The Pakistan Credit Rating Agency Limited

Rating Report

Engro Polymer & Chemicals Limited | Sukuk

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
09-Oct-2018	AA	-	Stable	Preliminary	-

Rating Rationale and Key Rating Drivers

The rating recognizes Engro Polymer's established foothold in the local PVC and caustic soda market. EPCL is the only manufacturer of Poly Vinyl Chloride (PVC), having a market share of ~67% in domestic market. Growth in economy and increase in construction activities led to increase in company's revenues and further improvement in profitability. Keeping in view growth trajectory, 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 has been raised through the issuance of right shares. Remaining CAPEX will be funded through internally generated cash and debt. EPCL further plans to invest $23mln through internal cashflow for installing Hydrogen Peroxide Plant. During expansion, the strength of the balance sheet is likely to remain intact. The ratings also reflect EPCL's association with one of the country's leading conglomerate – Engro Corp. EPCL plans to utilize proceeds of of this sukuk to reprofile its exisiting debt which will further strengthen its financial profile. The company intends to maintain a Debt Service Reserve Account during tenor of the Sukuk.

The rating is 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. Timely build up of Debt Service Reserve Account for payment of financial obligations will remain critical.

Disclosure	
Name of Rated Entity	Engro Polymer & Chemicals Limited | Sukuk
Type of Relationship	Solicited
Purpose of the Rating	Debt Instrument Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-18),Methodology | Sukuk(Jun-18),Methodology | Debt Instrument(Jun-18),Methodology | Criteria | Rating Modifier(Jun-18)
Related Research	Sector Study | Polyvinyl Chloride(Jun-18)
Rating Analysts	Muhammad Hassan | muhammad.hassan@pacra.com | +92-42-35869504

ENGRO POLYMER AND CHEMICALS LIMITED - PROFILE	
Incorporated	1997
Major business lines	• PVC • 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%).

ISSUER PROFILE

- EPCL is a subsidiary of Engro Corporation Limited (ECL) having majority stake of 56%. The other major shareholder of EPCL is Mitsubishi Corporation (11%).
- 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.

ABOUT THE SUKUK

- EPCL is in the process of issuing a Privately Placed, Over-The-Counter Listed, and Secured Sukuk of PKR 9bln (inclusive of PKR 5bln green-shoe option).
- Proceeds of the issue will be utilized largely for reprofiling of existing debt. 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 has been raised through the issuance of right shares. Remaining CAPEX will be funded through internally generated cash and debt.
- Tenor of the Sukuk will be 7.5 years with initial 5.5 years as grace period. The issue has proposed profit (3MK+.90bps) payable quarterly in arrears. The Sukuk's principal repayment will start after 66th month of issue date in 5 semi-equal semiannual installments.
- The instrument, will be secured by First Pari Passu Hypothecation charge over all movable fixed assets with 20% margin. Initially ranking charge would be created which would be upgraded into pari-passu within 120 days of Issue date
- EPCL shall maintain 'Debt Service Reserve Account' (DSRA) under lien of the Security Trustee whereby the installments (Principal plus Profit) will be made regularly prior to due date. EPCL shall provide 1/3rd of upcoming quarterly profit installment in DSRA on monthly basis and shall maintain 1/3 of the Principal repayment in the DSRA, 90 days prior to the Principal repayment due date and subsequently 1/3 on 60 days and 30 days before the Principal repayment due date.

GOVERNANCE & MANAGEMENT

- 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).
- Mr. Imran Anwer is the CEO of the company. He has hands-on experience 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.

BUSINESS RISK

- EPCL's topline has increased (1HCY18: PKR 17,102mln, 1HCY17: PKR 13,045mln), ~31%, mainly owing to higher volume and increase in the prices of its main product – PVC. PVC constitutes ~80% of its total topline. Caustic soda being the other product with remaining share in topline.
- During 1HCY18, company's cost of sales increased (~24%) – less than proportionate. Resulting in improved gross margin (1HCY18: ~26.7%, 1HCY17: ~22.7%) and operating margin (1HCY18: ~20.7%, 1HCY17: ~15.7%).
- During 1HCY18, operational expenses slightly increased YoY however decreased in proportion to sales. 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 2,784mln at end Jun18 (CY17: PKR 2,049mln, CY16: PKR 655mln).
- 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). EPCL also plans to utilize its byproduct-Hydrogen and start production of Hydrogen Peroxide (H2O) by investing ~$23mln through internal cashflow generation.

FINANCIAL RISK

- EPCL's cash cycle remained robust as almost all sales are on cash basis while the company has a credit period facility 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: 1HCY18: PKR 4,499mln, 1HCY17: 2,814mln). Despite hike in interest rates, due to debt reprofiling in previous years, finance cost has reduced YoY which resulted in improved interest coverage ratio (1HCY18: 15.1x, 1HCY17: 7.1x).
- EPCL currently has a leveraged capital structure. The company's capital structure stood at 42.8% in 1HCY18 (1HCY17: 55.5%). The company repaid some of its debt in 2QCY18 which lead to decrease in leveraging. With Right issue of PKR 5.4bln equity has increased which means that despite procurement of further debt company's leveraging is expected to remain at adequate level. Leveraging is expected to decrease once repayment starts.

Engro Polymer and Chemicals Limited

BALANCE SHEET	30-Jun-18	31-Dec-17	31-Dec-16	31-Dec-15
	6M	CY17	CY16	CY15
Non-Current Assets	**17,389**	**16,203**	**16,719**	**17,314**
Investments (Incl. associates)	**50**	**50**	**50**	**50**
Equity	50	50	50	50
Debt	-	-	-	-
Current Assets	**7,650**	**7,912**	**6,952**	**6,578**
Inventory	4,327	3,681	3,024	2,941
Trade Receivables	466	505	456	437
Others	2,857	3,726	3,471	3,200
Total Assets	**25,580**	**24,315**	**24,461**	**24,242**
Debt	**7,500**	**8,750**	**9,584**	**11,394**
Short-term	-	-	417	3,050
Long-term (Inlc. Current Maturity of long-term debt)	7,500	8,750	9,167	8,344
Other shortterm liabilities	8,069	7,845	8,909	7,545
Shareholder's Equity	**10,011**	**7,720**	**5,968**	**5,303**
Total Liabilities & Equity	**25,580**	**24,315**	**24,461**	**24,242**
INCOME STATEMENT				
Turnover	**17,102**	**27,731**	**22,854**	**22,264**
Gross Profit	4,560	6,065	3,935	2,773
Other Income	167	(233)	(127)	(330)
Financial Charges	(298)	(821)	(930)	(1,082)
Net Income	**2,784**	**2,049**	**655**	**(649)**
Cashflow Statement				
Free Cashflow from Operations (FCFO)	4,499	5,819	3,698	1,060
Net Cash changes in Working Capital	(1,119)	(3,363)	289	(1,260)
Net Cash from Operating Activities	3,000	1,894	3,102	(1,161)
Net Cash from InvestingActivities	(1,774)	(1,083)	(1,078)	(800)
Net Cash from Financing Activities	(1,784)	(503)	(1,807)	1,578
Net Inc/dec in Cash	(558)	308	217	(382)
Ratio Analysis				
Performance				
Turnover Growth	31.1%	21.3%	2.7%	-6.5%
Gross Margin	26.7%	21.9%	17.2%	12.5%
Net Margin	16.3%	7.4%	2.9%	-2.9%
ROE	111.2%	26.5%	11.0%	-12.2%
Coverages				
Interest Coverage (FCFO/Gross Interest)	15.1	7.1	4.0	1.0
Core: (FCFO/Gross Interest+CMLTD+Uncovered Total STB)	9.6	7.1	1.0	0.1
Debt Payback (Total LT Debt Including UnCovered Total STBs) / (FCFO- Gross Interest)	1.9	1.8	4.2	-577.6
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	13.6	32.5	-23.7	-18.0
Capital Structure (Total Debt/Total Debt+Equity)	42.8%	53.1%	61.6%	68.2%

Debt Instrument Rating Scale & Definitions

Debt Instrument 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.

Rating Symbol	Definition
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.

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.

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)
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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Sukuk	
Issue size	PKR 8,750mln (inclusive of Green Shoe option of PKR 5,000mln)
Tenor	7.5 Years from the date of issue with a 5.5 years grace period
Profit Rate	The issue has a floating rate of return at 3Months KIBOR + 0.90% p.a. Profit is payable quaretely in arrears
Principal Repayment	Five (5) equal semi-annual installments commencing from the 66th month after the Issue date
Call Option	Early redemption of the Issue will only be allowed after forty two (42) months from the Issue Date and subject to the satisfaction of Early Redemption Conditions The Issuer shall give thirty [30] calendar days prior written notice to the Trustee and Sukuk holders which shall also specify the date fixed for the exercise of the Early Redemption. The redemption shall either be of full Issue amount or part of the Issue amount.
Trustee	To be decided
Debt Service Reserve Account	Installments (Principal plus Profit) will be made regularly prior to due date. EPCL shall provide 1/3rd of upcoming quarterly profit installment in DSRA on monthly basis and shall maintain 1/3 of the Principal repayment in the DSRA, 90 days prior to the Principal repayment due date and subsequently 1/3 on 60 days and 30 days before the Principal repayment due date
Security	The underlying instrument will be secured by hypothecation charge over all present and future movable fixed assets with a minimum 20% margin. The value of assets backing this Sukuk stands at PKR ~32,000mln. Initially ranking charge would be created which would be upgraded into pari-passu within 120 days of Issue date

-----------PKR In Million -----------

Installment	Year	Due Date	Principal	Mark Up	Total Installment	Outstanding Balance
						8,750
1	2019	Mar-19		2,863	2,863	8,750
2	2019	Jun-19		2,863	2,863	8,750
3	2019	Sep-19		2,863	2,863	8,750
4	2020	Dec-19		2,863	2,863	8,750
5	2020	Mar-20		2,863	2,863	8,750
6	2020	Jun-20	G	2,863	2,863	8,750
7	2020	Sep-20	R	2,863	2,863	8,750
8	2021	Dec-20	A	2,863	2,863	8,750
9	2021	Mar-21	C	2,863	2,863	8,750
10	2021	Jun-21	E	2,863	2,863	8,750
11	2021	Sep-21		2,863	2,863	8,750
12	2022	Dec-21	P	2,863	2,863	8,750
13	2022	Mar-22	E	2,863	2,863	8,750
14	2022	Jun-22	R	2,863	2,863	8,750
15	2022	Sep-22	I	2,863	2,863	8,750

16	2023	Dec-22	O D	2,863	2,863	8,750
17	2023	Mar-23		2,863	2,863	8,750
18	2023	Jun-23		2,863	2,863	8,750
19	2023	Sep-23		2,863	2,863	8,750
20	2024	Dec-23		2,863	2,863	8,750
21	2024	Mar-24		2,863	2,863	8,750
22	2024	Jun-24	1,750	2,863	4,613	7,000
23	2024	Sep-24	-	2,290	2,290	7,000
23	2024	Dec-24	1,750	2,290	4,040	5,250
24	2025	Mar-25	-	1,718	1,718	5,250
25	2025	Jun-25	1,750	1,718	3,468	3,500
26	2025	Sep-25	-	1,145	1,145	3,500
27	2025	Dec-25	1,750	1,145	2,895	1,750
28	2026	Mar-26	-	573	573	1,750
29	2026	Jan-26	1,750	573	2,323	-