RATING REPORT

Syntronics Limited

REPORT DATE:
May 15, 2023

RATING ANALYSTS:
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RATING DETAILS				
	Latest Rating		Previous Rating	
Rating Category	Long-term	Short-term	Long-term	Short-term
Entity	BBB+	A-2	BBB+	A-2
Rating Outlook	Stable		Positive	
Rating Action	Maintained		Maintained	
Rating Date	*May 15, 2023*		*March 29, 2022*	

COMPANY INFORMATION	
Incorporated in 1998	**External auditors:** M/S. Shinewing Hameed Chaudhri Co. Chartered Accountants.
Public Limited Company (Unlisted)	**Chairman/CEO:** Mr. Abbas Sarfaraz Khan
Key Shareholders (with stake 5% or more):	
M/S. Gran Via Global Limited – 34.27% Mr. Iskander Mohammed Khan– 25.00% Mr. Abbas Sarfaraz Khan – 24.7% M/S. Premier Board Mills Limited – 11.02% Mr. Baber Ali Khan – 5.00%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: Corporates (August 2021) *https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf*

Syntronics Limited

OVERVIEW OF THE INSTITUTION

Syntronics Limited is involved in the manufacturing of Ad*Star® Polypropylene Laminated Bottom Block Sacks mainly for cement packaging. The company commenced operations in 1998 as Public Limited Company (Unlisted). Registered office of the company is in Islamabad while manufacturing unit is in Hattar, KPK.

Profile of Chairman/CEO

Mr. Abbas Sarfaraz Khan is the Chairman of board and Chief Executive Officer of Syntronics Limited. He is also the Chairman of Chashma Sugar Mills Limited and CEO of Premier Sugar Mills & Distillery Co. Limited and Arpak International Investment Limited. He also serves as director in other associated companies.

Financial Snapshot

Total Assets: end-HY23: 6.9b; end-FY22: Rs. 7.1b; FY21: end-Rs. 5.5b

Equity: end-HY23: Rs. 2.1b; end-FY22: Rs. 2.1b; end-FY21: Rs. 2.0b

Profit After Tax: HY23: Rs. 4m; FY22: Rs. 82m; FY21: 144m

RATING RATIONALE

Corporate Profile

Syntronics Limited (SL) is a family-owned business and is primarily involved in the manufacture of polypropylene bags which are used as packaging material in the cement industry as well as in the sugar, poultry feed and flour sectors. The company's primary sponsors are the 'Premier Group' which has exposure mainly in the sugar industry. Moreover, the company has a 12.5% shareholding in its associated company, Chashma Sugar Mills Ltd.

Business risk

The overall local packaging industry is partially fragmented with several medium sized entities offering similar products and end solutions. The company primarily caters to the cement sector which is cyclical nature and has witnessed depressed demand in the ongoing year, with total sales declining 18% YoY to 33.6m MT, owing to slow down in construction activity in line with the challenging macroeconomic environment. However, according to management, this demand risk is mitigated through the company's strong relationship with leading cement manufacturers, particularly Fauji Group, to whom SL is the sole supplier. Moreover, the industry is currently shifting from Kraft paper packaging to polypropylene bags due to regulatory action on the former on the account of health and environmental hazards. A Statutory Regulatory Order (SRO) was issued to this effect in the outgoing year. This is expected to have a positive effect on demand going forward.

On the supply-side front, the company has been able to avoid import restrictions at the group level due to the export base of its associated company, Chashma Sugar Mills Ltd. (CSML). The primary raw materials largely constitute of polypropylene and polyethylene polymers which are sensitive to volatility in international oil prices. Additionally, these products are mainly imported, constituting about 95.6% of the total raw material purchases in the ongoing year. This exposes the company to notable price risk and exchange rate volatility. However, according to management, the same are moderated through the company's ability to largely pass on the costs to customers but lag in cost transfer owing to significant currency devaluation may affect profit margins.

Capacity and operations

Ratings factor in growing capacity utilization levels of the company in the review period with the production capacity standing at 203.5m bags per annum. During the ongoing year, capacity utilization increased owing mainly to higher quantum of conventional bags while output of cement sacks remained relatively stable on an annualized basis. Total output stood at 52m units for cement sacks (FY22: 107m; FY21: 103m), 30m units for conventional bags (FY22: 54.6m; FY21: 48m) and 15m meters for fabric (FY22: 28m meters; FY21: 23m meters) in HYFY23. Breakdown of capacity utilization can be seen below:

	FY21	FY22	1HFY23
Production Capacity (mln bags)	203.5	203.5	101.8
Actual Production (mln bags)	174.4	189.7	97.3
Capacity Utilization (%)	**85.7%**	**93.2%**	**95.6%**

Additionally, the management is undergoing capacity expansion with the construction of a new production unit adjacent to the current factory as recent sanctions on the usage of Kraft paper as packaging in the cement sector for environmental and health concerns is expected to boost demand for polypropylene bags, the company's primary revenue driver. The capital expenditure is expected to enhance output to 347.5m bags per annum. Total cost of the project is about Rs. 1.4b out of which Rs. 700m has been funded from own sources while the remainder will be debt-financed. However, according to management, the timeline of the project is currently uncertain due to delays faced in importing machinery owing to import limitations and the disturbances caused by Russia-Ukraine war.

Moreover, the company's new Biaxially Oriented Polypropylene (BOPP) printing unit has come online during the ongoing year. Primary outputs from the facility are flexible stitched bags, used primarily in the packaging of flour and rice, as well as FFS reel which is utilized by the FMCG sector. Total cost of the project amounted to Rs. 120m out of which Rs. 75m was funded by debt and the remained through internal capital.

Consistent topline growth in the review period

During FY22, the company posted a 33.8% uptick in net sales, amounting to Rs. 5.1b (FY21: Rs. 3.8b). Total volumetric output increased by 7.1% to 162.9m units (FY21: 152.2m) primarily due to higher demand for stitched bags whereas average selling prices exhibited a 25% rise to Rs. 31.3/unit (FY21: Rs. 25.1) owing to transfer of rising input costs. The product mix comprises mainly of cement sacks which contributed about 60% to the topline (FY21: 65.5%) in FY22 followed by stitched bags and fabric bags that provided for 23% and 16% of net sales, respectively (FY21: 20%, 14%). The remainder pertained to waste material and sales rebate. Management envisages product sales mix to depict similar trend going forward.
Client concentration risk is considered to be on the higher side with about 58.5% of total net sales being contributed by top ten clients. However, the same is moderated through the long-standing relationships with clients.

Inflationary pressures, currency devaluation and elevated finance costs negatively impacting profitability margins of the Company

Gross margins of the Company decreased to 10.7% in the outgoing year (FY21: 13.3%) in FY22 largely due to rise in raw material costs, currency depreciation and lag in full transfer of costs. Net margins also exhibited a decline to 1.6% (FY21: 3.8%) as financing costs jumped to Rs. 230m (FY21: Rs. 124.1m) on the account of higher debt levels to finance higher working capital requirements coupled with policy rate hikes. Additionally, administrative costs as well as selling and distribution expenses increased to Rs. 91.8m and Rs. 46.4m, respectively (FY21: Rs. 73.3m, Rs. 37.3m) in line with inflationary pressures. Other expenses also increased to Rs. 68.9m (FY21: Rs. 39.6m) due to exchange loss while other income decreased to Rs. 9.6m (FY21: Rs. 22.8m) owing to lack of import rebate registered. Furthermore, share of profit from associated company, Chashma Sugar Mills Ltd. (CSML), stood at Rs. 27.4m (FY21: Rs. 31m).

During 1HFY23, net sales stood at Rs. 2.8b, a 10.3% increase on an annualized basis largely on the account of higher prices rather than volumetric growth. While gross margin remained stable at 10.7%, net margin exhibited further pressure, standing at 0.1% in HYFY23 largely due to increased financing costs. The management expects topline to reach Rs. 6.4b during FY23. Going forward, the company's ability to reach its revenue targets and uplift its bottom-line by managing its financing costs and sustaining income from associated company will be imperative from a rating's perspective.

Liquidity profile needs room for improvement to sustain the assigned ratings

The company's Fund from Operations (FFO) decreased to Rs. 78.3m in HYFY23 (FY22: Rs. 146.1m; FY21: Rs. 279.7m) primarily due to higher financing costs paid. With reduced cash flows and elevated borrowings, FFO-to-total debt and FFO-to-long-term debt stood at 0.03x (FY22: 0.05x, FY21: 0.16x) and 0.27x (FY22: 0.21x, FY21: 0.55x), respectively in HYFY23. Ratings are constrained on account of significant weakening in debt service coverage ratio reported at 0.95x (FY22: 0.94x, FY21: 2.34x) in HYFY23.

Stock-in-trade stood at Rs. 1.2b at end-1HFY23 (FY22: Rs. 1.4b, FY21: Rs. 1.1b) providing coverage for the next two months. As per management, the Company did not face LC constraints for import of raw material as sufficient export cover was provided by associated company. Trade debts amounted to Rs. 1.6b at end-June'22 (FY21: Rs. 1.1b) with a sound aging schedule as 45% of receivables were not past due, 19% due between 1-30 days, 29% due between 31-150 days and 8% due over 150 days. Current ratio and short-term borrowing coverage declined to 1.18x and 1.03x, respectively (FY22: 1.17x, 1.32x; FY21: 1.41x, 1.81x) at end-Dec'22, due to higher short-term borrowings to meet working capital requirements. Additionally, net operating cycle reduced in the ongoing year due to higher payables turnover but remains range-bound relative to industry. Ratings remain dependent on improvement of liquidity indicators as projected over the rating horizon.

Rising leverage levels in the review period due to elevated borrowings to finance increased working capital requirements amidst challenging macroeconomic environment

Equity base remained stable standing at Rs. 2.1b at end-Dec'22 (FY22: Rs. 2.1b, FY21: Rs. 2b) due to small quantum of profits in HYFY23. Total borrowings have been increasing on a timeline basis, standing at Rs. 3b at end-Dec'22 (FY22: Rs. 2.9b, FY21: Rs. 1.7b), primarily due to rise in short-term borrowings, which constitute about 80.6% of total borrowings, to meet working capital needs. Long-term debt stood at Rs. 586.2 (FY22: Rs. 685m; FY21: Rs. 508.4m) at end-Dec'22, out of which Rs. 250m pertained to TERF facility with a 5% markup for BMR capital expenditure incurred in FY21, payment of which will commence during Oct'23. Gearing increased to 1.43x at end-Dec'22 (FY22: 1.38x; FY21: 0.86x) owing to higher debt utilization while leverage declined slightly to 1.96x at end-Dec'22 (FY22: 2.06x; FY21: 1.48x) on the account of lower trade payables. Additionally, the company plans to drawdown long-term financing amounting to Rs. 1b in the ongoing year to fund set up of the aforementioned new production unit. Going forward, ratings will remain sensitive to the company's ability to meet projected capitalization levels.

Syntronics Limited **Annexure I**

FINANCIAL SUMMARY *(amounts in PKR millions)*				
BALANCE SHEET	**FY20**	**FY21**	**FY22**	**1HFY23**
Property, Plant & Equipment	1,126	1,139	1,736	1,760
Long-term Investment	912	959	1,125	1,125
Stock-in-Trade	491	1,068	1,386	1,215
Trade Debts	1,163	1,124	1,559	1,307
Tax Refund Due from Govt.	632	768	930	902
Other Assets	170	224	251	539
Cash & Bank Balances	29	177	77	15
Total Assets	**4,522**	**5,459**	**7,064**	**6,863**
Trade and Other Payables	387	883	987	674
Short Term Borrowings	1,091	1,213	2,234	2,440
Long-Term Borrowings *(Inc. current matur)*	478	508	685	586
Other Liabilities	296	355	436	437
Tier-1 Equity	**1,829**	**2,002**	**2,110**	**2,114**
Revaluation Surplus	441	499	611	611
Paid-Up Capital	315	315	315	315
INCOME STATEMENT	**FY20**	**FY21**	**FY22**	**1HFY23**
Net Sales	2,599	3,813	5,102	2,815
Gross Profit	344	507	547	302
Share of Profit from Associate	163	-31	27	0
Profit Before Tax	195	225	147	41
Profit After Tax	148	144	82	4
FFO	125	279.7	146.1	78.3
RATIO ANALYSIS	**FY20**	**FY21**	**FY22**	**1HFY23**
Gross Margin (%)	13.3%	13.3%	10.7%	10.7%
Net Margin (%)	5.7%	3.8%	1.6%	0.1%
Current Ratio (x)	1.53	1.41	1.17	1.18
Net Working Capital	857	978	623	615
FFO to Long-Term Debt (x)	0.26	0.55	0.21	0.27
FFO to Total Debt (x)	0.08	0.16	0.05	0.05
Debt Servicing Coverage Ratio (x)	1.16	2.34	0.94	0.95
Gearing (x)	0.86	0.86	1.38	1.43
Debt Leverage (x)	1.23	1.48	2.06	1.96
Inventory + Receivables/Short-term Borrowing (x)	1.52	1.81	1.32	1.03
CCC (days)	180	98	115	127

ISSUE/ISSUER RATING SCALE & DEFINITIONS Annexure III

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 — Annexure IV

Name of Rated Entity	Syntronics Limited
Sector	Paper & Packing
Type of Relationship	Solicited
Purpose of Rating	Entity & Instrument Ratings
Rating History	see table below
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 2023 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.
Due Diligence Meetings Conducted	see table below

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
15/05/2023	BBB+	A-2	Stable	Maintained
29/03/2022	BBB+	A-2	Positive	Maintained
31/12/2020	BBB+	A-2	Stable	Reaffirmed
10-12-2019	BBB+	A-2	Stable	Initial

Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Rashid Abbas	DG Finance	April 12, 2023
Mr. Asad Ali	Manager Finance and Accounts	April 12, 2023