



The Pakistan Credit Rating Agency Limited

Rating Report

Berger Paints Pakistan Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
21-Mar-2019	BBB+	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect Berger's established position and brand recognition in the premium domestic paint market of the country. The ratings incorporate strong governance framework and experienced management team along with effective control framework. The revenue of the company has largely remained at the same level. However, the revenue stream is well diversified with retail, industrial and government clients. The company imports most of its raw materials, the cost of which have increased due to rupee devaluation. The margins have come under pressure lately as the company was not able to fully pass the costs to its customers due to high competition. This has led to lower profitability accentuating business risk. The financial profile of the company is characterized by adequate coverages and moderately leveraged capital structure, while the working capital management is considered adequate.

The ratings are dependent upon the management's ability to improve margins and profitability. Prudent management of the working capital, maintaining good coverages and strong capital structure is also important for the ratings. Decline in topline and deterioration in margins leading to erosion of profitability will have negative impact on the ratings.

Disclosure

Name of Rated Entity	Berger Paints Pakistan 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 Paints(Mar-19)
Rating Analysts	Ateeb Riaz ateeb.riaz@pacra.com +92-42-35869504

Profile

Legal Structure Berger Paints Pakistan Limited (Berger) is a public listed company. The company is listed on Pakistan Stock Exchange (PSX). The registered office of the company is situated in Lahore, Pakistan, with production facility at Multan Road, Lahore.

Background Initially, Berger imported premium chemicals from United Kingdom to sell in local market. It established a manufacturing plant in Karachi in 1955 and a second plant in Lahore in 2006. In 1991, Slotrapid Limited, a company incorporated in British Virgin Islands, acquired 52.05% of its shares from Jenson & Nicholson Limited.

Operations The company is engaged in the manufacturing and trading of paints, varnishes and other related products. The company has several business segments, namely, i) Decorative business, ii) Automotive business, iii) General industrial finishes, iv) powder coating, v) Protective coatings, vi) Vehicle refinishes business, vii) road safety, viii) Government & marine, ix) construction chemicals, and x) Adhesives.

Ownership

Ownership Structure Slotrapid Limited, a foreign company incorporated in British Virgin Islands and holds interests in several businesses, owns 52.05% shares in Berger. 17% shares are held by Dadex family, while 10.5% shares are held by Miller Value Partners, a foreign investment management company. All other shares are held by financial institutions and individuals.

Stability The company's controlling shareholding structure rests with Slotrapid Limited, an offshore company.

Business Acumen The nominee of sponsors have strong experience in paint industry. They have also acquired Buxly paints, listed on PSX. This bodes well for the company.

Financial Strength Slotrapid Limited is an investment company and also has other business interests in Pakistan. It has previously supported the company in the form of right issue, along with other shareholders.

Governance

Board Structure The company has eight members on its board including four independent directors, three non-executive directors and Dr. Mahmood Ahmad (Managing Director). The board is currently chaired by Mr Maqbool H. H. Rahimtoola. Dr. Mahmood Ahmad represents Slotrapid Limited, while two non-executive directors are nominated by Dadex Family.

Members' Profile Mr Maqbool H. H. Rahimtoola is the Chairman of the board and has over 40 years of experience on the board of various multinational companies. All other members are professionally qualified with extensive professional experience and diversified skill mix.

Board Effectiveness The board has met 6 times in the FY18 with majority members present in the meeting. The board has established two sub-committees, i) Audit Committee, and ii) Human resource committee. Both are chaired by Independent Directors. The quality of discussion as reflected in board minutes is good as independent directors participated actively.

Financial Transparency KPMG Taseer Hadi & Co., Chartered Accountants are the external auditors of the company. They gave an unqualified opinion on company's financial statements for the year ended June 30, 2018. The board has also outsourced its internal audit department to E&Y Ford Rhodes & Co., Chartered Accountants.

Management

Organizational Structure The company has established a well-defined management structure divided into functional departments with clear lines of responsibilities.

Management Team The managing director, Dr. Mahmood Ahmad, is a seasoned business professional and has been associated with the company for several years. He has over 25 years of experience and is well-versed about the industry dynamics. The HR base of the group is strong with top management possessing ample knowledge and expertise of the related business.

Effectiveness The company has established several management committees to coordinate its operations. Executive committee is the apex management committee, which comprises senior management. The executive committee meeting is held monthly to appraise the company's performance and is headed by Managing Director. It has also established purchase committee, finance committee and credit committee.

MIS The company has implemented Oracle ERP to generate reports and manage the flow of information within the company. It is capable of generating customized MIS reports for the board and top management. The management maintains strong controls through the ERP.

Control Environment The management has a strong control environment in the company. The company also maintains strong quality control over its production processes.

Business Risk

Industry Dynamics The industry is highly competitive and price sensitive. Inflationary pressure and rupee devaluation has increased the cost of raw materials. There is an intense competition posed by market players and unorganized sector. One of the main driver of future growth is CPEC and infrastructure spending. However, due to recent change in government, any significant improvement is yet to be seen. The slowdown in economic activity, especially construction, will impact demand.

Relative Position The company is one of the major players in the premium domestic paint market. The main competitors are AkzoNobel, Nippon, Kansai, Master paint, Diamond paint and Brighto paint. Berger has ~10% share of the organized market.

Revenues The company's topline has shown slight increase over the last three years with CAGR of ~2.5%. For FY18, the company's topline clocked in at PKR 5,435mln. (FY17: 5,123mln.). The increase is mainly attributable to higher prices. In the 1HFY19, the revenue of the company remained in line with the previous year and clocked at ~PKR 2,641mln.

Margins The company's margins have come under pressure in the last three years. The gross margin declined in FY18 to ~24% (FY17:29%) on the back of higher raw materials cost due to rupee devaluation. This could not be fully passed on fully to customers. Consequently, the company's net margins decreased to 1.9% in FY18 (FY17: 3.9%). For 1HFY19, the gross and net margins stood at 23% and ~1.5% respectively.

Sustainability Demand for the company's products is expected to increase moderately. The management is not planning any major capital expenditure in short-term. The company is expected to maintain existing revenues and margins in the near future. Further, cost escalations can impact margins.

Financial Risk

Working Capital Working capital of Berger is a factor of inventory and receivables, as the company imports majority of its raw material. The cash cycle has increased slightly in FY18 to 80 days (FY17:77 days). For 1HFY19, cash cycle remained the same. Further, the working capital increased by PKR 189mln during FY18 (FY17: PKR 153mln), mainly due to relatively lower trade payables.

Coverages Despite decline in profits, FCFO remained at same level due to lower tax payments and stood at PKR 299mln in FY18 (FY17: 287mln). The interest coverage ratio stood at 3.2x in FY18 (FY17: 3.2x), in line with FY17 figures. The debt coverage ratio remained at the same level of 1.8x in FY18 (FY17: 1.8x). For 1HFY19, FCFO were PKR 132mln due to lower profitability, while the interest coverage and debt coverage remained at 2x and 1.3x, respectively. The debt coverage plunged due to increase in finance cost and decrease in FCFO during 1HFY19.

Capitalization Berger has moderately leveraged capital structure (1HFY19: ~49%, FY18: ~46%). The debt is mainly short-term, which is utilized to finance working capital requirements of the company.



Berger Paints Pakistan Limited

Listed Public Limited

BALANCE SHEET

	Dec-18 6M	Jun-18 12M	Jun-17 12M	Jun-16 12M
a Non-Current Assets	1,330	1,344	1,257	1,147
b Investments (Incl. Associates)	137	158	163	73
Equity Instruments	36	42	42	42
Debt Instruments	101	117	121	31
c Current Assets	3,092	2,768	2,769	2,484
Inventory	938	1,016	1,018	735
Trade Receivables	1,593	1,165	1,249	1,223
Others	562	587	501	526
d Total Assets	4,558	4,271	4,189	3,703
e Debt/Borrowings	1,469	1,276	1,155	905
Short-Term	1,265	1,138	949	864
Long-Term (Incl. Current Maturity of Long-Term Debt)	204	138	206	42
Other Short-Term Liabilities	1,416	1,323	1,486	1,326
Other Long-Term Liabilities	151	152	120	109
f Shareholder's Equity	1,522	1,520	1,428	1,362
g Total Liabilities & Equity	4,558	4,271	4,189	3,703

INCOME STATEMENT

a Turnover	2,641	5,453	5,123	5,082
b Gross Profit	619	1,304	1,490	1,547
c Net Other Income	24	25	61	17
d Financial Charges	(66)	(98)	(95)	(108)
e Net Income	37	103	202	185

CASH FLOW STATEMENT

a Free Cash Flow from Operations (FCFO)	132	300	287	412
b Total Cashflows (TCF)	132	300	287	412
c Net Cash changes in Working Capital	(207)	(189)	(153)	89
d Net Cash from Operating Activities	(131)	25	61	395
e Net Cash from Investing Activities	(23)	(145)	(206)	(171)
f Net Cash from Financing Activities	174	97	112	(318)
g Net Cash generated during the period	20	(23)	(34)	(94)

RATIO ANALYSIS

a Performance				
Turnover Growth	-3%	6%	1%	18%
Gross Margin	23%	24%	29%	30%
Net Margin	1%	2%	4%	4%
ROE	5%	7%	14%	23%
b Coverages				
Debt Service Coverage (X) (FCFO/Gross Interest+CMLTD+Uncovered STB)	1.3	1.8	1.8	2.9
Interest Coverage (X) (FCFO/Gross Interest)	2.0	3.2	3.2	4.0
Debt Payback (Years) (Total Debt (excluding Covered Short Term Borrowings) / F	1.5	0.7	1.0	0.1
c Capital Structure (Total Debt/Total Debt+Equity)				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	81	80	77	76
d Capital Structure (Total Debt/Total Debt+Equity)	49%	46%	45%	40%

Berger Paints Pakistan Limited

Mar-19

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		Short Term Ratings	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
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.	A1	A strong capacity for timely repayment.
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.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial 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.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
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.	C	An inadequate capacity to ensure timely repayment.
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.		



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 surveil the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

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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

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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.
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- (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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