The Pakistan Credit Rating Agency Limited

Rating Report

Fecto Cement Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-Mar-2019	A-	A2	Stable	Maintain	-
18-Dec-2018	A-	A2	Stable	Maintain	-
07-May-2018	A-	A2	Stable	Initial	-
07-May-2018	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Fecto Cement has a single manufacturing capacity, located in north region. The Company's sales are majorly driven by local market fundamental – an industry wide phenomenon. However, Fecto exported a minuscule part to India and Afghanistan - viable export markets given geographical location of the company. 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. Upcoming industry wide expansions of 11.7mln tpa (North Region only) 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. During 1HFY19, industry dynamics reflect weakening on account of global increase in prices of raw material (coal), depreciation of Pak Rupee, lower retention prices (especially in north region) and higher financing expenses. Lately, the coal prices showed downward trend due to cutdown of imports by China- are expected to remain range bound in medium term. The aforementioned factors have affected the company's sales and corresponding costs; which resulted in declining margins of Fecto. The company has announced green-field expansion. The management is eying an international investment group to be partner in the project - modalities are yet to be finalized. It has taken time for the project to start. With the new market conditions and the delay in the finalization of the project financing and other related matters, it is unlikely that the project will start over the short horizon. Currently, the company is operating on deleveraged structure. Given current business profile, any acquisition of long term finance will be a rating negative factor.

The ratings are dependent on improvement of company's business volumes and margins. The company's improved business performance in current stretched economic scenario - challenges on demand front - remains vital for ratings.

Disclosure

Name of Rated Entity	Fecto Cement 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	Sehar Fatima | sehar.fatima@pacra.com | +92-42-35869504

Profile

Legal Structure Fecto Cement Ltd is a listed Company. Its shares are traded on Pakistan Stock Exchange Limited (PSX). The Company's shares are quoted under the Cement Sector.

Background Incepted in 1981, Fecto Cement Limited (FECTCO) is part of the Fecto group. The group is diversified into import, export and trading of electrical wires, cables, home appliances and automobiles and later, expanded to industrial sectors by establishing a cement plant, sugar mills, tractor plant as well as paper sack and hardboard manufacturing units. Fecto Cement Limited is headquartered in Karachi, Pakistan and the cement plant is established near Islamabad. The quality standards of the company are ISO 9001:2000.

Operations Fecto Cement Limited is engaged in manufacturing, marketing and selling cement and clinker.

Ownership

Ownership Structure Fecto Group hold majority stake (75%) through Mr. Yasin; rest is widely spread among FIs and general public.

Stability The shareholding had lately been transferred to Mr. Yasin Fecto and his family by his siblings. The company's ownership structure is not expected to change in foreseeable future.

Business Acumen The business acumen of the company is considered adequate on account of long term association with cement sector.

Financial Strength The financial strength of the group is considered adequate.

Governance

Board Structure The overall control of the company vests in seven member board of directors (BoD), including the CEO. The BoD comprises three independent directors.

Members' Profile Fecto's board members carry necessary technical stature which is required for effective decision making.

Board Effectiveness The board meeting minutes are formally maintained and the attendance is considered adequate. High attendance of the members was observed during the meetings held in FY18.

Financial Transparency M/s. Rahman Sarfaraz Rahim Iqbal Chartered Accountant conducted the external audit services for fecto. They're 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 30th June, 2018.

Management

Organizational Structure Fecto Cement has a lean 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.

Management Team The CEO, Mr. Yasin Fecto, is a son of Mr. Ghulam Muhammad Fecto and is associated with the company since 1990s. Mr. Yasin holds a master's degree and has experience of cement and packaging sectors. The CEO is supported by a team of experienced individuals having long association with the company.

Effectiveness There is an Audit and HR & Remuneration committee reporting directly to the Board.

MIS The company has core operating software; modules include financial, purchase, inventory, sales and payroll; reports generated are considered of adequate frequency.

Control Environment The Company is currently operating with one line; plant is of European technology. Accredited with ISO 9001: 2008 and ISO 14001: 2004 certifications, Fecto Cement deploys good technology to ensure production of quality cement.

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 1HFY19, domestic dispatches inched down by 1%, exports up by 72% and total cement dispatches inched down by 4%. 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 cut down 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.

Relative Position At end-Jun18, Fecto Cement's market share dropped to 1.5% (FY17: 1.7%) categorizing Fecto as a small player. With capacity to produce 780,000 tons of clinker per annum.

Revenues During 1HFY19, turnover was recorded at PKR 2.4bln a meager 0.6% dip YOY (FY18 PKR 4.9bln, 1HFY18: PKR 2.4bln, FY17: PKR 5.1bln); sales mix tilted towards local market (1HFY19: 93%; FY18: 93%; FY17: 89%) – in line with industry trend. However, due to a significant dip of 41% in operating profit YOY (1HFY19: PKR 120bln; FY18: PKR 536mln; 1HFY18: PKR 292bln; FY17: PKR 1,143mln), 6% increase in the operating expense and hike in raw material costs witnessing a 6% increase YOY as the South African coal prices increased by ~10% in 1HFY19 coupled with depreciation of rupee, Fecto's profit after tax declined by a massive 54% YOY standing at PKR 105mln (FY18: PKR 442mln, 1HFY18: PKR 228mln; FY17: PKR 761mln). 5.4 In 1HFY19. Sales volume analysis revealed that local dispatches stood at ~0.3mln tons (FY18: ~0.7mln tons, FY17: ~0.7mln tons, FY16: ~0.6mln tons). During the year Fecto exported to Afghanistan and Sales contribution remained positive on accounts of higher demand (1HFY19: 8%; FY18: 9%). Capacity utilization (clinker) improved to stand at 80% YTD – Dec (YTD- Sept: 77%, FY18: 87.5%, FY17: 88%).

Margins During FY18 and 1HFY19, Fecto's Gross, operating and EBITDA margins deteriorated (Gross: 1HFY19: 15%, FY18: 21%, FY17: 30%, Operating: 1HFY19: 5%, FY18: 11%, FY17: 22.3%, PBIT: 1HFY19: 5%, FY18: 12%; FY17: 21%). In recent times, margins deterioration is a trend witnessed throughout the cement industry as the macroeconomic factors such as increase in global commodity prices (coal), intervention of government in tightening the Fiscal and Monetary policies (Lower PSDP allocation), a sharp hike in energy costs, and a massive 33%-rupee depreciation against US dollar (Jan18 – Jan19).

Sustainability Going forward, the company has planned and announced a green field expansion in Malakand agency in KPK of 1.8mln tpa, expected to come online in FY20. The estimated cost of the project is PKR 18bln with a debt to equity ratio of 80:20. The equity portion of PKR 3.6mln will include majority portion of preference shares.

Financial Risk

Working Capital During 1HFY19, Fecto's working capital requirements represented by net cash cycle (net working capital days) – a function of inventory, receivables and payables - decreased to 78days (end-Jun18: 81days; end- Dec17: 77days, end-Jun17: 72days). The liquidity profile as evident by the Current ratio witnessed an improvement over the recent quater (1HFY19: 5.6x; FY18: 4.8x; FY17: 5.2x).

Coverages During FY18 and 1HFY19, FCFO declined to PKR 426mln and PKR 134mln respectively (FY17: PKR 721bln) mainly due to reduced profitability. Coverages declined but remained above industry because of a deleveraged capital structure (Interest: 1HFY19: 247x, FY18: 555x) However; as per Fecto's expansion plan, the coverages will be affected.

Capitalization Over the last few years, the company has been operating on a deleveraged structure. Going forward, the company is planning to acquire debt of PKR 14bln in pursuit of green-field expansion. Hence, the project debt financing and planning of cash flows generated to finance the debt remains essential. The financing is planned to be arranged by the Joint Venture partner. Hence, long term finance is not planned to come on Fecto Cement's book.

Cement
Financials (Summary) in PKR mln
The Pakistan Credit Rating Agency Limited

Fecto Cement

Listed Public Limited

	A BALANCE SHEET	Dec-18	Jun-18	Jun-17	Jun-16
		6M	12M	12M	12M
1	**Non-Current Assets**	**1,805**	**1,846**	**1,850**	**1,879**
2	**Investments**	-	-	-	-
a	Equity Instruments	-	-	-	-
b	Debt Instruments	-	-	-	-
3	**Current Assets**	**3,093**	**3,177**	**2,869**	**2,197**
a	Inventory	1,226	1,329	1,277	922
b	Trade Receivables	69	75	16	13
c	Others	1,798	1,772	1,576	1,263
4	**Total Assets**	**5,107**	**5,230**	**4,821**	**4,077**
5	**Borrowings**	**21**	**15**	**0**	**-**
a	Short-Term	0	-	-	-
b	Long-Term (Incl. CMLTB)	21	15	0	-
6	Other Short-Term Liabilities	551	663	549	439
7	Other Long-Term Liabilities	321	342	378	404
8	**Shareholder's Equity**	**4,215**	**4,210**	**3,894**	**3,233**
9	**Total Liabilities & Equity**	**5,107**	**5,230**	**4,821**	**4,077**
	B INCOME STATEMENT				
1	**Sales**	**2,484**	**4,903**	**5,131**	**5,032**
2	**Gross Profit**	367	1,027	1,557	1,623
3	Non Operating Income	14	67	(50)	(74)
4	Total Finance Cost	(2)	(3)	(1)	(12)
5	**Net Income**	**105**	**442**	**761**	**814**
	C CASH FLOW STATEMENT				
1	Free Cash Flow from Operations (FCFO)	134	426	721	1,046
2	Total Cashflows (TCF)	134	426	721	1,046
3	Net Cash changes in Working Capital	(106)	(100)	(256)	8
4	Net Cash from Operating Activities	25	322	463	1,034
5	Net Cash from InvestingActivities	(17)	(212)	(171)	(19)
6	Net Cash from Financing Activities	(117)	(95)	(164)	(906)
7	Net Cash generated during the period	(109)	15	128	108
	D RATIO ANALYSIS				
1	**Performance**				
a	Sales Growth (for the period)	1%	-4%	2%	5%
b	Gross Profit Margin	15%	21%	30%	32%
c	Net Profit Margin	4%	9%	15%	16%
d	Return of Equity	5%	11%	21%	26%
2	**Working Capital Management**				
a	Gross Working Capital (Inventory Days + Receivable Days)	99.2	100.4	79.2	75.0
b	Net Working Capital (Inventory Days + Receivable Days - Payable Days)	77.7	81.0	72.0	71.3
3	**Coverages**				
a	Debt Service Coverage (FCFO / Finance Cost+CMLTB+Excess STB)	44.7	360.5	360407.7	99.7
b	Interest Coverage (FCFO / Finance Cost)	172.9	360.5	360407.7	99.7
c	Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.1	0.0	0.0	0.0
4	**Capital Structure (Total Debt/Total Debt+Equity)**				
a	Capital Structure (Current Borrowings / Total Borrowings)	78	81	72	71
b	Capital Structure (Total Borrowings / Total Borrowings+Equity)	0%	0%	0%	0%

Mar-19

Rating Scale

Credit Rating Scale & Definitions

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

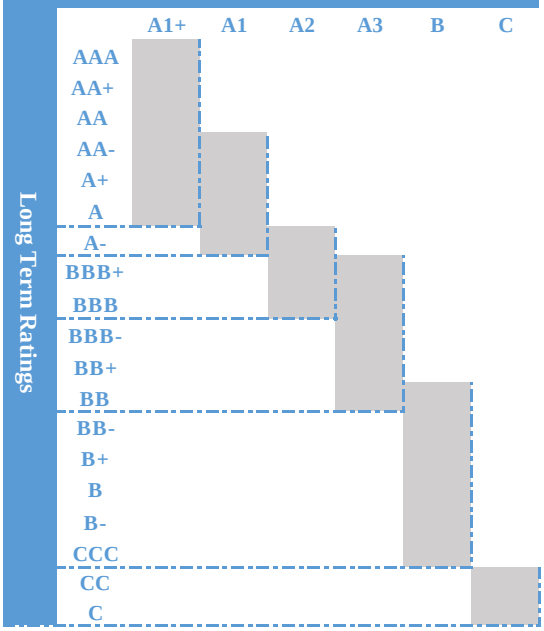
Long Term Ratings

AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ 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.

Short Term Ratings



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