# RATING REPORT

# Power Cement Limited (PCL)

**REPORT DATE:**
November 30, 2021

**RATING ANALYST:**

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## RATING DETAILS

| Rating Category | Indicative 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*** | *November 30, 2021* | | *November 09 , 2020* | |

## COMPANY INFORMATION

| | |
|---|---|
| **Incorporated in 1981** | **External auditors:** A.F. Ferguson & Co., Chartered Accountants, a member firm of the PwC network |
| **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%<br>Arif Habib Equity (Private) Limited- 19.54%<br>Arif Habib Corporation Limited- 7.28%<br>Mr. Syed Salman Rashid- 5.6% | |

## APPLICABLE METHODOLOGY(IES)

**VIS Entity Rating Criteria** *(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.

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 is principally engaged in the manufacturing, selling, and marketing of cement. The company operates in the South Zone, and has three manufacturing lines with cumulative clinker production capacity of 10,700 tons per day. Product portfolio encompasses Ordinary Portland Cement & Sulphate Resistant Cement, with approximately 93% and 7% share in sales mix respectively. The company sharply increased exports to Bangladesh and China during FY20, and also entered into African markets in FY21.

| Sales Breakup | FY18 | FY19 | FY20 | FY21 |
|---|---|---|---|---|
| Local | 99% | 99% | 89% | 79% |
| Exports | 1% | 1% | 11% | 21% |

During FY21, the new clinker production plant became online as part of capacity expansion plans initiated by the company in 2017. The project involved construction of Line III manufacturing facility incorporating 7,700 TPD clinker production plant and 8,500 TPD cement production plant. The cement plant commenced operations in 2020. During FY21, capacity utilization of all cement and clinker plants collectively stood at 54% (FY20: 32%) and 73% (FY20: 44%) respectively, while the capacity utilization of new line's clinker and cement plant were 101% and 71%, respectively.

Local Debt component of the Bank Loan, rated by VIS, was restructured in September 2020 under SBP's Debt Relief Scheme. The restructuring agreement incorporates the following revisions:

- Downward revision of profit rate to 6M KIBOR+1.5% from 6M KIBOR+2.25% per annum;
- Increase in loan tenor to 10 years (inclusive of 4 years grace period) from 8.5 years (inclusive of 2.5 years grace period). Principal repayment will commence in July 2022.

Furthermore, the company has entered into Supplemental Project Funds Agreement post Restructuring Agreement of local debt whereby sponsors have agreed to provide debt payment shortfall support during operations to local lenders for four years post commercial operations. Debt payment shortfall support for the foreign loan remains for the complete tenor.

All changes to loan terms remain positive.

**Rating Drivers**

**Strong sponsor support**

Ratings draw comfort from the strong sponsor profile of Arif Habib Group which is a leading industrial and financial conglomerate in Pakistan. The sponsor has provided support through securing the company's long term debt, and through project cost overrun and debt payment shortfall provisions for Line III expansion. Furthermore, the sponsor has injected equity in form of preference shares amounting to Rs. 2.4b during FY21 thus strengthening the equity base of the company; and is expected to provide further support going forward as need arises.

During the last quarter ended Sept 30, 2021, additional sponsor loan of Rs. 1.59b was extended for cash flow support. Ratings remain dependent upon the debt payment shortfall support available to local lenders for four years post commercial operations of Line III, and complete tenor for the foreign loan.

**Pressure on cement industry dynamics**

International coal prices are witnessing significant growth amid post-pandemic recovery due to global energy demand and supply shocks, with coal currently trading above $220/ton. With coal being a significant cost driver for cement manufacturers, players are bound to absorb price increase given limited capacity to pass on prices to consumers. Consequently, production costs for players using coal-based captive plants are also witnessing increase due to rise in power costs. As a result, cement players are likely to witness margin erosion in the short-term until coal prices normalize which are expected during CY22 thus improving industry's outlook going forward.

On the demand-side front; industry's fourth expansion cycle matches with economic growth of the country which will provide boost to the sector. During Q1'FY22, local dispatches witnessed 4% increase on a YOY basis. It is expected that local demand will remain strong going forward as the government continues its focus to promote the housing and construction sector. On the other hand, exports witnessed 44% decrease during Q1'FY22 vis-à-vis SPLY on account of increase in freight costs globally due to supply chain disruptions amid post-pandemic recovery period.

**Renewable energy projects in the pipeline leading to cost-efficiencies going forward**

Existing power requirements of the company stands at 35MW. The new Waste Recovery System (WHRS) which came online during FY21 fulfills 10MW of energy requirements through reuse of heat emission, while the rest is provided by national grid. Reliance on renewable energy source has led to 25% reduction in production costs during FY21, and the company is keen on further reducing energy costs by continuing focus on self-generation through solar and wind energy projects. The management is currently finalizing agreements for installation of captive power plants with prospective bidders. The projects will be under the Power Purchase Agreement (PPA) basis, thus requiring minimal capital expenditure.

**Strong revenue and profitability growth**

Sales revenue grew significantly to Rs. 14.2b (FY20: Rs. 4.1b) during FY21 driven by 135% increase in dispatches with commencement of new line. Sales in Q1'FY22 stood at Rs. 4.1b. With sizeable revenue growth, market share in the overall industry increased to 5.0% (FY20: 2.1%) during FY21 with market share in the south zone standing at 31.9% (FY20: 8.9%). Sales mix depicts increase in exports on a timeline basis; however the company plans to reduce the share going forward given lower margins vis-à-vis local sales.

Gross margins rose to 21.7% (FY20: (2.8)%) during FY21 due to 6% higher retention and operational efficiencies achieved with new plant operations. Selling and administrative expenses increased in tandem with sales growth, while an exchange gain amounting Rs. 336m was reported during the outgoing year due to exchange rate fluctuations as opposed to exchange loss of Rs. 257m reported during the previous year. Consequently, operating margins increased to 13.6% (FY20: (24)%) during FY21. Finance costs were lower during FY21 on account of lower interest rates, resulting in net margins of 2.5% (FY20 :(88)%) during FY21. Gross margins were maintained at 20.3% during Q1'FY22 while operating margins reduced to 10.1%. Net margins declined to (4.6)% in during the outgoing quarter due to high finance costs. Going forward, management foresees increase in volumetric sales in tandem with in industry growth while improvement in margins is expected on account of cost reduction through renewable energy projects.

**Pressure on debt servicing coverage**

During FY21, cash flow coverage remained constrained with Funds from Operations (FFO) reported at Rs. (669)m (Q1'FY22: Rs. (322)m; FY20: Rs. (1,193)m). Pressure on debt servicing continues till such time production efficiencies ramp up. Shortfall in debt servicing (Q1'FY22: 0.5x; FY21: 0.5x, FY20: (0.5)x) was met through issuance of preference shares in FY21 for Rs.2.4b and subsequent extension of sponsor's loan at the end of Q1'FY22. As per management, improving operational efficiencies including rationalization of raw material and power cost will remain key focus areas. Achievement of projected growth and margin improvement will be important for ratings going forward.

**Elevated capitalization indicators**

During FY21, equity base of the company increased to Rs. 10.7b (FY20: Rs. 8.5b) during FY21 on account of profitability and issuance of preference shares amounting to Rs. 2.4b. Leverage and gearing ratios therefore declined to 3.23x (FY20: 4.37x) and 2.62x (FY20: 3.40x) during FY21, however the same remains on the higher side. Capitalization indicators remained within similar levels during Q1'FY22 with leverage and gearing levels standing at 3.21x and 2.79x, respectively. Total debt increased minimally during FY21, and encapsulates long term financing including syndicate finance undertaken for Line III expansion and term loans, as well as short term financing for working capital requirements. Management expects gradual improvement in capitalization indicators going forward with repayment of debt obligations and projected growth in profitability.

## Power Cement Limited (PCL) — Appendix I

| FINANCIAL SUMMARY *(amounts in PKR millions)* | | | | | |
|---|---|---|---|---|---|
| **BALANCE SHEET** | **FY18** | **FY19** | **FY20** | **FY21** | **Q1'FY22** |
| **Fixed Assets** | 19,843 | 32,942 | 37,271 | 36,308 | 36,118 |
| **Long term Investments** | 13 | 16 | 24 | 25 | 25 |
| **Stock-in-Trade+ Stores, spares and loose tools** | 1,369 | 1,535 | 2,151 | 2,898 | 2,574 |
| **Trade Debts** | 456 | 386 | 419 | 275 | 286 |
| **Cash & Bank Balances** | 1,122 | 625 | 332 | 255 | 219 |
| **Total Assets** | 24,517 | 40,273 | 45,501 | 45,492 | 45,232 |
| **Trade and Other Payables** | 1,845 | 3,535 | 6,285 | 5,273 | 3,562 |
| **Long Term Debt** | 9,570 | 19,048 | 19,186 | 19,744 | 19,972 |
| **Short Term Debt** | 1,033 | 4,904 | 9,672 | 8,360 | 9,996 |
| **Total Debt** | 10,603 | 23,952 | 28,858 | 28,104 | 29,968 |
| **Paid Up Capital** | 10,634 | 10,634 | 10,634 | 10,634 | 10,634 |
| **Total Equity** | 11,299 | 11,574 | 8,479 | 10,745 | 10,744 |
| **INCOME STATEMENT** | | | | | |
| **Net Sales** | 4,343 | 3,858 | 4,113 | 14,221 | 4,114 |
| **Gross Profit** | 675 | 157 | (116) | 3,090 | 837 |
| **Operating Profit** | 358 | (256) | (988) | 1,928 | 416 |
| **Profit Before Tax** | 349 | (412) | (3,967) | (671) | (222) |
| **Profit After Tax** | 320 | 582 | (3,622) | 358 | (190) |
| **RATIO ANALYSIS** | | | | | |
| **Gross Margin (%)** | 15.5% | 4.1% | -2.8% | 21.7% | 20.3% |
| **Operating Margin (%)** | 8.2% | -6.6% | -24.0% | 13.6% | 10.1% |
| **Net Margin (%)** | 7.4% | 15.1% | -88.0% | 2.5% | -4.6% |
| **Trade debts/Sales*** | 10.5% | 10.0% | 10.2% | 1.9% | 1.7% |
| **FFO** | 89 | (108) | (1,193) | (669) | (322) |
| **FFO to Total Debt (%)*** | 0.8% | -0.5% | -4.1% | -2.4% | -4.3% |
| **FFO to Long Term Debt (%)*** | 0.9% | -0.6% | -6.2% | -3.4% | -6.4% |
| **Current Ratio (x)** | 1.4 | 0.7 | 0.4 | 0.4 | 0.4 |
| **(Stock+Trade Debts)/ Short term borrowing** | 176.7% | 39.2% | 26.6% | 38.0% | 28.6% |
| **Debt Servicing Coverage Ratio (x)*** | 0.7 | (0.6) | (0.5) | 0.5 | 0.5 |
| **Gearing (x)** | 0.94 | 2.07 | 3.40 | 2.62 | 2.79 |
| **Leverage (x)** | 1.17 | 2.48 | 4.37 | 3.23 | 3.21 |
| **ROAA (%)*** | 1.8% | 1.6% | -8.4% | 0.8% | -1.7% |
| **ROAE (%)*** | 3.2% | 5.1% | -36.1% | 3.7% | -7.6% |

**Annualized*

## 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** | | |
| | | **Nov 30, '21** | A(blr) | | Stable | Reaffirmed |
| | | **Nov 09, '20** | A(blr) | | Stable | Maintained |
| | | **Oct 25, '19** | A(blr) | | Negative | Maintained |
| | | **Oct 02, '18** | A(blr) | | | Finalized and reaffirmed |
| | | **Jul 10, '17** | A(blr) | | | Preliminary |
| | | **Rating Date** | **Medium to Long Term** | **Short Term** | **Rating Outlook** | **Rating Action** |
| | | | | **RATING TYPE: ENTITY** | | |
| | | **Nov 30, '21** | A- | A-2 | Stable | Reaffirmed |
| | | **Nov 09, '20** | A- | A-2 | Stable | Maintained |
| | | **Oct 25, '19** | A- | A-2 | Negative | Maintained |
| | | **Oct 02, '18** | A- | A-2 | Stable | Reaffirmed |
| | | **Jul 10, '17** | A- | A-2 | Stable | Initial |

**Instrument Structure**

Debt Facility of Rs. 16.2b with total term of the loan of 10 years (inclusive of 6 years repayment period and 4 years grace period). Pricing is 6M KIBOR plus 150 basis points per annum. Structural features of the Project Finance debt facility include:

- **Debt Payment Shortfall Support:** Available for the first 4 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.
- 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.

**Disclaimer**



**Due Diligence Meeting Conducted**

| S.No | Name | Designation | Date |
|---|---|---|---|
| 1 | Baleeghuddin | Head of Treasury | 15 Oct 2021 |
| 2 | Tahir Iqbal | Chief Financial Officer | 15 Oct 2021 |