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
07-May-2021	A-	A2	Stable	Maintain	YES
16-May-2020	A-	A2	Stable	Maintain	YES
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. In 1HFY21, the Company picked up pace and recover its losses to report profits that also in line with the cement industry trend. Flying Cement announced cement capacity expansion plan in FY16 but delayed it due to a number of announced capacities and unfavorable economic conditions. Cement sector announced third phase of expansion (~18 mln tpa) which is expected to increase with more players join the lane. Therefore, Flying Cement is also in process to complete its previously announced capacity to almost double its existing capacity of Line-I & brownfield expansion of Line-II (7,700tpd-Clinker). Furthermore, remarkable growth in local demand, curtailed policy rates and better cement prices giving the required supporting environment to flourish. Local capacity utilization already recorded growth to 85% in 1HFY21 (1HFY20: 65%). This depicts the sector's resilience to the bumpy ride of FY20 and impacts amid country wide lock down observed due to COVID-19 outbreak. Though construction sector began operations and high demand from private sector has been seen. During 1HFY21, Flying Cement recorded profits of PKR 89mln attributable to augmented supply side and better cement prices. Hence, margins took steep rise. The Company had completed WHRPP which is expected to improve margins in FY21 through cost savings however during FY20, company's bottom line turned red. The financial risk matrix remained manageable as long term finance being acquired in pursuit of expansion; short term finance already reduced. The equity base improved attributable to recent revaluation and equity injection by sponsors through right issue. In cognizance thereof, sponsors have subscribed to substantial amount of PKR 1.56bln of right shares to strengthen the equity base of the Company. Going forward, sustainability in margins and cash flows remains vital to the ratings. Rating watch incorporates delays in expansion projects and pressure on financial risk matrix.

The ratings are dependent on sustained profile of the company's business and financial risk profile; strengthening of equity base is vital. Any derivation from the envisaged financial structure (debt equity ratio, cash coverage etc) would be considered negative.

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-20),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria | Rating Modifier(Jun-20)
Related Research	Sector Study | Cement(Mar-21)
Rating Analysts	Anam Waqas Ghayour | anam.waqas@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 in Lahore Cantt and manufacturing facility established at Lilla Interchange (LHR-ISB Motorway); located in Punjab. To fulfill its coal requirements, it purchased locally from Baluchistan and the remaining portion 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 interest of young blood is considered positive for the sustainability of business.

Business Acumen The sponsors, Mr. Kamran Khan, Mr. Momin Qamar, Mr. Qasim Khan, Mr. Yousuf Khan, Mr. Mohammad Zaman & Mr. Ali Alam Qamar are associated with the company for a very long and have the capability of strategic decision making; business acumen is considered adequate.

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

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 three are non-executive directors and one female director, excluding three independent.

Members' Profile Board members carry adequate requisite skills, competence, knowledge and experience required for a vigilant oversight. Board members carrying different educational backgrounds and experiences, but majority are linked with Flying Group of Companies.

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 an independent member. Internal audit department reports to board which is in line with overall better practices of Code of Corporate Governance.

Financial Transparency M/s Naveed Zafer Ashfaq Jaffery & Co., newly appointed Chartered Accountants, the external auditor is categorized satisfactory by ICAP - has completed its review on the review of company's financial statements for the period ended Dec-20 of the 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, accompanied by professionals in respective teams.

Effectiveness There are no formal management committees as sponsors are directly involved in management. Important matters are discussed through formal meetings.

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 Flying Cement deploys a Japanese plant supplied by IHI Japan; the plant is designed at dry process. The mining lease for limestone stands at ~26yrs.

Business Risk

Industry Dynamics As per prime bifurcation of Cement industry into North & South, majority concentration lies in North region. Currently, cement industry is on revival path after the downward tendency in reported dispatches' during FY20, first half of the year witnessed high general inflation, rising utility prices and tight fiscal consolidation affecting the purchasing power of people and 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 has changed significantly in last year, driven by slowdown in 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 north region) remained challenge to profit margins. Cement industry is entering into 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 - optimal capacity utilisation 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, as Govt. has finally laid down the action plan to its announced pursuit for infrastructure.

Relative Position The Company is smaller player of the industry, by currently operating at a capacity of 1.2mln tpa which translates into market share of 2.3% of cement capacity operational in North region as of Jun-20. The Company is trying to maintain its share by doubling its existing capacity.

Revenues During 1HFY21, the company reported revenue of PKR 1.02bln (FY20: PKR 1.08bln; FY19: PKR 3.3bln), demonstrating a significant growth of ~89%. The cost of goods sold decreased (FY18: PKR 937mln, FY20: PKR 1,542mln; FY19: PKR 3,081mln), primarily due completion of WHR which slashed the energy cost massively. Finance costs decreased significantly to PKR 0.09mln (FY20: PKR 80mln; FY19: PKR 32mln), driven by curtailed policy rates and massive reduction in financial institution borrowing. The company was able to make a profit of PKR 89mln (FY20: Loss of PKR 531mln). The Company's return on equity was 2.2% (FY20: -7.1%; FY19: 2%), which is adequate.

Margins In recent years, Company's margins; Gross and EBITDA margins are in line with its peer universe's margins to 8.1% (FY20: -40.8%; FY19: 5.8%) and 18% (FY20: -30%; FY19: 9%), respectively. Overall, industry-wide margins were affected during FY20; however, the companies have revived their performance in 1HFY21.

Sustainability Going forward, management will keep its focus to maximize its capacity utilization to increase market share. The Company is actively working on the expansion project and expected to complete it in early FY22 in order to sustain its share in the market. After COD of Line-II (7,700tpd), the total capacity would be 11,700tpd of Clinker.

Financial Risk

Working Capital During 1HFY21, the Company's working capital requirements, represented by net cash cycle (net working capital days) – a function of inventory, receivables and payables – improved as 423days (FY20: 592days; FY19: 108days) as the company is trying to manage its cashflows by delaying creditors; which is not considered good after a certain level. As the company has improved internal cashflows, the company's short-term borrowing has been reduced. The quantum of STBs stood at PKR 238mln at end-Dec20 (end-Jun20: PKR 1,538mln; FY19: PKR 507mln).

Coverages During 1HFY21, the company's EBITDA was reported at PKR 179mln (FY20: PKR -328mln); in terms of margins, it stands at 18% (FY20: -30%), in line with the trend of peers. FCFO increased to PKR 210mln (FY20: PKR -335mln) owing to revival in profitability. Interest coverage significantly improved to 0x (end-Jun20: -4.2x) due to significant reduced gross interest of the Company, as well as improvement in cashflows, post FY20.

Capitalization During the first half of year-21, long-term debt remained at PKR 5.4bln from a financial institution other than that company borrowed from sponsor PKR 329mln as interest free loan which will be ultimately repaid after the expansion project. The Company is predicting long-term debt to increase for the capacity expansion for Line-II (7700tpd). The company's equity base reported at PKR 8.2bln (end-Jun20: PKR 8.15bln; end-Jun19: PKR 8.23bln). Debt to debt plus equity ratio increased significantly to ~42.3% (FY20: 39.7%, FY19: 24.2%), primarily due to doubling of long-term debt and reduction in short-term borrowings. During 1HFY21, Company's short-term borrowing slashed significantly which reduced the finance cost subsequently. The long-term loan facility includes a grace period of 2.25 years and principal to be repaid in 14 quarterly installments of PKR 93.75mln each.

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Financial Summary
PKR mln

Flying Cement Company Limited Cement	Dec-20 6M	Jun-20 12M	Jun-19 12M	Jun-18 12M
A BALANCE SHEET				
1 Non-Current Assets	13,986	13,320	11,249	6,671
2 Investments	-	-	-	-
3 Related Party Exposure	-	-	-	-
4 Current Assets	2,930	3,003	2,220	3,090
a Inventories	*2,121*	*2,100*	*1,195*	*887*
b Trade Receivables	*8*	*3*	*10*	*9*
5 Total Assets	16,916	16,323	13,470	9,762
6 Current Liabilities	1,190	1,456	836	510
a Trade Payables	*769*	*940*	*630*	*309*
7 Borrowings	5,716	5,042	2,249	1,916
8 Related Party Exposure	3,135	3,044	3,072	2,810
9 Non-Current Liabilities	600	597	596	606
10 Net Assets	6,275	6,185	6,716	3,919
11 Shareholders' Equity	6,275	6,185	8,232	3,919
B INCOME STATEMENT				
1 Sales	1,020	1,080	3,271	2,910
a Cost of Good Sold	*(937)*	*(1,542)*	*(3,081)*	*(2,653)*
2 Gross Profit	82	(462)	191	257
a Operating Expenses	(33)	(66)	(58)	(54)
3 Operating Profit	50	(528)	133	203
a Non Operating Income or (Expense)	*62*	*95*	*84*	*74*
4 Profit or (Loss) before Interest and Tax	111	(433)	217	277
a Total Finance Cost	*(0)*	*(80)*	*(33)*	*(44)*
b Taxation	*(22)*	*(17)*	*(42)*	*(52)*
6 Net Income Or (Loss)	89	(531)	142	182
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*248*	*(335)*	*189*	*210*
b Net Cash from Operating Activities before Working Capital Changes	*248*	*(415)*	*157*	*166*
c Changes in Working Capital	*(170)*	*(621)*	*1,179*	*(1,329)*
1 Net Cash provided by Operating Activities	78	(1,035)	1,335	(1,164)
2 Net Cash (Used in) or Available From Investing Activities	(733)	(2,208)	(1,507)	(402)
3 Net Cash (Used in) or Available From Financing Activities	2,259	2,132	821	1,747
4 Net Cash generated or (Used) during the period	1,603	(1,111)	649	181
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	88.9%	-67.0%	12.4%	17.8%
b Gross Profit Margin	8.1%	-42.8%	5.8%	8.8%
c Net Profit Margin	8.8%	-49.2%	4.4%	6.2%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	7.6%	-88.5%	41.8%	-38.5%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	2.9%	-9.4%	2.0%	5.3%
2 Working Capital Management				
a Gross Working Capital (Average Days)	576	858	160	124
b Net Working Capital (Average Days)	423	592	108	3
c Current Ratio (Current Assets / Current Liabilities)	2.5	2.1	2.7	6.1
3 Coverages				
a EBITDA / Finance Cost	1809.8	-4.1	9.7	8.8
b FCFO / Finance Cost+CMLTB+Excess STB	26.9	-2.5	2.1	0.7
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	15.7	-14.0	23.0	16.8
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	56.1%	54.3%	33.5%	47.3%
b Interest or Markup Payable (Days)	336379.7	1020.2	0.0	0.0
c Entity Average Borrowing Rate	0.0%	1.4%	0.9%	2.2%

Credit Rating

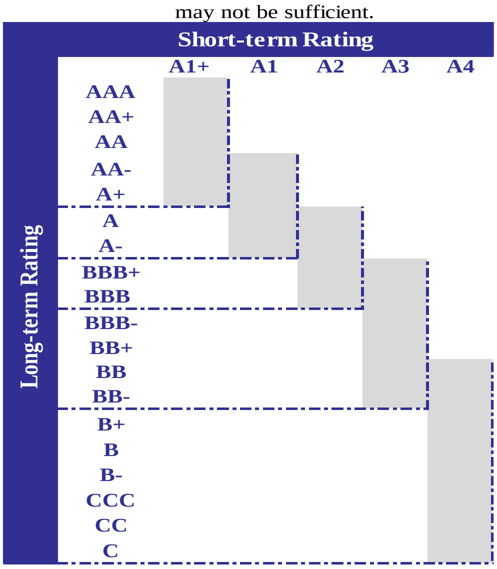
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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

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

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(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)

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(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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