

Technical Partner – IIRA, Bahrain | JV Partner – CRISL, Bangladesh

## RATING REPORT

### Novatex Limited

**REPORT DATE:**

September 25, 2017

**RATING ANALYSTS:**

Talha Iqbal

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#### RATING DETAILS

Rating Category	Initial Rating	
	Long-term	Short-term
Entity	AA-	A-1
Rating Outlook	Stable	
Rating Date	25 <sup>th</sup> September'2017	

#### COMPANY INFORMATION

<b>Incorporated in 1997</b>	<b>External auditors:</b> Kreston Hyder Bhimji & Co. Chartered Accountants, Karachi
	<b>Chief Executive Officer:</b> Abdul Razak Diwan
<b>Key Shareholders (with stake 5% or more):</b>	
G&T Family	
Gatron Industries Limited	

#### APPLICABLE METHODOLOGY(IES)

*Applicable Rating Criteria: Industrial Corporates (May, 2016) <http://www.jcrvis.com.pk/kc-meth.aspx>*

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## Novatex Limited

### OVERVIEW OF THE INSTITUTION

### RATING RATIONALE

Novatex Limited operates as an unlisted public limited company under the Gani and Tayub group of companies; the group has been in existence for over five decades with presence in various sectors including textile, plastic resin and power generation.

Shareholding of the company is held by G&T family with remaining shares by Gatron Industries.

#### Profile of Chairman & CEO

Mr. Diwan is a seasoned industrialist with 45 plus years' 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.

Financial Snapshot  
Total Equity: June 2017:  
Rs. 13.3b

Incorporated in 1991, Novatex Limited (Novatex) manufactures PET resins, PET preforms and BoPET films. The company started off its business in 1998 through manufacture of textile grade resins and later enhanced the production facilities to include production of bottle grade resins, PET preforms and flexible film packaging.

**PET Resin:** The Company has the capacity to produce all grades of resins (Textile-grade polyester chips are used for making the Polyester Filament yarn while bottle grade chips are used for manufacturing plastic bottles) with majority production comprising bottle grade resin. Novatex has more than doubled its bottle grade resin capacity in FY16.

**PET Preform:** PET preforms refers to un-inflated bottles, these are produced using resin developed in house, which constitutes around 40% of local resin consumption produced by Novatex. The company produces preforms for water & beverage companies and has a long-term supply contract in place with major players. The company is the process of enhancing its preform capacity which is expected to come online in December'2017.

**BoPET Films:** These are flexible films primarily used in packaging developed by stretching PET resin. Given that raw material is produced in-house quality and consistency is ensured. The company also exports to Turkey, Europe, North America, Middle East and Korea. With healthy growth in flexible packaging segment, management has also initiated expansion of another line which is expected to come online in FY19.

#### Rating Drivers

#### Market Position

The ratings assigned to Novatex reflect the company's dominant market position in all three business segments. The company enjoys leading market position in the PET Resin segment; Novatex along with Gani & Tayub group enjoys a leading market share in PET Preform and BOPET Films segment.

#### Diversified operations and revenue streams

Novatex has diversified local and international operations; three business segments and exports to 45 countries. Local sales have averaged around half of total sales over the last five years. The company's preform segment has recently diversified into the pharmaceutical sector which will facilitate further revenue diversification and growth over the medium term. Diversification benefits will also accrue through the sizeable planned investment in the power sector through Thalnova Power Thar (Private) Limited (TNPTL). While client concentration in sales is currently on the higher side, comfort is drawn from lengthy association of most large clients with Novatex.

#### Business Risk

Business risk profile of the company draws support from the following:

- Significant barriers to entry given the capital and technology intensive nature of operations and high switch over cost for clients.
- Focus on service quality, innovation & product development resulting in strong client relationships. Novatex manufactured a Multilayer bottle for Pepsi, a global first, while Novatex's lab is a Pepsi approved lab, which is globally recognized.
- Strategic long-term supply contracts with major beverage manufacturers.
- Healthy growth outlook for the Fast Moving Consumer Goods (FMCGs) and pharmaceutical sector which are catered by Novatex.
- Diversified local and international operations; three business segments and exports to 45 countries.
- Existing plant capacity of PET (Bottle Grade) Resin is of economic size resulting in

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production efficiencies and having surplus capacity enabling the company to handle high seasonal demand surges.

- Expansion in preform and BoPET division to further strengthen competitive positioning.

#### **Financial Profile**

Financial risk profile of the company is supported by improving profitability levels and resultant increase in cash flows. Debt levels have also reduced by more than half over the last three years. With a decline in debt levels and improvement in cash flows, Funds flow from operation in relation to outstanding obligations at (FY17: 138%; FY16: 49%; FY15: 28%) has increased by nearly 5 times over the last 2 years and is considered healthy. Gearing levels (FY17: 0.2(x); FY16: 0.44(x); FY15: 0.48(x); FY13: 0.74(x)) have declined (due to high retention of profits and lower debt levels) on a timeline basis and have historically remained within manageable levels even when raw material prices were at their highest levels. With raw materials representing a major cost component and significant volatility in prices (oil & natural gas), efficient procurement, inventory management and product pricing are critical to gross margins and cash flow metrics. As per management, product pricing is undertaken to ensure increase in cost is passed on to consumers. Besides healthy cash flows, liquidity profile also draws support from positive working capital cycle that the company enjoys.

#### **Expansion**

After successfully completing expansion in the PET Resin segment in FY16, Novatex is in the process of enhancing capacity in the Preform and BoPET segment. The equipment is being procured from leading suppliers (M/s Husky for Preform and M/s Dornier for BoPET film) in their respective field. Expansion in preform and BoPET division are projected to be completed by FY18 and FY19, respectively. Novatex is also in the process of diversifying in the power sector through TNPTL, a joint venture between Thal Limited and Novatex, which is a 330MW coal fired power plant at Thar coal mine mouth Sindh. Novatex's equity contribution is projected to be a mix of debt and equity and is spread over a period of three years. Given the envisaged future expansion & funding plan and even assuming the entire equity contribution for TNPTL is funded through debt, liquidity and capitalization indicators are projected to remain within benchmarks for the assigned ratings.

#### **Governance**

Overall control framework is adequate with Novatex using an Oracle based ERP system with satisfactory backup and network security arrangement. Scope of internal audit function includes all head office and factory areas with adequate planning and follow-up mechanism in place. Going forward, management will continue to focus on enhancing overall control and governance infrastructure.

**RATING SCALE & DEFINITION**

**Appendix I**

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:** JCR-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.jcrvis.com.pk/images/criteria\\_watch.pdf](http://www.jcrvis.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.jcrvis.com.pk/images/criteria\\_outlook.pdf](http://www.jcrvis.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.

**'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.jcrvis.com.pk/images/policy\\_ratings.pdf](http://www.jcrvis.com.pk/images/policy_ratings.pdf)

**'SD' Rating:** An 'SD' rating is assigned when JCR-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.

## JCR-VIS Credit Rating Company Limited

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REGULATORY DISCLOSURES		Appendix II			
<b>Name of Rated Entity</b>	Novatex Limited				
<b>Sector</b>	Chemicals/Packaging				
<b>Type of Relationship</b>	Solicited				
<b>Purpose of Rating</b>	Entity Rating				
<b>Rating History</b>	<b>Rating Date</b>	<b>Medium to Long Term</b>	<b>Short Term</b>	<b>Rating Outlook</b>	<b>Rating Action</b>
	<b>RATING TYPE: ENTITY</b>				
	25-09-2017	AA-	A-1	Stable	Initial
<b>Instrument Structure</b>	N/A				
<b>Statement by the Rating Team</b>	JCR-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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