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 |
|---|---|---|---|---|---|
| 19-Jul-2018 | AA- | A1+ | Stable | Upgrade | - |
| 25-Jan-2018 | 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 | - |

### Rating Rationale and Key Rating Drivers

The ratings recognize Engro Polymer's established foothold in the local PVC and caustic soda market. EPCL has efficient production process, sound technological infrastructure, and effective control environment. EPCL is the only manufacturer of Poly Vinyl Chloride (PVC), having a market share of ~67% in domestic market. The Company has successfully created a liking for its products. Lately, it is yielding strong margins attributing to improved international dynamics along with strong domestic demand; 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. However, over the years company has made vigorous efforts on operational efficiencies which has minimized vulnerability to unfavorable vinyl chain dynamics. 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 healthy margins and market share in the southern region. The uptick in profits, in turn, free cash flows, has yielded favorably for EPCL's financial profile. This is reflected in the 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 announced a CAPEX of PKR 10.3bln, an addition of 100K tons capacity on PVC and 50K tons of VCM, on a tune of PKR 7.6bln of which PKR 5.4bln is being raised through the Issuance of right shares. Remaining CAPEX will be funded through internally generated cash and debt. During expansion, the strength of the balance sheet will likely to remain intact.

The ratings are dependent upon holding sustained operations and continuity of improved margins. Successful execution of planned expansion, while, with the new debt to be acquired, maintenance of coverages would remain important to uphold ratings. Sustenance of import and anti-dumping duty is important for the sustainability of the risk profile of the company.

| Disclosure | |
|---|---|
| **Name of Rated Entity** | Engro Polymer & Chemicals Limited |
| **Type of Relationship** | Solicited |
| **Purpose of the Rating** | Entity Rating |
| **Applicable Criteria** | Methodology \| Corporate Ratings(Jun-18),Methodology \| Criteria \| Rating Modifier(Jun-18),Methodology \| Criteria \| LT ST Relationship(Jun-18) |
| **Related Research** | Sector Study \| Polyvinyl Chloride(Jun-17) |
| **Rating Analysts** | Hamza Ghalib \| hamza.ghalib@pacra.com \| +92-42-35869504<br>Muhammad Hassan \| muhammad.hassan@pacra.com \| +92-42-35869504 |

| ENGRO POLYMER AND CHEMICALS LIMITED - PROFILE | |
|---|---|
| **Incorporated** | 1997 |
| **Major business lines** | • PVC<br>• Caustic Soda |
| **Legal status** | Listed |
| **Head office** | Ocean Towers, Main Clifton Road, Karachi |
| **Capacity** | 195,000 Tons |

## INDUSTRY SNAPSHOT

- During CY17, total domestic PVC demand was ~279KT, which is expected to increase by ~7% to ~299K in CY18.
- Domestic PVC demand is met through EPCL (~67%) – as EPCL is the sole PVC producer in Pakistan, and through imports (~33%).
- There is 15% import protection duty on the import of PVC. Anti-dumping duty has been imposed on China, South Korea and Thailand between 3.4% - 20.5%
- During CY17, EPCL sold 84KT of caustic soda (CY16: 83KT), resulting in market share of 29% (CY16: 32%).

## OWNERSHIP

- EPCL is a subsidiary of Engro Corporation Limited (ECL) having majority stake of 56%. The other major shareholder of EPCL is Mitsubishi Corporation (10%).
- ECL is the holding company for all strategic investments which consists of several businesses including fertilizers, PVC resin, terminal operations, foods, power generation and commodity trade. ECL has a long-term rating of **'AA+' (Double A Plus)** by PACRA.
- MC is one of Japan's largest general trading company with over 200 offices and subsidiaries in approximately 90 countries worldwide and a network of over 600 group companies around the globe. EPCL receives adequate technical support from MC.

## 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 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 CY17.

## 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 five major divisions headed by experienced professionals – reporting to CEO. The divisions are a) Manufacturing – headed by Mr. Jahangir Waheed, b) Human Resource and Corporate Services – headed by Mr. Salman Hafeez, c) Finance – headed by Syed Abbas Raza and d) Supply Chain – headed by Mr. Aneeq Ahmed, e) 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.
- 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 (CY17: PKR 27,731mln, CY16: PKR 22,854mln), up by ~21%, mainly owing to higher volume and increase in the prices of its main product – PVC [Sales mix: PVC: ~82%, Caustic Soda: ~17%)
- During CY17, company's cost of sales increased (~15%) – less than proportionate. Resulting in gross margin (CY17: ~22%, CY16: ~17%) and operating margin (CY17: ~15%, CY16: ~10%) of the company have improved significantly.
- During CY17, operational expenses slightly increased YoY. Finance cost decreased by ~11% due to debt-reprofiling, boded well with the bottom line. Accounting for taxation, net profit of the company stood at PKR 2,049mln (CY16: PKR 655mln).
- Sustenance of import and anti-dumping duty is important for the sustainability of the risk profile of the Company.
- In the course of 3MCY17, topline of the company stood at PKR 8,687mln, an increase by ~27% in comparison to SPLY. Gross margin of the company largely maintained at the same level (3MCY18: ~28.7%, 3MCY18: ~28.4%). Accounting for taxation, net profit of the company stood at PKR 1,448mln (3MCY17: PKR 845mln)
- 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 primary raw material suppliers.
- The Company's cash flows remain a function of its profitability. This is improving, in turn, strong cashflows [FCFO: 3MCY18: PKR 2,574mln, CY17: 5,863mln, CY16: PKR 3,699]. Additionally, due to debt reprofiling in previous years, finance cost has reduced significantly which resulted in improved interest coverage ratio (CY17: 7.1x, CY16: 4.0x). The trend is continued in 3MCY18.
- EPCL currently has a leveraged capital structure. The company's capital structure stood at 53% in CY17 (CY16: 62%).
- EPCL has announced a CAPEX of PKR 10.3bln, to increase PVC production by 100K tons, and VCM production by 50K tons, on a tune of PKR 7.6bln of which PKR 5.4bln is being raised through issuance right shares and remaining PKR 2.2bln will be raised through debt. Other CAPEX of PKR 2.7bln, will be 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 | 31-Mar-18 | 30-Dec-17 | 31-Dec-16 | 31-Dec-15 |
|---|---|---|---|---|
| | 3M | CY17 | CY16 | CY15 |
| **Non-Current Assets** | **16,280** | **16,203** | **16,719** | **17,314** |
| **Investments (Incl. associates)** | **50** | **50** | **50** | **50** |
| Equity | 50 | 50 | 50 | 50 |
| Debt | - | - | - | - |
| **Current Assets** | **7,762** | **7,912** | **6,952** | **6,578** |
| Inventory | 3,879 | 3,681 | 3,024 | 2,941 |
| Trade Receivables | 392 | 505 | 456 | 437 |
| Others | 3,490 | 3,726 | 3,471 | 3,200 |
| **Total Assets** | **26,588** | **24,315** | **24,461** | **24,242** |
| **Debt** | **8,750** | **8,750** | **9,584** | **11,394** |
| Short-term | - | - | 417 | 3,050 |
| Long-term (Inlc. Current Maturity of long-term debt) | 8,750 | 8,750 | 9,167 | 8,344 |
| Other shortterm liabilities | 8,918 | 7,845 | 8,909 | 7,545 |
| **Shareholder's Equity** | **8,637** | **7,720** | **5,968** | **5,303** |
| **Total Liabilities & Equity** | **26,588** | **24,315** | **24,461** | **24,242** |

| INCOME STATEMENT | | | | |
|---|---|---|---|---|
| **Turnover** | **8,687** | **27,731** | **22,854** | **22,264** |
| Gross Profit | 2,500 | 6,065 | 3,935 | 2,773 |
| Other Income | 220 | (233) | (127) | (330) |
| Financial Charges | (158) | (821) | (930) | (1,082) |
| **Net Income** | **1,447** | **2,049** | **655** | **(649)** |

| Cashflow Statement | | | | |
|---|---|---|---|---|
| Free Cashflow from Operations (FCFO) | 2,560 | 5,819 | 3,698 | 1,060 |
| Net Cash changes in Working Capital | (150) | (3,363) | 289 | (1,260) |
| Net Cash from Operating Activities | 2,289 | 1,894 | 3,102 | (1,161) |
| Net Cash from InvestingActivities | (2,653) | (1,083) | (1,078) | (800) |
| Net Cash from Financing Activities | (5) | (503) | (1,807) | 1,578 |
| Net Inc/dec in Cash | (369) | 308 | 217 | (382) |

| Ratio Analysis | | | | |
|---|---|---|---|---|
| **Performance** | | | | |
| Turnover Growth | 27.5% | 21.3% | 2.7% | -6.5% |
| Gross Margin | 28.8% | 21.9% | 17.2% | 12.5% |
| Net Margin | 16.7% | 7.4% | 2.9% | -2.9% |
| ROE | 67.0% | 26.5% | 11.0% | -12.2% |
| **Coverages** | | | | |
| Interest Coverage (FCFO/Gross Interest) | 16.2 | 7.1 | 4.0 | 1.0 |
| Core: (FCFO/Gross Interest+CMLTD+Uncovered Total STB) | 5.7 | 7.1 | 1.0 | 0.1 |
| Debt Payback (Total LT Debt Including UnCovered Total STBs) / (FCFO- Gross Interest) | 4.1 | 1.8 | 4.2 | -577.6 |
| **Liquidity** | | | | |
| Net Cash Cycle (Inventory Days + Receivable Days - Payable Days) | 16.8 | 32.5 | -23.7 | -18.0 |
| **Capital Structure** (Total Debt/Total Debt+Equity) | 50.3% | 53.1% | 61.6% | 68.2% |

# Rating Scale

## Credit Rating Scale & Definitions

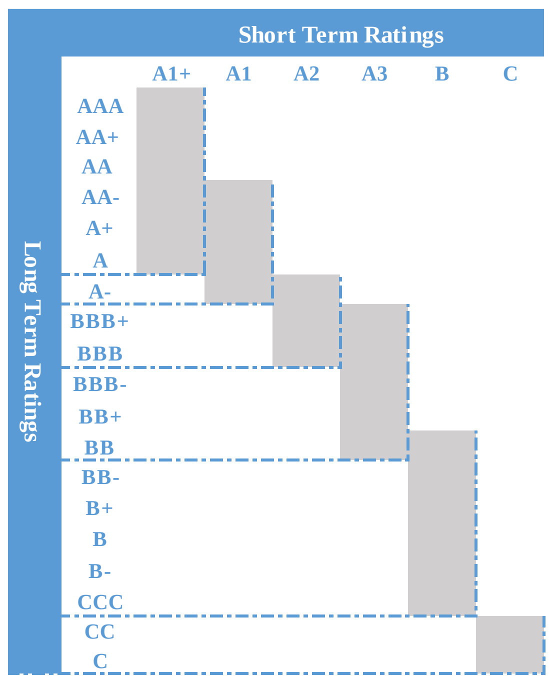
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

### Long Term Ratings

| | |
|---|---|
| AAA | **Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments |
| AA+<br>AA<br>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+<br>A<br>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+<br>BBB<br>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+<br>BB<br>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+<br>B<br>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<br>CC<br>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. | **Harmonization** A change in rating due to revision in applicable methodology or underlying scale. |

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(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**
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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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(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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(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
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(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)
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(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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