The Pakistan Credit Rating Agency Limited

Rating Report

Askari Cement Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
29-Mar-2019	A	A1	Stable	Maintain	-
16-Nov-2018	A	A1	Stable	Maintain	-
09-Aug-2018	A	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Askari Cement's ratings reflect its sustained position in the cement industry. The Company has two existing cement manufacturing units (Nizampur and Wah) - operating with combined capacity of 2.7mln tpa, operating in North Region. The company recently completed BMR at Nizampur plant and installed WHR at Wah plant which helped Company to be more operationally effective. 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. Export is another avenue. Industry wide exports (sizeable increase in South Region) have gone up due to muted growth in local demand. A new export window is created in Bangladesh market. Previously, cement exports were seen at its peak after financial crisis in 2008. The company was able to maintain growth trajectory trend in revenue in last few years. In the recent slowdown, the Company was successful to secure its margins mainly due to usage of local and Afghan coal; no exchange rate risk involved. The planned expansion at Nizampur plant will be designed to operate at 100% local coal. It is vital for management to uphold business profile of the company by sustaining margins and improving volumes. Company is moderately leveraged and strong sponsor strength provides a comfort. Furthermore, cashflows provide good coverage to anticipate repayment. Going forward, leveraging is expected to increase in longer-term owing to expansion planned. The ratings take comfort from strong financial strength of Fauji Foundation - fourth largest sponsoring group in the cement industry.

The ratings are dependent on current positioning of the company's business besides financial risk profile; strengthening of equity base is essential. Any significant deterioration in the sector's outlook particularly any continuation of slowdown in economic growth, interest rate fluctuation and delay in infrastructure projects may affect the ratings. Industry's dynamics encompassing expected challenges of substantial decline in local demand or deterioration in cement prices will negatively affect the ratings.

Disclosure

Name of Rated Entity	Askari 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	Saliha Sajid | saliha.sajid@pacra.com | +92-42-35869504

Profile

Legal Structure Askari Cement Limited (ACL) is an unlisted, public limited company incorporated in 1990. The Company is wholly owned subsidiary of Fauji Foundation.

Background Fauji Foundation (also known as Fauji Group), is amongst the renowned sponsoring groups in Pakistan. It is a Charitable Trust which was founded back in 1954 with the purpose of welfare of the ex-servicemen and their dependents. Fauji Foundation has another cement company named ‘Fauji Cement Company Limited’.

Operations The company is primarily engaged in the manufacturing and sale of Ordinary Portland Cement. Askari Cement’s registered office is located in Rawalpindi. The production facilities are located in North region (Wah and Nizampur) with the total operational capacity of 2.68mln tpa.

Ownership

Ownership Structure Askari Cement is wholly owned subsidiary of Fauji Foundation.

Stability Askari Cement's ownership is expected to remain stable as is amongst the largest sponsoring groups in Pakistan.

Business Acumen The business acumen of the group is considered very strong as group has experience of sectors various sectors experienced like Fertilizer, Petroleum, Banking, Power etc.

Financial Strength Fauji Foundation total assets stands at PKR 443bln during FY17 (FY16: 378bln) and turnover was reported at PKR 178bln (FY16: PKR 161bln).

Governance

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

Members’ Profile The sponsor dominated board is chaired by Chairperson Lt Gen Syed Tariq Nadeem Gilani, (Retd), who is also associated with various Fauji Foundation companies board. He holds extensive experience of banking, fertilizer, petroleum, power and several other sectors. All of the board members, except the CEO, are non-executive members and represents the sponsoring group.

Board Effectiveness The board has three committees in place to oversee and assist board regarding the company’s operational and financial matters. These committees include: 1) Audit and Finance committee 2) Human Resource Committee (HR) and 3) Technical Committee.

Financial Transparency M/s. KPMG Taseer Hadi & Co., Chartered Accountants, the external auditor, have given unqualified opinion on the company’s financial statements for the year ended Jun18.

Management

Organizational Structure Askari Cement has a multi-tier organizational structure, divided into five key functions, namely (i) Finance, (ii) Marketing, (iii) Technical and Operations, (iv) Internal Audit and (v) HR & Admin. All departments reports to heads except for Internal Audit who reports directly to board.

Management Team The CEO, Maj Gen Ghulam Mustafa Kausar, is a graduate from Command and Staff College Quetta and Armed Forces War College (National Defence University), is associated with the company as Managing Director / CEO since Aug-16. Maj Gen Ghulam Mustafa kausar is involved in all strategic, key business and financial decisions of the company. The CFO Mr. Khalid Faiz, is an Associate of Cost and Management Accountants (ACMA) and has been associated with the company since last 12 years.

Effectiveness The management is equipped with good professional skills and enjoys long association with the company. There are several management committees in,place to oversee operations.

MIS The MIS reports pertaining to sales, purchase, inventory, general ledger, payroll, costing & budget, and Preventive maintenance and other important financial figures.

Control Environment Askari Cement deploys an Oracle based ERP solution implemented at head office, on both manufacturing sites. Askari Cement Company has two cement manufacturing units which are located in areas of plentiful limestone reserves in Wah (Isalamabad) and Nizampur. Wah –European technology plant, while Nizampur is Chinese technology.

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 Out of total industry's cement capacity of 54.3mln tpa, Askari Cement holding a market share of 4.9% as at Jan-19.

Revenues Askari Cement’s sales (FY18: PKR 14,752mln; FY17: PKR 15,953mln) witnessed slight decline 6.9% YoY owing to demand slowdown especially for north players. During FY18, the company’s volumes witnessed marginal uptick to stand at 2.4mln (M. Tons) (FY17: ~2.3mln (M. Tons). Admin expense of the Company especially donation to its sponsor Fauji Foundation eroded the net profit. Other recurring non-core income from bank deposits supported bottom-line by PKR 143mln (FY17: PKR 143mln). Finance costs of the Company increased to PKR 515mln (FY17: PKR 506mln). Owing to these all factors the net profit stood at PKR 1.8bln (FY17: PKR 2.7bln), down ~33% YoY. During 1HFY19, the company recorded turnover of PKR 8.2bln (1HFY18: PKR 7.9bln). Other income of PKR 74mln supported the bottom-line. Hence, the net profit figure stood at PKR 1.4bln (1HFY18: 1.1bln). The Company is mainly selling locally. The Company’s export avenue is Afghanistan due to its plant location in North, which only consist of ~5% in FY18 (FY17: ~6%). Cement capacity utilization levels remained healthy 84% (FY17: ~87%).

Margins During FY18, decrease in local demand and also increase cost of good sold resulted in decrease in company’s margins; gross and EBITDA margin declined to 23.8% (FY17: 32.1%) and 23.7% (FY17: 34.7%), respectively. During 1HFY19, the Company was successful to secure its margins mainly due to usage of local and Afghan coal; no exchange rate risk involved. Gross and EBITDA margins stood at 28.8% and 32.0% respectively.

Sustainability Going Forward, Company is planning a capacity expansion at its Nizampur plant for which the board has approved the expansion plan and the feasibility analysis is under process which is expected to be finalized in end of Mar-19.

Financial Risk

Working Capital During FY18, Askari Cement working capital requirements, represented by net cash cycle (net working capital days) – a function of inventory, receivables and payables – stood at 29days (end-Jun17: -15days). The company manages its working capital requirements through mix of internal generation and short term borrowings. At end-Jun18, the company reported STBs of PKR 2.9bln (end-Jun17: PKR 3.1bln). During 1HFY19, Company’s net cash cycle slightly reduced to 27 days, due to increase in creditors days.

Coverages During FY18, EBITDA clocked in at PKR 3.5bln (end-Jun17: PKR 5.5bln), owing to declined profitability. Furthermore, FCFO also witnessing declining trend (end-Jun18: PKR 2.2bln; at end-Jun17: PKR 3.9bln), resutantly interest coverage ratio and core coverage ratio weaken YOY reported at 4.4x and 1.3x at end-Jun18 (end-Jun17: 7.8x and 1.2). During 1HFY19, Company’s interest coverage ratio and core coverage ratio stood at 8.6x and 2.4x respectively; improved due to scheduled profitability and of debt repayment. Going forward, coverages are likely to stay comfortable.

Capitalization During FY18, long-term debt increased to PKR 8.1bln (FY17: PKR 5.1bln) resultantly debt to debt plus equity ratio remained the same to ~40% (FY17: 41%), the long term debt increased due to recent BMR at Nizampur site and WHR plant at Wah. During 1HFY19, Company’s debt to equity ratio declined to 37% as no further debt has been taken due to completion of BMR and WHR.

PKR mln

Askari Cement
Unlisted Public Limited

		Dec-18	Jun-18	Jun-17	Jun-16
A	**BALANCE SHEET**	6M	12M	12M	12M
1	**Non-Current Assets**	**25,422**	**25,582**	**19,602**	**19,608**
2	**Investments**	**2,640**	**1,270**	**1,745**	**1,639**
a	Equity Instruments	-	-	-	1,639
b	Debt Instruments	2,640	1,270	1,745	-
3	**Current Assets**	**5,269**	**5,411**	**4,146**	**3,461**
a	Inventory	1,547	1,134	959	772
b	Trade Receivables	376	831	580	120
c	Others	3,346	3,447	2,608	2,569
4	**Total Assets**	**33,331**	**32,263**	**25,493**	**24,707**
5	**Borrowings**	**10,143**	**10,861**	**8,185**	**7,384**
a	Short-Term	2,502	2,855	3,088	1,199
b	Long-Term (Incl. CMLTB)	7,641	8,007	5,097	6,186
6	Other Short-Term Liabilities	2,868	2,516	2,676	2,498
7	Other Long-Term Liabilities	2,826	2,733	2,972	2,816
8	**Shareholder's Equity**	**17,493**	**16,153**	**11,660**	**12,008**
9	**Total Liabilities & Equity**	**33,331**	**32,263**	**25,493**	**24,707**
B	**INCOME STATEMENT**				
1	**Sales**	**8,186**	**14,752**	**15,953**	**15,600**
2	**Gross Profit**	2,351	3,513	5,118	5,463
3	Non Operating Income	(20)	138	(127)	(110)
4	Total Finance Cost	(286)	(515)	(506)	(585)
5	**Net Income**	**1,356**	**1,720**	**2,694**	**2,983**
C	**CASH FLOW STATEMENT**				
1	Free Cash Flow from Operations (FCFO)	2,456	2,242	3,970	4,221
2	Total Cashflows (TCF)	2,541	2,396	4,102	4,331
3	Net Cash changes in Working Capital	703	(938)	(374)	324
4	Net Cash from Operating Activities	2,996	846	3,192	3,996
5	Net Cash from InvestingActivities	(761)	(3,750)	(828)	(387)
6	Net Cash from Financing Activities	(373)	2,603	(4,189)	(3,692)
7	Net Cash generated during the period	1,862	(301)	(1,825)	(83)
D	**RATIO ANALYSIS**				
1	**Performance**				
a	Sales Growth (for the period)	11%	-8%	2%	15%
b	Gross Profit Margin	29%	24%	32%	35%
c	Net Profit Margin	17%	12%	17%	19%
d	Return of Equity	16%	12%	23%	26%
2	**Working Capital Management**				
a	Gross Working Capital (Inventory Days + Receivable Days)	43.3	43.3	27.8	25.3
b	Net Working Capital (Inventory Days + Receivable Days - Payable Days)	27.4	28.7	14.9	13.0
3	**Coverages**				
a	Debt Service Coverage (FCFO / Finance Cost+CMLTB+Excess STB)	2.9	1.4	2.4	2.5
b	Interest Coverage (FCFO / Finance Cost)	8.9	4.5	8.1	7.4
c	Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	1.8	4.6	1.5	1.7
4	**Capital Structure (Total Debt/Total Debt+Equity)**				
a	Capital Structure (Current Borrowings / Total Borrowings)	27	29	15	13
b	Capital Structure (Total Borrowings / Total Borrowings+Equity)	37%	40%	41%	38%

Rating Scale

Credit Rating Scale & Definitions

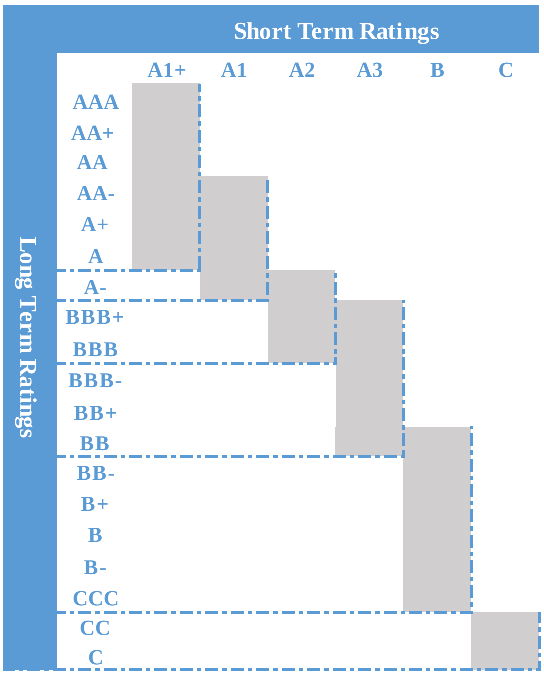
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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.



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