RATING REPORT

Power Cement Limited (PCL)

REPORT DATE:
October 29, 2019

RATING ANALYST:

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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	Negative		Stable	
Facility (Bank Loan)	A (blr)		A (blr)	
Rating Date	*October 25, 2019*		*October 02, 2018*	

COMPANY INFORMATION

Incorporated in 1981	**External auditors:** KPMG Taseer Hadi & Co., Chartered Accountants
Public Limited Company	**Chairman:** Mr. Nasim Beg
Key Shareholders (with stake 5% or more):	**CEO:** Mr. Muhammad Kashif Habib
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%	

APPLICABLE METHODOLOGY(IES)

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

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 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 with an installed capacity of 3.2m MT and 3.5m MT of clinker and cement, respectively. During August 2019, the company commissioned its Line 3 which encompasses cement capacity of 2.5m MT per annum. Total rated capacity of Line 1 and Line 2 is 0.9m tons per annum. Efficiency of the new plant compares to top-tier players with 85kwh (Old plant- 135kwh) per MT of cement and 720 kcal (Old plant- 990 kcal) per kg of clinker for electricity and coal consumption, respectively. Furthermore, the management is under negotiations with Chinese suppliers for installation of Waste Heat Recovery (WHR) plant which is expected to yield around 25% power savings.

Progress on Line III till June 2019:

During June 2019, PCL completed the procurement and installation of plant and machinery pertaining to 7,700 TPD clinker production plant and 8,500 TPD cement production plant. The plant has been procured from FLSmidth & Co. (Danish global engineering company). Total cost of the project was Rs. 25b, around one-third of which was funded through equity (right shares and foreign investment) while the remaining was financed through a long term syndicate debt. Amidst sizeable currency devaluation during the outgoing year, escalated project cost was partly funded through conversion of FCY loan and equity.

Key Rating Drivers

Strong sponsor profile & demonstrated track record of support

The assigned rating to PCL is underpinned by demonstrated track record of support of parent entity and sponsor family. Sponsor support is reflected in provision of interest-free sponsor loan in the past, project cost overrun support and debt payment shortfall support provided for line 3 expansion. Rating also incorporates structural features of the debt facility obtained for line 3 expansion.

Weak sector dynamics

- Cyclical nature of the cement industry is a key business risk factor. As per VIS, the cement sector has now entered competitive phase with slowing demand growth and increasing capacities exerting pressure on selling prices which has been compounded by rising cost of inputs. For players operating in the South zone, comfort is drawn from opportunity to export surplus capacities which will result in relatively higher utilization levels vis-à-vis players operating in the North.
- The industry witnessed a dip in dispatches in the outgoing fiscal year on account of general slowdown in the economy (lower GDP growth and increasing interest rates) resulting in subdued local demand and delay in disbursement of budgeted PSDP. Given the sizeable expected contraction in the large scale manufacturing sector in FY20, cement dispatches are expected to remain under pressure in FY20. Significant capacity additions and slowdown in demand has impacted the outlook of the sector. Demand patterns synchronizing with substantial supply side dynamics will continue to be an important rating driver, going forward. In this regard, timely commencement

of construction of dams and government's housing scheme is expected to support dispatches and sector outlook.

- Overall capacity utilization has declined and is expected to witness further pressure given sizeable capacities projected to come online in the North zone. Resultantly, pricing power is expected to remain constrained while competition is expected to intensify. Players in the South zone are expected to fare better in terms of capacity utilization given the greater export potential.
- Overall cement industry dispatches increased by 1% in FY19; local dispatches declined by 3% while exports grew by 37%. While overall dispatches from the South increased during FY19, cement dispatches from the North zone depicted a decline of 7%. During 1QFY20, cement dispatches in the South zone declined by 32.1%.

Industry Dispatches (m MT)	FY15	FY16	FY17	FY18	FY19
North					
Local	23.44	27.05	29.14	33.97	31.94
Exports	4.47	3.85	3.15	3.08	2.51
Total North Dispatches	**27.91**	**30.91**	**32.29**	**37.05**	**34.45**
South					
Local	4.76	5.95	6.51	7.18	7.94
Exports	2.73	2.02	1.51	1.67	4.01
Total South Dispatches	**7.49**	**7.97**	**8.02**	**8.84**	**11.95**
Total Industry					
Local	28.20	33.00	35.65	41.15	39.88
Exports	7.20	5.87	4.66	4.75	6.52
Total Industry Dispatches	**35.40**	**38.87**	**40.32**	**45.89**	**46.40**

- Export avenue for South players are expected to support utilization levels and partly limit the risk of oversupply and price competition. While rupee devaluation has improved margins on exports, margin on local sales still compare favorably than exports. Margins on exports are still significantly lower vis-à-vis local sales. Cost pressures are expected to escalate in the backdrop of cumulative 35% PKR devaluation (offsetting 34% drop in coal prices), higher power tariffs, increase in duties (FED) and rise in transportation cost amid imposition of new axle load restrictions.

Market position expected to improve with commencement of new line.
Market share of PCL in terms of dispatches in the South zone declined to 4.8% (FY18: 7.5%) as well as in the overall industry to 1.3% (FY18: 1.4%) during FY19. Decline in market share is partly attributable to commencement of new production lines by other players. Going forward, given completion of Line III expansion, market position of the company is expected to improve with market share expected to be around 20% based on installed capacity.

Profitability to witness growth on the back of market share and margin improvement. Demand dynamics along with raw material prices (coal and electricity tariff) would remain important determinants for quantum of profitability improvement
Given the increase in market share owing to commencement of new line, sales volume of the company is expected to increase significantly. This along with higher average retention prices (to pass on increase tariff and transportation charges) will result in higher overall revenues. Proportion of export sales in sales mix will increase with sales mix targeted at around 60:40 in terms of local and export sales. Major export markets will include Sri Lanka, Bangladesh and other African countries.

Higher efficiency of the new plant is expected to facilitate in significant improvement in gross margins vis-à-vis current levels. However, margin improvement is expected to be lower vis-à-vis initially envisaged given the weakening in sector dynamics. Quantum of margin improvement will depend on ability to pass on raw material and cost escalation which is expected to remain constrained in the current demand supply dynamics. However, overall profitability shall remain under pressure on account of higher finance cost due to increase in interest rates and higher borrowings to fund expansion.

Liquidity profile to remain constrained due to sizeable debt servicing cost over the rating horizon.
Given constrained profitability in the outgoing year, cash flow indicators have remained under pressure in FY18 and FY19 with FFO to Total Debt and FFO to Long Term Debt declining to 0.5% (FY18: 0.8%, FY17: 12%) and 0.7% (FY18: 0.9%, FY17: 50%) during 9MFY19, respectively. Consequently, debt service coverage ratio has also been reported on the lower side.

In line with profitability increase in FY20, cash flows are also projected to grow. However, the challenging operating environment may to some extent, impact the debt service ability. Comfort is drawn from sponsor support to cover debt payment shortfall. Debt payment shortfall support is 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.

Elevated leverage indicators
Equity base of the company improved in FY18 on account of issuance of right shares. Leverage indicators have trended upwards on a timeline basis owing to rise in debt levels to fund expansion and increasing working capital requirements. Long term debt on balance sheet only comprises syndicate finance facility for line 3 expansion; repayment of which shall commence from FY21. Short term debt is elevated at end-March 2019 owing to sales tax paid on imported machinery, imposition of which has been contested by the Company. Over the next two years, leverage indicators are expected to remain elevated given management plans to avail suppliers' credit for installation of WHR plant. Subsequently, management projects gradual improvement in leverage indicators on the back of higher profit generation and repayment of long-term debt.

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 (PCL) Appendix I

FINANCIAL SUMMARY *(amounts in PKR millions)*			
BALANCE SHEET	**FY17**	**FY18**	**9MFY19**
Fixed Assets	5,248	19,843	27,829
Long term Investments	13	13	14
Stock-in-Trade+ Stores, spares and loose tools	1,225	1,369	1,730
Trade Debts	331	456	638
Cash & Bank Balances	3,588	1,122	376
Total Assets	11,387	24,517	33,523
Trade and Other Payables	784	1,845	1,296
Long Term Debt	360	9,570	15,930
Short Term Debt	1,108	1,033	4,083
Total Debt	1,468	10,603	20,013
Paid Up Capital	3,657	10,634	10,634
Total Equity	8,394	11,299	11,340
INCOME STATEMENT			
Net Sales	4,481	4,343	3,051
Gross Profit	981	675	312
Operating Profit	808	358	38
Profit Before Tax	565	349	(53)
Profit After Tax	467	320	41
RATIO ANALYSIS			
Gross Margin (%)	21.9%	15.5%	10.2%
Net Margin	10.4%	7.4%	1.3%
Trade debts/Sales	7%	11%	16%
FFO	179	89	81
FFO to Total Debt (%)	12%	0.8%	0.5%
FFO to Long Term Debt (%)	50%	0.9%	0.7%
Current Ratio (x)	2.6	1.4	1.0
(Stock+ Trade Debts)/ Short term borrowing	140%	177%	58%
Debt Servicing Coverage Ratio (x)	1.3	0.7	1.0
Gearing (x)	0.17	0.94	1.76
Leverage (x)	0.36	1.17	1.96
ROAA (%)	5%	2%	0.2%
ROAE (%)	9%	3%	0.5%

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 & Facility Rating				
Rating History	**Rating Date**	**Medium to Long Term**	**Short Term**	**Rating Outlook**	**Rating Action**
			RATING TYPE: FACILITY		
	October 25, '19	A			Reaffirmed
	Oct 02, '18	A			Finalized and reaffirmed
	July 10, '17	A			Preliminary
	Rating Date	**Medium to Long Term**	**Short Term**	**Rating Outlook**	**Rating Action**
			RATING TYPE: ENTITY		
	October 25, '19	A-	A-2	Negative	Maintained
	Oct 02, '18	A-	A-2	Stable	Reaffirmed
	July 10, '17	A-	A-2	Stable	Initial
Instrument 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	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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