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
10-Apr-2021	A	A1	Positive	Maintain	-
10-Apr-2020	A	A1	Stable	Maintain	-
25-Oct-2019	A	A1	Positive	Maintain	-
26-Apr-2019	A	A1	Positive	Maintain	-
31-Dec-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	-
03-Nov-2015	A	A1	Stable	Upgrade	-

Rating Rationale and Key Rating Drivers

Cherat Cement’s Ratings reflect its position in the market emanating from its major market share (7%) prominent presence in north region. Capacity expansion in past played a vital role to augment its position. The Cement sector’s despatches have recorded splendid growth over the last couple of months; surged around 16% to 28.6mln tons in the first half of the current fiscal year 20-21 as demand in the domestic market accelerated. Export is another avenue. Industry-wide exports (sizeable increase in South Region) have gone up as a new export window is created in Bangladesh market where the sector is exporting notable volumes of cement and clinker. The Company’s revenues witnessed an increase attributable to uptick in sales (end-Dec20: PKR 11.5bln, Jun20: PKR 17bln, end-Dec19: PKR 9.5bln). During 1HFY21, margins improved slightly from the Covid19 period. A significant drop in coal prices on the back of reduced demand during Covid-19, stayed within the range of $57-$67 along with the much-debated cut on FED duty supported the performance. Therefore; the company managed to recoup previous losses and reported profits of ~PKR 1.12bln for half-yearly financial statements after the periods where the company’s bottom line turned red i-e; FY20 & 1HFY20. The management has also planned BMR of Line-I to enhance the efficiency. Furthermore, company is also establishing a solar captive power plant of 13MW. The Company's leveraging is at an adequate level, especially with the repayments being made.The strengthening of business profile by achieving optimal utilization of production capacities is essential. Going forward, improvement in profitability for timely repayment of debt remains vital. The Positive Outlook captures the enduring steps being taken by the management. These are expected to benefit the ratings over the short horizon as the reported results catch up to the profile.

The rating 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.

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-20),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria | Rating Modifier(Jun-20)
Related Research	Sector Study | Cement(Mar-21)
Rating Analysts	Anam Waqas Ghayour | anam.waqas@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 With an installed capacity of 4.5mln tons per annum, the company currently holds 7% share in country's operational cement 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 the 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 considered strong as the GFG group reported a revenue PKR 35.9bln and a loss of Rs. 1.9bln.

Governance

Board Structure The overall control of the company vests in eight member board of directors (BoD), including the CEO. The BoD comprises six non-executive directors, including three independent director out of which three are Ghulam Faruque family members, 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, five 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, 2020.

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 2002. 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 As per prime bifurcation of Cement industry into North & South, majority concentration lies in North region. Currently, cement industry is on revival path after the downward tendency in reported dispatches during FY20, first half of the year witnessed high general inflation, rising utility prices and tight fiscal consolidation affecting the purchasing power of people and second half was effected due to outbreak of Covid-19 pandemic. However, it is worth mentioning that Cement Industry managed to survive this bumpy ride and induced growth in reported dispatches by 1.98% for FY20. Market dynamics has changed significantly in last year, driven by slowdown in economic activity wherein plunge in international coal prices (1QFY21: $57, FY20: $67, FY19: $72), decreased FED & policy rate cut by ~525bps supported the industry however, competitive cement prices (especially in north region) remained challenge to profit margins. Cement industry is entering into new phase of capacity expansion. Industry's leveraging is moderate however it is expected to increase on the back of new expansions. Going forward - with full capacity utilization - supply glut and pressurized cement prices would remain challenging for cement players. Cement demand is expected to accelerate on the account of various PSDP funded projects including dams, civil construction projects and public developmental projects, as Govt. has finally laid down the action plan to its announced pursuit for infrastructure.

Relative Position The company's market positioning strengthened with 7% installed cement capacity in the country

Revenues Cherat Cement has achieved continuous growth in recent years by witnessing increase of 7.7% (YoY) in net revenues. Sales volume analysis revealed that domestic dispatches increased by almost 36%, exports recorded a growth of approximately 32% compared YoY due to increase in exports to Afghanistan. The sales mix remained tilted towards local sales (FY20: 84%, FY19: 87%). During 1HFY21 and FY20, the company's topline stood at PKR 11.58bln & 17.090bln respectively (FY19: PKR 15.863bln), up 7.7% YoY. During FY20, gross profit, however, took a dip on account of high energy cost to stand at PKR 386mln (FY19: PKR 2.8bln) and the finance costs increased to PKR 2.49bln (FY19: PKR 1.14bln – net of capitalization) on account of higher leveraging. Hence, the company posted net loss of PKR 1.8bln in FY20 as compared to the profit of PKR 1.7bln of corresponding year. However, during 1HFY21 reported a profit of PKR 1,129mln on back of increased sales.

Margins During the year, the company's margins further declined (gross: FY20: 2.3% FY19: 18.2%); primarily on account of significant surge in fuel costs and instability in cement prices in north region. However, coverage improved in 1HFY21 and stand at 23%. Furthermore, net profit margin also deteriorated and dropped to -11.1% in FY20 (FY19: 11.1%); relatively low when compared with peers. Similarly it also improved in 1HFY21 and increased to 9.7%.

Sustainability During FY19, Cherat cement commissioned Line-III. Following this expansion, the production capacity of the Company now stands at 4.5 million tons per year. Going forward, the management has also planned BMR of Line-I to enhance the capacity utilization. Furthermore, company is also establishing a solar captive power plant of 13MW.

Financial Risk

Working Capital Company maintain its working capital requirements through internal cash flows and also through short term borrowings. During 1HFY21 net cash cycle marginally decreased to 26 days (FY20: 44 days). Inventory days also decreased to 24 days in 1HFY21. (FY20: 42 days). The quantum of STBs stood at PKR 1,594mln (FY20: PKR 2.6mln) on account of enhanced working capital needs. Current ratio stood at 2.4x (FY 20: 2.4x, FY19: 3.2x).

Coverages During 1HFY21, Cherat Cement's EBITDA improved to PKR 3.2bln as compared to annual of PKR 1.55bln (FY19: PKR 3.59bln) while finance costs witnessed significant uptick. Though, debt service coverage moved to 1.1x at the end of 1HFY21 (FY20: 0.4x, FY19: 1.7x).

Capitalization At end-1HFY21, the company's long term debt stands at PKR 17.1bln (FY20: PKR 17.4bln, FY19: PKR 17.7bln). CMLTD increased to PKR 3,681mln (FY20: PKR 450mln) due to which the leveraging decreased to 61.8% (FY20: 64%), high leveraging was majorly because of debt from expansion line-III. Furthermore, the Company has cushion in form of STBs as total facility stands at PKR 1,594mln (FY20: PKR 2.6bln, FY19: PKR 2.9bln).

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Cherat Cement Company Limited	Dec-20	Jun-20	Jun-19	Dec-18
Cement	6M	12M	12M	6M
A BALANCE SHEET				
1 Non-Current Assets	25,103	25,846	26,932	26,640
2 Investments	5	-	-	-
3 Related Party Exposure	1,173	391	255	519
4 Current Assets	6,810	6,685	8,093	6,490
a Inventories	*1,817*	*962*	*1,268*	*855*
b Trade Receivables	*286*	*301*	*311*	*156*
5 Total Assets	33,090	32,922	35,280	33,649
6 Current Liabilities	2,782	2,776	2,494	1,867
a Trade Payables	*618*	*171*	*276*	*265*
7 Borrowings	18,717	20,064	20,603	19,323
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	28	28	428	841
10 Net Assets	11,564	10,054	11,756	11,617
11 Shareholders' Equity	11,564	10,054	11,756	11,617
B INCOME STATEMENT				
1 Sales	11,589	17,090	15,863	-
a Cost of Good Sold	*(8,827)*	*(16,704)*	*(12,980)*	*(5,766)*
2 Gross Profit	2,761	386	2,883	(5,766)
a Operating Expenses	(412)	(653)	(690)	(338)
3 Operating Profit	2,350	(266)	2,193	(6,104)
a Non Operating Income or (Expense)	*48*	*71*	*(3)*	*27*
4 Profit or (Loss) before Interest and Tax	2,398	(196)	2,190	(6,077)
a Total Finance Cost	*(885)*	*(2,527)*	*(1,143)*	*(228)*
b Taxation	*(385)*	*830*	*715*	*300*
6 Net Income Or (Loss)	1,129	(1,893)	1,763	(6,006)
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*3,103*	*1,314*	*3,263*	*(5,710)*
b Net Cash from Operating Activities before Working Capital Changes	*2,015*	*(1,163)*	*1,891*	*(5,936)*
c Changes in Working Capital	*325*	*2,208*	*(1,848)*	*(534)*
1 Net Cash provided by Operating Activities	2,341	1,046	43	(6,470)
2 Net Cash (Used in) or Available From Investing Activities	(885)	(294)	(3,910)	(3,163)
3 Net Cash (Used in) or Available From Financing Activities	(1,356)	(745)	3,850	2,581
4 Net Cash generated or (Used) during the period	100	7	(18)	(7,052)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	35.6%	7.7%	10.2%	N/A
b Gross Profit Margin	23.8%	2.3%	18.2%	N/A
c Net Profit Margin	9.7%	-11.1%	11.1%	N/A
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	29.6%	20.6%	8.9%	N/A
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	19.6%	-18.2%	16.1%	N/A
2 Working Capital Management				
a Gross Working Capital (Average Days)	47	49	47	N/A
b Net Working Capital (Average Days)	41	44	40	N/A
c Current Ratio (Current Assets / Current Liabilities)	2.4	2.4	3.2	3.5
3 Coverages				
a EBITDA / Finance Cost	3.7	0.6	3.2	-25.5
b FCFO / Finance Cost+CMLTB+Excess STB	1.1	0.4	1.7	-9.2
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	3.8	-14.8	8.3	-1.5
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	61.8%	66.6%	63.7%	62.5%
b Interest or Markup Payable (Days)	69.3	78.6	176.2	346.4
c Entity Average Borrowing Rate	9.1%	12.6%	6.0%	3.0%

Credit Rating

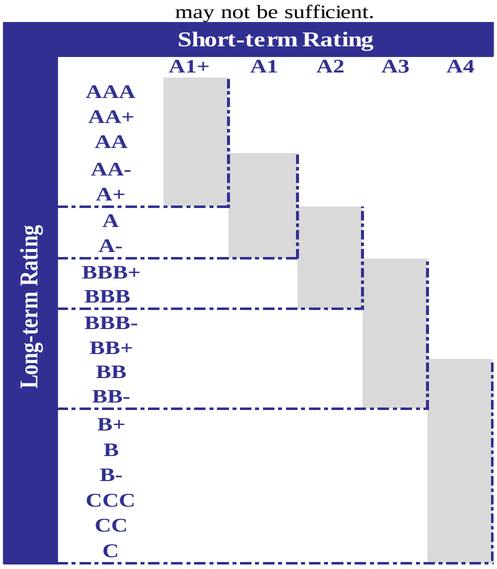
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	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.

Short-term Rating

Scale	Definition
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
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



The correlation shown is indicative and, in certain cases, may not hold.

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 some material identifiable event with indeterminable rating implications. 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 rating 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) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) 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.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

Entities

a) Broker Entity Rating
b) Corporate Rating
c) Financial Institution Rating
d) Holding Company Rating
e) Independent Power Producer Rating
f) Microfinance Institution Rating
g) Non-Banking Finance Companies (NBFCs) Rating

Instruments

a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk Rating

Regulatory and Supplementary Disclosure

(Credit Rating Companies Regulations,2016)

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