



The Pakistan Credit Rating Agency Limited

## Rating Report

### Cherat Cement Company Limited

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#### Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-Jun-2018	A	A1	Positive	Maintain	-
28-Dec-2017	A	A1	Stable	Maintain	-
06-Jun-2017	A	A1	Stable	Maintain	-
03-Nov-2016	A	A1	Stable	Maintain	-
03-Nov-2015	A	A1	Stable	Upgrade	-

#### Rating Rationale and Key Rating Drivers

The ratings reflect Cherat Cement's improving profile supplemented by strengthening market share of the company. The company has lately commenced line-II (1.3mln tpa) and has announced another expansion (2.4mln tpa) which will double the company's existing capacity and will allow the company in joining the league of mid-tier cement players. The company's revenues witnessed strong standalone growth primarily due to commencement of Line-II and strong sector demand dynamics. The company's high utilization levels, developments in achieving cost efficiencies and tapping new markets are a positive. The company is revamping its dealer's network to channel volumes coming from upcoming expansion. The business profile of the company is likely to behave strongly in medium term on the back of healthy volumetric growth and strong absolute EBITDA. Margins dropped; though remained competitive - an industry wide phenomenon. Leveraging has lately increased in pursuit of expansion. However, the comfort can be drawn from early repayment of existing debt and strong free cashflows generated to finance debt taken.

The ratings are dependent on upholding of the company's business vis-à-vis financial risk profile; strengthening of equity base is essential. Any significant deterioration in the sector's outlook particularly any unfavorable change in demand and expansion matrix, thereby exerting pressure on prices and margins, may negatively impact the ratings.

#### Disclosure

<b>Name of Rated Entity</b>	Cherat Cement Company Limited
<b>Type of Relationship</b>	Solicited
<b>Purpose of the Rating</b>	Entity Rating
<b>Applicable Criteria</b>	Methodology   Corporate Rating Methodology(Jul-17),Methodology   Correlation between long-term and short-term rating scale(Jun-17),Methodology   Criteria Modifiers(Jun-17)
<b>Related Research</b>	Sector Study   Cement(Nov-17)
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## CHERAT CEMENT COMPANY LIMITED PROFILE

<b>Incorporated</b>	1985
<b>Major Business</b>	Engaged in manufacturing, marketing and sale of Ordinary Portland Cement
<b>Legal Status</b>	Listed
<b>Head Office</b>	Karachi

### OWNERSHIP & GROUP PROFILE

- Ghulam Faruque Group (GFG) holds majority stake in the company through associated companies and family members; Financial Institutions and Mutual Funds also hold equity stake
- GFG – a medium sized group – mainly maintains interests in cement, sugar, packaging, engineering solutions, equipment supplying and HVAC contracting

### GOVERNANCE

- The overall control of board vests in eight member board including CEO, Mr. Azam Faruque; Seven non-executive directors, including one independent director, out of which four are family members
- There are Audit and Human Resource Committee in place to assist the board. Audit Committee reports to the board in line with code of corporate governance.
- The auditors of the company M/s. EY Ford Rhodes Chartered Accountants, issued an unqualified audit opinion pertaining to annual financial statements for FY17.

### MANAGEMENT

- Mr. Faruque, is associated with the company since 1992 and has diversified experience including corporate and financial sectors; Well-tiered organization structure with a professional management team
- The organizational structure is divided into eight functional departments, namely: (1) Procurement, (2) Production, (3) Sales & Marketing, (4) Information Technology, (5) Finance, (6) Corporate Affairs, (7) Human Resource and (8) Internal Audit. The Internal Audit department reports to the audit committee.

### SYSTEMS & CONTROLS

- Plant technology: European & Chinese; Strong technology infrastructure (SAP based ERP solution); comprehensive MIS reporting
- Total power needs: 32MW (line I: 15MW, line II: 17MW), met through multiple sources including WHRPP, WAPDA; FO-based generators as back up

### PERFORMANCE

- Cherat Cement's sales have been on rising trend since last few years. Topline witnessed significant growth (FY17: PKR 9.6bln, FY16: PKR 7.0bln); on account of significant growth in total dispatches (50% YoY) primarily due to commencement of line-II. Dispatches remained skewed towards local market in line with industry trend
- During 9MFY18, the sales volume analysis revealed that local dispatches witnessed significant growth on account of commencement of Line-II in Jan-17. The cement dispatches remained tilted towards local market (86%, IHFY17: 85%); Capacity Utilization Levels remained robust
- The turnover recorded for 9MFY18 is PKR 11.1bln (9MFY17: PKR 6.7bln). Gross and EBITDA margins declined to 23.0% and 25.9% (FY17: 33.3% and 34.7%) respectively mainly due to lower retention prices and fluctuating international coal prices. Going forward, with translation of rupee depreciation, the margins are expected to remain under pressure. Other recurring income (9MFY18: PKR 20.9mln) mainly coming from investments in group companies supported the bottom-line. Finance costs of the company decreased to PKR 267mln (9MFY17: PKR 98mln). Hence, the company posted profits of PKR 1.7bln, up 15% YoY
- As at end-Mar18, the company's investment portfolio stood at 4% (end-Jun17: 5%) of the equity base.
- Going forward, the company has announced brown-field expansion of 2.4mln tpa. The project has estimated cost of PKR 13.5bln with debt to equity ratio of 70:30. The project will be expected to be operational by Dec-18.

### FINANCIAL RISK

- During 9MFY18, Cherat Cement's working capital requirements, represented by net cash cycle (net working capital days) – a function of inventory, receivables and payables – improved to 13days (end-Jun17: 32days) on account of declining receivable days. The company manages its working capital requirements through mix of internal generation and short term borrowings.
- Core coverage ratio stood at 4.2x and 12.2x at end-Mar18 and end-Jun17 respectively.
- The company is currently leveraged at 51.0% as at end-Mar18 (end-Jun17: 38%). The company has short term borrowings of PKR 929mln as at end-Mar18 (end-Jun17: PKR 1.5bln). Going forward, leveraging is expected to increase further in pursuit of expansion.



# Cement

The Pakistan Credit Rating Agency Limited

Financials (Summary)

PKR mln

## Cherat Cement Company Limited

BALANCE SHEET	31-Mar-18 9MFY18	30-Jun-17 Annual	30-Jun-16 Annual
<b>Non-Current Assets</b>	<b>21,024</b>	<b>13,672</b>	<b>12,747</b>
<b>Investments (Incl. associates)</b>	<b>470</b>	<b>566</b>	<b>710</b>
Equity	470	566	710
Mutual Funds	-	-	-
<b>Current Assets</b>	<b>4,578</b>	<b>4,569</b>	<b>2,005</b>
Stores and Spares	1,417	1,437	813
Inventory	1,087	1,618	485
Others	2,074	1,515	707
<b>Total Assets</b>	<b>26,073</b>	<b>18,807</b>	<b>15,462</b>
<b>Debt</b>	<b>11,779</b>	<b>6,401</b>	<b>4,231</b>
Short-term	929	1,500	208
Long-term (Incl. Current Maturity of long-term debt)	10,850	4,901	4,023
Other short-term liabilities	1,958	1,011	1,562
Other Long-term Liabilities	1,006	933	529
<b>Shareholder's Equity</b>	<b>11,329</b>	<b>10,462</b>	<b>9,140</b>
<b>Total Liabilities &amp; Equity</b>	<b>26,073</b>	<b>18,807</b>	<b>15,462</b>
<b>INCOME STATEMENT</b>			
<b>Turnover</b>	<b>11,148</b>	<b>9,645</b>	<b>7,079</b>
Gross Profit	2,569	3,213	2,634
Operating Profit / (Loss)	2,139	2,708	2,208
Financial Charges	(267)	188	(44)
<b>Net Income</b>	<b>1,795</b>	<b>1,957</b>	<b>1,405</b>
<b>Cashflow Statement</b>			
Free Cashflow from Operations (FCFO)	2,363	2,894	1,734
Net Cash changes in Working Capital	1,319	(2,690)	572
Net Cash from Operating Activities	3,312	(6)	2,290
Net Cash from Investing Activities	(7,960)	(1,577)	(5,572)
Net Cash from Financing Activities	4,642	1,605	3,286
<b>Ratio Analysis</b>			
<b>Performance</b>			
Turnover Growth	66.0%	36.2%	7.8%
Gross Margin	23.0%	33.3%	37.2%
Net Margin	16.1%	20.3%	19.8%
ROE	17.5%	19.5%	19.1%
<b>Coverages</b>			
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB)	4.2	11.7	8.4
Interest Coverage (x) (FCFO/Gross Interest)	8.9	15.4	10.5
Debt Payback (Years) (Total Lt.Debt (excluding Covered Short Term Borrowings) / FC	3.9	1.8	2.6
<b>Liquidity</b>			
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	13	32	23
<b>Capital Structure</b> (Total Debt/Total Debt+Equity)	51.0%	38.0%	31.6%

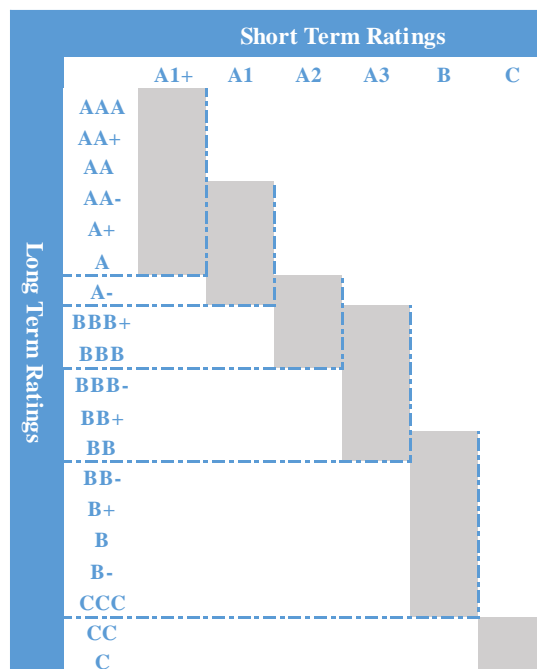
Cherat Cement Company Limited

June 2018

## 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	
<b>AAA</b>	<b>Highest credit quality.</b> Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	<b>A1+</b>	The highest capacity for timely repayment.
<b>AA+</b> <b>AA</b> <b>AA-</b>	<b>Very high credit quality.</b> 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.	<b>A1</b>	A strong capacity for timely repayment.
<b>A+</b> <b>A</b> <b>A-</b>	<b>High credit quality.</b> 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>A2</b>	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
<b>BBB+</b> <b>BBB</b> <b>BBB-</b>	<b>Good credit quality.</b> 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.	<b>A3</b>	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
<b>BB+</b> <b>BB</b> <b>BB-</b>	<b>Moderate risk.</b> 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>	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
<b>B+</b> <b>B</b> <b>B-</b>	<b>High credit risk.</b> 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>C</b>	An inadequate capacity to ensure timely repayment.
<b>CCC</b> <b>CC</b> <b>C</b>	<b>Very high credit risk.</b> 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.		
<b>D</b>	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

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- (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)

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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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