The Pakistan Credit Rating Agency Limited

ENGRO POLYMER & CHEMICALS LIMITED

	NEW [JUNE-17]	PREVIOUS [JUNE-16]
Long-Term	A	A-
Short-Term	A1	A2
Outlook	Stable	Stable

REPORT CONTENTS

JUNE 2017

Profile & Ownership

- EPCL, established in 1997, started commercial production in 1999. The company is listed on Pakistan Stock Exchange.
- EPCL is a subsidiary of Engro Corporation Limited (ECL) having majority stake of 56%. The other major shareholders of EPCL are Mitsubishi Corporation (10%) and International Finance Corporation (6%).

Governance

- Eight member board of directors including the CEO. Three members from the parent while two members represent Mitsubishi Corporation. The remaining three members are independent non-executive directors.
- Mr. Ghias khan is the chairman of EPCL and acts as a Non-Executive director. Two board committees in place; (i) Board Audit Committee (BAC) and (ii) Board Compensation Committee (BCC).

Management & Controls

- Mr. Imran Anwer joined EPCL as the CEO of the company in 2015.
- To oversee the management of the company, EPCL has constituted three committees comprising various members of the management team. Each committee is headed by the CEO as the chairman.
- The company operates through four major divisions headed by experienced professionals. All managers' report directly to the CEO.
- The strong organizational structure ensures effective delegation of functional responsibility across various departments, facilitating a smooth flow of operations.

Business Risk

- During 2016, the company achieved highest capacity utilization of ~96% out of total installed capacity of 178KT
- EPCL ramped up its revenue stream (CY16: PKR 22,854mln, CY15: PKR 22,264mln) mainly owing to increase in the prices of its main product, PVC, with the spurt of ~29% during CY16 - outcome of lower supply, primarily from China.
- During CY16, topline of Caustic Soda slightly increase by ~2%. EPCL sold 83KT (CY15: 83KT) - resulting in sustained market share of 32% during CY16 (CY15: 32%).
- During, 4QCY16, the performance of the company improved significantly due to softened ethylene prices coupled with increase in PVC prices and 12% import protection duty improved the gross profit of the company (4QCY16: PKR 1,904mln; 3QCY16: PKR 614mln).
- Operational expenses largely remained at the same level on a YoY basis. The sizeable finance cost decreased noticeably due to debt-reprofiling, the company's bottom-line culminating in a profit of PKR 655mln during CY16 (CY15: loss of PKR 649mln).
- In 1QCY17, EPCL posted a topline of PKR 6,812mln (1QCY16: 5,739mln) depicting a growth of ~18% YoY backed by continued PVC price support complementing with growing domestic demand. EPCL posted PAT of PKR 845mln (1QCY16: 17mln)
- Going forward, there would be rationalization in the margins on the back of global demand and supply dynamics, however, it would remain positive.

Financial Risk

- EPCL's cash cycle remained robust as almost all sales are on cash basis while the company is offered a credit period of 180 days by its sourcing partners.
- The Company's cash flows remain a function of its profitability. Due to debt reprofiling finance cost and current portion of long-term liabilities have reduced significantly resulted in improved coverages YoY.
- EPCL currently has a leveraged capital structure. The company's capital structure stood at 61% in CY16 (CY15:68%). Out of total debt, contribution from ECL is ~32% which will be converted into preference shares during CY17.
- During CY16, EPCL has re-profiled its debt liabilities. Under this arrangement, the company raised fresh debt of PKR 5,750mln with the average mark-up of KIBOR plus 0.8%. This new arrangement benefitted the company in terms of reduced interest expense and eased down principal repayment.

RATING RATIONALE

The ratings reflect EPCL's association with one of the country's leading conglomerate – Engro Corp. This association has benefited the company; lately provided debt facility of PKR 3bln.This financing facility is expected to be converted into preference shares during CY17. Preference share are callable and convertible to equity shares after the span of 3 years. EPCL's profile benefits from its position as the sole producer of PVC resins in the country, supplemented by sustained product demand and vertically integrated operations. EPCL has limited influence on both price ends (i) Ethylene - key raw material, and (ii) PVC - key product, wherein inherent volatility enhances the challenge. Margins are on the improving side due to stable PVC prices, softened ethylene prices along with incremental domestic consumption. Reduction in duty on import of raw material & imposition of anti-dumping duty should benefit. On the Caustic Soda front (the other major product), the company enjoys adequate margins and eloquent market share in the southern region, close to plant location. EPCL's debt-reprofiling has eased pressure on its financial risk reflected in improving trend of coverages; comfort is drawn by ~32% contribution by the parent in the total debt.

KEY RATING DRIVERS

The ratings are dependent upon sustained operations and continuity of improved margins. Maintaining an adequate financial discipline; wherein capex may be adopted according to available financial flexibility remains important

Engro Polymer and Chemicals Limited

BALANCE SHEET	31-Mar-17	31-Dec-16	31-Dec-15	31-Dec-14
	Quarterly	Annual	Annual	Annual
Non-Current Assets	**16,420**	**16,719**	**17,314**	**18,008**
Investments (Incl. associates)	**50**	**50**	**50**	**50**
Equity	50	50	50	50
Debt	-	-	-	-
Current Assets	**8,503**	**6,952**	**6,578**	**8,094**
Inventory	4,245	3,024	2,941	3,898
Trade Receivables	366	456	437	555
Others	3,892	3,471	3,200	3,641
Total Assets	**25,224**	**24,461**	**24,242**	**26,301**
Debt	**9,170**	**9,584**	**11,394**	**9,759**
Short-term	1	417	3,050	600
Long-term (Inlc. Current Maturity of long-term debt)	9,169	9,167	8,344	9,159
Other shortterm liabilities	9,240	8,909	7,545	10,603
Other Longterm Liabilities	-	-	-	-
Shareholder's Equity	**6,814**	**5,968**	**5,303**	**5,939**
Total Liabilities & Equity	**25,224**	**24,461**	**24,242**	**26,301**
INCOME STATEMENT				
Turnover	**6,812**	**22,854**	**22,264**	**23,819**
Gross Profit	1,936	3,935	2,773	1,821
Other Income	(53)	(127)	(330)	(135)
Financial Charges	(234)	(930)	(1,082)	(1,065)
Net Income	**845**	**655**	**(649)**	**(1,016)**
Cashflow Statement				
Free Cashflow from Operations (FCFO)	1,834	3,698	1,060	1,591
Net Cash changes in Working Capital	(1,124)	289	(1,260)	575
Net Cash from Operating Activities	590	3,102	(1,161)	1,287
Net Cash from InvestingActivities	374	(1,078)	(800)	(890)
Net Cash from Financing Activities	(415)	(1,807)	1,578	(720)
Ratio Analysis				
Performance				
Turnover Growth	18.7%	2.7%	-6.5%	-3.1%
Gross Margin	28.4%	17.2%	12.5%	7.6%
Net Margin	12.4%	2.9%	-2.9%	-4.3%
ROE	50.3%	11.0%	-11.7%	-17.5%
Coverages				
Interest Coverage (FCFO/Gross Interest)	7.8	4.0	1.0	1.5
Core: (FCFO/Gross Interest+CMLTD+Uncovered Total STB)	3.5	1.0	0.1	0.2
Total: (TCF) / (Gross Interest+CMLTD+Uncovered Total STB)	3.5	1.0	0.1	0.2
Debt Payback (Total LT Debt Including UnCovered Total STBs) / (FCFO- Gross Interest)	1.5	4.2	-577.6	23.3
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	-13.8	-17.5	-31.8	-26.0
Capital Structure (Total Debt/Total Debt+Equity)	57.4%	61.6%	68.2%	62.2%

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STANDARD 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

AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments. This capacity is highly unlikely to be adversely affected by foreseeable events.
AA+ AA 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.
A+ A 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.
BBB+ BBB 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.
BB+ BB BB-	**Speculative.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic change over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**Highly speculative.** Significant 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.
CCC CC C	**High default 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.
D	Obligations are currently in default.

Short Term Ratings

A1+: The highest capacity for timely repayment.

A1:. A strong capacity for timely repayment.

A2: A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.

A3: An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.

B: The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.

C: An inadequate capacity to ensure timely repayment.

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. Rating Watch may carry designation – Positive (rating may be raised, negative (lowered), or developing (direction is unclear). A watch should be resolved with in foreseeable future, but may continue if underlying circumstances are not settled.

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'.

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, or e) the entity/issuer defaults.

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Regulatory and Supplementary Disclosure

Rated Entity

Name of Rated Entity Engro Polymer & Chemicals Limited
Sector Chemicals
Type of Relationship Solicited

Purpose of the Rating
Independent Risk Assessment
Regulatory Requirement

Rating History

Dissemination Date	Long Term	Short Term	Outlook	Action
30-Jun-17	A	A1	Stable	Upgrade
30-Jun-16	A-	A2	Stable	Maintain
30-Jun-15	A-	A2	Stable	Downgrade
30-Jun-14	A	A1	Stable	Initial

Related Criteria and Research Chemicals - Polyvinyl Chloride | Jun17

Rating Methodology: Corporate Rating Methodology (2016)

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Rating Team Statement

Rating Procedure
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PACRA initiates immediate review of the outstanding rating(s) upon becoming aware of any information that may be reasonable be expected to result in any change (including downgrade) in the rating

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Probability of Default (PD)

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