



The Pakistan Credit Rating Agency Limited

Rating Report

Fecto Cement Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
27-Sep-2019	A-	A2	Stable	Maintain	-
30-Mar-2019	A-	A2	Stable	Maintain	-
18-Dec-2018	A-	A2	Stable	Maintain	-
07-May-2018	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Fecto Cement has a single manufacturing capacity, located in north region, with an annual cement capacity of 0.8mln tons. The Company's sales are majorly driven by local market fundamental – an industry wide phenomenon. However, Fecto exported a minuscule part to India and Afghanistan - viable export markets given geographical location of the company. During FY19, industry dynamics especially for cement players operating in north region have shifted significantly on account of fluctuating cement prices, increase in FED on coal import and depreciation in Pak Rupee against other currencies. Along with these factors, muted local demand has affected the company's sales whereby volumetric sales went down. The aforementioned factors have affected the company's sales and corresponding costs; which resulted in deterioration of margins of Fecto. The company has announced green-field expansion, since some time, modalities are yet to be finalized. It has taken time for the project to start. With the new market conditions and the delay in the finalization of the project financing and other related matters, it is unlikely that the project will start over the short horizon. Currently, the company is operating on deleveraged structure. Given current business profile, any acquisition of long term finance will be a rating negative factor.

The ratings are dependent on improvement of company's business volumes and margins. The company's improved business performance in current stretched economic scenario – challenges on demand front - remains vital for ratings.

Disclosure

Name of Rated Entity	Fecto Cement Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	PACRA_Methodology_Corporate_FY19(Jun-19),PACRA_Criteria_LT ST Relationship_FY19(Jun-19),PACRA_Criteria_Rating Modifiers_FY19(Jun-19)
Related Research	Sector Study Cement(Apr-19)
Rating Analysts	Sehar Fatima sehar.fatima@pacra.com +92-42-35869504

Profile

Legal Structure Fecto Cement Ltd is a listed Company. Its shares are traded on Pakistan Stock Exchange Limited (PSX). The Company's shares are quoted under the Cement Sector.

Background Incepted in 1981, Fecto Cement Limited (FECTO) is part of the Fecto group. The group is diversified into import, export and trading of electrical wires, cables, home appliances and automobiles and later, expanded to industrial sectors by establishing a cement plant, sugar mills, tractor plant as well as paper sack and hardboard manufacturing units. Fecto Cement Limited is headquartered in Karachi, Pakistan and the cement plant is established near Islamabad. The quality standards of the company are ISO 9001:2000.

Operations Fecto Cement Limited is engaged in manufacturing, marketing and selling cement and clinker.

Ownership

Ownership Structure Fecto Group hold majority stake (75%) through Mr. Yasin; rest is widely spread among FIs and general public.

Stability The shareholding has lately been transferred to Mr. Yasin Fecto and his family by his siblings. The company's ownership structure is not expected to change in foreseeable future.

Business Acumen The business acumen of the sponsor is considered adequate on account of long term association with cement sector.

Financial Strength The financial strength of the group is considered adequate.

Governance

Board Structure The overall control of the company vests in seven member board of directors (BoD), including the CEO. The BoD comprises three independent directors

Members' Profile Fecto's board members carry necessary technical stature which is required for effective decision making.

Board Effectiveness The board meeting minutes are formally maintained and the attendance is considered adequate. High attendance of the members was observed during the meetings held in FY19.

Financial Transparency M/s. Rahman Sarfaraz Rahim Iqbal Chartered Accountant are the external auditors for fecto. They're in 'A' category of SBP list of external auditors and has a QCR rating. They have performed interim review on the financial statements for the six months ending December, 2018.

Management

Organizational Structure Fecto Cement has a lean organizational structure with the company's operations grouped under eight key functions. These include 1) Procurement, 2) Production, 3) Sales & Marketing, 4) Information Technology, 5) Finance, 6) Corporate Affairs, 7) Human Resource, and 8) Internal Audit.

Management Team The CEO, Mr. Yasin Fecto, is a son of Mr. Ghulam Muhammad Fecto and is associated with the company since 1990s. Mr. Yasin holds a master's degree and has experience of cement and packaging sectors. The CEO is supported by a team of experienced individuals having long association with the company.

Effectiveness There is an Audit and HR & Remuneration committee reporting directly to the Board.

MIS The company has core operating software; modules include financial, purchase, inventory, sales and payroll; reports generated are considered of adequate frequency.

Control Environment The Company is currently operating with one line; plant is of European technology. Accredited with ISO 9001: 2008 and ISO 14001: 2004 certifications, Fecto Cement deploys good technology to ensure production of quality cement.

Business Risk

Industry Dynamics Cement industry is divided into North and South region – majority (76%) operational capacity exists in North region. Industry has achieved its majority capacity expansions in last two years of around 14mln tons per annum. During FY19, north region witnessed 5% and 18% decline in local and export dispatches respectively attributable to contractionary fiscal policy, slowdown in large infrastructural activities and low demand from Afghanistan and India (export avenues). South region witnessed uptrend in dispatches which is correlated with longevity of export window available through sea. Industry dynamics has changed significantly driven by unsustainable cement prices (especially in north region) on account of supply glut recently created, muted demand and rupee depreciation. Cement players witnessed significant dip in margins on account of aforementioned factors. Currently, leveraging of industry is moderate (31% as at end-Mar19) but increased interest rates has amplified the stress on financial risk profile of players. Going forward – with full utilization of lately commenced plants – industry is expected to face expanded capacity challenge. Cement prices and margins are expected to stay under stress as demand front deemed to stay weak for at least upcoming one year.

Relative Position At end-Jun19, Fecto Cement's market share stood at 1.8% (FY18: 1.5%) categorizing Fecto as a small player. With capacity to produce 819,000 tons of clinker per annum.

Revenues During 9MFY19, turnover was recorded at PKR 3.6bln a witnessing negative growth 5.2% YOY (FY18 PKR 4.9bln, 9MFY18: PKR 3.8bln, FY17: PKR 5.1bln); sales mix tilted towards local market (9MFY19: 87%; FY18: 93%; FY17: 89%) – in line with majority players operating in north region. In 9MFY19, Sales volume analysis revealed that local dispatches stood at ~0.4mln tons (FY18: ~0.7mln tons, FY17: ~0.7mln tons, FY16: ~0.6mln tons). Capacity utilization (clinker) declined to stand at 62% 9MFY19 (FY18: 87.5%, FY17: 88%). Operating profit (9MFY19: PKR 158bln; 9MFY18: PKR 439bln) came down 64% YoY and 7% increase in the operating expense coupled with depreciation of rupee, Fecto's profit after tax declined by a massive 59% YOY standing at PKR 137mln (9MFY18: PKR 330mln).

Margins During FY18 and 9MFY19, Fecto's Gross, operating and EBITDA margins deteriorated (Gross: 9MFY19: 15%, FY18: 21%, FY17: 30%, Operating: 9MFY19: 4%, FY18: 11%, FY17: 22.3%, PBIT: 9MFY19: 5%, FY18: 12%; FY17: 21%). In recent times, margins deterioration is a trend witnessed throughout the cement industry as the macroeconomic factors such as intervention of government in tightening the Fiscal and Monetary policies (Lower PSDP allocation), a sharp hike in energy costs, rupee depreciation against US dollar and increased competition in north region.

Sustainability Going forward, the the management is lying to upload the volumes and margins. Surplus cash is kept in short term avenues. So that in case need arise the same can be utilized.

Financial Risk

Working Capital During 9MFY19, Fecto's working capital requirements represented by net cash cycle (net working capital days) – a function of inventory, receivables and payables - slight increased to 82 days (end-Jun 18: 81 days; end- Mar 18: 75 days, end-Jun 17: 72 days). This is attributable to inventory days hike to stand at 97 days (9MFY18: 83 days) - which is a negative factor. Current ratio witnessed an improvement over the recent quarter (9MFY19: 5.2x; FY18: 4.8x; FY17: 5.2x).

Coverages During 9MFY19 and 9MFY18, FCFO declined to PKR 177mln and PKR 417mln respectively mainly due to reduced profitability. Coverage declined but remained above industry because of a deleveraged capital structure.

Capitalization Over the last few years, the company has been operating on a deleveraged structure. Going forward, the management is not planning to acquire long term finance in medium term.



The Pakistan Credit Rating Agency Limited

Financial Summary

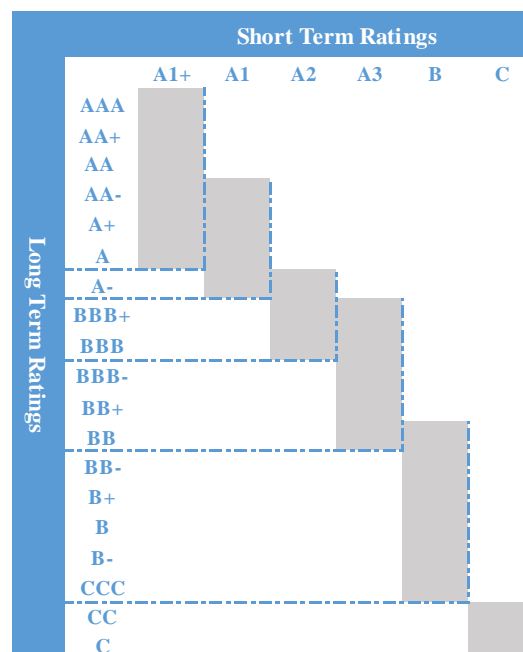
PKR mln

Fecto Cement Ltd Infrastructure Cement	Mar-19 9M	Jun-18 12M	Jun-17 12M	Jun-16 12M
A BALANCE SHEET				
1 Non-Current Assets	1,802	1,846	1,850	1,879
2 Investments	150	-	-	-
3 Related Party Exposure	188	207	102	-
4 Current Assets	3,041	3,177	2,869	2,197
a Inventories	1,232	1,329	1,277	922
b Trade Receivables	65	75	16	13
5 Total Assets	5,182	5,230	4,821	4,077
6 Current Liabilities	585	663	549	439
a Trade Payables	178	353	169	35
7 Borrowings	37	15	-	-
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	313	342	378	404
10 Net Assets	4,247	4,210	3,894	3,233
11 Shareholders' Equity	4,247	4,210	3,894	3,233
B INCOME STATEMENT				
1 Sales	3,620	4,903	5,131	5,032
a Cost of Good Sold	(3,092)	(3,875)	(3,574)	(3,408)
2 Gross Profit	528	1,027	1,557	1,623
a Operating Expenses	(370)	(491)	(413)	(378)
3 Operating Profit	158	536	1,143	1,245
a Non Operating Income or (Expense)	17	67	(50)	(74)
4 Profit or (Loss) before Interest and Tax	176	603	1,093	1,171
a Total Finance Cost	(3)	(3)	(1)	(12)
b Taxation	(36)	(158)	(331)	(345)
6 Net Income Or (Loss)	137	442	761	814
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	177	426	721	1,046
b Net Cash from Operating Activities before Working Capital Changes	174	422	719	1,025
c Changes in Working Capital	(138)	(100)	(256)	8
1 Net Cash provided by Operating Activities	36	322	463	1,034
2 Net Cash (Used in) or Available From Investing Activities	(180)	(212)	(171)	(19)
3 Net Cash (Used in) or Available From Financing Activities	(89)	(95)	(164)	(906)
4 Net Cash generated or (Used) during the period	(234)	15	128	108
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	-1.5%	-4.4%	2.0%	--
b Gross Profit Margin	14.6%	21.0%	30.3%	32.3%
c Net Profit Margin	3.8%	9.0%	14.8%	16.2%
d Cash Conversion Efficiency (EBITDA/Sales)	7.3%	13.4%	23.5%	25.6%
e Return on Equity (ROE)	4.3%	10.9%	21.3%	26.4%
2 Working Capital Management				
a Gross Working Capital (Average Days)	102	100	79	75
b Net Working Capital (Average Days)	82	81	72	71
c Current Ratio (Total Current Assets/Total Current Liabilities)	5.2	4.8	5.2	5.0
3 Coverages				
a EBITDA / Finance Cost	216.0	555.8	601906.5	122.8
b FCFO / Finance Cost+CMLTB+Excess STB	144.2	360.5	360407.5	99.7
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.2	0.0	0.0	0.0
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	0.9%	0.3%	0.0%	0.0%
b Interest or Markup Payable (Days)	0.0	0.0	0.0	0.0
c Average Borrowing Rate	6.3%	8.0%	N/A	2.3%

Credit Rating Scale & Definitions

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings		Short Term Ratings	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
AA+	Very high credit quality. Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.	A1	A strong capacity for timely repayment.
AA		A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
AA-		A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
A+	High credit quality. Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.	B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
A		C	An inadequate capacity to ensure timely repayment.
A-			
BBB+	Good credit quality. Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.		
BBB			
BBB-			
BB+	Moderate risk. Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.		
BB			
BB-			
B+	High credit risk. A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.		
B			
B-			
CCC	Very high credit risk. Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.		
CC			
C			
D	Obligations are currently in default.		



Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.	Rating Watch Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.	Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.	Withdrawn A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults, or/and f) PACRA finds it impractical to surveil the opinion due to lack of requisite information.	Harmonization A change in rating due to revision in applicable methodology or underlying scale.
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Rating Team Statements

(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) Conflict of Interest

- i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
- ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
- iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term “family members” shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions

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- (5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business

- (6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
- (7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
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- (9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
- (10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
- (11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

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- (12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA’s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
- (13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers’ associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
- (14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
- (15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
- (16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst’s area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
- (17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review

- (18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
- (19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
- (20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
- (21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)

Probability of Default

(22) PACRA’s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA’s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA’s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)

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