RATING REPORT

Power Cement Limited (PCL)

REPORT DATE:
November 9, 2020

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	Stable		Negative	
Facility (Bank Loan)	A (blr)		A (blr)	
Rating Date	*November 9, 2020*		*October 25, 2019*	

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 *(May 2019)*
http://vis.com.pk/kc-meth.aspx

Power Cement Limited

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. Total rated capacity of Line 1 and Line 2 is 0.9m tons per annum, and 2.5m MT per annum for Line 3 which came online in January 2020.

Line 3 plant is operational

In January 2020, the Line 3 became operational at around 60-70% capacity utilization. The plant achieved 100% capacity utilization from July onwards to date. To recall, the Line 3 is a 7,700 TPD clinker production plant and 8,500 TPD cement production plant. The plant had been procured from FLSmidth & Co. (Danish global engineering company).

Furthermore, the WHR plant has now been installed and commissioned. It is expected to yield around 25% power savings.

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.

Cement sector dynamics are improving

- Over the past couple of years, cement sector had entered competitive phase with increasing capacities exerting pressure on selling prices which had been compounded by rising cost of inputs. Demand patterns synchronizing with substantial supply side dynamics will be important for improvement in sector dynamics. In this regard, timely commencement of construction of dams and government's housing scheme is expected to support dispatches and sector outlook.

- Cyclical nature of the cement industry is a key business risk factor. The cement industry is going through an expansionary cycle whereby significant capacities have been added over the last 3 years. The expansion cycle has almost completed with installed capacity expected to increase from 47m tons in 2017 to around 70m tons once the expansion cycle is completed.

- Given government focus on construction of dams and housing, demand is expected to recover during ongoing fiscal year. Industry profitability is expected to improve due to soft coal prices and lower interest rates.

Market position expected to improve further with complete utilization of new line

Market share of PCL in terms of local dispatches increased to 9.1% (FY19: 7.4%) in 9MFY20. Improvement in market share is attributed to increase in volumetric sales. Given commencement of Line 3 operations, market position of the company is expected to be around 20% based on installed capacity.

During July 2020, PCL reported market share of 20% during July 2020. During last 3-4 months, PCL not only strengthened its foothold in the market but also captured around 24% market share during September. The same trend is expected to continue.

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

Sales increased by 16% in 9MFY20 to Rs. 2.6b (FY19: Rs. 3.0b). During the two months of July and August 2020, the company reported sales of Rs. 3.6b. 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 (supported by initiation of WHR plant) is facilitating improvement in gross margins. Quantum of margin improvement will depend on ability to pass on raw material and cost escalation which has improved in the current demand supply dynamics. Overall profitability is expected to improve with higher quantum of sales, increase in gross margin and lower finance cost due to decrease in interest rates.

Given limited principal repayments over the next two years, debt servicing coverage is expected remain satisfactory

Cash flows were constrained in 9MFY20. Long-term debt outstanding was Rs. 18.0b at end-9MFY20. Long term debt on balance sheet only comprises syndicate finance facility for line 3 expansion. Repayment of long-term debt has been restructured such that the first repayment of Rs. 1.5b that was scheduled for January 2021 will now commence in July 2023. Given limited principal repayments over the next two years, debt servicing coverage is expected remain satisfactory.

Elevated leverage indicators

Equity base declined in 9MFY20 on account of accumulated losses. Leverage indicators have increased owing to decrease in equity and increase in short term debt to fund working capital requirements. 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	FY18	FY19	9MFY20
Fixed Assets	19,843	32,942	35,858
Long term Investments	13	14	15
Stock-in-Trade+ Stores, spares and loose tools	1,369	1,535	2,079
Trade Debts	456	386	415
Cash & Bank Balances	1,122	625	116
Total Assets	24,517	40,008	44,089
Trade and Other Payables	1,845	3,535	4,072
Long Term Debt	9,570	18,135	18,003
Short Term Debt	1,033	4,904	7,863
Total Debt	10,603	23,040	25,866
Paid Up Capital	10,634	10,634	10,634
Total Equity	11,299	12,222	10,585
INCOME STATEMENT			
Net Sales	4,343	3,051	2,647
Gross Profit	675	312	(143)
Operating Profit	358	38	(583)
Profit Before Tax	349	(53)	(2,487)
Profit After Tax	320	41	(1,750)
RATIO ANALYSIS			
Gross Margin (%)	15.5%	10.2%	-5.4%
Net Margin	7.4%	1.3%	-66.1%
Trade debts/Sales	10.5%	12.7%	11.8%
FFO	89	(332)	(149)
FFO to Total Debt (%)	0.8%	-1.4%	-0.8%
FFO to Long Term Debt (%)	0.9%	-1.8%	-1.1%
Current Ratio (x)	1.4	0.7	0.5
(Stock+Trade Debts)/ Short term borrowing	176.7%	39.2%	31.7%
Debt Servicing Coverage Ratio (x)	0.7	(4.3)	0.5
Gearing (x)	0.94	1.89	2.44
Leverage (x)	1.17	2.27	3.17
ROAA (%)	1.8%	0.1%	-5.5%
ROAE (%)	3.2%	0.3%	-20.4%

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	see table below

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: FACILITY				
November 9, '20	A			Reaffirmed
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				
November 9, 20	A-	A-2	Stable	Maintained
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.
Meeting with	Baleeghuddin – Head of Treasury Tahir Iqbal – Chief Financial Officer
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