The Pakistan Credit Rating Agency Limited

Rating Report

Cherat Cement Company Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
26-Apr-2019	A	A1	Positive	Maintain	-
31-Dec-2018	A	A1	Positive	Maintain	-
30-Jun-2018	A	A1	Positive	Maintain	-
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	-

Rating Rationale and Key Rating Drivers

The ratings reflect Cherat Cement’s improving profile supplemented by strengthening market share of the company. The company commenced line-II (1.3mln tpa) in Jan-17 and completed another expansion (~2.1mln tpa) in Jan-19, doubling the company’s existing capacity. This will bode well in future years on account of volumetric uptick. The company has already joined league of mid-tier cement players. Upcoming industry wide expansions of 11.7mln tpa (North Region only) majority commissioning by Sep-19 and slowdown in the growth of local demand seems a challenge. The demand needs to be up to secure companies’ margin. Export is another avenue. Industry wide exports (sizeable increase in South Region) have gone up due to muted growth in local demand. A new export window is created in Bangladesh market. Previously, cement exports were seen at its peak after financial crisis in 2008. The company’s revenues witnessed strong standalone growth primarily driven by full year utilization of Line-II. The company’s high utilization levels, developments in achieving cost efficiencies and tapping new markets are a positive. During 1HFY19, industry margins witnessed decline due to lower retention prices especially in the north region, fluctuating international coal prices, pak rupee depreciation and increased import duty on coal. Lately, the coal prices showed downward trend due to cutdown of imports by China- are expected to remain range bound in medium term. The company also incentivized dealers to enter new markets which lead to decline in margins. This will assist in channelling enhanced volumes from new line commenced. The business profile of the company is likely to behave average in medium term on the back of slow demand specially for the north players and squeezing EBITDA. Strong utilization and vigilant channelling of volumes and necessary to uphold margins. Going forward, company is determined to hold its existing position in the market. Leveraging is expected to stay at the same level for a shorter period.

The ratings are dependent on upholding company's market position along with sustenance of business volumes and margins. Company's long-term debt repayment is important to improve financial risk matrix. The company's strong business performance in current stretched economic scenario - challenges on demand front - remains vital for ratings.

Disclosure	
Name of Rated Entity	Cherat Cement Company 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 | Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
Related Research	Sector Study | Cement(Nov-18)
Rating Analysts	Saliha Sajid | saliha.sajid@pacra.com | +92-42-35869504

Profile

Legal Structure Cherat Cement Company Limited (Cherat Cement), a public limited company incorporated in 1981, commenced operations in 1985. The company is listed on Pakistan Stock Exchange (PSX).

Background Cherat Cement Company is one of leading companies of Ghulam Faruque Group. Over last decade, Ghulam Faruque Group has solidified its position by having interests in various sectors i.e cement, sugar, packaging, software solution, power, air conditioning, CNG installation, sales and servicing of engineering parts, etc.

Operations The company's installed capacity stands at ~4.5mln tpa; market share (8.0%) as at Mar-19, in the overall industry's installed capacity. The company's home markets include Nowshera, Peshawar and Charsada.

Ownership

Ownership Structure 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.

Stability Presently, third generation is heading the business of GFG companies. Hence, the ownership is expected to remain same in foreseeable future.

Business Acumen The business acumen of sponsors is considered strong as sponsoring family has diversified interests. Over the years, GFG has strengthened its foothold in various business ventures.

Financial Strength Financial Strength of the group is considered strong as GFG group reported a revenue of PKR ~29bln in Jun-18.

Governance

Board Structure The overall control of the company vests in eight member board of directors (BoD), including the CEO. The BoD comprises seven non-executive directors, including three independent directors. The board has four representatives from sponsoring family, including the CEO.

Members' Profile Cherat Cement has a balanced and professional board with well- qualified members having diverse business experience.

Board Effectiveness During the year, six board meetings were held. Directors' attendance in the board meetings remained strong; meeting minutes are formally maintained. Two board committees, Audit and Human Resource and Remuneration, are in place to assist the board on relevant matters.

Financial Transparency M/s EY Ford Rhodes Chartered Accountants – 'A category' SBP panel member – is the external auditor of the company, has expressed unqualified opinion on Cherat Cement's financial statements for the year ended June 30, 2018 and half yearly December 31, 2018.

Management

Organizational Structure Cherat Cement has a well-tiered organization structure with the company's operations grouped under eight key functions. These include 1) Procurement, 2) Production, 3) Sales & Marketing, 4) Information Technology, 5) Finance, 6) Corporate Affairs, 7) Human Resource, and 8) Internal Audit. All departments are headed by Executive Directors/ General Mangers (GMs), who, in turn, directly report to the CEO.

Management Team The CEO, Mr. Azam Faruque, is a grandson of Mr. Ghulam Faruque and is associated with the company since 1992. Mr. Faruque is a foreign qualified professional with diversified exposure including Oil and Gas, packaging, cement, power, sugar, and financial sectors. The group's Chief Financial Officer, Mr. Yasir Masood, had been associated with GFG group since 2006. The CEO is supported by a team of experienced individuals having long association with the company.

Effectiveness The management is supported by five committees (i) Management, (ii) Production, (iii) Sales & Marketing, (iv) IT Steering and (v) Human Resource. The necessary information is captured in minutes.

MIS Cherat Cement is one of the cement companies that deploys SAP based ERP solution in Pakistan. The software enables the management to generate various regular and customized reports of different frequency (daily, weekly, monthly and yearly) pertaining to production, sales, cement prices and other important financial figures.

Control Environment CCCL operates with three lines; one is European and others are Chinese Technology. Accredited with ISO9001: 2015 and ISO14001: 2015 certifications. Power needs are managed through alternate sources including WHR, RDF and TDF. Post line III installation, power requirement stands at 50-53.5 MW. Captive power capacity has been increased to 70 MW. CCCL has national grid connection of 63 MW.

Business Risk

Industry Dynamics Cement industry is divided into North and South region – majority players operating in North region. Cement industry undergoing expansions with majority capacities commencing operations in FY20. During FY19, sizeable drop in domestic consumption was witnessed which led to drop in local cement dispatches by 4% attributable to slowdown in large construction projects driven by lesser PSDP utilization. Previously, cement exports were seen at its peak after financial crisis in 2008. Currently, exports to Afghanistan and India also witnessed downtrend by ~22% and ~5% YoY. However, exports via sea to Bangladesh witnessed uptrend of 58%. Margins of industry players came under pressure driven by escalation of international coal prices (8HFY19: $96, FY18: $90, FY17: $77, F16: $53), rupee depreciation and unsustainable cement prices (especially in north region) due to slowdown in local demand. Lately, the coal prices showed downward trend due to cutdown of imports by China- are expected to remain range bound in medium term. Currently, leveraging of industry is moderate but in increasing interest rates environment it is critical for cement players to vigilantly manage cost structure. Cement demand is expected to stay nominal (at least for upcoming one year) as new government's prerogative for infrastructure will take some time to materialize. Therefore, upcoming capacity expansion utilization will be challenging factor.

Relative Position The Company with the total operational capacity of 4.5mln tpa, enjoys 8.0% market share in country's total installed cement capacity as at Mar-19.

Revenues Cherat Cement dispatches decline (YoY) by ~19.1%, primarily driven by slowdown in the country wide construction activities. Sales volume analysis revealed that cement local dispatches witnessed decline of 12% (1HFY19: 0.9mln tons; FY18: 2.2mln tons, 1HFY18: 1.0mln tons). Exports to Afghanistan also decline by 23%. Capacity utilization (clinker) level remained robust 97% (FY17: 97%). During 1HFY19, the company's topline showed a decline to PKR 7.0bln (1HFY18: PKR 7.6bln), down 7.2% YoY. Other income of PKR 71mln (1HFY18: PKR 37mln), mainly in the form of dividend & interest from Cherat Packaging, supported the bottom line. The finance costs increased to PKR 228mln (1HFY18: PKR 182mln – net of capitalization) on account of higher leveraging. Tax benefit from line-II supported the company's bottom line which stands at PKR 1.03bln (1HFY18: 1.35bln), down by 23.8% YoY.

Margins During 1HFY19, margins witnessed decline (gross: 1HFY19: 18%, 1HFY18: 25%); primarily due to increase in international coal prices, duty on coal and exchange rate fluctuation. In addition to general industry factors, the company also incentivized dealers in order to enter new markets. This will assist in channelling enhanced volumes from new line-III. EBITDA margins also decreased to 21.3% (1HFY18: 27.3%); industry wide going down.

Sustainability Cherat Cement has solidified its position in industry by taking first mover's advantage by adding line-II in its profile of 1.3mln tpa and line-III of ~2.1mln tpa. Going forward, as the industry is under pressure on account of slow demand - utilization of cement lines will be a challenging factor.

Financial Risk

Working Capital During FY18, working capital requirements – a function of inventory and payable. Inventory days decreased to 21days at end-Dec18 (end-Jun18: 30 days). Hence, net cash cycle decreased to 6days at end-Dec18 (end-Jun18: 18days). STBs increased to PKR 1.9bln (FY18: PKR .96bln) to manage company working capital.

Coverages During FY18, EBITDA has decreased (end-Dec18: PKR 1.5bln, end-Dec17: PKR 2.1bln); mainly due to lower PBT. The interest service coverage of the company weaken to 6.1x at end-Dec18 (end-Jun18: 9.2x; end-Jun17: 16.2x) on account increased leveraging and declined free cashflows. Going forward, coverages are likely to bounce back as future cashflows will start emanating from newly commenced line.

Capitalization At end-Dec18, the company's long term debt increased to PKR 17.4bln (end-Jun18: PKR 15.1bln; end-Dec17: PKR 6.8bln); debt to debt plus equity ratio surged to 62% (end-Jun18: 59%); end-Dec17: 41%) owing to majorly debt driven expansion of line-III. Cherat Cement maintains cushion in form of STBs (end-Jun18: utilized: PKR 1.9bln, total available facility: PKR 3.3bln). Going forward, the debt levels are expected to remain within bound as the expansion (line-III) has been completed and some early payments are made by the company for line -II.

Financials (Summary) in PKR mln
PKR mln

Cherat Cement Company Limited
Listed Public Limited

		Dec-18	Jun-18	Jun-17	Jun-16
A	**BALANCE SHEET**	**6M**	**12M**	**12M**	**12M**
1	**Non-Current Assets**	**26,640**	**23,841**	**13,672**	**12,747**
2	**Investments**	**519**	**397**	**566**	**710**
a	Equity Instruments	519	397	566	710
b	Debt Instruments	-	-	-	-
3	**Current Assets**	**6,490**	**6,282**	**4,569**	**2,005**
a	Inventory	855	754	844	305
b	Trade Receivables	156	188	131	-
c	Others	5,479	5,340	3,594	1,700
4	**Total Assets**	**33,649**	**30,520**	**18,807**	**15,462**
5	**Borrowings**	**19,323**	**16,064**	**6,401**	**4,231**
a	Short-Term	1,923	964	1,500	208
b	Long-Term (Incl. CMLTB)	17,400	15,100	4,901	4,023
6	Other Short-Term Liabilities	1,867	2,289	1,011	1,562
7	Other Long-Term Liabilities	841	993	933	529
8	**Shareholder's Equity**	**11,617**	**11,174**	**10,462**	**9,140**
9	**Total Liabilities & Equity**	**33,649**	**30,520**	**18,807**	**15,462**
B	**INCOME STATEMENT**				
1	**Sales**	**7,033**	**14,388**	**9,645**	**7,079**
2	**Gross Profit**	1,267	3,139	3,213	2,634
3	Non Operating Income	27	(53)	(9)	(112)
4	Total Finance Cost	(228)	(357)	(188)	(44)
5	**Net Income**	**1,027**	**2,132**	**1,957**	**1,405**
C	**CASH FLOW STATEMENT**				
1	Free Cash Flow from Operations (FCFO)	1,323	3,122	2,894	1,734
2	Total Cashflows (TCF)	1,336	3,142	2,916	1,748
3	Net Cash changes in Working Capital	(534)	(462)	(2,690)	572
4	Net Cash from Operating Activities	563	2,307	(6)	2,290
5	Net Cash from InvestingActivities	(3,163)	(11,190)	(1,577)	(5,572)
6	Net Cash from Financing Activities	2,581	8,885	1,605	3,286
7	Net Cash generated during the period	(19)	1	23	5
D	**RATIO ANALYSIS**				
1	**Performance**				
a	Sales Growth (for the period)	-2%	49%	36%	8%
b	Gross Profit Margin	18%	22%	33%	37%
c	Net Profit Margin	15%	15%	20%	20%
d	Return of Equity	18%	20%	20%	16%
2	**Working Capital Management**				
a	Gross Working Capital (Inventory Days + Receivable Days)	25.3	24.3	26.7	N/A
b	Net Working Capital (Inventory Days + Receivable Days - Payable Days)	16.9	17.6	21.0	N/A
3	**Coverages**				
a	Debt Service Coverage (FCFO / Finance Cost+CMLTB+Excess STB)	2.1	4.2	12.1	21.7
b	Interest Coverage (FCFO / Finance Cost)	6.1	9.2	16.2	44.2
c	Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	7.9	5.4	1.8	2.4
4	**Capital Structure (Total Debt/Total Debt+Equity)**				
a	Capital Structure (Current Borrowings / Total Borrowings)	14%	8%	24%	6%
b	Capital Structure (Total Borrowings / Total Borrowings+Equity)	62%	59%	38%	32%

Credit Rating Scale & Definitions

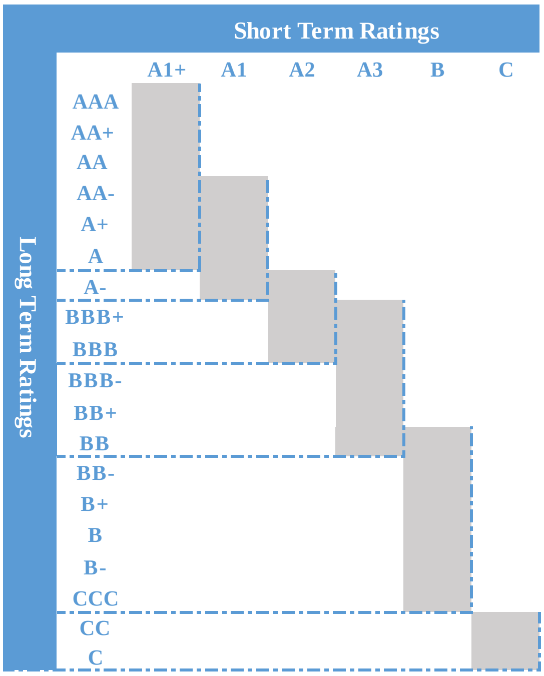
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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.

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)

Proprietary Information