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
02-Apr-2021	A-	A2	Stable	Maintain	YES
22-Apr-2020	A-	A2	Stable	Maintain	YES
27-Sep-2019	A-	A2	Stable	Maintain	-
30-Mar-2019	A-	A2	Stable	Maintain	-
18-Dec-2018	A-	A2	Stable	Maintain	-
07-May-2018	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Fecto Cement has a single manufacturing capacity, located in north region, with an annual cement capacity of 0.8mln tons. The company's market share stands at 1.6% in operational cement capacity. The Company’s sales are majorly driven by local market fundamental – an industry wide phenomenon. However, Fecto exported a minuscule part to Afghanistan - viable export markets given geographical location of the company. The cement sector achieved tremendous growth in despatches specifically local despatches post Covid-19 pandemic economic slowdown. The revival of economic activity based upon the PSDP funded projects including the construction of dams & CPEC related civil construction projects. Cement sector's local capacity utilization also recorded growth owing to accelerated local demand and the sector is entering into new era of expansions of ~18mlntpa. Leveraging levels on industry level are expected to go up owing to expansions. The likelihood of impact is considered high where quantum is directly correlated with operational strength and supported equity base. Curtailed key policy rate is providing much-needed room to the sector. The company's capacity enhancement program is in planning stage. The company’s business profile remains critical as per new era of expansions will change the industry’s dynamics and company may lose its market share if planned expansion of 1.8mln tpa will be put on hold. Going forward, along with improvement in volumes, managing direct & indirect costs, restoring operating and EBITDA margins at earlier healthier levels remains vital for the company. Rating watch incorporates deteriorating performance of the company in the last few quarters, wherein company reported humble growth in sales for 1HFY21 but still on lower side when compared to its peer universe. The company has announced green-field expansion, since some time, modalities are yet to be finalized. It has taken time for the project to start. With the supporting market conditions, the delays in finalization of the project financing and other related matters will remain critical. The financial risk profile would remain a predominant determinant in the ratings of the company. Currently the quantum of debt is not high. Any aggressive leveraging would take the ratings downward. Currently, the long-term financing is used to finance BMR projects including installation of solar plant & up-gradation of Silos & cooling system on plants.

The ratings are dependent on improvement of company’s business volumes and margins. The company's improved business performance in current economic scenario – challenges on quarry leases, effective cost management & relative position - 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-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	Anam Waqas Ghayour | anam.waqas@pacra.com | +92-42-35869504

Profile

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

Background Incepted in 1981, Fecto Cement Limited (FECTO) 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 holds a majority stake (75%) through Mr. Yasin; the rest is widely spread among FIs and the general public.

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

Business Acumen The shareholding has lately been transferred to Mr. Yasin Fecto by his siblings. The company's ownership structure is not expected to change in foreseeable future.

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

Governance

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

Members' Profile Fecto's board members carry the 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 FY20.

Financial Transparency M/s. Rahman Sarfaraz Rahim Iqbal Chartered Accountant conducted the external audit services for Fecto. They're in the 'A' category of the SBP list of external auditors and have a QCR rating. They have expressed an unqualified opinion on the financial statements for the year ended 30th June 2020.

Management

Organizational Structure Fecto Cement has a lean organizational 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, except internal audit, are headed by Executive Directors/ General Managers (GMs), who, in turn, directly report to the CEO while Internal Audit reports to the Board Audit Committee in line with the requirement of the Code of Corporate Governance.

Management Team The CEO, Mr. Yasin Fecto, is the son of Mr. Ghulam Muhammad Fecto and is associated with the company since 1990s. Mr. Yasin holds a master's degree and has experience in the cement and packaging sectors. The CEO is supported by a team of experienced individuals having a 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; the plant is of European technology. Accredited with ISO 9001: 2008 and ISO 14001: 2004 certifications, Fecto Cement deploys good technology to ensure the production of quality cement. Fecto Cement deploys good technology to ensure the production of quality cement. The fuel requirement is met mainly through coal imported from South Africa & Indonesia. Fecto Cement's total electricity (power) requirements stand at 14MW. The company utilizes 10MW out of the total 19MW available from WAPDA. The company also utilizes electricity obtained from the Waste Heat Recovery Plant of 5MW.

Business Risk

Industry Dynamics As per prime bifurcation of Cement industry into North & South, majority concentration lies in North region. Currently, the cement industry is on a revival path after the downward tendency in reported dispatches' during FY20, the first half of the year witnessed high general inflation, rising utility prices, and tight fiscal consolidation affecting the purchasing power of people, and the 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 have changed significantly in last year, driven by a slowdown in an 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 the north region) remained a challenge to profit margins. The cement industry is entering into a 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 At end-Jun20, Fecto Cement's market share is 1.6% categorizing Fecto as a small player. With the capacity to produce 828,000 tons of clinker p.a.

Revenues During 1HFY21, turnover was recorded a significant growth of 21% YOY to stood at PKR 2.3bln(1HFY20: PKR 1.9bln, FY20 PKR 3.6bln). In line with the industry trend, local dispatches of the company decreased during FY20 owing to subdued economic activity due to high inflation rates and hiked policy rates in the first half of the year and the outbreak of Covid-19 further deteriorated the despatches, whereas dispatches picked up pace subsequently and the sector is reviving sooner than expected. Given the Naya Pakistan Housing and potentially the construction package break ground in upcoming periods, sales are expected to remain tilted towards local despatches. Cost of sales amounted to PKR 2.24bln during 1HFY21, mainly comprising energy cost, raw materials consumed, salaries & wages, and packing materials. Gross profit reported of PKR 96mln during 1HFY21 after the gross loss was reported in FY20 of PKR 715mln. During 1HFY21, operating costs were recorded at ~PKR 162mln (1HFY20: PKR 184mln). Hence Company made a loss in 1HFY21 of PKR (60)mln (FY20: PKR 1052mln, 1HFY20: PKR 74mln).

Margins During 1HFY21, Fecto's margins deteriorated (Gross: FY20: -20.7%, FY19: 12.5%, Operating: FY20: -30.4%, FY19: 2.1%, EBITDA: FY20: -27%, FY19: 4.8%). During 1HFY21, there was a significant revival in gross margins to stand at 4.1% (1HFY20: 7.8%) operating: 1HFY21: decline -2.9% (1HFY20: -0.2%), EBITDA: 1HFY21: decline -2% (1HFY20: 14%). This is due to the increase in the prices of fuel, energy and competitive cement prices in north region.

Sustainability Going forward, the company has previously planned and announced a greenfield expansion in Malakand agency in KPK of 1.8mln tpa, which was expected to come online in FY20, but the plan did not complete. The estimated cost of the project was PKR 18bln with a debt to equity ratio of 80:20. Going Forward, Fecto is planning to go for expansion in (Khushab) Punjab.

Financial Risk

Working Capital During 1HFY21, Fecto's working capital requirements represented by net cash cycle (net working capital days) – a function of inventory, receivables, and payables - decreased to 194days (end-Jun20: 259days; end- Dec19: 183days, end-Jun19: 186days). The liquidity profile as evident by the current ratio remained manageable to ensure adequate liquidity levels over the period under review (1HFY21: 3.7x; FY20: 4.5x; 1HFY20: 3.9x, FY19: 7.6x).

Coverages During 1HFY20, FCFO and EBITDA became negative PKR (63)mln and PKR (48)mln respectively. In FY20, FCFO and EBITDA took a massive dip to PKR (944)mln PKR (1031)mln (FY19: FCFO- PKR 84mln, EBITDA- PKR 227mln) respectively mainly due to reported losses over the periods.

Capitalization Over the last few years, the company has been operating on a deleveraged structure. Currently, Fecto acquired long-term financing to finance its BMR projects. Going forward, expansion plans will impact the leveraging of the company in medium term. During 1HFY21, Company's debt to equity ratio stood at 21.5% (FY20: 17.1%).

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Financial Summary
PKR mln

Fecto Cement Ltd	Dec-20	Jun-20	Jun-19	Jun-18
Infrastructure | Cement	6M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	1,882	1,861	1,966	1,846
2 Investments	-	-	-	-
3 Related Party Exposure	474	492	549	207
4 Current Assets	2,801	2,481	2,552	3,177
a Inventories	*1,494*	*1,277*	*1,258*	*1,329*
b Trade Receivables	*28*	*25*	*68*	*75*
5 Total Assets	5,157	4,834	5,067	5,230
6 Current Liabilities	748	556	336	663
a Trade Payables	*373*	*124*	*51*	*353*
7 Borrowings	943	725	43	15
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	18	44	356	342
10 Net Assets	3,448	3,508	4,332	4,210
11 Shareholders' Equity	3,448	3,508	4,332	4,210
B INCOME STATEMENT				
1 Sales	2,332	3,464	4,740	4,903
a Cost of Good Sold	*(2,236)*	*(4,179)*	*(4,146)*	*(3,875)*
2 Gross Profit	96	(715)	594	1,027
a Operating Expenses	(162)	(336)	(494)	(491)
3 Operating Profit	(67)	(1,052)	101	536
a Non Operating Income or (Expense)	*24*	*46*	*35*	*67*
4 Profit or (Loss) before Interest and Tax	(43)	(1,006)	136	603
a Total Finance Cost	*(27)*	*(29)*	*(5)*	*(3)*
b Taxation	*10*	*264*	*(41)*	*(158)*
6 Net Income Or (Loss)	(60)	(770)	89	442
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*(63)*	*(1,031)*	*84*	*390*
b Net Cash from Operating Activities before Working Capital Changes	*(36)*	*(1,017)*	*79*	*387*
c Changes in Working Capital	*(159)*	*267*	*(94)*	*(100)*
1 Net Cash provided by Operating Activities	(195)	(750)	(15)	287
2 Net Cash (Used in) or Available From Investing Activities	(47)	56	(173)	(194)
3 Net Cash (Used in) or Available From Financing Activities	225	366	(121)	(95)
4 Net Cash generated or (Used) during the period	(17)	(328)	(308)	(1)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	34.6%	-26.9%	-3.3%	-4.4%
b Gross Profit Margin	4.1%	-20.7%	12.5%	21.0%
c Net Profit Margin	-2.6%	-22.2%	1.9%	9.0%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	-9.5%	-22.1%	-0.2%	5.9%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	-3.6%	-21.4%	2.0%	10.9%
2 Working Capital Management				
a Gross Working Capital (Average Days)	214	268	202	195
b Net Working Capital (Average Days)	194	259	186	175
c Current Ratio (Current Assets / Current Liabilities)	3.7	4.5	7.6	4.8
3 Coverages				
a EBITDA / Finance Cost	-2.0	-36.5	70.8	525.9
b FCFO / Finance Cost+CMLTB+Excess STB	-0.8	-15.0	7.0	330.6
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	-1.5	-0.1	0.5	0.0
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	21.5%	17.1%	1.0%	0.3%
b Interest or Markup Payable (Days)	74.3	201.9	0.0	0.0
c Entity Average Borrowing Rate	7.8%	8.7%	12.0%	6.5%

Credit Rating

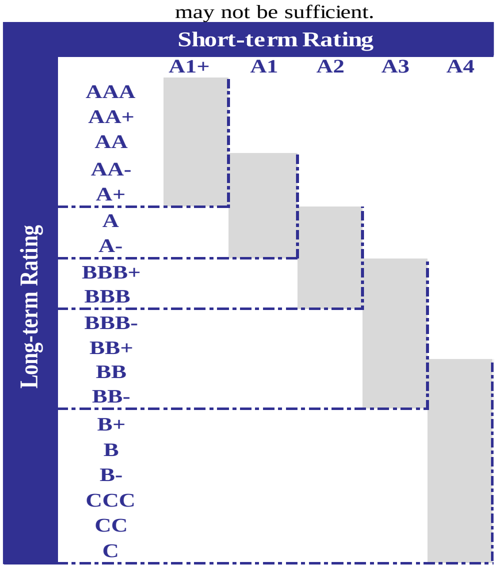
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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