The Pakistan Credit Rating Agency Limited

Rating Report

Flying Cement Company Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
16-May-2019	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Flying cement operates as a market player with one manufacturing unit - having capacity of 0.72mln tpa, in North region. Currently, installation of WHR and BMR on manufacturing site is underway. The Company also announced doubling its existing capacity in FY16 but delayed it due to a number of announced capacities by majority cement players. The Company's strategy is to enter market after all the new capacities will be absorbed. Upcoming industry wide expansions of ~ 7.0mln tpa (North Region only) commissioning by 1HFY20 and slowdown in the local demand seems a challenge. The demand needs to be up to secure companies' margin. The company was able to maintain growth trajectory trend in revenue in last few years. Despite recent slowdown in industry, the Company's operating profit and margins witnessed improvement YoY primarily due to measures on efficiency. The company has a competitive edge regarding freight costs as local coal is used plant's location is near to Company's home markets. It is vital for management to uphold business profile of the company by sustaining margins and improving volumes. The sponsor's capital injection plan 1) PKR 200mln in FY19 2) PKR 470mln in 1QFY20 will give support to the financial risk profile. Going forward, leveraging will increase but cap is set for company, owing to planned expansion. Current coverages are adequate; principal repayment is scheduled after commencement of new line in Mar-21; cashflows are expected to be supportive at that time. Going forward, Company is focusing on efficiency side to improve its cost structure and achieve economies of scale.

The ratings are dependent on sustained profile of the company's business and financial risk profile; strengthening of equity base is essential. Any significant deterioration in the sector's outlook particularly continuation of slowdown in industry's dispatches, 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	Flying Cement Company 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(Apr-19)
Rating Analysts	Saliha Sajid | saliha.sajid@pacra.com | +92-42-35869504

Profile

Legal Structure Flying Cement Company Limited was incorporated in December 1992 as a public limited company. It started commercial production in 2005. The Company is listed on PSX.

Background Initially, the family was engaged in Flying coaches' business back in 1970s. The group started Flying Paper Industries Limited in 1986 and Flying Board & Paper Products Limited. Flying Cement was part of diversification strategy followed by group.

Operations Flying Cement registered Head Office is situated at Sarwar Road, Lahore Cantt and manufacturing facility established at Lilla Interchange (LHR-ISB Motorway); located in province Punjab. To fulfill its coal requirements, majority portion is purchased locally from Baluchistan and remaining is imported from South Africa and Indonesia.

Ownership

Ownership Structure Flying Cement is majority owned by sponsor family members.

Stability The shareholding is divided equally between the family members. As third generation has entered business at executive positions. The division between the next generation is yet be seen. However, the interest of young blood is considered positive for the sustainability of business.

Business Acumen The sponsors, Mr. Kamran Khan and Mr. Momin Qamar are associated with the company for very long and has capability of strategic decision making. Some shareholders are young blood, started working in family business with different educational backgrounds; business acumen is considered adequate.

Financial Strength Flying Group consist of 3 companies; 1) Flying Paper Industries Limited, 2) Flying Board & Paper Products and 3) Flying Cement Company Limited.

Governance

Board Structure The overall structure vests with eight board members, including CEO. Three directors are Flying Cement's executives – CEO, Director Technical & Administration, Director Finance, Director Marketing – while four are non-executive directors, including two independent and one female director. Five of the eight board members are from sponsoring family.

Members' Profile Board members carry adequate requisite skills, competence, knowledge and experience required for a vigilant oversight. Board members carrying different educational background and experience, but majority are linked with Flying Group of Companies. With reference to board meetings, attendance of directors is considered good.

Board Effectiveness There are two board committees in place to assist board through decision making process. The committees are: 1) Audit Committee and 2) Human Resource & Remuneration Committee (HR&R), both chaired by independent member. The attendance of the board is also considered adequate.

Financial Transparency M/s. Tahir Siddiqi and Co., Chartered Accountants, the external auditor is rated satisfactory auditor by ICAP has given unqualified opinion on the company's financial statements for the year ended Jun-18 and reviewed Dec-18 accounts of company.

Management

Organizational Structure Flying Cement has a multi-tier organizational structure, divided into four key functions, namely (I) Finance, (ii) Technical & Administration/ HR/ IT, (iii) Factory Administration and, (iv) Sales/ Marketing. Each function is headed by a separate director who, in turn, reports to the Board directly.

Management Team The CEO, Mr. Agha Hamayun Khan, associated with the group since 24 years. Mr. Kamran Khan, Chairman of group, having 36 years of experience and is handling technical matters and capacity expansion of the company. Mr. Momin Qamar, Director Finance, having 36 years of experience. The sons of both brothers are also into cement business. Mr. Qasim Khan Graduate in Business, having 10 years of experience, is looking after the marketing side of business. Mr. Ali Alam Qamar (Graduate Finance) joined the business recently and is following footsteps of his father. The management is equipped with necessary technical skills and relevant industry experience.

Effectiveness Majority of the sponsors are into management so there are no formal committees for the management. Important matters are discussed in the meeting of the management.

MIS Flying Cement deploys in house software by the Australian software firm. Majority of the reports are generated through Server but some of them are Excel based. The reports generated relate to Finance, Production process, Stock details and Sales etc. on daily, monthly and quarterly basis.

Control Environment The company deploys Japanese plant at its manufacturing facility supplied by IHI Japan. The company's lease for limestone mining stands at 23 years from now.

Business Risk

Industry Dynamics Cement industry is undergoing expansions with majority capacities coming online in FY20. During 1HFY19, drop in local dispatches by 1% is attributable to slowdown in demand. Previously, cement exports were seen at its peak after financial crisis in 2008. During 1HFY19, country's cement and clinker exports witnessed sizable growth of 72% YOY; attributable to Bangladesh window. Margins of industry players came under pressure driven by escalation of international coal prices (1HFY19: $96, FY18: $90), rupee depreciation and unsustainable cement prices (especially in north). 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. Therefore, upcoming capacity expansion utilization will be challenging factor.

Relative Position Flying cement is small player currently operating at capacity of 0.72mln tpa; 2.8% market share in North region. The company is trying to maintain its share by doubling its existing capacity.

Revenues During FY18, the company reported revenue of PKR 2.9bln (FY17: PKR 2.5bln), demonstrating growth of ~16%. The cost of goods sold increased (FY18: PKR 2.6bln, FY17: PKR 2.2bln) primarily due to five ball mills power consumption. Other income from deposit with banks supported revenue stream. Finance costs increased significantly to PKR 44mln (FY17: PKR 8mln), driven by increase in financial institution borrowing. Hence, net profit stood at PKR 182mln (FY17: PKR 161mln). During 1HFY19, the company's revenues increased marginally to PKR 1.8bln (1HFY18: PKR 1.3bln).

Margins In recent years, company shifted its coal consumption from imported coal to local coal. Hence, company's margins' sustained when compared with peers. During 1HFY19, Gross and EBITDA stood at 11.0% and 14.0% (1HFY18 Gross: 10%, EBITDA: 14%) respectively.

Sustainability Going forward, management will focus on cost efficiency to secure its margins and maximize capacity utilization to achieve economies of scale. The Company announced expansion in FY16 but owing to number of other expansions announced delayed plan to Mar-21. The cost of the project would be PKR 5bln with 51:49 debt to equity ratio. Also, with completion of WHR and BMR the company will be able to achieve efficiency.

Financial Risk

Working Capital During 1HFY19, Company's working capital requirements, represented by net cash cycle – a function of inventory, receivables and payables – improved to 66 days. Current ratio is providing a comfort (end-Jun18: 11.3x; end-Jun17: 0.9x). During 1HFY19, company's net cash cycle reduced to 66 days and STBs stood at PKR 675mln.

Coverages During FY18, EBITDA and FCFO were reported at PKR 369mln (FY17: PKR 303mln) and PKR 210mln (FY17: PKR 191mln) respectively owing to enhanced profitability. During 1HFY19, company's interest coverage ratio and core coverage ratio stood at 2.0x (FY18: 5x) and 1.6x respectively.

Capitalization During the year, long term debt remained at PKR 1.2bln from financial institution and PKR 1.6bln from sponsor as interest free loan; sponsor loan will be converted into equity. The management is predicting total debt to cap at PKR 3.6bln for the capacity expansion. The company's equity base reported at PKR 3.9bln (end-Jun17: PKR 3.7bln); will improve as management has capital injection plan. The capital will be injected in tranches 1) PKR 200mln in FY19, 2) PKR 500mln in 1QFY20 and 3) PKR 200mln in FY20. During 1HFY19, debt to debt plus equity ratio increased to ~47.3% (FY17: 23.4%). Alignment of grace period with principal repayments and capital injection will support financial risk profile. Leveraging is expected to stay at moderate level.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Flying Cement Company Limited	Dec-18	Jun-18	Jun-17	Jun-16
Cement	6M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	6,972	6,671	5,655	5,301
2 Investments	-	-	-	-
3 Related Party Exposure	-	-	-	-
4 Current Assets	3,068	3,090	1,573	1,019
a Inventories	*1,033*	*887*	*548*	*432*
b Trade Receivables	*8*	*9*	*3*	*1*
5 Total Assets	10,039	9,762	7,229	6,320
6 Current Liabilities	619	510	1,740	1,662
a Trade Payables	*413*	*309*	*1,618*	*1,551*
7 Borrowings	2,055	1,916	565	174
8 Related Party Exposure	2,750	2,810	579	300
9 Non-Current Liabilities	619	606	607	608
10 Net Assets	3,996	3,919	3,737	3,576
11 Shareholders' Equity	3,996	3,919	3,737	3,576
B INCOME STATEMENT				
1 Sales	1,791	2,910	2,470	2,476
a Cost of Good Sold	*(1,592)*	*(2,653)*	*(2,267)*	*(2,309)*
2 Gross Porfit	199	257	203	167
a Operating Expenses	(33)	(54)	(45)	(32)
3 Operating Profit	166	203	158	135
a Non Operating Income	*45*	*74*	*49*	*63*
4 Profit or (Loss) before Interest and Tax	211	277	207	198
a Total Finance Cost	*(98)*	*(44)*	*(8)*	*(3)*
b Taxation	*(35)*	*(52)*	*(38)*	*(50)*
6 Net Income Or (Loss)	78	182	161	146
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*188*	*210*	*191*	*250*
b Net Cash from Operating Activities before Working Capital Changes	*90*	*166*	*163*	*250*
c Changes in Working Capital	*95*	*(1,329)*	*(414)*	*(78)*
1 Net Cash provided by Operating Activities	185	(1,164)	(251)	172
2 Net Cash (Used in) or Available From Investing Activities	(346)	(1,108)	(450)	(187)
3 Net Cash (Used in) or Available From Financing Activities	135	1,747	699	4
4 Net Cash generated or (Used) during the period	(26)	(525)	(2)	(11)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	23.1%	17.8%	-0.2%	--
b Gross Profit Margin	11.1%	8.8%	8.2%	6.7%
c Net Profit Margin	4.3%	6.2%	6.5%	5.9%
d Cash Conversion Efficiency (EBITDA/Sales)	14.3%	12.7%	12.3%	11.7%
e Return on Equity (ROE)	3.9%	4.7%	4.4%	4.1%
2 Working Capital Management				
a Gross Working Capital (Average Days)	99	91	73	63
b Net Working Capital (Average Days)	62	-30	-161	-165
c Current Ratio (Total Current Assets/Total Current Liabilities)	5.0	6.1	0.9	0.6
3 Coverages				
a EBITDA / Finance Cost	2.7	8.8	45.3	239.2
b FCFO / Finance Cost+CMLTB+Excess STB	1.6	0.7	0.8	0.3
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	15.7	16.8	7.1	4.5
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Short-Term Borrowings / Total Borrowings	47.5%	47.3%	23.4%	11.7%
b Interest or Markup Payable (Days)	0.2	0.2	0.1	0.2
c Average Borrowing Rate	5.3%	1.8%	0.8%	0.3%

Rating Scale

Credit Rating Scale & Definitions

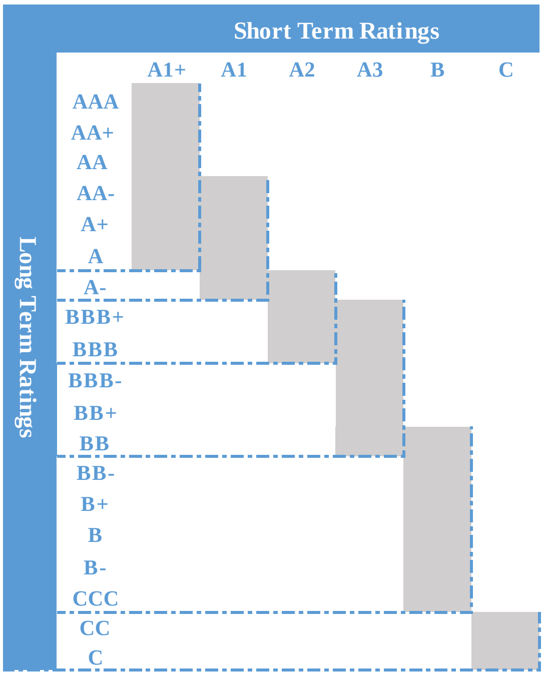
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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.

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)
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