

KOHAT CEMENT COMPANY LIMITED (KCCL)

Ratings (June 2006)

Kohat Cement Company Limited

Entity	New	Previous
Long-term:	A	A-
Short-term:	A1	A2

Financial Data

PKR (mln)

	31-Mar-06	30-Jun-05
Total Assets	2,735.7	1,651.9
Profit After Tax	570.2*	386.5
Gross Margin %	51.55	38.72
Net Profit Margin %	34.13	22.53
Equity/Total Assets %	75.40	65.48

* For the nine months ended March 31, 2006.

Analysts

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Rating Rationale Assessment

- The ratings reflect the augmentation in the risk absorption capacity through retention of robust profits and a recent right issue. Despite an anticipated decline due to substantial capacity expansions across the sector, the overall capacity utilization and margins levels are expected to remain at reasonably comfortable levels in the wake of growing cement demand and likely continuation of producers' understating. KCCL, owing to its locational advantage and expected increase in market share through sizeable capacity enhancement, is well positioned to capitalize on the emerging business opportunities.

- The company recorded substantial increase in profitability, on the back of higher capacity utilization and increased margins. The robust growth in cement demand continued during the year, thereby boosting the capacity utilization levels across the sector. Meanwhile, margins also increased to record high levels, on the back of sharp upsurge in selling prices, emanating from a constrained supply position for most of FY06.

- The newly installed white cement dry process plant of 0.135mln tons per annum (tpa) capacity has commenced commercial production since December 01, 2005. Currently there are two other producers of white cement in the country. Due to sizeable capacity expansion by one of the main producers, the overall available capacity has increased substantially relative to demand, implying pressure on capacity utilization. However, given the relatively high level of margins, which are likely to be sustained due to a tacit understanding among producers, the overall contribution in the bottom line for KCCL is expected to be healthy, even with a dip in sales volumes. Meanwhile, the company benefited from adjustment of high initial depreciation allowance on the project cost, against robust profitability earned during the period, thus resulting in low cash outflows on account of taxation.

- In line with the sector, the company is in the process of installing a new dry cement production line of grey cement, which would raise the existing grey cement production capacity from 0.567mln tpa to 2.677mln tpa. After the completion of the project, the market share of the company in the production sharing arrangement is likely to expand. The total project cost is around PKR 4bln, which is to be financed in the debt equity ratio of 70:30. Out of the total equity share, PKR 400mln has already been raised through a recent right issue, while the remaining PKR 800mln is to be met through internal cash generation. The arrangements with financial institutions for financing the project have already been finalized. Work on the project is progressing as per schedule, and the plant is expected to commence commercial production by Jul07. The new plant is mainly based on Chinese technology, while a few important components are being imported from Europe to enhance the overall productivity and efficiency of the production process. Thus, while ensuring quality, the management has also been able to curtail the cost of expansion, which is comparatively low compared to expansions of similar size being carried out by other companies.

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Cement Sector & KCCL

- The trend of robust growth in demand persisted during the current year, leading to improvement in overall capacity utilization levels to above 90%. The growth in demand is attributable to the improved economic outlook, increased construction activity in the housing sector and industrial projects undergoing BMR, higher infrastructure spending by the government, commencement of earthquake rehabilitation activities after the end of winter season and rise in exports to Afghanistan. Despite a sizeable rise in production costs, mainly the fuel expense and transportation charges, the operating margins and hence profitability across the sector reached record high levels owing to sharp upsurge in the prices of cement in the local and export market, emanating from relatively constrained supply situation for most of the current financial year.
- In anticipation of the improving local demand and export prospects, a large number of cement manufacturers are in the process of capacity enhancements. It is expected that the country's cement production capacity will be doubled in two year's time. While the trend of robust growth in demand is likely to continue, and would be further supplemented by planned continuation of mega water reservoirs by FY09, it would be substantially less than the corresponding increase on the supply side, putting pressure on the capacity utilization from the current high levels.
- To counter the cyclical trends inherent in the sector, cement manufacturers have made a production sharing arrangement under the aegis of All Pakistan Cement Manufacturers Association (APCMA), which, despite some intermittent threats, has been holding strong over the years. This arrangement ensures stability in prices and thus margins, especially in a surplus capacity scenario through regulating supply levels of the producers, according to their rated production capacities. While, temporary disruption in this arrangement might occur, this is not expected to last, as no player has a clear edge in terms of operating efficiencies or production capacities to survive such a situation, without a material adverse financial impact. Hence, the mutual benefit of all the participants is a major factor underpinning the prospects of continuation of this arrangement in the long run.
- Going forward, with additional capacities coming on line, the gross margins are likely to decline. However, they are expected to sustain at a reasonable level, allowing a comfortable profitability and cashflow levels for the industry, even at low capacity utilization levels.
- As KCCL is undergoing substantial capacity

expansion, relative to its existing size, its market share in the production sharing arrangement is expected to increase, signifying ability to achieve higher sales volumes even at low capacity utilization. Meanwhile, its close proximity to main consumption centres and neighbouring Afghanistan, allows the company to achieve relatively higher net retention prices and the potential to tap and increasing share in the growing export market. Going forward, the overall profitability of the company is expected to improve on the back of increasing sales volumes, while a fair contribution is also expected from the newly installed white cement plant.

Capital Structure and Cashflows:

- The equity base of the company registered a substantial increase on the back of retention of strong healthy profits and recent 25% right issue at a premium of PKR 12.5 per share. The financial leverage of the company is very low at present. Despite an expected increase due to long-term debt for meeting the capex requirement for the expansion project, the overall gearing is likely to remain at a comfortable level.
- Cashflows from operating activities and financial coverages portrayed a strong increasing trend in recent years, on the back of improving level of profits. Given the strong level of cash generated from operations, the company is expected to comfortably meet the equity portion of financing of the new production line of grey cement. Going forward, with increasing profit levels, the internal cash generation capacity is expected to remain strong, resulting in strong capacity to service the financial obligations. Further, additional comfort can be drawn from the favourable structure of the long-term debt to be acquired for the expansion project, having a grace period of one and half years, and stepped up principal repayments.

Profile

- Kohat Cement Company Limited (KCCL) was established in 1980 under the State Cement Corporation of Pakistan. The company, subsequent to its privitisation in 1992, was acquired by Atta group, which currently holds around 80% of the stake. All the directors, belonging to the Atta family, are high worth individuals having the capacity to support the company in the event of any temporary liquidity crunch. The group also has major interests in real estate and hotel business. The chief executive has an extensive exposure to the cement industry and remained the Chairman of All Pakistan Cement Manufacturers Association (APCMA) for six years (Apr97-Mar03).

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Financial Summary – Kohat Cement Company Limited

(PKR mln) For the period ended	31/03/06	30/06/05	30/06/04
Credit Statistics			
EBITDA	844.9	647.1	488.9
EBITDA Net Interest Cover (x)	18.1	32.7	22.8
Current Ratio (x)	2.4	1.5	1.2
Quick Ratio (x)	1.9	1.2	0.9
Profitability			
Turnover	1,670.7	1,715.4	1,397.8
Turnover Growth	n.a.	22.72%	47.27%
EBIT	778.3	580.7	416.7
Net Income	570.2	386.5	292.7
Gross Margin	51.55%	38.72%	35.45%
Net Profit Margin	34.13%	22.53%	20.94%
Return on Equity (ROE)	n.a.	43.50%	48.92%
Return on Assets (ROA)	n.a.	25.14%	22.78%
Cash Flow			
Cash Generated by Operations prior to W/C changes	846.5	647.2	488.1
Working Capital Changes	15.1	(31.7)	(4.1)
Net Finance Charges Paid	(46.2)	(22.9)	(24.2)
Taxation & other charges Paid	(183.0)	(132.6)	(118.3)
Net Cash from Operating Activities	632.4	459.9	341.5
Capital Expenditure	(677.1)	(278.7)	(123.3)
Cash in/(out) flow from other investing activities	8.9	2.2	2.6
Cash in/(out) flow pre-financing	(31.6)	183.3	220.8
Shares Issued	410.8	-	-
Dividends Paid	(4.2)	-	(12.6)
Net Debt Decrease/ (Increase)	375.0	183.2	105.2
Opening Net Debt	35.3	(147.9)	(253.2)
Closing Net Debt	410.3	35.3	(147.9)
Capital Structure			
Short Term Debt	(129.2)	(136.7)	(126.7)
Long Term Debt	(124.3)	(117.1)	(189.3)
Total Debt	(253.5)	(253.8)	(316.1)
Less: Cash & Bank Balances	663.8	289.1	168.1
Net Debt	410.3	35.3	(147.9)
Total Equity	2,062.7	1,081.7	695.2
Total Debt/Equity	12.3%	23.5%	45.5%
Equity/Total Assets	75.40%	65.48%	48.86%

n.a. Ratios are not relevant based on quarterly information.