RATING REPORT

Power Cement Limited (PCL)

REPORT DATE:
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RATING ANALYSTS:
Talha Iqbal Chhoangalia
talha.iqbal@jcrvis.com.pk

Sidra Ahsan Qureshi
sidra.qureshi@jcrvis.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	
Facility (Bank Loan)	A (blr)		A (blr)	
Rating Date	*October 02, 2018*		*August 10, 2017*	

COMPANY INFORMATION

Incorporated in 1981	**External auditors:** KPMG Taseer Hadi & Co., Chartered Accountants
Public Limited Company	**Chairman of the Board:** Mr. Nasim Beg
Key Shareholders (with stake 5% or more): Mr. Muhammad Arif Habib- 21.41% Arif Habib Equity (Private) Limited- 19.54% Arif Habib Corporation Limited- 7.28% Mr. Syed Salman Rashid- 5.6%	**Chief Executive Officer:** Mr. Muhammad Kashif Habib

APPLICABLE METHODOLOGY(IES)

JCR-VIS Entity Rating Criteria *Industrial Corporates (May 2016)*
http://www.jcrvis.com.pk/docs/Corporate-Methodology-201605.pdf

Power Cement Limited (PCL)

OVERVIEW OF THE INSTITUTION

Power Cement Limited (PCL) was incorporated on December 1st 1981 as a private limited company and was later converted into a public limited company on July 9, 1987. PCL is listed on Pakistan Stock Exchange Limited (formerly Karachi and Lahore Stock Exchanges) 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.

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

Power Cement Limited (PCL) operates in the South Zone; currently operating with Line 1 and Line 2 and is in the process of adding Line 3. Rationale for line 3 expansion includes rising demand and enhancing market share in an industry where a number of peers are undergoing/completed expansion. Total rated capacity of Line 1 and Line 2 is 0.9m tons per annum. With the completion of Line 3 (7,700 tons per day), rated capacity for cement production is expected to reach around 3.4m tons per annum. Efficiency of the new plant will compare to that of top-tier players with 85kwh per ton of cement and 720 kcal per kg of clinker for electricity and coal consumption, respectively.

Market share of PCL decreased in the South Zone in terms of installed capacity during the outgoing year due to commencement of 3 major new plants. Topline of the company has grown at a CAGR of 9% over the last five years (2012-2017). Sales mix of the company is dominated by local sales with proportion of local dispatches in total sales having increased given higher domestic demand and favorable retention prices. Given the significant depreciation in Pakistani rupees, contribution margins on exports have improved with increase in quantum of exports having been noted in recent months. Despite ongoing expansion, management has continued to focus on enhancing capacity utilization and efficiency of existing plant. Resultantly, capacity utilization increased to 73% (FY17: 54%; FY16: 57%) during 9MFY18.

Progress on Line 3 till June'2018:

- Equipment Supply contracts were signed with FLSmidth & Co. (Danish global engineering company) and supervision contract was signed with Cement Plant Consultants of Denmark, both during 2017. Around 70% of the shipments have been received till date.
- 98% of mechanical and electrical drawings have been completed. The design of the grid station is being done by the contractor M/s Midas Engineering. Civil work has started while the erection of the plant is expected to commence once civil work is completed.
- The contract for the civil construction and mechanical erection work was signed with a leading Chinese contractor, CEEC Tianjin Electric Power Construction Limited. Over half of the civil work has been completed.

Facility Structure:

Project cost of Line 3 is estimated at Rs. 25b (Inclusive of IDC, Contingencies and Buffer for exchange rate fluctuation); 65% of the project cost is being financed through debt (Rs. 16.197b) while the rest of the funding has been raised via equity. The following funding sources have been arranged by PCL:

Funding Source	Amount	Description
Local Debt Syndicate (Islamic Finance)	PKR 12.1 Billion (after scale-down)	Led by NBP and HBL. Total 10 lenders are in the Syndicate.
Foreign Debt Syndicate (Islamic Finance)	EUR 35 Million equiv.	Including Islamic Corporation for Development (ICD), Saudi Arabia; OPEC Fund for International Development (OFID), Austria; DEG MBH, Germany
Local Equity raising	PKR 7.4 Billion	Proceeds from right share issue already received.
Foreign Equity raising	EUR 11 Million	Consortium of FLSmidth& Co. (Danish global engineering company),IFU (Danish Investment

		Fund) and IIP (IFU Investment Partners)

Total term of the loan is 8.5 years (inclusive of grace period of 2.5 years). The expansion is expected to go live in the last quarter of fiscal year FY19 with repayment of principal commencing from January 2021. Structural features of the project finance debt facility include:

- **Project Cost Overrun Support:** Corporate and Personal guarantees of key sponsors for funding cost overruns during construction, upon first demand from lenders. The project cost overrun support shall be uncapped.
- **Debt Payment Shortfall Support:** Available for the first 2 years of expanded plant's operations, for the local currency portion (around 75% of the facility amount) of the total facility. The remaining foreign currency portion (25%) of the facility is guaranteed for the entire debt tenor.
- **Devaluation & Contingency Buffer** to the tune of Rs. 1.9b is incorporated in the project cost.
- Formation of a **Debt Payment Account (DPA)** such that the balance in the DPA will be equal to the total semi-annual debt installment seven days prior to each due date. Moreover, sponsors will have the option to provide an SBLC, as an alternate risk mitigating item for the Lenders, if required.

Key Rating Drivers

- **Strong Sponsor Profile & Facility Structure:** The assigned rating to PCL is underpinned by financial profile and demonstrated track record of support of parent entity and sponsor family. The support is reflected in interest-free loan provided by sponsors in the past and project cost overrun support and debt payment shortfall support provided for line III expansion. JCR-VIS anticipates support from sponsors for PCL if needed, as has already been demonstrated in the past. Rating also incorporates structural features of the debt facility which are expected to mitigate time & cost overrun and devaluation risk.

- **Industry Dynamics:** As per JCR-VIS, the cement sector is now projected to enter competitive phase with pressure expected on selling prices and rising cost of inputs. Demand outlook for the sector is expected to post a stable growth on the back of ongoing infrastructure projects under China Pakistan Economic Corridor and demand for housing and commercial space. However, slow-down in economic growth, increase in interest rates and delay in infrastructure projects may impact projected demand growth. After witnessing significant decline during FY18, JCR-VIS expects industry margins to remain under pressure in FY19 on account of rupee depreciation and expected increase in competition, particularly in the South region; however, decline in coal prices may offer some respite. Expansion projects of three players (Lucky Cement in Dec'2017, ACPL in Jan'2018 and DGKC in May'2018) representing around two-third of existing capacity have come online over the last 6-8 months. While the marketing arrangement has largely operated smoothly post expansion, JCR-VIS expects prices to become more competitive given the supply side surpluses in the mid-term.

- **Market Position:** Ratings take into account PCL's existing market position (lower market share, efficiency and gross margins) and brand strength which currently compares less favorably to peers. However, the same is expected to improve significantly with completion of planned expansion.

- **Profitability and Liquidity:** Given the decline in margins, profitability and funds generated from operations has depicted weakening during FY17 and 9MFY18. Going forward, profitability will be a function of quantum of dispatches where increasing competition and lower quota in the ongoing year are expected to be major challenges. A mix of cash generated from operations and borrowings will be used for funding current maturity of long-term debt and capex on existing lines. Interest during construction for expansion is already a part of the project cost while repayment of principal of debt acquired for expansion will be paid from cash flows of the new plant.

- **Debt Servicing Coverage:** With the completion of line III, dispatches and gross margins are projected to increase significantly. Key risk to timely debt servicing includes inability to pass on increase in cost of production and lower than projected growth in demand resulting in greater than anticipated competition leading to lower margins. Under revised assumption of coal prices and factoring in higher electricity tariff, cushion in debt servicing is projected to decline significantly unless increase in cost of production is passed on. During FY18, industry players have not been able to pass on increase in coal prices which has impacted margins and cash flows.

- **Capitalization and Funding:** During the outgoing year, the company successfully concluded its right shares issuance process resulting in strengthening of capital base. Consequently at end-March'2018 share capital of the company increased to Rs. 10.6b (2016: Rs. 3.66b). Leverage indicators have trended upwards due to rise in debt levels. Going forward, leverage indicators will increase further as debt drawdown for planned expansion picks pace. Despite significant rupee depreciation during FY18, management has communicated that overall project cost is expected to remain within the stipulated limit on account of contingency and devaluation buffers already built in the project cost. However, JCR-VIS will continue to monitor overall project cost for escalations, if any, and sources used for funding of the same will be tracked.

- **IT infrastructure:** The company has completed implementation of a new Enterprise Resource Planning (ERP) system (Microsoft Dynamics) consisting of various integrated modules such as finance, sales and marketing, procurement and inventory. This will facilitate in improving the overall control environment.

Power Cement Limited — Appendix I

FINANCIAL SUMMARY					(Amounts in PKR Millions)
BALANCE SHEET	**31-Mar-18**	**30-Jun-17**	**30-Jun-16**	**30-Jun-15**	**30-Jun-14**
Fixed Assets	13,360	5,248	4,445	4,423	4,403
Stock-in-Trade	248	225	165	285	177
Trade Debts	465	331	271	259	143
Cash and Bank Balances	2392	3809	15	47	5
Total Assets	18,499	11,387	6,243	5,988	5,785
Trade and Other Payables	672	784	723	608	935
Long Term Debt(Including current maturity & Deferred Accrued Markup)	5,353	587	1,018	1,400	2,335
Total Equity	11,276	8,394	2,348	1,862	1,428
INCOME STATEMENT	**31-Mar-18**	**30-Jun-17**	**30-Jun-16**	**30-Jun-15**	**30-Jun-14**
Net Sales	3,310	4,481	4,144	3,831	3,496
Gross Profit	618	981	947	971	344
Operating Profit	397	808	713	667	6
Profit After Tax	289	467	486	433	-74
RATIO ANALYSIS	**31-Mar-18**	**30-Jun-17**	**30-Jun-16**	**30-Jun-15**	**30-Jun-14**
Gross Margin (%)	18.7	21.9	22.8	25.3	9.9
Manufacturing Margin (%)	19.4	21.6	22.7	24.9	10.1
FFO	155	179	376	673	3.3
FFO to Total Debt	0.04	0.11	0.24	0.44	0
Debt Leverage (x)	0.64	0.36	1.66	2.22	3.05
Gearing (x)	0.48	0.20	0.67	0.83	1.52
ROAA (%)	2.6	5.0	7.9	7.4	-1.3
ROAE (%)	3.9	7.7	20.8	26.4	-5.1

ISSUE/ISSUER RATING SCALE & DEFINITIONS

Appendix II

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

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

(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

'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.

REGULATORY DISCLOSURES — Appendix III

Name of Rated Entity	Power Cement Limited
Sector	Cement and Construction
Type of Relationship	Solicited
Purpose of Rating	Entity & Facility Rating

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: FACILITY				
Oct 02, '18	A			Finalized and reaffirmed
July 10, '17	A			Preliminary
RATING TYPE: ENTITY				
Oct 02, '18	A-	A-2	Stable	Re-affirmed
July 10, '17	A-	A-2	Stable	Initial

Facility Structure

Debt Facility of Rs. 16.197b with total term of the loan of 8.5 years (inclusive of 6 years repayment period and 2.5 years grace period). Structural features of the Project Finance debt facility include:

- **Project Cost Overrun Support:** Corporate guarantee and Personal guarantees of key sponsors for funding cost overruns during construction, upon first demand from lenders. The project cost overrun support shall be uncapped.
- **Debt Payment Shortfall Support:** Available for the first 2 years of expanded plant's operations, for the local currency portion (three-fourths of the facility amount) of the total facility. The remaining, foreign currency portion (25%) of the facility will be guaranteed for the entire debt tenor.
- **Devaluation & Contingency Buffer** to the tune of Rs. 1.9b is incorporated in the project cost.
- Formation of a **Debt Payment Account (DPA)** such that the balance in the DPA will be equal to the total semi-annual debt installment seven days prior to each due date. Moreover, sponsors will have the option to provide an SBLC, as an alternate risk mitigating item for the Lenders, if required.

Statement by the Rating Team

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.

Probability of Default

JCR-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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