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 |
|---|---|---|---|---|---|
| 15-Nov-2019 | A- | A2 | Stable | Maintain | - |
| 16-May-2019 | A- | A2 | Stable | Initial | - |

**Rating Rationale and Key Rating Drivers**

Flying cement operates with one manufacturing unit, having capacity of 1.2mln tpa, in the North region. Lately, the Company had completed BMR which resulted in improving margins in initial quarters of FY19. Furthermore, Waste Heat Recovery plant is planned to commence in Dec-19. The Management is expecting improvement on the efficiency side. The Company announced cement capacity expansion plan in FY16 but delayed it due to a number of announced capacities by majority cement players. During FY19, industry dynamics especially for cement players operating in north region have shifted significantly on account of fluctuating cement prices, increase in FED on coal import and depreciation in Pak Rupee against other currencies. Along with these factors, muted local demand has affected the company's sales whereby volumes went down. Margins witnessed decline; largely in line with the cement players operating in north region. The financial risk matrix remained adequate; long term finance being acquired in pursuit of expansion. The comfort is taken from principle repayments arising after commencement of new line and subsequent additional cash flows. The equity base strengthened attributable to recent revaluation and equity injection by sponsors; further equity strengthening is on the cards. Going forward, leveraging is expected to increase but will remain range bound.

The ratings are dependent on sustained profile of the company’s business and financial risk profile; strengthening of equity base is essential. Any derivation from the envisaged financial structure (debt equity ratio, cash coverage etc) would be considered negative. 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-19),Methodology \| Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria \| Rating Modifier(Jun-19) |
| **Related Research** | Sector Study \| Cement(Sep-19) |
| **Rating Analysts** | Sehar Fatima \| sehar.fatima@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, in QCR list by ICAP has given unqualified opinion on the company's financial statements for the year ended Jun-19.

## 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 divided into North and South region – majority (76%) operational capacity exists in North region. Industry has achieved its majority capacity expansions in last two years of around 14mln tons per annum. During FY19, north region witnessed 5% and 18% decline in local and export dispatches respectively attributable to contractionary fiscal policy, slowdown in large infrastructural activities and low demand from Afghanistan and India (export avenues). South region witnessed uptrend in dispatches which is correlated with longevity of export window available through sea. Industry dynamics has changed significantly driven by unsustainable cement prices (especially in north region) on account of supply glut recently created, muted demand and ruppee depreciation. Cement players witnessed significant dip in margins on account of aforementioned factors. Currently, leveraging of industry is moderate (31% as at end-Mar19) but increased interest rates has amplified the stress on financial risk profile of players. Going forward – with full utilization of lately commenced plants – industry is expected to face expanded capacity challenge. Cement prices and margins are expected to stay under stress as demand front deemed to stay weak for at least upcoming one year.

**Relative Position** Flying Cement is a small cement player with operational capacity of 1.2mln tpa with existing market share of 2.6% in the north region.

**Revenues** During FY19, revenue of PKR 3.2bln was recorded (FY18: PKR 2.9bln), up by 10.3% YoY. Volumetric analysis reveals downtrend of 2% - in line with trend followed by majority cement players in the north region. The company's capacity utilization level inched down 71% (FY18: 73%); all sales in local market. Gross profit declined YoY to PKR 171mln (FY18: PKR 257mln). Finance costs decreased to PKR 32mln (FY18: PKR 42mln). Hence, PAT declined to PKR 142mln (FY18: PKR 182mln), down 22%. In 1QFY19, revenue of PKR 422mln was recorded (1QFY18: PKR 851) while PAT declined to PKR 22mln.

**Margins** Flying margins have significantly declined in the last quarters of FY19 (gross: 5.8%, FY18: 8.8%, operating: FY19: 4.1%, FY18: 7.0%). EBITDA margin also witnessed a dip (FY19: 9.4%, FY18: 12.7%). Margins deterioration is a trend witnessed in the performance of players operating in north region primarily on account of instability in cement prices, muted local demand, and Rupee depreciation. In 1QFY20, the gross and operating profit margins remained largely same at 10.5% and 7.5% (1QFY19: 10.7% and 9.1%) 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 in industry delayed plan to Mar-21. The cost of the project would be PKR 5bln with 51:49 debt to equity ratio. The lately completed BMR will enhance the efficiency of the company while Waste Heat Recovery plant is planned to commence in Dec-19.

## Financial Risk

**Working Capital** Flying Cement's working capital requirements represented by net cash cycle (net working capital days) - a function of inventory, receivables and payables - increased to 65days (FY18: -30days). During 1QFY19, the net working capital cycle surged to 135 days (1QFY18: 32 days) primarily due to hike in inventory days; requires management attention, going forward.

**Coverages** During FY19, FCFO declined to PKR 189mln (FY18: PKR 210mln) whilst interest and core coverage inched up to 6.0x and 2.1x (end-Jun18: 5.0x and 0.7x) respectively attributable to declined finance cost. During 1QFY20, interest and core coverage remained 0.8x and 0.4x (1QFY19: 1.0x and 0.3x) respectively.

**Capitalization** The equity base witnessed increase attributable to revaluation on fixed assets and capital injection by sponsors. Hence, total leveraging declined to 24.2% (FY18: 47.3%) as at end-Jun19. Short term borrowings to total borrowings stood at (FY19: 19.3%, FY18: 20.1%); total borrowings recorded at PKR 2,249mln (FY18: PKR 1,916mln). Going forward, leveraging is expected to increase in pursuit of expansion but will remain range bound.

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*Financial Summary*
*PKR mln*

| Flying Cement Company Limited | Sep-19 | Jun-19 | Jun-18 | Jun-17 |
|---|---|---|---|---|
| Cement | 3M | 12M | 12M | 12M |
| **A BALANCE SHEET** | | | | |
| 1 Non-Current Assets | 11,631 | 11,249 | 6,671 | 5,655 |
| 2 Investments | - | - | - | - |
| 3 Related Party Exposure | - | - | - | - |
| 4 Current Assets | 2,767 | 2,220 | 3,090 | 1,573 |
| *a Inventories* | *1,281* | *1,195* | *887* | *548* |
| *b Trade Receivables* | *9* | *10* | *9* | *3* |
| **5 Total Assets** | 14,398 | 13,470 | 9,762 | 7,229 |
| 6 Current Liabilities | 780 | 836 | 510 | 1,740 |
| *a Trade Payables* | *614* | *630* | *309* | *1,618* |
| 7 Borrowings | 2,843 | 2,249 | 1,916 | 565 |
| 8 Related Party Exposure | 1,472 | 1,557 | 2,810 | 579 |
| 9 Non-Current Liabilities | 595 | 596 | 606 | 607 |
| **10 Net Assets** | 8,709 | 8,232 | 3,919 | 3,737 |
| **11 Shareholders' Equity** | 8,709 | 8,232 | 3,919 | 3,737 |
| **B INCOME STATEMENT** | | | | |
| **1 Sales** | 422 | 3,271 | 2,910 | 2,470 |
| *a Cost of Good Sold* | *(378)* | *(3,081)* | *(2,653)* | *(2,267)* |
| **2 Gross Profit** | 44 | 191 | 257 | 203 |
| *a Operating Expenses* | (14) | (58) | (54) | (45) |
| **3 Operating Profit** | 30 | 133 | 203 | 158 |
| *a Non Operating Income or (Expense)* | *15* | *84* | *74* | *49* |
| **4 Profit or (Loss) before Interest and Tax** | 46 | 217 | 277 | 207 |
| *a Total Finance Cost* | *(19)* | *(33)* | *(44)* | *(8)* |
| *b Taxation* | *(5)* | *(42)* | *(52)* | *(38)* |
| **6 Net Income Or (Loss)** | 22 | 142 | 182 | 161 |
| **C CASH FLOW STATEMENT** | | | | |
| *a Free Cash Flows from Operations (FCFO)* | *14* | *189* | *210* | *191* |
| *b Net Cash from Operating Activities before Working Capital Changes* | *14* | *157* | *166* | *163* |
| *c Changes in Working Capital* | *(425)* | *1,179* | *(1,329)* | *(414)* |
| **1 Net Cash provided by Operating Activities** | (411) | 1,335 | (1,164) | (251) |
| **2 Net Cash (Used in) or Available From Investing Activities** | 582 | (1,507) | (402) | (369) |
| **3 Net Cash (Used in) or Available From Financing Activities** | 484 | 821 | 1,747 | 699 |
| **4 Net Cash generated or (Used) during the period** | 655 | 649 | 181 | 79 |
| **D RATIO ANALYSIS** | | | | |
| **1 Performance** | | | | |
| *a Sales Growth (for the period)* | -48.4% | 12.4% | 17.8% | -0.2% |
| *b Gross Profit Margin* | 10.5% | 5.8% | 8.8% | 8.2% |
| *c Net Profit Margin* | 5.2% | 4.4% | 6.2% | 6.5% |
| *d Cash Conversion Efficiency (EBITDA/Sales)* | 19.0% | 9.4% | 12.7% | 12.3% |
| *e Return on Equity (ROE)* | 1.0% | 2.3% | 4.7% | 4.4% |
| **2 Working Capital Management** | | | | |
| *a Gross Working Capital (Average Days)* | 270 | 117 | 91 | 73 |
| *b Net Working Capital (Average Days)* | 135 | 65 | -30 | -161 |
| *c Current Ratio (Total Current Assets/Total Current Liabilities)* | 3.5 | 2.7 | 6.1 | 0.9 |
| **3 Coverages** | | | | |
| *a EBITDA / Finance Cost* | 4.4 | 9.7 | 8.8 | 45.3 |
| *b FCFO / Finance Cost+CMLTB+Excess STB* | 0.4 | 2.1 | 0.7 | 0.8 |
| *c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)* | -124.3 | 13.4 | 16.8 | 7.1 |
| **4 Capital Structure (Total Debt/Total Debt+Equity)** | | | | |
| *a Total Borrowings / Total Borrowings+Equity* | 26.6% | 24.2% | 47.3% | 23.4% |
| *b Interest or Markup Payable (Days)* | 0.0 | 0.0 | 0.0 | 0.0 |
| *c Average Borrowing Rate* | 2.5% | 1.0% | 1.8% | 0.8% |

# Rating Scale | Corporate

2019

## Credit Rating Scale & Definitions

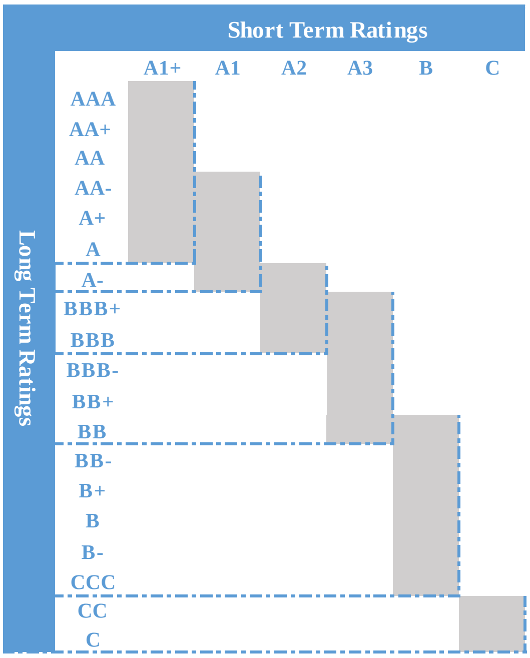
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

### Long Term Ratings

| | |
|---|---|
| AAA | **Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments |
| AA+<br>AA<br>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+<br>A<br>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+<br>BBB<br>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+<br>BB<br>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+<br>B<br>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<br>CC<br>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)
**Proprietary Information**