RATING REPORT

Power Cement Limited

REPORT DATE:
December 30, 2022

RATING ANALYSTS:
Muhammad Tabish
muhammad.tabish@vis.com.pk

Ali Yousuf
ali.yousuf@vis.com.pk

RATING DETAILS				
Rating Category	**Latest Rating**		**Previous Rating**	
	Long-term	**Short-term**	**Long-term**	**Short-term**
Entity	A-	A-2	A-	A-2
Rating Outlook	Stable		Stable	
Rating Date	*December 30, 2022*		*November 30, 2021*	

COMPANY INFORMATION	
Incorporated in 1981	**External auditors:** A.F. Ferguson & Co., Chartered Accountants (*member firm of the PwC*)
Public Limited Company	**Chairman:** Mr. Nasim Beg
Key Shareholders (with stake 5% or more):	**CEO:** Mr. Muhammad Kashif Habib
Mr. Muhammad Arif Habib ~21.4%	
Arif Habib Equity (Private) Limited ~19.5%	
Arif Habib Corporation Limited ~7.3%	
Mr. Syed Salman Rashid ~5.6%	

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

Power Cement Limited

OVERVIEW OF THE INSTITUTION

Power Cement Limited (PCL) was incorporated in 1981 as a private limited company and was later converted into a public limited company in 1987. Previously, the company was known as Al-Abbas Cement Limited and was acquired by Arif Habib Group in 2010. PCL is listed on Pakistan Stock Exchange Limited with the head office situated in Karachi, and factory located in DehKaloKohar, Nooriabad Industrial Estate, District Jamshoro (Sindh). The company is engaged in manufacturing, selling and marketing of cement.

Sponsor Profile

PCL is a subsidiary of Arif Habib Corporation Limited (AHCL) which is the holding company of Arif Habib Group. AHCL is majorly involved in making strategic investments in a diversified portfolio of subsidiary companies and associates with exposure in sectors like Fertilizer, Financial Services, Real estate, Construction Materials, Energy and others.

RATING RATIONALE

Corporate Profile

Power Cement Limited (PCL) is a four-decade-old company engaged in production, distribution, and marketing of cement in the country's southern region along with exports. Product portfolio includes Ordinary Portland Cement and Sulphate Resistant Cement (only cement certified for 53 Grade in south zone from PSQCA). Moreover, the company has extensive network of more than 250 distributors, dealers and suppliers. Headquartered in Karachi, the production site is at Nooriabad, District Jamshoro. The company holds several international export standards and ISO certifications.

Entire energy requirement of 35 MW is met through an optimum mix of National Grid, Waste Heat Recovery System (WHRS – 10MW plant installed in 2021) and Solar Power (7MW project commissioned in Aug'22).

Operating Performance

PCL has three manufacturing lines, with a cumulative nameplate clinker and cement production capacity of 10,700 and 11,235 tonnes per day (TPD), respectively. Capacity utilization levels have declined in the outgoing year in response to lower market demand.

Figure: Annual Capacity & Production Data (in million MTs)

	FY19	FY20	FY21	FY22
Installed Capacity				
Clinker	0.9	2.1	3.2	3.2
Cement	0.9	2.2	3.4	3.4
Actual Production				
Clinker	0.6	0.9	2.3	1.9
Cement	0.6	0.7	1.8	1.6
Capacity Utilization				
Clinker	*67%*	*44%*	*73%*	*58%*
Cement	*62%*	*32%*	*54%*	*47%*

Mega capacity expansion project began full production in FY21; recent renewable energy projects have led to cost-efficiencies.

The capacity expansion project began in 2017, and included the construction of a Line III manufacturing facility (clinker production plant of 7,700 TPD and cement production plant of 8,500 TPD) with full production starting in FY21. Moreover, recent addition of renewable energy sources (including WHRS and Solar Project) have resulted in ~25% reduction in production costs over the review period. Going forward, in order to further reduce reliance on national grid, management has initiated a 9MW wind power project, which is currently in the preliminary evaluation phase.

Cement industry – Overview

Cement industry apart from contributing ~11% to large-scale manufacturing sector, is critical to the country's economic development as sector performance influences growth in the allied segments (e.g. steel, chemicals, wood etc). Market structure is oligopolistic with total 16 firms and 24 operational plants. High capital cost of plant development, query availability and extensive regulatory requirement to establish new plants act as high entry barriers.

Geographically, the sector is split into two regions: North and South, with the north covering areas of Punjab, KPK, and AJK and the south includes Sindh and Baluchistan. Almost 70% of operational plants are located in the north region, with the remainder based in south. Manufacturers in the south zone have more room for revenue diversification as they can access a variety of export markets via sea, whereas northern players export potential is mainly limited to Afghanistan and India. In addition, southern players also benefit from lower transportation costs when procuring raw materials from ports. Lucky Cement is currently the largest player, followed by Bestway Cement, D.G. Khan Cement and others.

Energy costs account for ~60% of total production costs, and coal, as a cheap source of energy, is widely used and constitutes major chunk of power cost. Majority of players rely on imported coal, thus exposure to price volatility and currency risk is present. Other major raw materials used in cement manufacturing process are limestone, clay and gypsum. Cement prices are a function of market demand and supply dynamics while variations in prices are generally dependent upon the behavior of major cost components, including coal prices, exchange rate, fuel costs and freight charges.

Industry – Current demand supply dynamics and future prospects
At present, sector production capacity is recorded ~70m MT while expansion plans for enhancing capacity up to ~87m MT by FY24 are underway. Cement demand is highly correlated to construction and infrastructure development including private and Public Sector Development Program (PSDP).

In FY22, total cement dispatches fell by ~8% to 52.9m MT, with local sales volume remaining flat with a 1% decline while exports declined by ~44%. The downward trend continued in the current fiscal year, with total dispatches dipping by ~25% (local sales falling more than exports) in 3M'FY23 vis-à-vis SPLY as demand remained subdued due to a slowdown in construction activities, inflationary pressure, impact of floods, and rising production costs given sharp hike in global coal prices.

Figure: Industry – Cement Dispatches (in million MTs)

	FY20	FY21	FY22		1Q'FY22	1Q'FY23
Local	**40.1**	**48.1**	**47.6**		**11.3**	**8.6**
North	*34.3*	*40.4*	*39.4*		*9.5*	*7.2*
South	*5.7*	*7.5*	*8.2*		*1.8*	*1.3*
Export	**7.9**	**9.3**	**5.3**		**1.5**	**1.0**
North	*2.0*	*2.5*	*0.9*		*0.3*	*0.3*
South	*5.9*	*6.7*	*4.3*		*1.2*	*0.7*
Total	**47.9**	**57.4**	**52.9**		**12.8**	**9.6**

Short-term outlook for the industry is stressed, as rising cement costs driven by commodity super cycle in coal with limited capacity to pass on prices to consumers and increase in domestic inflation, is likely to weigh on demand and profitability margins. Furthermore, elevated political uncertainty and expectation of a relatively lower development budget going forward is also likely to act as a drag on demand. Long-term outlook remains positive, given Pakistan's status as a developing nation, low per capita consumption of cement and easy domestic availably of limestone.

Key Rating Drivers

Strong sponsor strength and demonstrated support in form of equity injection through issuance of preference share and capital contribution over the review period.
PCL is part of reputed Arif Habib Group, a leading industrial and financial conglomerate in Pakistan. The sponsor continues to provide support by securing long-term debt, shortfall provisions of debt repayment (syndicate loan undertaken for capacity expansion project) and injecting Rs.2.4b in preference shares in FY21 and Rs. 7b in capital contribution in FY22.

The recent Rs. 7b collective investment is a long-term Musharka agreement classified as 'Equity' under IAS 32; financing carries a profit rate of 3M KIBOR plus 175bps and principal repayment with profit is at the sole discretion of the company given cash flows availability.

Revenue growth is driven by price increase while volumetric offtake noted a declining trend since last review.
Sales revenue surpassed Rs. 17b mark in FY22, following a sizeable growth in the previous year given increased dispatches with commencement of a new line. However, the year-on-year uptick of ~23% was driven solely by price growth, while overall volumetric off-take fell by ~11% (local cement dispatches remained flat and export volume contracted by ~34% in line with industry trend). Similarly, total dispatches fell further in 3M'FY23, despite the company posting topline growth of 35% vis-à-vis SPLY owing to price increase. Market share remained stable at ~4.0% (FY21: 4.1%) in the overall industry dispatches while the same in south zone increased slightly to 17.0% (FY21: 16.7%).

Figure: Cement Dispatches (in million MTs)

	FY20	**FY21**	**FY22**		**1Q'FY22**	**1Q'FY23**
Local Dispatches	0.6	1.6	1.6		0.4	0.3
Local %	*59%*	*69%*	*77%*		*70%*	*57%*
Export Dispatches	0.4	0.7	0.5		0.2	0.2
Export %	*41%*	*31%*	*23%*		*30%*	*43%*
Total	**1.0**	**2.4**	**2.1**		**0.6**	**0.5**
Retention Price (In Rs.)	***6,046***	***6,439***	***9,202***			

In terms of product mix, ordinary portland cement accounts for more than 90% of revenue, with the remaining shared by sulphate resistant cement and power block cement. On average, institutional segment constitute around 30% to 35% of total sales. In terms of sales concentration, top two clients account for 41.5% (FY21: 41.6%) in FY22. Key export markets are Sri Lanka, China, Malta, Bangladesh, and other East African countries; however, it varies year to year due to global demand supply dynamics.

Sizeable jump in input costs combined with significant financial charges on debts translated into negative net margins.
Despite newly installed cost-effective manufacturing line and management's concerted efforts to reduce costs by increasing reliance on renewable energy sources, profitability margins were significantly impacted during the review period as gains in production

costs were weighed down by sharp upswing in coal prices, electricity tariffs, transportation costs, and packing material costs, combined with rupee depreciation.

Given sizeable increase in international coal prices and freight costs, import-to-local coal consumption ratio fell to 50:50 from 85:15 the previous year. Financial charges despite the decrease in debt level remained unchanged due to increase in benchmark rates during the year. Gross margin fell from 21.7% to 14.2%, while net margin turned negative, translating into a net loss of Rs. 444m in FY22.

Pressure on debt servicing through operational cash flows remains. Ratings are dependent upon debt payment shortfall support available to local lenders for the next two years and complete tenor for foreign loan.
Cash flow coverage has remained constrained, with Funds from Operations (FFO) reported consistently negative since FY19. The shortfall in debt servicing has been covered over the years by sponsor loan, issuance of preference shares and recent capital contribution.

Debt profile comprises a mix of Long-term (LT) financing (including syndicate debt undertaken for capacity expansion and term loans) and Short-term (ST) debt for working capital requirements (cumulative running finance lines stood at Rs. 7.6b at end-FY22). Total debt stood at Rs. 24.7b (FY22: Rs. 22.7b; FY21: Rs. 28.1b) at end-3M'FY23.

Figure: Break-up of LT Financing (*Incl. Current Maturity*)

Rs. in billions	FY20	FY21	FY22
Syndicated Loan			
- *Local Currency*	12.1	13.0	13.1
- *Foreign Currency**	6.6	5.9	5.9
Term Loan & Refinance Scheme	0.4	0.8	0.9
Total LT Debt	**19.1**	**19.7**	**19.9**
Current maturity	**(1.8)**	**(1.3)**	**(2.4)**

**includes revaluation impact*

Foreign debt repayments have been regular, while local currency debt component was restructured in Sept'20 under SBP's debt relief scheme, with downward revision in profit rate and enhancement of grace period. Repayments began in July'22 and remaining loan tenure is of 6 years with semi-annual instalments; management intends to renegotiate the existing terms to extend repayment period even further. The balance in Debt Payment Account (DPA) is kept equal to total semi-annual debt instalment seven days prior to each due date. As per agreement, a breach in maintenance of few financial covenants/metrics mentioned is noted; however, waiver request is submitted.

Following the restructuring of local debt, PCL entered into a Supplemental Project Funds Agreement whereby sponsors agreed to provide debt payment shortfall support to local lenders for first four years post commercial operations of Line III (now two years remain) and entire tenor for foreign investors. Management has planned to extend the shortfall support period for local debt.

Sponsor contribution has resulted in improved capitalization levels.
Equity base increased from Rs. 8.5b in FY20 to Rs. 17.2b in FY22 on the back of preference share issuance and contribution from associated undertakings. Thus, leverage

metrics have noted considerable improvement, wherein gearing has declined by nearly half to 1.31x (FY21: 2.62x). The company has no history of paying dividends to ordinary shareholders.

Sound corporate governance framework supported by a well-designed organizational structure, experienced management team and detailed disclosures.

Board comprises seven members including Chairman and CEO. There are 2 independent directors present on the board. During the year, five-board meeting were held with satisfactory attendance level. For effective oversight, two board level committees, namely Audit Committee, Human Resources & Remuneration Committee are in place. As per best practices, independent member chairs both committees and the board has female representation as well.

The company has a well-designed organizational structure under assigned heads, directors, and sales team for carrying out operations across all business segments. Senior management team comprises seasoned professionals with relevant industry experience. Since last review, turnover was noted at the position of chief financial officer, company secretary and internal audit head. Total staff strength stands at 480 employees at end-FY22 with average service duration of 4.5 years. With adequate systems and policies in place, IT infrastructure is deemed sound. Detailed annual report disclosures reflect strong disposition towards transparency and disclosures.

Power Cement Limited (PCL) Appendix I

FINANCIAL SUMMARY							*(amounts in PKR millions)*
BALANCE SHEET	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**	**1Q'FY22**	**1Q'FY23**
Fixed Assets	19,843	32,942	37,271	36,308	35,672	36,118	35,484
Long term Investments	13	16	24	25	26	25	26
Stock-in-Trade+ Stores, SLT	1,369	1,535	2,151	2,898	3,288	2,574	3,846
Trade Debts	456	386	419	275	234	286	414
Cash & Bank Balances	1,122	625	332	255	218	219	290
Total Assets	24,517	40,273	45,501	45,492	46,449	45,232	48,033
Trade and Other Payables	1,845	3,535	6,285	5,273	4,421	3,562	4,905
Long Term Debt	9,570	19,048	19,186	19,744	19,918	19,972	19,109
Short Term Debt	1,033	4,904	9,672	8,360	2,784	9,996	5,576
Total Debt	10,603	23,952	28,858	28,104	22,702	29,968	24,685
Paid Up Capital	10,634	10,634	10,634	10,634	11,119	10,634	11,119
Total Equity	11,299	11,574	8,479	10,745	17,283	10,744	17,011
INCOME STATEMENT							
Net Sales	4,343	3,858	4,113	14,221	17,495	4,114	5,571
Gross Profit	675	157	(116)	3,090	2,482	837	807
Operating Profit	358	(256)	(988)	1,928	1,304	605	238
Profit Before Tax	349	(412)	(3,967)	(671)	(1,331)	31	(650)
Profit After Tax	320	582	(3,622)	358	(444)	62	(272)
RATIO ANALYSIS							
Gross Margin (%)	15.5%	4.1%	-2.8%	21.7%	14.2%	20.3%	14.5%
Operating Margins	8.2%	-6.6%	-24.0%	13.6%	7.5%	14.7%	4.3%
Net Margin	7.4%	15.1%	-88.0%	2.5%	-2.5%	1.5%	-4.9%
Trade debts/Sales	10.5%	10.0%	10.2%	1.9%	1.3%	1.7%	1.9%
FFO	89	(108)	(1,193)	(669)	(709)	(322)	(1,126)
FFO to Total Debt (%)	0.8%	-0.5%	-4.1%	-2.4%	-3.1%	-4.3%	-18.2%
FFO to Long Term Debt (%)	0.9%	-0.6%	-6.2%	-3.4%	-3.6%	-6.4%	-23.6%
Current Ratio (x)	1.4	0.7	0.4	0.4	0.7	0.4	0.6
(Stock + Trade Debts)/ ST debt	176.7%	39.2%	26.6%	38.0%	126.5%	28.6%	76.4%
DSCR (x)	0.7	(0.2)	(0.5)	0.5	0.5	0.5	0.1
Gearing (x)	0.94	2.07	3.40	2.62	1.31	2.79	1.45
Leverage (x)	1.17	2.48	4.37	3.23	1.69	3.21	1.82
ROAA (%)	1.8%	1.4%	-8.4%	0.8%	-1.0%	0.5%	-2.3%
ROAE (%)	3.2%	5.0%	-36.1%	3.7%	-3.2%	2.5%	-7.2%

ISSUE/ISSUER RATING SCALE &DEFINITIONS Appendix II

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	Appendix III
Name of Rated Entity	Power Cement Limited
Sector	Cement and Construction
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				
Dec 30, 2022	A-	A-2	Stable	Reaffirmed
Nov 30, 2021	A-	A-2	Stable	Reaffirmed
Nov 09, 2020	A-	A-2	Stable	Maintained
Oct 25, 2019	A-	A-2	Negative	Maintained
Oct 02, 2018	A-	A-2	Stable	Reaffirmed
Jul 10, 2017	A-	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.
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. Copyright 2022 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.

Due Diligence Meeting Conducted

Name	Designation	Date
Mr. Baleeghuddin	Head of Treasury	Dec 16, 2022
Mr. Irfan Sikander Bawa	Chief Financial Officer	