



Rating Action

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PACRA DOWNGRADES RATINGS IN THE CEMENT INDUSTRY

PACRA has downgraded four cement companies and anticipates a difficult operating environment for the cement sector in the foreseeable future. PACRA views business risk to be on the rise, even though the industry currently enjoys healthy gross margins backed by sustained higher sales prices and recent decrease in variable costs. However, an already 20% decline in local dispatches and slumping expected demand in the upcoming season are all signals that the local market demand is dwindling. Sales in otherwise expanding and lucrative export market are likely to be adversely affected due to the global slowdown, including Pakistan’s export markets – India, Afghanistan, and the UAE. Consequently, the export window, which, in any case, was considered to be for a limited time, is narrower, now with the downturn. The decrease in demand and increase in capacity due to recent plant expansion may precipitate a price war amongst domestic manufacturers. On the domestic front, a thin ray of hope exists for a pickup in cement demand if the government executes the allocated, but as yet unutilized, PKR300bln worth of PSDP (Public Sector Development Programme). Performance prospects are further diminished when heightening financial risk is factored into the equation. A to date 33% rise in the cost of borrowing in the current year, expected to increase further, has stretched the coverages of most cement companies leading to decline in operating profitability and distressed cashflows. The consolidated impact of the aforementioned factors upon the sector translates into significant decline in its risk absorption capacity and propensity to repay its contractual obligations, hence warranting pressure on credit ratings.

RATING ACTION

Entity	Long-Term Rating		Short-Term Rating		Debt Instrument	
	New	Previous	New	Previous	New	Previous
Maple Leaf Cement Factory Limited	BBB+	A	A2	A2	A-	A+
Pioneer Cement Limited	BBB	A-	A3	A2	Sukuk (PKR 8,000mln)	
Kohat Cement Company Limited	BBB-	A-	A3	A2		
Dewan Cement Limited	BB	A-	B	A2	BB+	A
					Proposed TFC (PKR 5,000mln)	

RATING RATIONALE AND KEY DRIVERS

1. **Maple Leaf Cement Factory Limited (MLCFL)**

The downward adjustment in the ratings is based upon a significant increase in financial risk likely to distress the capital structure, and weakening industry dynamics that are expected to further subdue the performance. Nonetheless, the ratings take into account the demonstrated, strong sponsor support enjoyed by the company in view of its association with a reputed business group. It also reflects the relatively lower business risk afforded by the company on account of its strong franchise and established brand name, diversified product mix, flexible production facility configuration, robust plant design and export-favorable strategic location.

The ratings are dependent upon the company's ability to strike a balance between minimizing erosion of margins and utilize its large capacity by increasing turnover and hence maintaining positive cashflows. Meanwhile, equity support from the sponsors and further deterioration in the financial risk remain critical factors for the ratings.

2. **Pioneer Cement Limited (PCL)**

The ratings reflect the heightening financial risk of the company, as repeated attempts to reprofile debt have hitherto remained largely unsuccessful. Furthermore, performance prospects are likely to be on the decline as business risk increases industry-wide. Nonetheless, the ratings recognize the company's current robust sales volumes, established market presence and strategic geographical location favoring exports. Moreover, the demonstrated ability of the sponsors to support the company in times of financial constraints continues to support the ratings.

The ratings remain dependent upon prudent management of the financial risk through debt reprofiling. Simultaneously, PCL's ability to sustain present export volumes leading to adequate utilization of its expanded capacity to achieve economies of scales, hence protecting margins, continuing support from the sponsors and any further deterioration in the financial risk remain critical factors for the ratings

3. **Kohat Cement Company Limited (KCCL)**

The ratings reflect the mounting business risk for the company underlying its constrained ability to augment profitability through improvement in turnover as the capacity expansion plan fails to materialize in a timely manner. Meanwhile, the financial risk of the company is on the rise due to increasingly higher borrowing costs. Nonetheless, the ratings recognize the company's relatively low-leveraged capital structure affording it higher risk absorption capacity. These ratings are dependent upon the company's ability in successfully utilizing its expected expanded capacity for improving margins and cash flows and to capitalize upon its advantageous plant



location to enhance turnover, though increasingly difficult in the existing demand dynamics. Meanwhile, deterioration in financial risk profile and continued support from the sponsors remain critical factors.

4. Dewan Cement Limited (DCL)

The ratings reflect a relatively significant deterioration in the financial risk profile of the company as major initiatives to reprofile debt have yet not materialized, leading to renewed urgency to meet contractual obligations. Furthermore, different options being explored by the sponsors to restructure the company's business model have hitherto remained unsuccessful. Also, in its currently weakened state, the impact of deteriorating cement sector dynamics, is likely to be magnified, specially, in view of subdued sponsor financial strength. The ratings are dependent upon the company's ability to achieve a breakthrough in restructuring of company's assets and/or liabilities. Also, continued sponsor support and material reduction in leveraging would be supportive factors for the ratings.

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