RATING REPORT

Kompass Pakistan (Pvt) Limited

REPORT DATE:

March 17, 2023

RATING ANALYSTS:

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Rating Category	Latest		Previous	
	Long-term	**Short-term**	**Long-term**	**Short-term**
Entity	BBB+	A-2	BBB+	A-2
Rating Date	*March 17, 2023*		*June 10, 2022*	
Rating Outlook	Stable		Positive	
Rating Action	Maintained		Reaffirmed	

COMPANY INFORMATION	
Incorporated in 2007	**External auditors:** M/s EY Ford Rhodes Chartered Accountants
Private Limited Company	**Chairman:** *Vacant*
Key Shareholders (with stake 5% and more):	**Chief Executive Officer:** Mr. Umair Ahmed Jalil
Mr. Umair Ahmed Jalil – 50%	
Mr. Hasan Jalil – 50%	

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

Kompass Pakistan (Pvt.) Limited

OVERVIEW OF THE INSTITUTION

Kompass Pakistan (Pvt) Ltd was incorporated in January 2007 as a private limited company under the repealed Companies Ordinance, 1984 (now Companies Act, 2017). The company is engaged in the business of manufacturing flexible plastic packaging material, especially of packing of liquids.

RATING RATIONALE

Kompass Pakistan (Pvt.) Ltd. (KPL) is a family-owned company primarily engaged in the manufacture of flexible packaging materials including wrappers, bags and pouches which are utilized mainly by the Fast-Moving Consumer Goods (FMCG) industry. KPL has a fully integrated packaging facility in which it extrudes polyethylene films and procures Biaxially Oriented Polypropylene Films (BOPP), biaxially-oriented polyethylene terephthalate (BoPET) and Cast Polypropylene (CPP films) from the local market which are then printed and laminated in accordance with the customer needs. The company has two types of printing- (i) Rotogravure & (ii) Flexographic. KPL mainly specializes in the latter technology. Production units of the company are situated at Port Qasim and Korangi, Karachi Pakistan.

<u>Key Rating Divers:</u>

Strong demand from the FMCG sector supports capacity utilization.

On an annualized basis, actual production witnessed an increase in the ongoing year owing to strong demand from the FMCG sector despite deteriorating economic conditions. Breakdown of capacity utilization is tabulated below:

Capacity Utilization Breakdown (Annualized)				
	FY20	**FY21**	**FY22**	**1HFY23**
Capacity Utilization (%)	67.7%	55.2%	61.3%	69.9%

The company expanded its flexographic printing facility to 3 lines in FY21 and commissioned an additional extrusion line in FY22. The company intends to further expand its printing capabilities, however, with weakening economic conditions along with difficulties in opening Letters of Credit (LC) to import required machinery, management decided to postpone expansion plans. The company also gravure printing facility to offer a one-window solution to meet customers' specific requirements.

Property, plant and equipment (PPE) witnessed an increase primarily due to additions in plant and machinery. These capital expenditures pertained to machineries for compounding, laminating and extrusion lines to enhance capacities across the value chain.

Furthermore, the company signed a technology transfer agreement with Constantia Flexibles, one of the world's largest packaging companies, in the previous year that provides expertise in relation to the manufacturing of recyclable plastic packaging products. These new products are planned to be introduced into the market in the next year (FY24).

Business risk profile is considered moderate given stable demand supported by end clients belonging to the FMCG and ability to pass on increase in raw material prices

Economic growth, rising income levels and increasing urbanization are greatly changing consumer behavior and demand for packaged foods and consumer goods. End clients mostly belonging to FMCG segment reduces the demand risk where the demand is relatively stable. Business risk profile is also supported by the ability of local manufacturers to pass increase in raw material prices.

Pakistan's packaging market is partially fragmented with several medium sized entities offering similar products and complete packaging solutions. A major challenge faced by the sector is prices and availability of the raw material specifically polymers such as polypropylene, & polyethylene. The polymers act as a major raw material in the extrusion of the film and represent 60% of the raw material consumed. Polymer prices are largely a function of global crude oil prices, demand supply dynamics and volatility in exchange rate. About one-half of total raw materials are imported mainly consisting of plastic resin and film exposing the company to exchange rate and price volatility risks. However, the company is able to largely transfer these risks to customers as per agreed contract terms with clients. On the flip side, it is pertinent to mention that during FY22, the company was unable to fully pass on the impact of rising raw material costs hence negatively impacting profit margins.

Strong topline performance owing to volumetric and price growth. Margins may remain in pressure owing to ongoing economic challenges.

In the outgoing year, the company registered a 35.5% increase in net revenue contributed by a mix of volumetric and price growth.

The company has notable client concentration risk with the top ten customers constituting 73.1% of total net sales in the outgoing year (FY21: 71.3%). However, the same is mitigated through the long-term association with primary renowned FMCG companies.

Gross profit in absolute terms for the outgoing year increased while both gross and net margins decreased to 10.7% and 2.5%, respectively (FY21: 14.4%, 6.1%). Depletion in gross margins resulted mainly from higher raw material costs and depreciation expenses pertaining to recent capital expenditures. The former contributed the most to this increase, constituting about 85.2% of cost of goods manufactured (FY21: 79.8%) in FY22, due to rising prices. Moreover, net margins were subdued primarily owing to notable increase in finance costs on the back of higher total borrowings in FY22. Additionally, administrative expense increased due to rising inflation and a royalty fee charged by Constantia Flexibles as per their technology transfer agreement. Furthermore, higher other expenses due to exchange loss and lower other income owing to lack of exchange gain and lower scrap sales added further strain on net margins in FY22.

In 1HFY23, the company's net revenue increased YoY with gross and net margins standing at 12.6% and 2.3%, respectively. Improvement in GMs during the period are a function of quarterly price adjustments being due in this quarter. Going forward, as per management, the company's margins are expected to be stable despite a continually tumbling rupee, volatile international oil prices and uncertainty pertaining to LC restrictions. This is due to these risks being moderated by the company's ability to transfer rising costs to customers, cost optimization through expansions across the value chain, and robust demand owing to the primary client-base consisting of well-established FMCG companies. Hence, sustaining margins as projected amidst finance cost pressure will be important from ratings perspective.

Satisfactory liquidity position due to sufficient cash flow coverage

With weakening in net profitability, funds from operations (FFO) were also subdued during 1HFY23. However, on an annualized basis, FFO coverage to total debt and to long-term debt remained adequate with the same reported at 19% (FY22: 12%, FY21: 44%) and 28% (FY22: 17%, FY21: 56%) respectively. DSCR also weakened to 1.55x (FY22: 1.30x, FY21: 3.40x) owing to greater debt mobilization and subdued cash flow coverage. Although it remains adequate against benchmarks for the assigned ratings, improvement in the same over the rating horizon will be considered important.

Stock in trade increased in the outgoing year primarily due to higher cost of raw materials inventory. According to management, the company normally maintains 2-3 months stock of plastic resin and film, the two major raw materials. Trade receivables increased at end-Dec'22, accounting for 19% of net sales (FY22: 20%, FY21: 22%). However, the aging schedule remained satisfactory with 82.7% not past due, 16.6% due up to 90 days and only 0.7% due over 90 days. According to management, customers are usually extended a 45-day credit period on average, however, in the case of major clients, extended credit period is also provided. Other liquidity indicators have remained satisfactory in the ongoing year with current ratio standing at 1.29x (FY22: 1.27x, FY21: 1.47x) and short-term borrowing coverage reporting at 3.14x (FY22: 2.69x, FY21: 5.81x) at end-Dec'22.

With greater debt mobilization to finance working capital needs and expansion plans, capitalization indicators increased in FY22. The same showcased improvement in HYFY23 owing to debt repayment and profit retention

The company's Tier-1 equity has been increasing on a timeline basis due to internal capital generation. Around 80% (FY22: 75%) of the long-term financing that contributes 68% to the total debt mix comprised TERF facility carrying low interest rate. This was utilized for capital expenditure on the new flexo printing line as well as laminating, compounding and extrusion lines in the previous two fiscal years. However, given ongoing challenging market dynamics, no further long-term debt is planned in the medium-term. Short-term borrowings increased at end-Dec'22 owing to higher working capital requirements. After increasing in FY22, leverage and gearing indicators showed slight improvement to 2.51x and 1.52x (FY22: 2.61x, 1.75x) in the ongoing year on the back of debt repayment and growth in equity base. Going forward, capitalization levels are expected to further improve on the account of higher retained earnings and repayment of long-term debt.

Kompass Pakistan (Pvt.) Limited **Appendix I**

BALANCE SHEET (in million PKR)	30-Jun-20	30-Jun-21	30-Jun-22	31-Dec-22
Total Equity	**1,862**	**2,194**	**2,366**	**2,557**
RATIO ANALYSIS	**30-Jun-20**	**30-Jun-21**	**30-Jun-22**	**31-Dec-22**
Gross Margin (%)	13.9%	14.4%	10.7%	12.6%
Net Margins (%)	4.1%	6.1%	2.5%	2.3%
Current Ratio	1.65	1.47	1.27	1.29

**Annualized*

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 DISCLOSURE	Appendix III
Name of Rated Entity	Kompass Pakistan (Pvt) Ltd
Sector	Packaging
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				
03/17/2023	BBB+	A-2	Stable	Maintained
06/10/2022	BBB+	A-2	Positive	Reaffirmed
05/07/2021	BBB+	A-2	Positive	Maintained
04/08/2020	BBB+	A-2	Stable	Reaffirmed
02/01/2019	BBB+	A-2	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

	Name	Designation	Date
1	Mr. Sohail Ismail	CFO	Feb 2, 2023