The Pakistan Credit Rating Agency Limited

Rating Report

Engro Polymer & Chemicals Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
	A+	A1+	Stable	Upgrade	-
30-Jun-2017	A	A1	Stable	Upgrade	-
30-Jun-2016	A-	A2	Stable	Maintain	-
30-Jun-2015	A-	A2	Stable	Downgrade	-
30-Jun-2014	A	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings recognize Engro Polymer's established foothold in the local PVC segment and in caustic soda market. This emanates from efficient production process, sound technological infrastructure, and effective control environment. EPCL is the only manufacturer of Poly Vinyl Chloride (PVC), having dominant market share. The Company has successfully created liking for its products. Lately, it is enjoying strong margins attributed to improved international dynamics along with incremental domestic consumption; boding well with the overall profitability. Although EPCL has limited influence on both price ends (i) Ethylene - key raw material, and (ii) PVC - key product, import and anti-dumping duties benefit. On demand side, expanding economy – particularly construction – has led to double digit growth; a trend that is expected to persist. 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. The uptick in profits, in turn free cashflows, has yielded favorably for EPCL's financial profile. This is reflected in efficient working capital cycle and healthy coverages; hence, financial risk stays well managed. Moreover, EPCL's debt-reprofiling has further eased pressure on its financial risk profile. The ratings also reflect EPCL's association with one of the country's leading conglomerate – Engro Corp. This association has benefited the company historically.

EPCL has planned a CAPEX of PKR 10.3bln, addition of PVC by 100K tons, significant debottlenecking of VCM plant on a tune of PKR 7.6bln of which PKR 5.4bln will be raised through fresh equity in form of right share and remaining PKR 2.2bln through debt. Other CAPEX of PKR 2.7bln, funded through internally generated cash and debt. EPCL's expansionary stance would likely to benefit the company and this is not expected to push up leveraging significantly.

The ratings are dependent upon holding sustained operations and continuity of improved margins. Execution of planned expansion, while, with the new debt to be acquired, maintenance of coverages would remain critical.

Disclosure

Name of Rated Entity	Engro Polymer & Chemicals Limited
Type of Opinion	Entity
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating Methodology (Jul-17)
Related Reseach	Sector Study | Polyvinyl Chloride (Jun-17)
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ENGRO POLYMER AND CHEMICALS LIMITED - PROFILE	
Incorporated	1997
Major business lines	• PVC • Caustic Soda
Legal status	Listed
Head office	Main Clifton Road, Karachi
Plant Location	Port Qasim, Sindh

INDUSTRY SNAPSHOT

- During CY16, total domestic PVC demand was ~218KT, which is expected to increase by ~17% to ~255K in CY17.
- Domestic PVC demand is met through EPCL (~77%) – as EPCL is the sole PVC producer in Pakistan, and through imports (~23%)
- There is 12% import protection duty on the import of PVC. Anti-dumping duty has been imposed on China, South Korea and Thailand between 11% - 42%
- During CY16, EPCL sold 83KT of caustic soda (CY15: 83KT), resulting in sustained market share of 32% (CY15: 32%).

OWNERSHIP

- EPCL is primarily involved in the manufacturing, marketing and distribution of PVC and its allied products with design annual capacity of 195,000 tons per annum (tpa). Another segment is Caustic Soda, which adds meaningful diversification to the company's business. EPCL markets PVC products under the brand name of 'SABZ'.
- 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 general public (34%).

GOVERNANCE

- The Board of Directors (BoD) comprises 7 members including CEO. Four members from the parent while one member represent Mitsubishi Corporation. The remaining two members are the CEO and independent non-executive director.
- Mr. Ghiasuddin Khan – the CEO of Engro Corp, is Non-Executive Chairman of EPCL. Two board committees in place; (i) Board Audit Committee (BAC) and (ii) Board Compensation Committee (BCC).
- A.F.Ferguson & Co. Chartered Accountants, are the auditors of the company since long. The said firm is rated an 'A' category firm by SBP. They expressed an unqualified opinion on EPCL's financial statements for CY16.

MANAGEMENT

- Mr. Imran Anwer is the CEO of the company. He has hands-on experinance in the domain of petrochemical industry. To oversee the management of the company, EPCL has constituted three committees (i) Management Committee, (ii) Corporate HSE Committee (iii) Committee for Organization & Employee Development, comprising various members of the management team - headed by the CEO.
- The company operates through four major divisions headed by experienced professionals – reporting to CEO. The divisions are a) Manufacturing – headed by Mr. Jahangir Waheed, c) Human Resource and Corporate Services – headed by Mr. Salman Hafeez, d) Finance – headed by M. Imran Khalil and e) Supply Chain – headed by Mr. Syed Ali Akbar, d) Marketing – headed by Mr. Abdul Qayoom.
- The strong organizational structure ensures effective delegation of functional responsibility across various departments, facilitating a smooth flow of operations.

SYSTEM & CONTROLS

- EPCL continuously updates technology infrastructure in all its manufacturing and support functions, while adapting to new technology, processes to ensure quality and cost effectiveness.
- EPCL maintains an effective control environment with defined policies and procedures. EPCL's internal audit function performs regular reviews on the financial, operational and compliance controls and reports directly to the audit committee for all critical issues.
- The company deploys SAP as ERP solution. SAP implementation was divided into two phases. First phase comprises Materials Management, FICO and Sales & Distribution was implemented in CY15. During CY17, ECPL has successfully implemented phase 2 - including production planning and plant maintenance modules.

BUSINESS RISK

- EPCL ramped up its revenue stream (9MCY17: PKR 20,390mln, 9MCY16: PKR 16,610mln), up by ~23%, mainly owing to increase in the prices of its main product – PVC, driven by strong demand, global supply crunch, and imposition of anti-dumping duty [Sales mix: PVC: ~83%, Caustic Soda: ~17%)
- During 9MCY17, company's cost of sales increased (~6%) – less than proportionate. Resultantly, gross margin (9MFY17: ~24%, 9MFY16: ~12%) and operating margin (9MFY17: ~18%, 9MFY16: ~5%) of the company have improved significantly,
- During 9MCY17, operational expenses largely remained at the same level YoY. Finance cost decreased by ~14% due to debt-reprofiling, boded well with the bottom line. Accounting for taxation, net profit of the company stood at PKR 1,944mln (9MCY16: PKR 28mln).
- Given robust demand and anti-dumping support, EPCL is likely to enhance its volumes and margins
- Going forward, EPCL plans to expand the production capacity of PVC by 100K MT which is expected to kick off in 3Q2020. After incorporating expansion, total PVC capacity will reach to 295K MT (Current Capacity: 195K MT)

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. This is improving, in turn, strong cashflows. Additionally, due to debt reprofiling finance cost has reduced significantly resulted in improved interest coverage ratio (9MCY17: 8.0x, 9MCY16: 3.4x)
- EPCL currently has a leveraged capital structure. The company's capital structure stood at 54% in 9MCY17 (9MCY16: 66%).
- EPCL has planned a CAPEX of PKR 10.3bln, addition of PVC by 100K tons, significant debottlenecking of VCM plant on a tune of PKR 7.6bln of which PKR 5.4bln will be raised through fresh equity in form of right share and remaining PKR 2.2bln through debt. Other CAPEX of PKR 2.7bln, funded through internally generated cash and debt. This is not expected to push up leveraging significantly, hence, financial risk stays well managed.

Engro Polymer and Chemicals Limited

BALANCE SHEET	30-Sep-17	31-Dec-16	31-Dec-15	31-Dec-14
	9M	CY16	CY15	CY14
Non-Current Assets	**16,214**	**16,719**	**17,314**	**18,008**
Investments (Incl. associates)	**50**	**50**	**50**	**50**
Equity	50	50	50	50
Debt	-	-	-	-
Current Assets	**7,150**	**6,952**	**6,578**	**8,094**
Inventory	3,709	3,024	2,941	3,898
Trade Receivables	449	456	437	555
Others	2,993	3,471	3,200	3,641
Total Assets	**23,414**	**24,461**	**24,242**	**26,301**
Debt	**9,265**	**9,584**	**11,394**	**9,759**
Short-term	265	417	3,050	600
Long-term (Inlc. Current Maturity of long-term debt)	9,000	9,167	8,344	9,159
Other shortterm liabilities	6,236	8,909	7,545	10,603
Shareholder's Equity	**7,914**	**5,968**	**5,303**	**5,939**
Total Liabilities & Equity	**23,414**	**24,461**	**24,242**	**26,301**
INCOME STATEMENT				
Turnover	**20,390**	**22,854**	**22,264**	**23,819**
Gross Profit	4,960	3,935	2,773	1,821
Other Income	(212)	(127)	(330)	(135)
Financial Charges	(590)	(930)	(1,082)	(1,065)
Net Income	**1,944**	**655**	**(649)**	**(1,016)**
Cashflow Statement				
Free Cashflow from Operations (FCFO)	4,714	3,698	1,060	1,591
Net Cash changes in Working Capital	(4,273)	289	(1,260)	575
Net Cash from Operating Activities	22	3,102	(1,161)	1,287
Net Cash from InvestingActivities	(603)	(1,078)	(800)	(890)
Net Cash from Financing Activities	(554)	(1,807)	1,578	(720)
Net Inc/dec in Cash	(1,135)	217	(382)	(323)
Ratio Analysis				
Performance				
Turnover Growth	22.8%	2.7%	-6.5%	-3.1%
Gross Margin	24.3%	17.2%	12.5%	7.6%
Net Margin	9.5%	2.9%	-2.9%	-4.3%
ROE	32.0%	11.0%	-11.7%	-17.5%
Coverages				
Interest Coverage (FCFO/Gross Interest)	8.0	4.0	1.0	1.5
Core: (FCFO/Gross Interest+CMLTD+Uncovered Total STB)	8.0	1.0	0.1	0.2
Debt Payback (Total LT Debt Including UnCovered Total STBs) / (FCFO- Gross Interest)	1.6	4.2	-577.6	23.3
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	4.7	-17.5	-31.8	-26.0
Capital Structure (Total Debt/Total Debt+Equity)	53.9%	61.6%	68.2%	62.2%

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

AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments.
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-	**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.
B+ B 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.
CCC CC C	**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.
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.

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 surveill the opinion due to lack of requisite information

Regulatory and Supplimentary Disclosure

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

(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(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.
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(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)

Independence & Conflict of interest
(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)
Proprietary Information