The Pakistan Credit Rating Agency Limited

Rating Report

Kohat Cement Company Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
12-Feb-2021	A	A1	Stable	Maintain	-
13-Feb-2020	A	A1	Stable	Maintain	-
28-Sep-2019	A	A1	Stable	Maintain	-
29-Mar-2019	A	A1	Stable	Maintain	-
22-Nov-2018	A	A1	Stable	Maintain	-
04-May-2018	A	A1	Stable	Maintain	-
29-Dec-2017	A	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Kohat Cement's ratings reflect its good market position in cement industry. The company's market share in north region rose to 9.6% after successful completion of brown-field expansion of 2.3mln tpa, last year. The financing is arranged with debt to equity ratio of 43:57 – majorly equity driven. During July20-Jan21, North based mills dispatched ~24mln tons cement for domestic consumption - ~17% higher as compared to SPLY. Exports from North were ~1.4mln tons showing decline of ~10%. Management is eying to participate in current boom in cement industry by further green field expansion. Industry dynamics especially for cement players operating in north region on account of competitive cement prices, increase in coal prices and depreciation in Pak Rupee against other currencies remain critical. The curtailed key policy rates will be a positive contributor towards the overall sector. Company aims to optimally utilize the recently expanded line IV, in order to cut off direct cost. In FY20 company's bottom line followed a downward trajectory amid COVID-19, on the account of industry shutdown. However in line with the industry trend, company's bottom line reported a profit of ~PKR 507mln in 1QFY21 as demand has picked up the pace. The company has available short term limit of ~PKR 3.3 billion out of which ~72% remained unutilized which shows company's low reliance on short term borrowings. The company's fairly low leveraging, healthy liquid investment book provides comfort to the ratings. Company owns an investment property along with a significant amount of liquid assets having a book value of ~PKR 3.7bln and ~PKR 1.6bln which mitigates the financial risk factor to a large extent.

The ratings are dependent on upholding of company's market position in addition to sustenance of business volumes and margins. The company's strong business performance in current scenario remains vital for ratings. Upholding of governance practices remains important for the ratings.

Disclosure	
Name of Rated Entity	Kohat 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-20)
Rating Analysts	Bazah Tul Qamar | bazahtul.qamar@pacra.com | +92-42-35869504

Profile

Legal Structure Kohat Cement Company Limited (Kohat Cement) a subsidiary of ANS Capital (Pvt.) Ltd, is a public listed company established in 1984 by State Cement of Pakistan. Subsequent to its privatization in 1992, the company was taken over by new management headed by Mr. Aizaz Sheikh. The company is listed on Pakistan Stock Exchange (PSX).

Background State Cement Corporation of Pakistan (SCCP) established a 1000 TPD Romanian cement line at Kohat in 1984. The Government of Pakistan in open bidding in 1992 privatized the Company. The registered office and the factory are located in Kohat, whereas the Head Office is located in Lahore.

Operations Kohat Cement is engaged in the production and sale of cement. The Company's products include Grey Cement and White Cement. The Company offers Ordinary Portland Grey Cement under the brand name ‘Kohat Cement’ and White Portland Cement under the brand name ‘Kohat Super White’. Four separate production lines (three for grey and one for white cement) allows the company to have a broader product slate

Ownership

Ownership Structure Kohat Cement is majority owned by sponsor family through ANS Capital (Pvt.) Limited (~55%) where, the ownership of ANS Capital (Pvt). Ltd. resides equally between Mr. Aizaz & Mr. Nadeem Atta sheikh. The other major proportion of shareholding is of Mrs. Hijab Tariq (widow of late Mr. Tariq Atta) owns 17%.

Stability Kohat’s ownership structure is seen stable as no major ownership changes are expected in near future. Majority stake will rest with ANS Capital (Pvt.) Limited.

Business Acumen The sponsors, especially the CEO, has interests vested in various sectors through holding company. This strengthens the sponsor’s business acumen.

Financial Strength Being the flagship entity of sponsors, willingness to support the company in case the need arises is considered high; also supplemented by access to capital markets.

Governance

Board Structure The overall control of the company vests in eight members board of directors - including the Chief Executive – Nadeem Atta Sheikh. Other than Chief Executive, Mr. Aizaz Mansoor is the chairman of the board. All board members are from sponsoring family, except two independent & one non-executive director.

Members’ Profile The board members’ have good business acumen on the back of significant local industry exposure in several sectors. The board meetings minutes are formally maintained reflecting good participation by the members present. Mr. Ahmed Sajjad & Mr. Talha Saeed elected as independent directors since Jun,19 and also serving as chairman of board committees.

Board Effectiveness Kohat Cement has two committees: Audit committee and Human Resource & Remuneration Committee; this is in compliance with the Code of Corporate Governance.

Financial Transparency KPMG Taseer Hadi & Co., Chartered Accountants conduct the external audit services for Kohat Cement. ‘KPMG’ is in ‘A’ category of SBP list of external auditors and has a QCR rating. They have expressed unqualified opinion on the financial statements for the year ended June 30th, 2020.

Management

Organizational Structure The company has a multi-tier structure. Currently, the organizational structure is divided into fourteen main functions.

Management Team Mr. Nadeem Atta Sheikh is currently holding the position of CEO (previously ED) and Mr. Aizaz Mansoor (previously CEO) is serving as the chairman of the board. The CEO is supported by a team of experienced individuals equipped with necessary technical skills and relevant industry exposure.

Effectiveness The Chief Executive Officer and Executive Directors are supported by a team of experienced professionals at key management positions.

MIS Kohat Cement has strong technology infrastructure with reasonably defined policies and procedures. However, the Company doesn’t have a documented and approved IT Strategy. Kohat has taken initiatives on need basis and developed IT strategy according to their management report.

Control Environment Control Environment Kohat Cement deploys rigorous quality check parameters during each level of manufacturing process to ensure good quality cement.

Business Risk

Industry Dynamics Cement industry is divided into North and South region – majority (76%) operational capacity exists in North region. Industry has completed phase II of capacity expansion of around 18mln tons per annum. Industry dynamics significantly shifted attributable to supply glut which resulted in price war, on top of that Covid-19 global pandemic resulted in economic slowdown that has significantly impacted local demand and exports as well; situation has become real challenging for players operating in north region after halt in Indian exports. During FY20, total dispatches recorded significant reduction during the month of March, April & May on avg. declining rate of 24.67% owing to economic slowdown due to globally declared pandemic Covid-19. However, Govt. efforts to stimulate economy by massive reduction in interest rates (~ 650bps cut since Jan-20), deferment facility on principal loan repayment and subsidized loans for salaries payment assisted the industry to pick up pace hence, total dispatches during the period recorded an uptick of ~1.98% YoY. Going forward, the Govt. announced infrastructure projects include Diamir Bhasha Dam and reduced coal prices along with bottom hit oil prices will play in favor of cement players however, channeling of excess supply on account of recent expansions, restoration of cement prices and exchange rates fluctuation will remain crucial for the industry

Relative Position Kohat cement's market share stands at 9.5% in total cement operational capacity of the country.

Revenues During 3MFY20, the company recorded revenue of PKR 2.99bln (FY19: PKR 15.6bln, 3MFY19: PKR 3.52bln), witnessing decrease of ~15% YoY. Sales mix remained tilted towards local market (3MFY20: ~92%, FY19: ~95%; FY18: ~97%) attributable to limited export avenues. Furthermore, during the 3MFY20, the company’s capacity utilization levels were also dropped by ~13% YoY to 539,210 M.Tons (3MFY19: 586,634 M.Tons). Similarly, Gross Profit also reported decline of ~86% YoY% (3MFY20; PKR 123mln; 3MFY19: 859mln) mainly attributed to reduced turnover and increased cost of sales by ~78% (3MFY20; PKR 2870mln; 3MFY19: 2662mln). Reduced other income of PKR 86mln further deteriorated the bottom-line, to stand at PKR 88mln (FY19: 2468mln; 9MFY1: PKR 529mln), down by ~83% YoY.

Margins Kohat’s margins have declined over the past year but still remained at comfortable level (Gross: 3MFY20: ~4%, FY19: ~27%, 3MFY19: ~25%, Operating: 3MFY20: ~1.3%, FY19: ~25%, 3MFY19: ~22%). Also, EBITDA margin witnessed deterioration (3MFY20: ~7%, FY19: 28%, 3MFY19: 27%), which is in line with the current industry trend especially in north mainly due to rupee depreciation, fluctuating cement prices and increased FED on coal import

Sustainability The expansion project is financed with debt equity of 46:54. The debt portion is aligned with the portfolio of investment properties, rest will be supported with the internal cash generation (present on balance sheet) of the company.

Financial Risk

Working Capital During 3MFY21, Kohat cement’s working capital requirements represented by net cash cycle (net working capital days) - reduced to 9 days (end Jun 20: 42 days) – a function of reduced receivables days (3MFY21: 9 Days; FY20: 20days) and inventory conversions days (3MFY21: 20days; FY20: 50days) where payables (3MFY21: 19Days; FY20: 28days) largely stayed the same. Overall, working capital requirements managed through good cashflows However reliance on short term borrowing has increased in FY20 and1QFY21 1QFY21: PPKR 925mln FY20: PKR 1,320mln).

Coverages As at end-Sep20, Kohat Cement’s EBITDA increased massively, standing at PKR 1,181mln and this significant increase in FCFO has improved the coverages (end-Sep20: 8x; end-Jun20: 0.4x. However, coverages will further improve as the economic condition has gradually stabilizing.

Capitalization As at end-Sep20, debt to debt plus equity ratio rose to ~26.2% (FY20: 27.2%: FY19: 22.9%), on the back of expansion. Leverage still remained lower comparative to other medium size players in the industry. Kohat cement has maintained an investment portfolio including investment properties (valued as at Jun,20; PKR 3.6bln) to meet the obligation against long term financing. Additionally, equity base of the company has currently achieved its Pre-COVID Position at end-Sep20: PKR 19.23bln; end-June19: PKR 19.67bln.

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Financial Summary
PKR mln

Kohat Cement Company Limited Infrastructure	Sep-20 3M	Jun-20 12M	Jun-19 12M	Jun-18 12M
A BALANCE SHEET				
1 Non-Current Assets	22,591	22,827	22,017	9,254
2 Investments	3,852	3,852	5,639	8,815
3 Related Party Exposure	-	-	-	-
4 Current Assets	5,927	5,198	3,659	5,247
a Inventories	*591*	*1,016*	*709*	*659*
b Trade Receivables	*508*	*494*	*714*	*646*
5 Total Assets	32,370	31,877	31,315	23,316
6 Current Liabilities	4,744	4,677	4,277	3,395
a Trade Payables	*1,318*	*1,278*	*629*	*1,222*
7 Borrowings	6,815	6,989	5,647	426
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	1,577	1,485	1,718	1,517
10 Net Assets	19,234	18,727	19,673	17,977
11 Shareholders' Equity	19,234	18,727	19,673	17,977
B INCOME STATEMENT				
1 Sales	5,174	11,300	15,646	13,439
a Cost of Good Sold	*(4,216)*	*(11,325)*	*(11,473)*	*(9,113)*
2 Gross Profit	959	(24)	4,173	4,325
a Operating Expenses	(91)	(303)	(340)	(300)
3 Operating Profit	868	(327)	3,834	4,025
a Non Operating Income or (Expense)	*(33)*	*179*	*(112)*	*52*
4 Profit or (Loss) before Interest and Tax	835	(148)	3,722	4,077
a Total Finance Cost	*(138)*	*(409)*	*(46)*	*(107)*
b Taxation	*(189)*	*114*	*(1,207)*	*(990)*
6 Net Income Or (Loss)	507	(444)	2,469	2,980
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*1,108*	*175*	*3,437*	*3,142*
b Net Cash from Operating Activities before Working Capital Changes	*887*	*(127)*	*3,098*	*3,077*
c Changes in Working Capital	*92*	*(376)*	*1,648*	*(51)*
1 Net Cash provided by Operating Activities	979	(502)	4,745	3,026
2 Net Cash (Used in) or Available From Investing Activities	(62)	(19)	(13,090)	(3,272)
3 Net Cash (Used in) or Available From Financing Activities	(175)	839	4,454	(791)
4 Net Cash generated or (Used) during the period	742	318	(3,891)	(1,037)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	83.2%	-27.8%	16.4%	-0.7%
b Gross Profit Margin	18.5%	-0.2%	26.7%	32.2%
c Net Profit Margin	9.8%	-3.9%	15.8%	22.2%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	23.2%	-1.8%	32.5%	23.0%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	10.7%	-2.3%	13.1%	17.9%
2 Working Capital Management				
a Gross Working Capital (Average Days)	23	47	32	35
b Net Working Capital (Average Days)	0	17	10	15
c Current Ratio (Current Assets / Current Liabilities)	1.2	1.1	0.9	1.5
3 Coverages				
a EBITDA / Finance Cost	8.5	1.6	127.7	89.1
b FCFO / Finance Cost+CMLTB+Excess STB	3.9	0.1	3.3	9.3
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	1.5	-29.0	1.6	0.1
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	26.2%	27.2%	22.3%	2.3%
b Interest or Markup Payable (Days)	83.3	193.8	1098.5	26.6
c Entity Average Borrowing Rate	8.2%	6.0%	1.0%	8.6%

Credit Rating

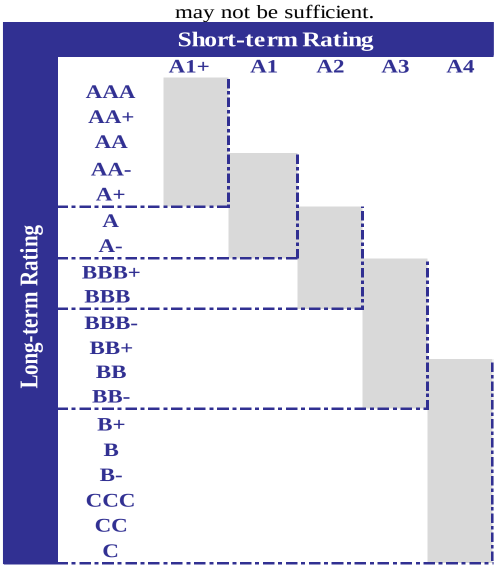
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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

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(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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