The Pakistan Credit Rating Agency Limited

Rating Report

Berger Paints Pakistan Limited

Report Contents

1. Rating Analysis
2. Financial Information
3. Rating Scale
4. Regulatory and Supplementary Disclosure

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
07-Nov-2019	BBB+	A2	Stable	Maintain	-
20-Sep-2019	BBB+	A2	Stable	Maintain	-
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 declined due to relative slowdown in overall construction and related activities. 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 gross margin has come under pressure lately as the Company was not able to fully pass the costs to its customers due to high competition. However, operating margin was improved through effective cost control, which enabled the company to maintain its net profitability. The financial profile of the Company is characterized by strong coverages and working capital management, while the capital structure remains moderately leveraged.

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. Significant decline in top line and/or 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-19),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria | Rating Modifier(Jun-19)
Related Research	Sector Study | Paints(Sep-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 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 holding 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. The remaining shareholding is held by financial institutions and individuals.

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

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 Berger.

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 subscription to 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 met 4 times in the FY19 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, 2019. 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 Company 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. 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 within the Company, and robust quality control over its production processes.

Business Risk

Industry Dynamics The paint 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. The main drivers of growth for the industry are construction related activities and infrastructure spending. However, due to general economic slowdown and lesser developmental spending, volumes remain under pressure. This is expected to 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 top line is well diversified as it is engaged in both B2B and B2C businesses. The Company's top line decreased by ~6% during FY19 and clocked in at PKR 5,120mln (FY18: PKR 5,453mln). The decrease is mainly attributable to overall slowdown in construction activities. The Company's top line remained stable in 1QFY20 and clocked in at PKR 1,130mln (1QFY19: PKR 1,163mln).

Margins The Company's margins have stayed under pressure during FY19 and clocked in at ~22% (FY18: ~24%, FY17: ~29%). The gross margins declined on the back of higher raw material cost due to rupee devaluation, as the Company imports majority of its raw materials. This could not be fully passed on to customers due to price sensitivity of products and intense competition among organized sector players. However, the operating margin improved to ~5% during FY19 (9MFY18: ~4%) on the back of better cost control. The Company's net margin remained in-line with previous year (FY19: ~2%, FY18: ~2%), as the improved operating profit was off-set by higher finance cost (FY19: PKR 165mln, FY18: PKR 98mln). The bottom-line clocked in at ~PKR 101mln during FY19 (FY18: PKR 102mln). In 1QFY20, the gross margin was ~18% and the operating margin decreased to 1% in 1QFY20 as the Company was unable to pass increased costs. The Company suffered a loss of PKR 18mln and had a net margin of -1.6% due to increased finance costs (1QFY20: PKR 47mln, 1QFY19: PKR 29mln).

Sustainability Demand for the Company's products is expected to remain at the same level due to stagnant construction activity in the country. 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.

Financial Risk

Working Capital The Company's reliance on short-term borrowings has increased during FY19 and clocked in at ~PKR 1,205mln (FY18: ~PKR 1,138mln). The cash cycle remained on the higher side during FY19 (Gross- FY19: 162days, FY18: 149days, Net- FY19: 96days, FY18: 80days). The cash cycle increased due to higher trade receivables. The net trade assets stood at PKR 1,845mln during FY19 (FY18: PKR 1,642mln), while room to borrow of the Company increased to PKR 640mln (FY18: PKR 504mln), showing adequate room for further borrowings. In 1QFY20, the Company's net working capital days stood at 120 days (1QFY19: 90 days) and it had room to borrow of PKR 704mln.

Coverages The free cash flows (FCFO) of the Company increased and stood at ~PKR 345mln during FY19 (FY18: ~PKR 300mln). However, the finance cost of the Company soared to PKR 149mln during FY19 (FY18: PKR 94mln) due to higher benchmark rate and short-term borrowings. This has resulted in deterioration of both interest coverage and debt coverage ratios to 2.3x and 1.5x during FY19, respectively (FY18: Interest coverage: 3.2x, Debt coverage: 1.8x). In 1QFY20, the Company had cash flows of PKR 95mln (1QFY19: PKR 37mln). Finance costs also increased to PKR 47mln (1QFY19: 29mln). The interest coverage stood at 2.0x and the debt coverage stood at 1.4x during 1QFY20.

Capitalization The Company has moderately leveraged capital structure. The leveraging of the Company stood at ~47% during FY19 (FY18: ~46%). The slight increase in leveraging is attributable to higher short-term borrowings utilized to finance the increasing working capital requirements. Short-term borrowings comprise ~88% of total borrowings. During 1QFY20, the Company's leveraging remained stable at 46%. The leveraging is expected to remain stable, going forward.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Berger Paints	Sep-19	Jun-19	Jun-18	Jun-17
Paints	3M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	1,293	1,314	1,344	1,257
2 Investments	45	45	68	75
3 Related Party Exposure	81	82	90	88
4 Current Assets	3,001	2,907	2,768	2,769
a Inventories	*1,066*	*917*	*1,016*	*1,018*
b Trade Receivables	*1,430*	*1,461*	*1,165*	*1,249*
5 Total Assets	4,419	4,347	4,271	4,189
6 Current Liabilities	1,368	1,238	1,323	1,486
a Trade Payables	*995*	*897*	*979*	*1,076*
7 Borrowings	1,332	1,375	1,276	1,155
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	158	154	152	120
10 Net Assets	1,561	1,580	1,520	1,428
11 Shareholders' Equity	1,561	1,580	1,520	1,428
B INCOME STATEMENT				
1 Sales	1,130	5,120	5,453	5,123
a Cost of Good Sold	*(922)*	*(4,004)*	*(4,149)*	*(3,633)*
2 Gross Profit	208	1,116	1,304	1,490
a Operating Expenses	(197)	(850)	(1,090)	(1,195)
3 Operating Profit	12	266	214	295
a Non Operating Income or (Expense)	*30*	*12*	*31*	*65*
4 Profit or (Loss) before Interest and Tax	42	278	245	361
a Total Finance Cost	*(47)*	*(165)*	*(98)*	*(95)*
b Taxation	*(13)*	*(12)*	*(45)*	*(64)*
6 Net Income Or (Loss)	(18)	101	102	202
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*95*	*345*	*300*	*287*
b Net Cash from Operating Activities before Working Capital Changes	*48*	*203*	*215*	*214*
c Changes in Working Capital	*(56)*	*(232)*	*(189)*	*(153)*
1 Net Cash provided by Operating Activities	(8)	(29)	25	61
2 Net Cash (Used in) or Available From Investing Activities	(1)	7	(145)	(206)
3 Net Cash (Used in) or Available From Financing Activities	(42)	77	96	96
4 Net Cash generated or (Used) during the period	(52)	55	(24)	(50)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	-11.7%	-6.1%	6.5%	0.8%
b Gross Profit Margin	18.4%	21.8%	23.9%	29.1%
c Net Profit Margin	-1.6%	2.0%	1.9%	3.9%
d Cash Conversion Efficiency (EBITDA/Sales)	6.1%	7.9%	6.5%	9.5%
e Return on Equity (ROE)	-4.6%	6.5%	6.9%	14.5%
2 Working Capital Management				
a Gross Working Capital (Average Days)	197	162	149	151
b Net Working Capital (Average Days)	120	96	80	77
c Current Ratio (Total Current Assets/Total Current Liabilities)	2.2	2.3	2.1	1.9
3 Coverages				
a EBITDA / Finance Cost	1.5	2.7	3.8	5.5
b FCFO / Finance Cost+CMLTB+Excess STB	1.4	1.5	1.8	1.8
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.8	0.9	0.7	1.0
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	46.0%	46.5%	45.6%	44.7%
b Interest or Markup Payable (Days)	76.0	96.8	56.2	0.0
c Average Borrowing Rate	13.9%	11.2%	7.7%	8.7%

Rating Scale | Corporate

2019

Credit Rating Scale & Definitions

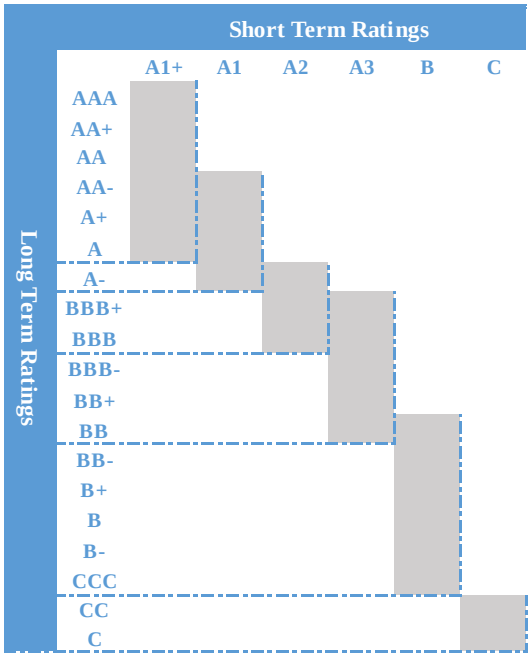
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings

AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ 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.

Disclaimer: PACRA's ratings are an assessment of the credit standing of entities/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA's opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security's market price or suitability for a particular investor.

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**
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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.
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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)
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(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)
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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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