

RATINGS (JUNE 2011)

MAPLE LEAF CEMENT FACTORY LIMITED (MLCFL)

Rating	Sep-07	Dec-07	May-08	Dec-09	Dec-09	Jun-10	Jun-11
AA-							AA-
A+							A+
A							A
A-							A-
BBB+			RW				BBB+
BBB							BBB
BBB-				RW			BBB-
BB+							BB+
BB							BB
BB-							BB-
B+							B+
B							B
B-							B-
CCC							CCC
CC							CC
C							C
SD							SD
D							D

Rating Watch: RW Entity ratings:
 Negative Outlook: ⊖ Instrument ratings:

FINANCIAL DATA

	PKR mln		
	31-Mar-11 ^A	30-Jun-10	30-Jun-09
Total Assets	34,202	26,095	25,661
Total Debt	18,331	16,518	16,003
Total Equity	9,373	5,134	6,718
Turnover	9,566	13,631	15,251
Operating Profit/(Loss)	36	(567)	2,421
Net Income/(Loss)	(1,565)	(2,584)	(983)
Gross Margin (%)	15.73%	21.56%	32.49%
Debt/(Debt+Equity) (%)	66.17%	76.29%	70.43%

^A Based on unaudited accounts for nine months ended March 31, 2011

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SUKUK ISSUE

The company issued a privately placed secured Sukuk of PKR 8,000mln in Jan'08. The instrument was issued for a period of 8 years. However, MLCFL was not able to meet the due interest installment in Dec 2009, which led to restructuring of the Sukuk. Under new terms, the total tenor of the instrument is 9 years (ending Dec 2018) including a grace period of 2.75 years. The principal redemption is in 36 quarterly installments and would commence in September 2012. The markup on the issue is 3MK+100bps, which would increase to 3MK+170bps after the fifth year. The Sukuk is secured by first pari passu charge over all present and future fixed assets of the company with additional 25% margin.

RATING RATIONALE AND KEY RATING DRIVERS

- The ratings reflect MLCFL's high business risk emanating from challenging industry dynamics that resulted into low capacity utilization, in turn, subdued revenues. Meanwhile, a price war among industry players, besides raw material cost fluctuations, led to sizeable reduction in margins. However, lately prices regained strength, a result of cement manufacturers' cognizance towards margin-led recovery as demand growth at both local and export fronts may be limited. This is expected to improve overall business prospects of the company besides providing some relief to the cash flows. Nevertheless, high leveraging, suppressed cash flows, resulting in weak coverages remain key concerns. The ratings incorporate the company's diversified product mix and established brand name in the local market.
- The ratings are dependent on the management's ability to achieve optimal capacity utilization, while generating sufficient cash flows to meet its upcoming major debt service obligations. Meanwhile, any significant downfall in cement prices for a longer time span may put further pressure on overall risk profile of the company.

ASSESSMENT

- The cement industry, characterized by cyclical nature and intense competition, has experienced the weakening of tacit understanding amongst producers, thus, leading to a price war. Meanwhile, rising energy prices – comprising a major portion in total costs – coupled with lower retentions prices (particularly for first half of FY11) and plummeting demand in export markets, have adversely impacted the sector's profitability. However, price has shown signs of bottoming out and a significant price recovery in the local market has been seen lately. This coupled with a recent tax reduction, would bode well for the industry.
- MLCFL is the fourth largest cement manufacturer in Pakistan with a market share of ~7%. MLCFL's plant provides the company with the operational flexibility to offer a diversified product slate with specialized and value-added products. During FY10, the company, facing tough competition, witnessed a price driven decline in its revenues. While cost per ton remained largely stagnant, gross margins observed a decline. The company posted significant loss during the year. During initial quarters of FY11, the margins further squeezed (6MFY11: 13.8%, FY10: 21.6%). However, since the start of third quarter, cement prices increased, giving room to the margins (cumulative for 9MFY11 15.7%). While the company remained focused on margin based business, production decreased (~15%) owing to supply overhang and lower export demand. Nevertheless, the company achieved operational breakeven in 9MFY11.
- Going forward, the management expects the prices to remain stable largely at current levels. However, rise in energy prices, a key component of production cost, would be the key risk to margins. Meanwhile, local demand is likely to sustain, though export potential may observe some decline. Given the company's strong position in the local market, capacity utilization is expected to remain intact. Meanwhile, the company would focus on bringing efficiency in all areas of operations. The company has formed a logistics department with the aim to minimize distribution expenses by establishing an integrated supply-chain network. Moreover, the waste heat recovery system which became operational at end-Dec 2010 has begun generating substantial cost savings for MLCFL. However, with sub optimal capacity utilization, the plant's efficiency is still below potential. Going forward, an increase in production remains the key to realizing energy and distribution cost savings.
- Despite favorable restructuring (apart from a loan from ICD of USD \$ 12.8mln) subsequent to the company's default in 2nd Quarter FY10, MLCFL's cash flows and coverages remained under significant pressure due to the high quantum of borrowings and subdued bottom-line. Moreover, MLCFL is facing problems in availing working capital lines on account of an already high Debt to Total Capital ratio. Going forward, the availability of these lines will be critical for the company's operations.
- The company's financial risk remains high on account of a highly leveraged capital structure. In addition, short-term borrowings (STB) remained uncovered as net current assets (without taking into account STB) remained negative. This could potentially create a maturity mismatch. The company has to manage significant interest as well as principal payments of major borrowings during FY12 subsequent to expiry of their grace period. The management is expected to meet these obligations from internal sources, as long as the company's assumption regarding cement prices holds, else further restructuring would need to take place.

PROFILE

- Maple Leaf Cement Factory Limited, one of the leading cement manufacturers, was established in 1956 and is listed on all three stock exchanges of the country. The cement plant is located at Dadukhal, District Mianwali, in Northern Pakistan. The plant is based on modern European machinery with two dry process lines and two wet process lines with total capacity of 3.7mtpa. The company also has a diversified product portfolio – white cement, well head cement and conventional grey cement.
- Kohinoor Maple Leaf Group – mainly through Kohinoor Textile Mills Limited (KTML) – owns the majority stake (65%) in the company, while individuals own the rest.
- Saigol family effectively controls group companies with strong presence on the board of directors (five family members on MLCFL's board) and key management positions. Mr. Sayeed Saigol, the CEO, joined the company in 2005. He is supported by a team of professionals with adequate experience in related fields.

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