</p> <p>Revenue streams in this segment primarily originate from products such as R PET, Bottle Grade Chips, Textile Grade Chips, Film Grade Chips, and PET Flakes. Revenue from this segment has depicted an increase in FY23 primarily attributed to the rise in effective prices driven by the devaluation of the rupee. PET Resin remains the highest contributor to sales in FY23, with the segment's revenue comprising a combination of both local and export sales.</p> <p>PET Preform: PET preforms are test tube shaped un-inflated bottles, which Novatex manufactures in-house by using PET Resin. The Company's products primarily serve water, beverage, and pharmaceutical sectors. Novatex along with a group company – Gatron Industries holds a major market share in Pakistan’s preform market. In FY23, production has been increased due to a stable demand in preforms.</p>

Sales of Preform caters to the local market while exports are nominal. Segments sales have witnessed a notable increase on the back of an increase in product prices. The demand for PET preforms in Pakistan is expected to remain stable, given majority of the demand is noncyclical driven by leading beverage manufacturers. However, the prevailing macroeconomic conditions, including elevated inflation rates and finance costs, may impact demand to some extent.

BoPET Films: BoPET films are flexible films primarily used in packaging and are produced by stretching PET resin. The Company holds a large market share in BoPET films locally in terms of installed capacity. The other major local player in this segment is Ismail Industries Limited.

Revenue from this segment depicted growth due to a sizable increase in both prices and volumes. The management conveyed that the exports segment would be a focus. Going forward, a higher proportion of higher value-added products is expected to translate to improvement in margins of this segment.

Moreover, the Company has installed BoPET Film Line III encompassing capacity of 40,000 taking installed capacity to 100,000 MT. The project's COD is expected in April 2024.

Diversification into Thal Nova Power Plant (Pvt.) Limited (TNPTL) with an equity investment of 24.7%

Novatex undertook diversification in the power sector through investment in TNPTL. Novatex established Nova Powergen Limited (NPL) as a special purpose entity for routing its investment in TNPTL. TNPTL is a joint venture between Novatex, 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. The financial close of the power plant was achieved on 30th, September 2020 and the commercial operations has been achieved on 17th February 2023. The total project cost has been recorded at \$530 mln with Novatex's equity contribution of 24.7%, primarily funded through internal cash flows.

Key Rating Drivers

Business risk profile derives support from strong market presence, capital intensive products, and diversified local and international operations.

The business risk profile of the chemicals industry is considered medium to low given the stable demand primarily driven by clients belonging to the Fast-Moving Consumer Good (FMCG) and pharmaceutical sectors. The Company is particularly exposed to changes in PET resin prices, which are subject to fluctuations resulting from temporary supply and demand imbalances. However, business risk profile draws support from favorable medium term demand trends in key export markets and a significant share in the local market.

Given the technology and capital-intensive nature of the business, significant investment is required on the part of any new entrants, which acts as strong barriers for new entrants. Additionally, Novatex's supply contracts with major players in the beverage industry provide comfort to the Company's position in the market.

Topline increased on account of increased selling prices, however, was outpaced by escalating input costs, resulting in margin reduction.

The Company, in FY23, reported growth in its top line, primarily attributable to the increase in the local sales, while exports remained unchanged. This increase in local sales is on account of the Company's ability to transfer its higher input costs to its customers, considering its large market leadership position in the chemicals sector. The 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. However, the local as well as export volumes remained intact due to demand constraints.

Gross margins in FY23 contracted, constrained by the cost of inventory buildup during the period. Operating Profit also decreased due to an evident increase in distribution and selling expenses. Concurrently a massive increase in the Company's finance costs due to an 825-basis-point increase in local policy rates during FY23 deteriorated the Company's net margins.

Capital structure of the Company affected with increased debt drawdown and transfer of equity to Nova Frontier.

In FY23, the Company's capitalization profile was constrained by the transfer of equity for its demerger with Nova Frontiers. The Company also increased its debt drawdown on account of the installation of BoPET Line III and increasing working capital requirements during the period under review.

Coverage profile declined due to affected company operations; liquidity position weakened with increased liabilities.

The Company's debt service coverage ratio (DSCR) decreased in FY23. The primary factor contributing to this decline was a reduction in the Company's funds flow from operations (FFO) as a result of impaired operational performance.

Concurrently, the Company's liquidity position in FY23 also experienced a dip. This decline was primarily due to a relatively higher increase in current liabilities, specifically a concurrent rise in the amount owed to the subsidiaries' creditors and short-term borrowings, as compared to the growth in current assets. However, there was a marginal improvement in the Company's short-term debt coverage in FY23. This slight uptick was attributed to a marginal increase in the Company's stock in trade.

Considerations for Future Review

Going forward, ratings will be underpinned by further enhancement of the Company's corporate governance framework. Moreover, Novatex's ability to achieve its projected plans and realization of cash flows from its diversification into new business segments will also be important considerations for future rating reviews.

REGULATORY DISCLOSURES					Appendix I
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
	<u>RATING TYPE: ENTITY</u>				
	22-02-2024	AA	A-1+	Positive	Maintained
	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	
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.				
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Due Diligence Meetings Conducted	S.No.	Name	Designation	Date	
	1.	Mr. Rizwan Diwan	Chief Executive Officer	17-Jan-2024	
	2.	Mr. Umair Ilyas	Chief Financial Officer		
	3.	Mr. Mustufa Bilwani	Deputy Chief Financial Officer		
	4.	Mr. Kafeel Zehri	Group Head – Financial Planning & Business Analysis		
	5.	Mr. Muhamamad Tufail	Divisional Head – Finance		
6.	Mr. Salman Hanif	Business Analyst – Special Projects			