



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
08-May-2020	BBB+	A2	Stable	Maintain	YES
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 strong brand in the premium domestic paint market of the country. The ratings incorporate a strong governance framework and an experienced management team leading to effective controls. The Company's revenue stream is well diversified with retail, industrial and government clients. The paint industry remains competitive and faces pressure from informal sector. The Company partially passed on escalating costs to customers resulting in relatively lower revenues and margins. However, the profitability remained intact by curtailing operating expenses. The financial profile of the Company is characterized by strong coverages and adequate working capital management. The capital structure remains moderately leveraged mainly comprising short-term borrowing.

The 'Rating Watch' signifies uncertainty due to imposition of countrywide lockdown by the Government to halt the spread of COVID-19. The Company had also closed production facility in compliance with Government directive. The Government has allowed construction sector to open in a phased manner. The Company, being part of this sector, has recently been able to resume operations. The demand for the Company's product is expected to be impacted. However, declining prices of raw materials (i.e. Petrochemicals and commodity chemicals), tax incentives and relaxations announced by the Government and recent rate cut of 425bps will provide some respite, going forward.

The ratings are dependent upon the management's ability to sustain operations in prevailing uncertain environment. Generating operating cashflows along with maintaining efficient supply chain and prudent working capital is important. Prolonged shutdown due to COVID-19 and/or significant delay in recovery of sales will impact 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 or 'the Company') is a public listed company. The registered office of the Company is situated in Lahore, Pakistan, and production facility is located at Multan Road, Lahore.

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

Operations The Company is engaged in the manufacturing and trading of paints, varnishes and other related products. The Company has several product segments including decorative paints, automotive paints, general industrial finishes, powder coating, protective coatings, vehicle refinishes, road safety, government & marine, construction chemicals, and adhesives. They are divided into three business lines, namely, i) Retail Business, ii) Non-Retail Business, and iii) Allied Business.

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. Around 17% shares are held by Dadex family, while 10.5% shares are owned 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 majority owners have strong experience in paints industry. They have also acquired Buxly Paints Limited, listed on PSX. This experience 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 boards 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 & Remuneration Committee. Both are chaired by Independent Directors. The quality of discussion as captured in meeting minutes reflects adequate involvement of board members.

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 senior management possesses 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. The other committees are the 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 supplemented by robust quality control system for its production processes. Additionally, Berger has technical collaboration agreements with international firms to ensure that quality standards are adhered to.

Business Risk

Industry Dynamics The paint industry is highly competitive and price sensitive. Inflationary pressure and rupee devaluation has increased the cost of production. The sector also faces competition posed the informal sector. The main drivers of growth for the industry are construction related activities and infrastructure spending. Due to the lockdown implemented amidst Covid-19 pandemic, volumes are expected to remain under pressure. However, the government has announced a package for construction and allied businesses to gradually resume operations along with certain incentives. This, coupled with recent rate cut of 425bps, is expected to ease pressure to an extent.

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

Revenues During 1HFY20, the Company's top-line declined by ~7% YoY and stood at PKR 2,445mln (1HFY19: PKR 2,641mln) as a slight increase in prices impacted demand and reduced volumes. The Company's top line is well diversified as it is engaged in both B2B and B2C businesses. The largest product segment is decorative paints, which contributes over 50% of the top-line.

Margins In 1HFY20, Berger's gross margin declined to ~21% (1HFY19: ~23%) as the Company was unable to fully pass on increased input costs to its customers. Meanwhile, operating margin improved to ~5% (1HFY19: 4%) due to reduced marketing expense. The Company's finance cost increased to PKR 98mln (1HFY19: PKR 66mln) as benchmark rate increased. Meanwhile, the Company earned non-operating income of PKR 53mln, which consisted mostly of exchange gain. Consequently, the Company's net profit clocked in at PKR 41mln (1HFY19: PKR 37mln) as net profit margin improved slightly to 1.7% (1HFY19: 1.4%).

Sustainability Berger had suspended its plant operations in line with Government directive regarding lockdown of all non-essential activities to contain the spread of COVID-19. Since the lockdown has coincided with the paint industry's peak season, the revenues of the industry are expected to suffer. However, resumption of construction and allied industry activities, declining raw material costs, and rate cut of 425bps is expected to provide some respite for the Company.

Financial Risk

Working Capital In 1HFY20, Berger's inventory days increased to 77 days (FY19: 69 days) as the Company maintained higher inventory level to cater to the upcoming peak season. Meanwhile, trade receivable days also increased to 108 days (FY19: 94 days) due to lower sales in the period. As a result, gross working capital days increased to 185 days (FY19: 162 days). The trade payable days during 1HFY20 remained stable at 70 days (FY19: 67 days). Resultantly, the net working capital days clocked in at 114 days (FY19: 96 days). In 1HFY20, Berger's short term trade leverage remained stable at 24% (FY19: 23%) depicting sufficient room to borrow against trade assets.

Coverages Berger's cash flows from operations increased to PKR 189mln during 1HFY20 (1HFY19: PKR 132mln). Meanwhile, the Company's finance cost increased to PKR 98mln (1HFY19: PKR 66mln) due to higher benchmark rate. The interest coverage ratio improved slightly to 2.1x (1HFY19: 2.0x). Furthermore, the debt coverage ratio improved to 1.7x (1HFY19: 1.3x). The improvement in debt coverage was due to repayment of long term debt (1HFY20: PKR 49mln, 1HFY19: PKR 68mln) and proportionately higher cash flows from operations.

Capitalization The capital structure of the Company is moderately leveraged. During 1HFY20, the Company's leveraging remained stable at ~48% (FY19: ~47%). Going forward, the leveraging is expected to remain at similar level as there are no plans for capital expenditure in the near future. Short term borrowings constitute ~89% of the Company's total borrowings.



The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Berger Paints Pakistan Limited Paints	Dec-19 6M	Jun-19 12M	Jun-18 12M	Jun-17 12M
A BALANCE SHEET				
1 Non-Current Assets	1,298	1,314	1,344	1,257
2 Investments	32	32	42	42
3 Related Party Exposure	94	95	116	121
4 Current Assets	3,173	2,907	2,768	2,769
<i>a Inventories</i>	1,133	917	1,016	1,018
<i>b Trade Receivables</i>	1,443	1,461	1,165	1,249
5 Total Assets	4,598	4,347	4,271	4,189
6 Current Liabilities	1,370	1,238	1,323	1,486
<i>a Trade Payables</i>	990	897	979	1,076
7 Borrowings	1,463	1,375	1,276	1,155
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	164	154	152	120
10 Net Assets	1,601	1,580	1,520	1,428
11 Shareholders' Equity	1,601	1,580	1,520	1,428
B INCOME STATEMENT				
1 Sales	2,445	5,120	5,453	5,123
<i>a Cost of Good Sold</i>	(1,939)	(4,004)	(4,149)	(3,632)
2 Gross Profit	506	1,116	1,304	1,490
<i>a Operating Expenses</i>	(383)	(850)	(1,090)	(1,195)
3 Operating Profit	123	266	214	296
<i>a Non Operating Income or (Expense)</i>	53	12	31	65
4 Profit or (Loss) before Interest and Tax	176	278	244	361
<i>a Total Finance Cost</i>	(98)	(165)	(98)	(95)
<i>b Taxation</i>	(36)	(12)	(45)	(64)
6 Net Income Or (Loss)	41	101	102	202
C CASH FLOW STATEMENT				
<i>a Free Cash Flows from Operations (FCFO)</i>	189	345	299	287
<i>b Net Cash from Operating Activities before Working Capital Changes</i>	95	203	214	214
<i>c Changes in Working Capital</i>	(171)	(232)	(189)	(153)
1 Net Cash provided by Operating Activities	(76)	(29)	25	61
2 Net Cash (Used in) or Available From Investing Activities	(34)	7	(145)	(206)
3 Net Cash (Used in) or Available From Financing Activities	71	77	96	96
4 Net Cash generated or (Used) during the period	(39)	55	(24)	(50)
D RATIO ANALYSIS				
1 Performance				
<i>a Sales Growth (for the period)</i>	-4.5%	-6.1%	6.5%	--
<i>b Gross Profit Margin</i>	20.7%	21.8%	23.9%	29.1%
<i>c Net Profit Margin</i>	1.7%	2.0%	1.9%	3.9%
<i>d Cash Conversion Efficiency (EBITDA/Sales)</i>	8.8%	7.9%	6.5%	9.5%
<i>e Return on Equity (ROE)</i>	5.2%	6.5%	6.9%	14.2%
2 Working Capital Management				
<i>a Gross Working Capital (Average Days)</i>	185	162	149	134
<i>b Net Working Capital (Average Days)</i>	114	96	80	58
<i>c Current Ratio (Total Current Assets/Total Current Liabilities)</i>	2.3	2.3	2.1	1.9
3 Coverages				
<i>a EBITDA / Finance Cost</i>	2.4	2.7	3.7	5.5
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	1.7	1.5	1.8	1.8
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>	0.8	0.9	0.7	1.0
4 Capital Structure (Total Debt/Total Debt+Equity)				
<i>a Total Borrowings / Total Borrowings+Equity</i>	47.8%	46.5%	45.6%	44.7%
<i>b Interest or Markup Payable (Days)</i>	90.9	96.8	56.2	0.0
<i>c Average Borrowing Rate</i>	12.5%	11.2%	7.7%	7.8%

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)
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- 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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- (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)
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- (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)
- (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)

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- (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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