RATING REPORT

Engro Polymer and Chemicals Limited

REPORT DATE:
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RATING ANALYSTS:

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RATING DETAILS

	Latest Rating	
Rating Category	**Long-term**	**Short-term**
Entity	AA-	A-1+
Rating Date	*July 19, 2018*	
Rating Outlook	Stable	
Outlook Date	*July 19, 2018*	

COMPANY INFORMATION

Incorporated in 1997	**External auditors:** A.F. Fergusons & Co. Chartered Accountants
Public Limited Company	**Chairman of the Board:** Ghias Khan
Shareholders having stake of more than 5%: Engro Corporation Limited- 56.19% Mitsubishi Corporation- 10.24%	**Chief Executive Officer:** Imran Anwer

APPLICABLE METHODOLOGY(IES)

Applicable Rating Criteria: Industrial Corporates (May, 2016) http://www.jcrvis.com.pk/kc-meth.aspx

Engro Polymer and Chemicals Limited (EPCL)

OVERVIEW OF THE INSTITUTION

Pattern of Shareholding depicts that Engro Corporation Limited (ENGRO) has a shareholding of 56.2% in the company followed by Mitsubishi Corporation holding 10.24% of EPCL's shares as on December 31, 2017. General local public holds 12.43% shares of the company.

Profile of Chairman

Mr. Ghias Khan is the President and CEO of ECORP. Before this position, Mr. Khan has held several executive and board roles across Dawood Hercules Group companies.

Profile of CEO

Mr. Imran Anwer assumed the charge of CEO in 2015. He is a Chartered Accountant and possesses over 20 years of experience. Prior to this position, he has held senior level positions at Engro Foods and has worked for PwC Karachi and Deloitte & Touche Jeddah.

RATING RATIONALE

Engro Polymer and Chemicals Limited (EPCL) was incorporated in 1997. It is the only fully integrated Chlor-Vinyl Chemical Complex in Pakistan which deals in the manufacturing, marketing and distribution of Poly Vinyl Chloride (PVC) and Caustic Soda. EPCL has an installed capacity of 195,000MT of PVC and 106,000MT of Caustic Soda. The Company also operates a 65MW gas based power plant which is used for internal uses and excess power is supplied to Engro Fertilizers (related party).

EPCL has announced CAPEX plan of Rs. 10.3b which includes an addition of 100K tons of capacity on PVC and 50K tons of capacity increase in VCM on a tune of Rs. 7.6b of which 70% is being raised through fresh equity. Remaining CAPEX plan includes value addition in Chlor-Alkali segment and enhancement of operational efficiencies and is being funded through a mix of debt and internally generated cash. Post expansion, PVC capacity is expected to increase to 295,000MT with the same projected to come online by 3Q20.

Rating Drivers

Sponsor Profile

Major shareholding of EPCL is vested with a renowned conglomerate- Engro Corporation Limited (ENGRO). Sponsor has a diversified pool of investments in agri-solutions, consumer, energy infrastructure and petrochemicals. Ratings draw comfort from sponsor's strong financial profile and demonstrated track record of support to EPCL.

Market Position

EPCL is the sole manufacturer of PVC in Pakistan. PVC demand witnessed a year on year growth of 28% in 2017 to 279,000MT. Around two-third of the demand is currently being catered by EPCL with remaining demand being met through imports. Market position of the Company is expected to be strengthened post expansion with EPCL aiming to recoup lost market share due to capacity constraints. Post capacity expansion, risk of over supply remains limited with demand projected to surpass the increased capacity by 2021 with installed capacity of EPCL being 295,000MT. No new capacities have been announced or are projected to come online over the rating horizon.

EPCL is the only player in the South market in the Caustic Soda business with a market share of 29% in 2017 with remaining demand being met by Northern players.

Business Risks

- **Demand Prospects**

Demand growth of PVC has remained strong over the last five years and increased at a CAGR of 11%. Growth in demand has been driven by the construction sectors. Pipes and fittings constitute the major portion of PVC demand at over 50% followed by film/packaging, cable compound and shoes. Growth in demand has also been supported by new applications including foam board, roofing, flooring, and consumer packaging. JCR-VIS expects demand growth over the rating horizon to continue to grow on the back of healthy projected construction sector growth, development of new applications and improvement in currently lower per capita consumption of PVC against regional peers (Pakistan: 1.2kg; India: 2.3kg; Indonesia: 2.5kg).

- **International Vinyl Chain Dynamics**

Domestic prices of PVC are largely contingent on international vinyl chain. The assigned ratings incorporate rationalization of international vinyl chain where oversupply situation has reduced. Moreover supply deficit scenario has increased further, particularly in the South Asian market Demand for PVC in Asia and South Asia stood at 29m tons and 3.5m tons, respectively vis-à-vis capacity of 27m tons and 1.7m tons, respectively. Nevertheless, cyclicality in business has historically remained high due to volatility in primary raw material prices translating into moderate to high business risk. However, the company has enhanced operational efficiencies through several interventions to minimize vulnerability of unfavorable vinyl chain dynamics. Going forward, ratings are dependent on international demand-supply dynamics where JCR-VIS has been given to understand that limited international capacities of PVC are projected to come online relative to ethylene capacities which is expected to bode well for the Company.

- **Caustic Business Dynamics**

The Chlor-alkali sector comprises three players operating in the country. Overall installed capacity of the sector is higher than the demand leading to a competition driven market. Business prospects of the caustic soda sector remains positive characterized by stable and growing demand and strong margins due to cost leadership of EPCL.

Operating Performance

Over the last few years, capacity utilization has been optimal across all segments with the company operating near full capacities in both PVC (2017: 105%; 2016: 97%) and Chlor Alkali segments (2017: 99%; 2016: 97%). During 2017, the company performed debottlenecking of its PVC manufacturing unit increasing its capacity from 178,000 MT to 195,000MT. EPCL's operating performance has noted significant improvement over the last five years owing to enhanced productivity and operational efficiencies. Cost reduction initiatives and efficiency enhancement projects have resulted in lower utilization of ethylene and gas to produce PVC. Other initiatives include prudent management of fixed costs, rationalizing useful life of property plant and equipment thereby resulting in reduced depreciation charge; lower conversion costs due to higher production have translated into enhanced profitability.

Profitability Profile

Net sales of the company increased by 21% in 2017 to Rs. 27.7b (2016: Rs. 22.8b) on account of higher PVC prices and growth in volumes. Gross Margins (GMs) of both PVC and Chlor Alkali segment reported an increase in 2017. Improvement in PVC margins was due to higher PVC prices and lower ethylene prices while cost efficiencies contributed to increase in margins in both segments. Consequently overall GMs of the company increased to 22% (2016: 17%) during 2017. Increase in sales, improvement in gross margins and decline in financial charges, contributed to significant growth in profit before tax to Rs. 3.1b (2016: Rs. 1.2b) in 2017.

Liquidity

Liquidity profile of the company is considered strong in view of healthy cash flows in relation to outstanding obligations and favorable working capital cycle due to advance cash payment from customers. With current assets being greater than current liabilities, current ratio of EPCL was reported greater than 1.16(x) at end-1Q18. In absolute terms, FFO amounted to Rs. 5.2b (2016: Rs. 2.8b) during 2017 depicting a sizeable increase of 85% on account of higher profitability. Debt service coverage ratio and FFO/LTD remain healthy at 5.68x (2016: 0.94x) and 60% (2016: 31) in 2017, respectively. Given growing cash flows and projected dividend payout, healthy cash accumulation is expected over the rating horizon.

Capitalization

Capitalization indicators are adequate with gearing levels having declined significantly over the last 3 years. Gearing was reported at 1.01x (2017: 1.13x, 2016: 1.61x; 2015: 2.14x) at end-March'2018. Utilization of supplier credit has also witnessed a noticeable decline from a high of Rs. 6.6b at end-2012 to Rs. 1b at end-2017 indicating significant availability of funding if needed. Despite planned expansion, leverage indicators are projected to improve given the funding mix for expansion projects and healthy internal capital generation.

Engro Polymer and Chemicals Limited — Appendix I

FINANCIAL SUMMARY *(amounts in PKR millions)*				
BALANCE SHEET	**2015**	**2016**	**2017**	**1Q18***
Fixed Assets	16,249	16,008	16,011	16,094
Long term Investments	50	50	50	50
Stock-in-Trade	2,941	3,024	3,681	3,879
Trade Debts	437	456	505	392
Cash & Bank Balances	155	372	680	310
Total Assets	24,242	24,461	24,315	26,588
Trade and Other Payables	6,301	6,722	4,513	4,806
Long Term Debt	8,327	9,167	8,750	8,750
Short Term Debt	3,026	415	-	-
Total Debt	11,353	9,582	8,750	8,750
Total Equity	5,303	5,968	7,720	8,637
INCOME STATEMENT				
Net Sales	22,264	22,854	27,731	34,749
Gross Profit	2,773	3,935	6,065	10,000
Operating Profit/ (Loss)	778	2,107	3,930	8,758
Profit Before Tax/ (Loss)	(366)	1,180	3,109	8,127
Profit After Tax/ (Loss)	(649)	655	2,049	5,788
RATIO ANALYSIS				
Gross Margin (%)	12.5%	17.2%	21.9%	28.8%
Net Margin	-2.9%	2.9%	7.4%	16.7%
Net Working Capital	(6,781)	(2,050)	218	1,341
Trade debts/Sales	2%	2%	2%	1%
FFO	66	2,813	5,212	9,696
FFO to Total Debt (%)	1%	29%	60%	111%
FFO to Long Term Debt (%)	1%	31%	60%	111%
Current Ratio (x)	0.5	0.8	1.0	1.2
Debt Servicing Coverage Ratio (x)	NA	0.9	5.7	18.9
Gearing (x)	2.14	1.61	1.13	1.01
ROAA (%)	-3%	3%	8%	23%
ROAE (%)	-12%	12%	30%	71%

** Annualized*

ISSUE/ISSUER RATING SCALE & DEFINITION — 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: JCR-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.jcrvis.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.jcrvis.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.

'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.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-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	Engro Polymer and Chemicals Limited
Sector	Chemicals Industry
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see table below
Instrument Structure	N/A
Statement by the Rating Team	JCR-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	JCR-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				
July 19, 2018	AA-	A-1+	Stable	Initial