RATING REPORT

Pakistan Cables Limited (PCL)

REPORT DATE:
October 11, 2019

RATING ANALYSTS:

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RATING DETAILS				
	Latest Rating		Previous Rating	
Rating Category	Long-term	Short-term	Long-term	Short-term
Entity	A	A-1	A	A-1
Rating Date	*October 11, 2019*		*September 4, 2018*	
Rating Outlook	Stable		Stable	
Rating Action	*Reaffirmed*		*Initial*	

COMPANY INFORMATION	
Incorporated in 1953	**External auditors:** KPMG Taseer Hadi & Co. Chartered Accountants
Public Listed Company	**Chairman of the Board:** Mr. Mustapha A. Chinoy
Key Shareholders (with stake 5% or more)	**Chief Executive Officer:** Mr. Fahd Kamal Chinoy
Directors, CEO, Spouses & Family Member – 48.87%	
Associated Cos., Undertakings and Related Parties – 17.12%	
Mutual Funds – 9.33%	
General Public & Others – 17.62%	
Banks, DFIs and Insurance Companies – 7.06%	

APPLICABLE METHODOLOGY(IES)
Applicable Rating Criteria: Industrial Corporates (May, 2016)
https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Corporate-Methodology-201904.pdf

Pakistan Cables Limited (PCL)

OVERVIEW OF THE INSTITUTION

In 1953, Pakistan Cables Limited (PCL) was incorporated as a private limited company. Subsequently, in 1955 it was converted to a public limited company. Registered office of the company is located in Karachi, Pakistan.

Profile of Chairman

Mr. Mustapha A. Chinoy holds a BSc in Economics from Wharton School of Finance, University of Pennsylvania. He has been a member of PCL's board since 1986. Apart from PCL, Mr. Mustapha also chairs the board of International Industries Limited.

Profile of CEO

Mr. Fahad K. Chinoy has been part of PCL's board since 2017. He became CEO of PCL in July 2019. He holds an MBA from INSEAD and a BA in Economics and Political Science from the University of Pennsylvania, USA. He is also a Director of Focus Humanitarian Assistance Pakistan and Amir Sultan Chinoy Foundation and is a certified director from PICG.

RATING RATIONALE

Pakistan Cables Limited (PCL) is engaged in manufacture of copper rods, wires, cables & conductors, aluminum extrusion profiles (alumex) and PVC compounds. Majority shareholding of the company is vested with the Chinoy Group, either directly or indirectly through a related party. PCL has been in the business of manufacturing wires & cables for almost six decades and operates as a listed public limited company presently. The company initiated production of conductors, wires and cables for transmission and distribution of electricity in 1953 but has expanded its production facilities over time to diversify its product offerings. Timeline of addition of other facilities is indicated as follows:

- PCL is integrated upstream for two of its critical raw material inputs, copper rod and polyvinylchloride (PVC) compound. In 1996, the company set up a plant to manufacture High Conductivity Oxygen Free copper rod. Resultantly, PCL's wires are manufactured using 99.99% pure oxygen free copper rods to date. In view of the increased demand, the production capacity of the plant has been regularly enhanced over the years.
- In 1979, PCL commenced extrusion of aluminum rod from billets. In 1984, the production facility was upgraded to manufacture anodized aluminum profile sections for architectural applications.
- In 2008, PCL set up a PVC compounding plant to manufacture high quality electric cable grade PVC compounds.
- The company also installed a 2-MW gas-fired tri-generation power plant which currently caters to around half of PCL's aggregate power requirement.

The company uses only London Metal Exchange registered 'A' grade copper cathodes for production of copper rods. At present, the company operates through a single manufacturing facility in SITE, Karachi. During FY19, the company commenced development of new factory premises in Nooriabad, Sindh in order to enhance its manufacturing capabilities and create efficiencies in its internal processes. Management expects installation of new plants and transfer of existing plants to the new facility by end-FY22.

Rating Drivers:

Business risk profile is characterized by temporary slowdown in demand on account of lower projected GDP growth, high competition from the informal sector and imports and risk of margin attrition due to currency devaluation. However, overall business risk profile is supported by stable and growing demand for wires & cables in the long run

The wiring & cable industry is characterized by significant competition with presence of several large players and numerous small unorganized firms. Organized sector caters to 20% of the market demand, while the remaining proportion is satisfied by the unorganized sector. Business to business segment is exposed to competition from Chinese imports while retail sales face competition from informal manufacturers. Given the customs duty and sales tax exemptions provided by the government, imports of wires and cables from China have witnessed considerable growth during the last few years. Moreover, a downturn has been witnessed in the Pakistani's economic growth with GDP growth rate declining to 2.8% (FY18: 5.8%) in FY19. Resultantly, a reduction in consumer demand and investment activity may result in lower demand for wires and cables in the short run. Other key business risk factors include volatility in international metal prices (both copper and aluminum) and rupee depreciation.

VIS expects demand for wires & cables to remain stable over the medium term to long term as GDP growth recovers. Moreover, with the government's recent efforts to document economy, share of the organized sector may increase as tax burden on the undocumented sector will make their products more expensive. Risk of volatility in metal prices is also considered manageable through efficient procurement.

Sound sponsor profile, experienced management team and strong market position of the company provide comfort to the ratings

The assigned ratings incorporate PCL's position as one of the leading cables & wiring manufacturers in the country. Moreover, the extensive experience and track record of the management team is also a key rating driver. As per management, consistency is one of the key competitive strengths of the company and the same is achieved through the manufacturing expertise it has gained over a long period of time. Senior management has largely remained stable over the years. Mr. Fahd Kamal Chinoy (Deputy CEO) replaced Mr. Kamal Chinoy (former CEO) as the Chief Executive Officer (CEO) of the company in July 2019. Majority shareholding of the company is held by Chinoy Group of Companies, which also owns International Industries Limited and International Steels Limited.

Slowdown in economic activity resulted in only modest growth in topline of the company in FY19; however, the overall profitability of the company witnessed considerable reduction primarily on account of higher marketing and finance costs. Management anticipates a challenging year ahead from profitability perspective due to sluggish demand, uncertainty in exchange rate and higher borrowings costs

Net sales of the company continued to witness an increasing trend in FY19 (FY19: Rs. 9.70b; FY18: Rs. 9.56b) on account of increase in prices; however, the growth in topline was modest in comparison to the preceding year due to slowdown in industrial and construction activity. Client wise concentration risk in sales is considered to be manageable with top 10 clients accounting for 30.6% (FY18: 31.1%) of total net sales in FY19. Top 2 clients, which constituted approximately 18% of the company's sales in FY19, have very long term association with the company, thereby reducing the sales concentration risk. Gross profit for FY19 amounted to Rs. 1.15b (FY18: Rs. 1.14b). Gross margins of the company were reported slightly lower at 11.8% (FY18: 11.9%) as rupee depreciation translated to higher costs of inputs, all of which could not be transferred to the customers, especially to the retail segment customers.

Marketing, distribution and selling expenses registered sizeable growth of 16.3% by increasing to Rs. 509.8m (FY18: Rs. 438.3m) in FY19. The increase was mainly on account of higher advertising expenses, which the management believes were essential to maintain brand reputation. Finance costs also increased significantly to Rs. 188.6m (FY18: Rs. 133.6m) as a result of higher interest rates along with increase in the quantum of debt to fund expansion plans. Higher finance and advertisement costs coupled with other factors such as higher effective tax rate due to absence of tax credit and impairment loss on an associate investment translated to a lower net profit of Rs. 126.2m (FY18: Rs. 305.3m). Net margins of the company were reported at 1.3% (FY18: 3.2%). Going forward, management expects another challenging year in view of lower demand resulting from economic slowdown, uncertainty in exchange rate and higher borrowings costs. However, management also expects profitability to recover in the medium to long term with recovery in the GDP growth rate.

Liquidity profile of the company is considered adequate

In line with decrease in profitability of the company and sizeable cash outflow pertaining to tax, Funds from Operations (FFO) of the company was reported lower at Rs. 162.9m (FY18: Rs. 458.9m). Decrease in FFO coupled with an increase in borrowings of the company resulted in lower FFO in relation to long term debt (FY19: 0.2x; FY18: 1.3x) and FFO in relation to total debt (FY19: 0.1x; FY18: 0.2x). Stock in trade and trade debts provide adequate coverage for short term borrowings, while current ratio is also considered satisfactory as it remained above 1.0x at end-FY19. Working capital cycle has depicted increase on a timeline basis, due to which cash flow from operations is restricted. Going forward, management plans to focus on collection of receivables in order to reduce the Days Sales Outstanding (DSO) and improve cash flow management.

Capitalization indicators have improved in FY19 primarily on account of right share issuance; leverage indicators may trend upwards due to additional borrowing for expansion project but are expected to remain at manageable level

Equity base (excluding revaluation surplus on assets) of the company registered an increase to Rs. 3.3b (FY18: Rs. 2.7b) at end-FY19. The increase was achieved primarily on the back of right share issuance. Dividend payout ratio for FY19 amounted to 70.5% (FY18: 64.1%). In order to fund capex, quantum of long term borrowings was also increased to Rs. 789.4m (FY18: Rs. 358.1m) at end-FY19. However, given the greater increase in equity vis-à-vis borrowings, both gearing and debt leverage ratios improved to 0.7x (FY18: 0.8x) and 1.09x (FY18: 1.29x) at end-FY19. With additional funding requirements for future expansion, long term borrowings may witness further increase in the short term. Hence, leverage ratios will increase but are expected to remain manageable. At present, cash flows remain adequate to service borrowings as indicated by debt servicing coverage ratio of 1.4x (FY18: 3.1x).

Presence of sound corporate governance framework

Overall corporate governance framework is supported by adequate board composition and oversight. Overall board composition is line with the best practices. In order to ensure effective oversight, two committees exist at Board level, namely the Audit Committee and Human Resource and Remuneration Committee. Governance framework is supported by documented policies, procedural framework along with focus on transparency as evident from governance related disclosures in the annual report which provide important information for stakeholders.

Pakistan Cables Limited (PCL) Appendix I

FINANCIAL SUMMARY			*(amounts in PKR millions)*
BALANCE SHEET	**FY17**	**FY18**	**FY19**
Fixed Assets	2,166	2,186	3379
Stock-in-Trade	1,915	1,955	2203
Trade Debts	1,319	1,971	2089
Cash & Bank Balances	53	573	88
Total Assets	5,790	7171	8432
Trade and Other Payables	1,316	1,096	813
Long Term Debt	263	358	789
Short Term Debt	922	1779	1,499
Total Equity	2,008	2,654	3255
INCOME STATEMENT	**FY17**	**FY18**	**FY19**
Net Sales	8,084	9561	9704
Gross Profit	1,268	1,137	1146
Administrative Expenses	230	249	266
Marketing, Selling and Distribution Cost	406	438	510
Other Income	98	41	55
Finance Cost	66	134	189
Taxation	146	38	50
Profit After Tax	479	305	126
RATIO ANALYSIS	**FY17**	**FY18**	**FY19**
Gross Margin (%)	15.7	11.9	11.8
Net Margin (%)	5.9	3.2	1.3
Net Working Capital	1,180	1882	2277
FFO	628.6	458.9	163.0
FFO to Total Debt (x)	0.5	0.2	0.1
FFO to Long Term Debt (x)	2.4	1.3	0.2
Gearing (x)	0.6	0.8	0.7
Debt Leverage (x)	1.33	1.29	0.81
Debt Servicing Coverage Ratio (x)	9.43	3.14	1.39
Current Ratio	1.50	1.63	1.84
(Trade Debts+ Stock in trade) / Short Term Borrowings	3.51	2.21	2.86

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: 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	Pakistan Cables Limited
Sector	Cable & Wire Manufacturing
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see table below
Instrument Structure	N/A
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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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
10/11/2019	A	A-1	Stable	Reaffirmed
8/30/2018	A	A-1	Stable	Initial