# RATING REPORT

# Lucky Cement Limited (LCL)

**REPORT DATE:**
February 19, 2020

**RATING ANALYST:**

Talha Iqbal
*talha.iqbal@vis.com.pk*

Asfia Aziz
*asfia.aziz@vis.com.pk*

| Rating Category | Latest Rating | |
|---|---|---|
| | **Long-term** | **Short-term** |
| **Entity** | AA+ | A-1+ |
| **Rating Outlook** | Stable | |
| ***Rating Date*** | *February 19, 2020* | |

| COMPANY INFORMATION | |
|---|---|
| **Incorporated in 1993** | **External auditors:** A. F. Ferguson & Co. Chartered Accountants |
| **Public Limited Company** | **Chairman:** Mr. Muhammad Yunus Tabba |
| **Key Shareholders (with stake 5% or more):** | **CEO:** Mr. Muhammad Ali Tabba |
| *Directors and Spouse- 19.48%*<br>*Sponsors- 18.34%*<br>*Associated Companies, Undertakings & related parties- 22.85%*<br>*Mutual Funds- 5.94%*<br>*General Public (Local)- 8.84%*<br>*General Public (Foreign)- 15.29%* | |

| APPLICABLE METHODOLOGY(IES) |
|---|
| **VIS Entity Rating Criteria** ***(April 2019)***<br>https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Corporate-Methodology-201904.pdf |

# Lucky Cement Limited

## OVERVIEW OF THE INSTITUTION

Lucky Cement Limited (LCL) was incorporated on September 18, 1993 as a public limited company. LCL is listed on Pakistan Stock Exchange Limited as well as London Stock Exchange, with the head office situated in Karachi, and regional office located in Pezu, KPK. Further, the Company's liaison offices are situated in Islamabad, Quetta, Multan, D.I.Khan, Lahore and Peshawar. The company has two production facilities at Pezu, District Lakki Marwat in Khyber Pakhtunkhwa and at Main Super Highway in Karachi, Sindh. The company is engaged in manufacturing, selling and marketing of cement.

**Profile of Chairman**

Mr. Muhammad Yunus Tabba possesses more than 50 years of experience spanning across various sectors. He has also been awarded "Businessman of the year" by the Chamber of Commerce several times during his career. Furthermore, in recognition of his services rendered in the field of entrepreneurship and public service, he has been bestowed with the award of "Sitara-e-Imtiaz" by the President of Islamic Republic of Pakistan.

**Profile of CEO**

Mr. Muhammad Ali Tabba also serves as the CEO of Yunus Textile Mills Ltd (YTML), a state-of-the-art home textile mill and the largest exporter of home textile products from Pakistan. Mr. Tabba also serves in the capacity of

## RATING RATIONALE

**Diversified presence and strong financial profile of sponsor is a key rating driver**

Lucky Cement Limited (LCL) is a part of the Yunus Brother Group (YBG) which is a leading conglomerate with strong financial profile and has diverse presence across multiple sectors. Ratings assigned to LCL draw support from strong financial profile and diversified presence of sponsor.

**Consistently strong operating performance with the Company being an efficient and low cost producer**

LCL caters to both North and South markets of the country through its production facilities located in Pezu and Karachi. Recently in December 2019, the company successfully commenced its brownfield expansion of 2.8m MT per annum at its Pezu plant in the North. With the addition of new line, total installed cement capacity increased to 12.15m MT from 9.35m MT per annum previously. Ratings also reflect LCL being one of the most efficient players as reflected by lowest cost per ton in the cement sector.

**Investments to represent significant portion of total assets and earnings over the medium term reflecting a well-diversified business risk profile.**

Around 28% (Rs. 35.1b) of the total asset base comprises long term investments in subsidiaries and associated companies at end-September'19. Investment portfolio is diversified across a wide array of sectors including Power, Automobile, Pharmaceutical, Healthcare, Polyester, Animal Health and Chemicals & Agri Sciences.

**Cement sector has recently entered competitive phase with increasing capacities exerting pressure on selling prices which has 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 is expected to be completed in the ongoing fiscal year with installed capacity expected to increase from 47m tons in 2017 to 70m tons once the expansion cycle is completed. 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 local dispatches in the outgoing fiscal year on account of general slowdown in the economy (lower GDP growth and increasing interest rates along with government's policy of demand compression). 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.

**Leading market position**

Market share of LCL in terms of overall dispatches stood at 16.4% during FY19. Market share in exports was reported on the higher side at 27.9% (FY18: 23.8%) during FY19. LCL's overall market share in terms of dispatches was higher than market share based on installed capacity

Vice Chairman on the Board of ICI Pakistan Limited and is also the Chairman of KIA Lucky Motors. Moreover, Mr. Tabba also serves in the role of Chairman Lucky Electric Power Company Limited. Mr. Muhammad Ali Tabba was awarded the "Sitara-e-Imtiaz" by the President of Islamic Republic of Pakistan in 2018.

during 1QFY20 signifying strong dealer network and market penetration.

**Efficient operations, strong balance sheet and surplus liquidity have facilitated in maintaining a satisfactory profitability profile despite challenging operating environment. Profitability indicators (ROAA and ROAE) to revert to normal levels over the medium term once dividend income from investments materialize and sector dynamics improve**

Gross sales of the Company remained around year level in FY19. Proportion of exports in overall sales stood at around 15% (FY18: 8.5%) and is expected to increase given healthy demand outlook from exporting countries and excess supply situation in the local market. In line with industry trend, gross margins of the Company have witnessed a declining trend and were reported at 15.5% (FY19: 29.1%; FY18: 35.7%) in 1QFY20. However, gross margins compare favorably to peers. Profitability profile has historically been supported by sizeable cash balances and dividend income from investments. Recently, borrowings have been mobilized to fund investments; however, impact of finance cost on profitability is expected to remain limited given utilization of concessionary rate (primarily ERF and FE-25) borrowings. Profitability indicators (ROAA and ROAE) have been impacted in recent years on account of sizeable investments and capital expenditure undertaken. VIS expects profitability indicators to revert to normal levels over the medium term once dividend income from investments materializes and cement sector dynamics improve.

**Strong liquidity profile as evident from healthy cash flows, strong coverages and surplus liquidity on balance sheet.**

Over the years, LCL has consistently generated healthy cash flow from operations which has resulted in accumulation of surplus liquid on balance sheet. Excess cash flow has allowed the Company to undertake significant investments and capital expenditure over the last three from internally generated cash. Adjusted funds flow from operations (FFO including other income) was reported at Rs. 14.1b during FY19 (FY18: Rs. 16.1b) and Rs. 1.9b during 1QFY20. Working capital cycle is satisfactory while receivable and inventory days have been maintained within manageable levels. Recently, short term borrowings have been mobilized and stood at Rs. 3.35b at end-Sep'2019. Stock in trade and trade debts are well in excess of short term borrowings while current ratio has historically remained consistently at over 1(x).

**Low leverage indicators, conservative financial policy and healthy internal capital generation depicts sound capitalization profile**

Equity base of the Company has grown at a CAGR of 12.3% over the past four years on account of healthy internal capital generation. Dividend payout ratio of the Company has ranged between 20%-35% while the Company has followed a policy of pursuing capital expenditure from internally generated cash. Owing to a conservative financial policy, the company has historically remained debt free. Recently debt has been mobilized; quantum of the same remains modest given size of cash flows and LCL's existing equity base. While cash requirements are expected to remain elevated to fund investments during the ongoing calendar year, VIS expects gearing levels to remain below 0.1(x) over the rating horizon.

**Sound corporate governance framework supported by a well-designed organizational structure, experienced management team and strong disposition towards transparency and disclosures**

LCL has instituted a well-designed organizational structure comprising separate departments for key functions. All divisions have independent management teams and organizational structure. Board composition is in line with best practices while effective oversight mechanism is in place through functioning board committees. Detailed annual report disclosures reflect strong disposition towards transparency and disclosures.

## Lucky Cement Limited (LCL) Appendix I

| FINANCIAL SUMMARY- Unconsolidated (Rs. in m) | | | | | |
|---|---|---|---|---|---|
| **BALANCE SHEET** | **FY16** | **FY17** | **FY18** | **FY19** | **1QFY20*** |
| Fixed Assets | 33,887 | 37,488 | 40,913 | 57,276 | 58,773 |
| Long term Investments | 12,422 | 13,314 | 24,981 | 34,314 | 35,116 |
| Stock-in-Trade + Stores and Spares | 7,582 | 8,403 | 10,580 | 11,063 | 11,517 |
| Trade Debts | 2,182 | 1,583 | 2,424 | 2,059 | 2,470 |
| Short term investments | 400 | 45 | 35 | 1,056 | 1,074 |
| Cash & Bank Balances | 26,806 | 33,738 | 27,435 | 15,657 | 12,948 |
| Total Assets | 85,909 | 97,337 | 108,999 | 125,089 | 125,638 |
| Trade and Other Payables | 8,551 | 9,159 | 13,121 | 19,196 | 18,219 |
| Long Term Debt | - | - | - | - | - |
| Short Term Debt | - | - | - | 2,900 | 3,350 |
| Total Debt | - | - | - | 2,900 | 3,350 |
| Paid Up Capital | 3,234 | 3,234 | 3,234 | 3,234 | 3,234 |
| Total Equity | 69,323 | 79,785 | 86,367 | 94,318 | 93,165 |
| | | | | | |
| **INCOME STATEMENT** | | | | | |
| Net Sales | 45,135 | 45,687 | 47,542 | 48,021 | 9,629 |
| Gross Profit | 21,746 | 21,298 | 16,952 | 13,984 | 1,492 |
| Profit Before Tax | 18,400 | 18,778 | 15,119 | 12,221 | 1,022 |
| Profit After Tax | 12,944 | 13,692 | 12,197 | 10,490 | 956 |
| | | | | | |
| **RATIO ANALYSIS** | | | | | |
| Gross Margin (%) | 48.2% | 46.6% | 35.7% | 29.1% | 15.5% |
| Net Margin (%) | 28.7% | 30.0% | 25.7% | 21.8% | 9.9% |
| Net Working Capital | 29,777 | 36,024 | 27,718 | 9,801 | 6,453 |
| Adjusted FFO | 16,025 | 16,488 | 16,084 | 14,091 | 1,879 |
| FFO to Total Debt (%) | NA | NA | NA | 486% | 224% |
| FFO to Long Term Debt (%) | NA | NA | NA | NA | NA |
| Debt Servicing Coverage Ratio (x) | | NA | NA | NA | 95.56 |
| Gearing (x) | - | - | - | 0.03 | 0.04 |
| Current Ratio (x) | 4.10 | 4.48 | 2.82 | 1.42 | 1.26 |
| STD Coverage | NA | NA | NA | 452% | 418% |
| ROAA (%) | | 15% | 12% | 9% | 3% |
| ROAE (%) | | 18% | 15% | 12% | 4% |

**Ratios Annualized*

*** FFO Adjusted for dividend income*

## 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.

<table>
<tr><th colspan="6">REGULATORY DISCLOSURES — Appendix III</th></tr>
<tr><td>Name of Rated Entity</td><td colspan="5">Lucky Cement Limited</td></tr>
<tr><td>Sector</td><td colspan="5">Cement and Construction</td></tr>
<tr><td>Type of Relationship</td><td colspan="5">Solicited</td></tr>
<tr><td>Purpose of Rating</td><td colspan="5">Entity Rating</td></tr>
<tr><td rowspan="3">Rating History</td><td>Rating Date</td><td>Medium to Long Term</td><td>Short Term</td><td>Rating Outlook</td><td>Rating Action</td></tr>
<tr><td colspan="5"><u>RATING TYPE: ENTITY</u></td></tr>
<tr><td>19/02/2020</td><td>AA+</td><td>A-1+</td><td>Stable</td><td>Initial</td></tr>
<tr><td>Instrument Structure</td><td colspan="5">N/A</td></tr>
<tr><td>Statement by the Rating Team</td><td colspan="5">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.</td></tr>
<tr><td>Probability of Default</td><td colspan="5">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.</td></tr>
<tr><td>Disclaimer</td><td colspan="5">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. VIS is not an NRSRO and its ratings are not NRSRO credit ratings. Copyright 2020 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.</td></tr>
<tr><td rowspan="2">Due Diligence Meetings Conducted</td><td></td><td colspan="2">Name</td><td>Designation</td><td>Date</td></tr>
<tr><td>1</td><td colspan="2">Mr. Irfan Chawala</td><td>CFO</td><td>21-Jan-2020</td></tr>
</table>