RATING REPORT

CBM Plastics (Pvt) Limited (CBM)

REPORT DATE:
November 13, 2019

RATING AN-ALYSTS:
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Rating Category	Rating	
	Long-term	**Short-term**
Entity	BBB+	A-2
Rating Date	*November 13, 2019*	
Rating Outlook	Stable	
Outlook Date	*November 13, 2019*	

COMPANY INFORMATION	
Incorporated in 1992	**External auditors:** M/s DAUDALLY, LALANI & CO
Private Limited Company	**Chief Executive Officer:** Mr. Iftikhar Hussain
Key Shareholders :	
Muhammad Asif Zindani ~41.8%	
Iftikhar Hussain ~ 22.2%	
Mushtaq Kassam Chhapra ~ 10.3%	
Ahmed Chhapra ~ 9.2%	
Samir Shaukat Chhapra ~ 6.2%	
Kamran Chhapra ~ 5.1%	

APPLICABLE METHODOLOGY(IES)
Applicable Rating Criteria: Corporates (May, 2016) ***https://www.vis.com.pk/kc-meth.aspx***

CBM Plastics (Pvt) Limited

OVERVIEW OF THE INSTITUTION

CBM Plastics was incorporated as a private limited company on Dec'31. 1992. The Company is principally engaged in manufacturing of plastic containers and packages. The registered office of the Company is situated in 301/302, Mehdi Tower 115-A S.M.C.H.S. Karachi.

Profile of CEO

Mr. Iftikhar Hussain has been the CEO of CBM Plastics since 1993 an dprior to that he held the position of Financial Controller at Jaffer Brother (Pvt) Limited, where he was associated since 1985. Mr. Hussain is a graduate from University of Pennsylvania in Computer Science. He also did his post-graduation in Finance from New Your University.

RATING RATIONALE

Stable Profitability Margins

CBM's profitability is shielded from variation in raw material prices – which mainly includes HDPE – and exchange rate parity, which, as per contract, is passed on to the client. Accordingly, CBM's gross margins are very stable.

Concentration risk is mitigated by CBM's Market Positioning

CBM's topline depicts concentration, as revenues from the top 5 clients constitute 88% of the aggregate revenues. However, comfort is derived from long standing business relationships with major clients and CBM's importance to the client's business operations, wherein in some cases CBM is the sole supplier and in other cases it's the majority supplier (80-90%). CBM also enjoys a strong market positioning in the container making industry, as evident from the list of renowned clientele; as per management, the Company enjoys a competitive advantage in the industry, on account of stringent quality assurance tests, which they pioneered in the industry.

Business Growth

CBM's top line revenues have been growing at a CAGR of 11% during the past 4-year period (FY15-FY19). Given increase in client orders and new client acquisition, the management has envisaged the topline to grow by a fifth in 2020, subsequent to which growth momentum is envisaged to drop around 5%.

Tax Issues are translating in a strain on Liquidity

About 19% of the Company's asset base is tied up with the tax authorities, wherein advance income tax has been paid, and a refund is pending from the tax authorities. These tax issues translate in a strain on liquidity, as the Company pays upfront tax at import stage, which is much higher than the actual tax charge; in the past 3 years, on an average, the Company has paid 2.65x the actual tax charge recorded on the income statement.

Leveraging has increased and is considered high

As of Jun'19, CBM's gearing (inclusive of operating lease) stood at 1.7x. However it is pertinent to mention that majority (75%) of the debt represents short term running finance lines and these are fully matched by stock of inventory and trade debts. The remaining debt includes a mix of off-balance sheet operating lease (13%) and on-balance sheet finance lease (11%). Going forward, we expect gearing to rise to 1.9x and then fall as the debt is paid off.

Cash Flow Coverage is on the lower side

Due to higher income tax paid on import stage, the Company's FFO dropped in FY18 and did not recover to the same level in FY19. With the Company taking on additional off balance sheet financing during the period, the debt service coverage has dropped, and is considered to be low. (FY19: 1.2x; FY18: 1.2x; FY17: 1.7x). Based on additional contracted revenues, we expect the DSCR to rise slightly, but remain below 1.5x during the rating horizon.

Company Profile

CBM Plastics ('CBM' or 'the Company') manufactures plastic containers (jerry cans & plastic drums) for packaging of lube oil, pesticides, food products and ethanol. The Company has a diverse product portfolio, with products ranging from 50 ml to 250 liter containers. As of Jun'18, the Company had a staff strength of 470, of which 363 were factory employees.

CBM was incorporated in December 1992 & initiated its operations in February 1994. The Company operates with 2 manufacturing plants, located at SITE Karachi, with a total manufacturing capacity of 120m plastic containers.

Shareholding of the Company is distributed amongst 9 individual shareholders, including the CEO. The Company's shareholding pattern is as follows:

Table 1: Shareholding Pattern (%)

S.No	Name	No. of Shares	%
1	Muhammad Asif Zindani	6.27	41.82
2	Iftikhar Hussain (CEO)	3.32	22.16
3	Mushtaq Kassam Chhapra	1.54	10.26
4	Ahmed Chhapra	1.38	9.23
5	Samir Shaukat Chhapra	0.92	6.15
6	Kamran Chhapra	0.77	5.13
7	Muhammad Yousuf	0.38	2.52
8	Fouzia Asif	0.27	1.81
9	Nasreen Hussain	0.14	0.91
		15.00	**100**

CBM operates in a duopolistic market structure where it competes with two to three HDPE bottle manufacturers.

The major raw material for the extrusion of the plastic containers is HDPE, which is completely imported from Saudia Arabia & Qatar.

Key Management Profile

Mr Iftikhar Hussain is one of the key sponsors of the Company, who initiated the operations in 1993. He is spearheading the management of the company since 1993. Mr. Hussain is a graduate from New York University, USA. Other senior management team members are presented in the table below.

Table 2: Management Team at CBM Plastics

Name	Designation
Mr Sheikh Nadeem Rasool	GM Finance & Operations
Mr Asif Hussain	Manager – Inventory & Warehousing

Mr. Sheikh Nadeem Rasool has been serving as the GM Finance & Operations since 1994.

Mr. Asif Hussain oversees the Inventory management & Quality control along with warehousing system. He has previously worked in Cisco Systems, USA in the capacity of Database designs and management.

CBM's organization structure is attached as an annexure to this report.

Business Segments & Product Portfolio

CBM manufactures a range of plastic containers with size varying from 50 ml to 250 ltr to cater to a variety of customers in the lube oil, pesticides, ethanol and food sector.

Figure 1: Product Suite

The volumetric sales concentration is such that 90% of the volume is generated by lube oil sales, 5% by pesticides and rest by ethanol and food products. The capacities and utilization are presented in the figure below. The utilization has depicted some volatility, which included a fall in FY18 and an increase in FY19. The fall in FY18 was mainly on account of additional capacities coming on line during the period. As per management, the capacity utilization, as it stands presently around at 82%, is on the higher side and further increase in the same is unlikely. The remainder 18% capacity deficit is on account of designated public holidays and other leaves.

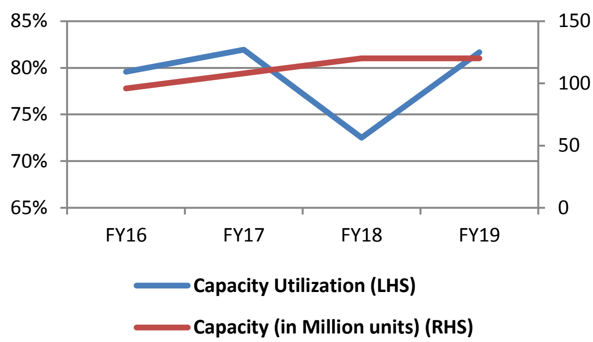


Figure 2: Capacity & Capacity Utilization

High client concentration remains the mainstay of CBM, as inherent in the market structure in which CBM operates. The top 5 sales, customer-wise, as a percentage of total sales stands at 88% for FY19 (FY18: 88%, FY17: 86%).

However, concentration risk is somewhat mitigated by the long standing business relationships with the major clients and CBM's importance to the client's business operations, wherein in some cases CBM is the sole supplier and in other cases it's the majority supplier (80-90%). Standard contracts with clients are for a 3-year period.

CBM enjoys a strong market positioning in the container making industry, as evident from the list of renowned clientele. As per management, the Company enjoys a competitive advantage in the industry, on account of stringent quality assurance tests, which they pioneered in the industry.

Business Model

CBM plastics has been operating on a fixed gross margin since last 20 years, by passing on the volatility in raw material prices and exchange rate parity to the client by way of a distinct pricing formula for the plastic containers. The price of a plastic container is a function of HDPE weight & its dollar price along with the container color, referred to as the Masterbatch. This price is revised every month owing to the updated price of HDPE taken from IHS Polymer Index. The same is equated as follows in further detail:

Price = (HDPE resin weight for plastic container * index adjusted landed cost of HDPE resin * USD conversion rate*resin wastage factor) + (Masterbatch weight * landed cost of Masterbatch * USD conversion rate * Masterbatch wastage factor) + conversion charges + packaging charges + labelling charges + (Labels cost * Label wastage factor) + Mould amortization + transportation charges - discount.

The pricing model as depicted above gives a natural hedge to the company from the price risk emanating from volatility in crude oil prices, which is a raw material of HDPE polymer, and foreign exchange risk arising on the import payables.

CBM procures HDPE every month throughout the year in tandem to the production requirements. This business strategy is tantamount to the stable gross and operating margins, hence to mitigating any inventory risk on the balance sheet, along with additional inventory financing and storage costs.

Power Generation

The power arrangements for each of the sites are presented in the table below:

Table 3: Power Generation & Requirement

	Site I	Site II
Requirement	3 MW	3 MW
Gas Generation	2.2 MW	200 KW
KE	3.0 MW	1.3 MW
Backup Diesel	4.0 MW	2.0 MW

As depicted in the table, the Company has ample capacity through backup diesel generators to meet the power requirement in case primary arrangements fail.

Information Technology

The Company runs a SQL based server, which is connected to the client for real time record keeping. The front end of the system utilizes a '.Net' based application. The database backup is done on daily basis.

Financial Risk Analysis

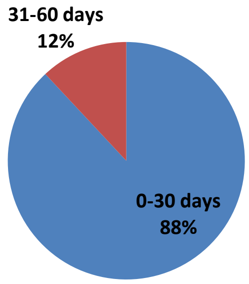
Asset Mix.

Table 4: Balance Sheet Extract (Rs. in Millions, unless stated otherwise)

	FY15	FY16	FY17	FY18	FY19
Property, Plant & Equipment	798 (33%)	810 (32%)	1,080 (37%)	1,149 (34%)	1,362 (34%)
Stock in Trade	552 (23%)	562 (22%)	451 (15%)	575 (17%)	673 (17%)
Trade Debt	568 (23%)	540 (21%)	680 (23%)	705 (21%)	849 (21%)
Advance Income Tax	331 (14%)	315 (12%)	394 (13%)	609 (18%)	773 (19%)
Cash & Bank	15 (1%)	44 (2%)	59 (2%)	52 (2%)	77 (2%)
Other Assets	171 (7%)	254 (10%)	276 (9%)	301 (9%)	238 (6%)
Total Assets	2,436	2,526	2,940	3,390	3,973

- Given CBM's operations are capital intensive, about a third of the asset base is tied up in Property, Plant & Equipment.
- Amount tied up in working capital is also on the higher side, with stock in trade and trade debt constituting 38% of the asset base.
- As of Jun'19, stock in trade can be broken up into raw material and finished goods, comprising 56% and 44% of the aggregate respectively.
- Trade debts represent a source of credit risk for the Company. Nevertheless, comfort is derived from the aging profile of the trade debts.

Figure 3: Aging of Trade Debts (Jun'19)



- Historically, in the periodic accounts reviewed, which date back to Dec'15, we have not noted any provisioning on account of bad debts, which depicts a good repayment experience.
- CBM has a sizable proportion (19%) of its asset base tied up in advance income tax.. A breakup of the balance is as follows:

Table 5: Advance Income Tax Breakup (Rs. in Millions)

	Jun'19
Advance Income Tax for 2019	202
Tax Refund Receivable - 2018	229
- 2017	182
- 2016	130
- 2003-2015	29

Sales & Profitability

- Topline of the Company has increased gradually on a timeline basis at a CAGR of 10.7% over the past 4 year period (FY16-FY19). In absolute terms, CBM's topline was reported at Rs 4.6b (FY18: Rs. 4.2b) for FY19.
- The topline revenues include export proceeds, which constituted about 1% of the yearly sales.
- Given the business model of CBM, wherein the Company just passes off adverse/favorable variation in commodity price and exchange rate to the customer, the Company's gross margins has ranged within 9.2%-9.8% during the past 5-year period (FY15-FY19). The slight variation is attributable to different products and margin negotiated with client at the onset of the relationship.

- Administrative & Distribution expenses as a % of sales have remained stable at 3% & 1% throughout the period (FY15-FY19).
- Accordingly, the Company's operating margin has also depicted stability, ranging within 6.3%-6.8% during the period (FY15-FY19).
- Given the rise in benchmark rates, the Company's pre-tax profit margins have dropped.

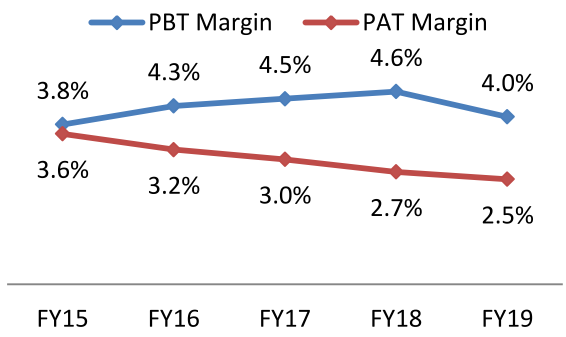


Figure 4: PBT and PAT Margins

- Given the growth in business operations both RoAA and RoAE have fallen.

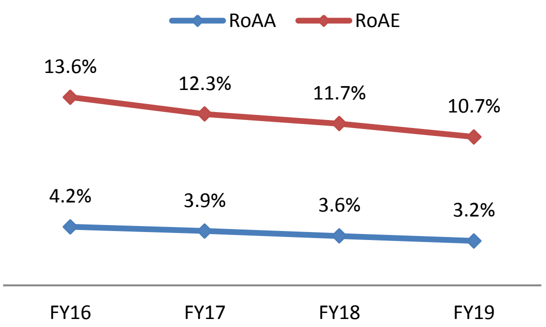


Figure 5: RoAA & RoAE

Liquidity and Funding

- CBM has been operating at a stable cash cycle over the past three years, as depicted in the table below.

Table 6: Operating & Cash Cycle

	FY17	FY18	FY19
Inventory (Days) – A	51	56	60
Trade Receivable (Days) – B	70	62	66
Trade Payables (Days) – C	53	56	61
Operating Cycle (A+B)	121	118	127
Cash Cycle (A+B-C)	68	61	66

- In case, we add the advance income tax into the operating & cash cycle, CBM's operating & cash cycle would be higher at 187 and 127 days respectively.
- CBM's FFO has depicted a declining trend over the past 4 years due to higher advance income tax paid on the import stage, and the same was reported as Rs 191.2m (FY18: 131.9m, FY17: 211.5m, FY16: 262.5m) for FY19.
- An operating cycle of ~120 days necessitates the usage of running finance lines, which forms bulk of the Company's debt, as illustrated below:

Table 7: Debt (Rs. in Millions)

	FY18	FY19
Short Term Borrowings	1,221	1,496
Finance Lease	77	164
Current Maturity of Finance Lease	85	60

- CBM has also taken off balance sheet financing, the quantum of which is provided in the table below. These are mainly operating lease transactions. The debt has been included in our leverage calculations.

Table 8: Operating Lease (Rs. in Millions)

	FY18	FY19
Long Term (1-5 years)	51	67
Current (<1 year)	136	200
Current Maturity of Finance Lease	187	267

- Lower FFO levels and higher utilization of long term and short term borrowings over the four year period have decreased the FFO to Total Debt to 0.1x (FY18 : 0.08x, FY17: 0.17x, FY16: 0.27x). We expect it to remain at similar levels during our rating horizon.
- The FFO to Long Term Debt for CBM is considered adequately high at 39% (FY18: 37.9%). Given lower Long Term Debt envisaged, the same is expected to rise to around 60%.
- In case we include import bills payable of Rs. 631m in the debt calculations, the FFO to Debt would fall to 7.3% (FY18: 6.4%).
- The Debt Servicing Coverage Ratio (DSCR) is reported at 1.22x (FY18: 1.17x,

FY17: 1.7x, FY16: 1.86x) for FY19. Based on additional contracted revenues, we expect the DSCR to rise slightly, but remain below 1.5x during the rating horizon.

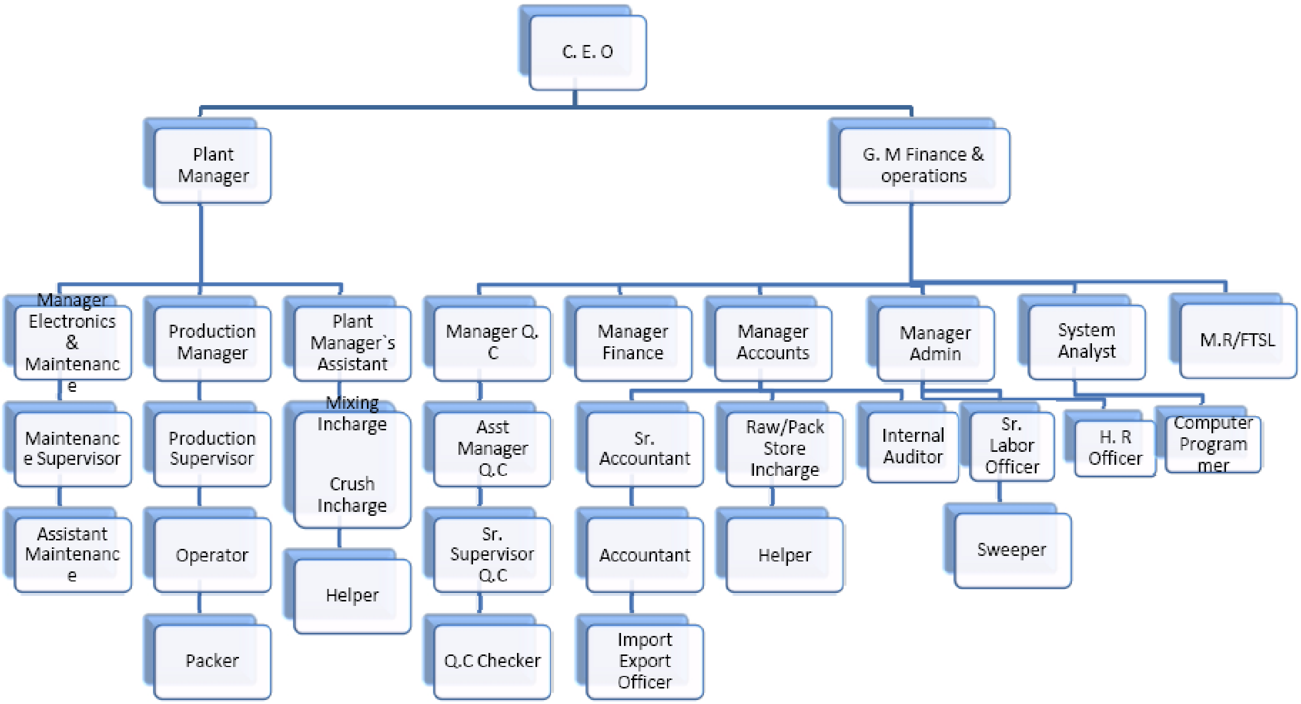
Capitalization and Funding

Table 9: Capitalization (Rs. in Millions)

	FY18	Jun'19
Net Equity	**1,015**	**1,182**
- **Paid up Capital**	150	150
- **Unappropriated Profit**	715	882
- **General Reserve**	150	150
Surplus on Revaluation of PPE	**34**	**34**

- CBM has a constant payout history of 13%, with remaining profitability being retained. As a result, equity grew at a CAGR of 13% over the four-year period (FY15 - FY19) driving the same rate of growth in the form of fixed capital formation.
- As of Jun'19, CBM had gearing of 1.45x (Jun'18: 1.36x). Inclusive of operating lease, the gearing would be higher at 1.68x (Jun'18: 1.55x).
- Given higher debt projections identified to meet the growth related capital expenditure the Company has envisaged additional borrowings, and accordingly we expect gearing to rise to 1.9x and then fall as the debt is repaid.

Appendix I: Organizational Structure



FINANCIAL SUMMARY *(amounts in PKR millions)* Appendix II				
BALANCE SHEET	**FY16**	**FY17**	**FY18**	**FY19**
Property Plant & Equipment	810.13	1,079.94	1,148.57	1,192.64
CWIP	142.68	145.88	113.78	149.90
Stock in Trade	562.21	451.19	574.73	698.36
Trade Debts	540.23	679.81	704.51	849.31
Advance Income Tax	314.86	394.07	609.18	773.07
Cash and Bank Balances	44.01	58.61	51.77	76.59
Total Assets	2,525.55	2,939.81	3,389.82	3,916.72
Trade and other payable	540.64	525.49	684.25	780.59
Long Term Debt *(*incl. current maturity)*	156.27	258.01	348.30	430.94
Short Term Debt	830.90	994.41	1,220.96	1,496.25
Adjusted Equity	815.40	912.70	1,014.95	1,103.23
Paid-up Capital	150.0	150.0	150.0	150.0
INCOME STATEMENT				
Sales Revenue	3,226.88	3,556.34	4,164.33	4,664.09
Gross Profit	297.60	345.89	407.66	441.74
Administrative Expenses	(77.26)	(99.57)	(105.84)	(121.27)
Selling & Distribution	(15.51)	(18.69)	(24.51)	(27.99)
Financing Cost	(83.96)	(85.94)	(96.51)	(125.93)
Profit Before Tax	138.17	158.50	192.66	187.55
Profit After Tax	104.30	106.67	112.39	117.55
RATIO ANALYSIS				
Gross Margin (%)	9.2%	9.7%	9.8%	9.5%
Net Margin (%)	3.2%	3.0%	2.7%	2.5%
Current Ratio (x)	1.04	1.01	1.01	1.07
FFO	262.65	211.53	131.92	191.27
FFO/Total Debt (x)	0.27	0.17	0.08	0.10
Gearing (x)	1.21	1.37	1.55	1.68
Debt Leverage (x)	2.07	2.18	2.49	2.76
Debt Servicing Coverage (x)	1.86	1.70	1.17	1.22
ROAA (%)	4%	4%	4%	3%
ROAE (%)	14%	12%	12%	11%

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix III

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 IV
Name of Rated Entity	CBM Plastics (Pvt) Limited
Sector	Plastic Packaging
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	
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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Rating History:

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
13-Nov-2019	BBB+	A-2	Stable	Initial