

## PIONEER CEMENT LIMITED (PCL)

### RATINGS (Jan 2008)

#### PIONEER CEMENT LIMITED (PCL)

Entity	New
Long Term	A-
Short Term	A2

### FINANCIAL DATA

	PKR (mln)	
	30-Jun-07	30-Jun-06
Total Assets	8,610.5	8,405
Equity	2,670.4	2,926.4
Turnover	3,131.5	3,075.9
Net Income	(93.5)	675.9
Gross Margin (%)	10.2	40.0
ROE (%)	(3.3)	26.1
Net Debt / Equity (%)	177.6	151.4

### ANALYSTS

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### ASSESSMENT

- The ratings reflect PCL's exposure to relatively high business risk emanating from the cyclical nature of the cement industry, accentuated by the emerging significant capacity overhang in the sector. Nevertheless, the company enjoys a competitive position in the sector, an outcome of its strong market share, strategic location in the Northern region and better export prospects. The ratings also recognize the management's pre-emptive measures to manage its financial risk through debt restructuring. The company's association with a known business group and the demonstrated ability of sponsors to lend support in times of financial distress are also key rating factors.
- In the recent period, the cement industry, with additional capacities increasing the supply surplus, has experienced weakening of the mutual understanding amongst producers in terms of capacity utilization and pricing. This has put pressure on the selling price of cement, resulting in dampening profitability for most companies during FY07. While domestic cement demand is showing consistent growth, to achieve higher capacity utilization, the industry is putting greater emphasis on tapping export markets. In this regard, the recent development regarding prospects of exports to India and the Middle East is likely to reduce the cement industry's business risk to some extent in the near-term and is expected to have a positive impact on the local market in the shape of price stability. However, if the prevailing political uncertainty in the country prolongs, it could have a depressing impact on the domestic cement demand and prices, thus impacting the sector's prospects adversely.
- PCL is one of the leading cement manufacturers in the country and holds around 5% market share. It was also one of the first companies to bring its expansion on line. In tandem with the industry trend, the company posted strong results in FY06 and FY05 (Net Income FY06: PKR 676mln FY05: PKR 332mln) on the back of robust demand and high cement prices. However, the sanguine pattern didn't continue in FY07, as the company could not insulate its margins from the industry trends. Moreover, additional costs incurred by the company relating to increased capacity, expanded distribution network and higher financial charges attributed to PCL's subdued performance. The situation did not improve in the 1Q08, as the company posted a net loss of PKR 122mln for the quarter.
- The company has established export operations in Afghanistan and also ventured in the Middle East region recently. PCL acquired Bureau of Indian Standards (BIS) certification for exports to India lately and has already secured export orders. PCL is expected to earn good margins from its export operations to India, due to its close proximity to India (via *Wagah/Lahore* boarder). Overall, PCL intends to export around 15%-20% of its total cement production. Going forward, the management is focusing on improving its margins by increasing efficiency of its plant. The company has also started using 80:20 blend of imported and local coal that will help reduce its energy cost and impact the margins positively. These steps augur well for the overall profitability of the company.
- The gearing of the company is currently high and there is significant maturity mismatch, as indicated by PCL's low current ratio. The management is planning to re-profile its debt structure to manage this situation and intends to issue a Sukuk bond. Given the current maturity pattern of its obligations, it is imperative that the company raises funding to restructure its borrowings. The recently concluded 17.5% right issue (around PKR 360mln) at a premium (PKR 2) would improve the equity base of the company, improving the leveraging of the company as well. The cashflow generation ability of the company was adversely impacted due to lower prices and subdued performance in FY07 and 1QFY08, also distorting the coverage ratios. With improved business prospects, this trend is likely to be arrested. PCL enjoys favourable credit terms with its suppliers as reflected by its net cash cycle surplus. This helps the company in managing its working capital requirements. The debt restructuring, while lowering the financial cost, is also expected to synchronize the debt repayment with the emerging cashflow pattern.

### Key Rating Drivers

- The ratings are dependent on successful and timely completion of debt re-profiling and management's ability to effectively utilize new capacity to improve turnover, in turn, margins and cashflows. The sustainability of the export operations, especially in the medium-term, also remains critical. Meanwhile, failure in restructuring of debt on favorable terms, a prolonged price war – resulting in diminishing margins – or a major slump in cement despatches demand in the domestic market would have negative implications for the ratings.

### Profile

- Pioneer Cement Limited, established in 1986 and listed on all three stock exchanges, is a part of Noon Group. The group, through its various members, controls the majority stake (60%) in the company. First National Equity Limited (FNE), a leading brokerage house, is the other major stakeholder (around 9% shareholding), while various financial institutions, insurance companies and general public own the rest.
- The group has established presence in the textile machinery, sugar, trading and food sectors. Noon family, known industrialists of Pakistan, effectively controls group companies, including PCL with strong presence on the board of directors.
- The CEO of the company has been associated with Noon group for over 35 years and is a veteran of the cement industry. He has been with PCL since its inception. The top management is supported by a team of professionals with extensive experience in project development and cement industry.