KOHAT CEMENT COMPANY LIMITED (KCCL)

Ratings (August 2007)

Kohat Cement Company Limited

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

Financial Data

PKR (mln)

	*31-Mar-07	30-Jun-06
Total Assets	5,620.1	3,076.1
Profit After Tax	75.32	789.8
Gross Margin %	23.79	51.55
Net Profit Margin %	6.12	33.94
Equity/Total Assets %	41.98	74.25

** Based on unaudited results for the nine months ended March 31, 2007.*

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ASSESSMENT

- The ratings reflect the cyclical nature of the cement industry, which exposes cement manufacturing companies to a relatively high business risk. Moreover, given the current supply surplus in the industry, it would be difficult for KCCL to achieve higher capacity utilization at reasonable margins in the near-term. At the same time, the ratings recognise the company's relatively low leveraged capital structure that has helped in managing the financial risk.
- For the last many years, cement producers have worked with tacit understanding in terms of capacity utilization and pricing. This arrangement has been beneficial to the industry owing to reduced price competition, ensuring a relatively high level of margins. However, with additional capacities, increasing the supply surplus, the sector has experienced weakening of the "cartel" arrangement, negatively impacting output prices and margins. Going forward, though the growth in domestic demand is likely to be maintained, it is unlikely to compensate for the emerging capacity overhang. Over the near-term, in the absence of any break-through in exports, the performance of the cement industry is likely to remain under stress and more susceptible to seasonal swings in domestic demand.
- In line with the emerging trend in the cement sector, KCCL registered significant increase in profitability in FY06 owing to higher capacity utilization and improved margins. Nevertheless, oversupply in the industry due to commencement of new capacities despite maintained growth in domestic demand pulled down cement prices resulting in diminishing profit margins during the FY07 across the industry. KCCL, despite sizeable contribution of export sales in the total turnover, ensuring higher capacity utilization, and freight-cost advantage amongst peers due to plant location, could not fully insulate its margins from the industry trend. Resultantly, the company's profitability declined sharply during FY07.
- The company's equity base, consequent to a right issue and retention of profits, improved significantly during FY06. The company's cash flows and consequently financial coverages remained strong during FY06 due to robust profitability. However, with additional borrowing for ongoing capital expenditure and pressure on cash flows on account of declining profits, the coverages have weakened during FY07. However, these remain adequate, an outcome of the management's intentional strategy of keeping the leveraging at a low level (end-Mar07 Debt: Equity = 55:45). Going forward, though the profit margins are likely to remain under pressure, the company's cash flows are expected to be augmented with commencement of new capacity resulting in significant growth in the turnover. This is expected to help in mitigating the financial risk.
- The installation of new gray cement line of 6700 tpd clinker capacity within the present premises has been delayed by a few months mainly due to extended piling work and is expected to start in the current year. Moreover, due to extended work, unfavourable changes in steel prices and the further cost related to the modification of the plant design has resulted in cost over-runs of around PKR 1.2 bln. A part of this additional cost, PKR 366 mln, is arranged through internal cash generation, while the balance is being financed through additional borrowing. After commencement of the new line, the installed capacity of grey cement would increase substantially from 0.6mln tpa to 2.7mln tpa, and the company's share in the overall sector's capacity would increase to around 6% from less than 2% at present.

KEY RATING DRIVERS

- These ratings are dependent on timely completion of the expansion project, helping the management to increase its turnover, in turn, improving the cash flows. Meanwhile, any sustained major slump in overall demand for cement adversely affecting the margins would have negative implications for the company's prospects.

PROFILE

- Kohat Cement Company Limited (KCCL), established in 1980 under the State Cement Corporation of Pakistan, was acquired by Atta group subsequent to its privatisation in 1992. The group currently holds around 70% of the stake in KCCL. The company also has a white cement production facility (capacity: 0.141mln tpa). Although currently the capacity utilization is low, the management expects the same to increase gradually.
- All the directors, belonging to the Atta family, are high net 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).