The Pakistan Credit Rating Agency Limited

Rating Report

Cherat Packaging Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
24-Dec-2019	A	A1	Stable	Maintain	-
28-Jun-2019	A	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect Cherat Packaging Limited's established position as the largest cement bag manufacturer in the country. Over the years, the company has built a strong business profile and recently diversified by adding flexible packaging. The company has maintained healthy margins and profitability over the years despite its raw material being sensitive to rupee devaluation. The margins and, in turn, profitability of the company has come under pressure. This is mainly in flexible packaging segment as the company is trying to establish its presence. The long term prospects of the company are linked with demand and expansion in local cement capacity, exports cement demand and flexible packaging business. The company has a leveraged capital structure. The coverages have been subdued due to higher borrowings and rising interest rates. The long term debt is related to expansion activities, whereas short term debt has increased substantially pursuant to aggressive inventory procurement. The company's association with Ghulam Faruque Group and its strong governance framework are key rating factors.

The ratings are dependent upon the management's ability to improve margins while sustaining its market share. Prudent management of the working capital, maintaining sufficient cash flows and coverages is imperative for the ratings. Materialization of management's strategy of diversification through flexible packaging into better margins and profitability is important. Any significant decrease in margins and | or coverages will impact the ratings.

Disclosure

Name of Rated Entity	Cherat Packaging Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-19)
Related Research	Sector Study | Paper and Packaging(Nov-19)
Rating Analysts	Madiha Sohail | madiha.sohail@pacra.com | +92-42-35869504

Profile

Legal Structure Cherat Packaging Limited ("Cherat Packaging" or " The Company") is a public limited company, listed on Pakistan Stock Exchange Limited.

Background The Company was incorporated in 1989 and started its production of paper sacks in 1992 and diversified its business with manufacturing of polypropylene bags in 2012. In 2017, company entered in the field of flexible packaging.

Operations The main business activities are manufacturing and selling of paper sacks, polypropylene bags and flexible packaging material. The plant has an annual production capacity of 595 million cement bags and 12.6 mln Kgs (FY18: 7.2 mln Kgs.) of flexo and roto printing. The company also exports cement bags.

Ownership

Ownership Structure Cherat Packaging is part of the Ghulam Faruque Group. Faruque (Pvt.) Ltd holds 10.3% stake in Cherat Packaging Limited, followed by Cherat Cement Company Limited (7.4%), Greaves Pakistan Private Limited (5%), Mirpurkhas Sugar Mills Limited (5%). The remaining stake is held by general public, financial and non-financial institutions.

Stability Since inception, Ghulam Faruque Group has continuously strengthened and diversified its lines of businesses.

Business Acumen The sponsors have strong business accument emanating from the groups established presence in cement, sugar and industrial Air conditioning and engineering sector. Mr. Akbarali Pesnani, the Chairman, is an MBA and fellow member of both the Institute of Chartered Accountants and Institute of Cost and Management Accountants of Pakistan. All other directors are also seasoned professionals and possess manifold experiences in the relevant fields.

Financial Strength Faruque Private Limited, the Group holding company, had net worth of ~PKR 4.4bln at June-end 2018. Apart from packaging business, the holdco also owns shareholding in other group companies.

Governance

Board Structure The Company's Board comprises eight members. Four board members are non-executive, two are independent director and two are executive directors, including the CEO. During the year Mr Tariq Faruque and Mr. Abrar Hassan resigned and was replaced by Mr. Ali H.Shirazi and Mr. Abid Vazir on board. The board is currently chaired by Mr. Akbarali Pesnani, the independent director. He brings an external viewpoint to effectively carry out oversight function of the board. The Company intends to engage a female director on board in compliance with Code of Corporate Governance.

Members' Profile All the directors are highly qualified and have extensive experience in the fields of accounting, auditing, banking, manufacturing and financial services. There is a good mix of professional skills and qualifications possessed by the board members. Six out of eight directors possess more than ten years of strategic leadership experience.

Board Effectiveness Five board meetings were held during FY19. All directors attended at least three board meetings except the directors, resigned during the year. The quality of discussion as captured in meeting minutes reflects high involvement of the board members in business activities. The board has two committees namely: i) Audit Committee ii) Human Recourse and Remuneration Committee.

Financial Transparency EY Ford Rhodes Chartered Accountants are the external auditors of the company, they are listed on category 'A' of SBP's panel of auditors. They have expressed an unqualified opinion on the financial statements for the period ending June-19. The company has an in-house internal audit department, which reports to the Audit Committee.

Management

Organizational Structure The Company has a well-developed organizational structure. The Company operates through two regional offices, located in Lahore and Islamabad, and a registered office located in Peshawar, reporting to the Head Office in Karachi. All the functional Heads report to the Company's COO. The CFO and COO report to the CEO of the Company.

Management Team Mr. Amer Faruque is the CEO of the company. He is a Bachelor of Science (BS) graduate in Business Administration majoring in Management / Marketing from Drake University, USA. The COO, 'Mr. Yasir Masood (FCA)' who is also the CFO of the company having experience of more than two decades. He has been associated with Cherat Packaging for fourteen years and has been a driving force in shaping it into one of the leading cement packaging brands in Pakistan. All functional departments are headed by seasoned professionals.

Effectiveness There are no management committees in place, which indicates a room for improvement.

MIS CPL's manufacturing division is in KPK. The head office in Karachi, regional offices and manufacturing facility are integrated through single ERP platform. The Company uses SAP and customized software to generate various types of operational reports as required by the management in order to monitor the activities effectively.

Control Environment To ensure operational efficiency and appraisal of internal controls, the Company has an in-house internal audit department. The audit committee reviews the internal audit department report and planned activities. The Company has an effective mechanism for identification, assessment and reporting of all types of risk arising out of the business operations.

Business Risk

Industry Dynamics Demand for Pakistan's paper bag and polypropylene packaging industry is mainly derived from the demand of cement which has lately exhibited slight increase after slowdown due to low economic activity. The demand is seen as stable and higher input costs are passed onto cement companies gradually

Relative Position The Company fortified its position as top notch market player among cement bags manufacturers and constitute 28% of the total cement bags industry in Pakistan. Further, the Company also carving its footprints in flexible packaging by rapidly penetrating in the flexible packaging industry.

Revenues The company's revenue exhibits grew by 14% to ~PKR: 8.1 bln in FY19 (FY18 ~PKR 7.1). in 1QFY20 the topline grew by ~37% to ~PKR 2.4 bln as flexible packaging capacity came online.

Margins The company witnessed improved gross margins of ~17% in FY19 (FY18: ~15%) as it effectively passed on the increase in raw material prices. The profitability clocked in at PKR 1.4 bln in FY19. During `QFY20 margins dropped, especially in flexible packaging segment, as the company was trying to gain market share. This combined with higher finance cost impacted profitability (Net Income 1QFY20: ~PKR 22 mln , 1QFY19: ~PKR 226 mln)

Sustainability The Company intends to maintain its position as leading market player in cement bags packaging; The Company is trying to gain market share in the flexible packaging market. Margins are expected to improve going forward.

Financial Risk

Working Capital The net working capital cycle increased to 198 days in 1QFY20 (FY19: 170 days) and remain high. This is mainly triggered by increase in inventory days on the back of decision by the management to hold inventory as it anticipate increase in prices of raw materials. The company uses short-term borrowings to finance the working capital. Trade level cushion stands at 35% in 1QFY20.

Coverages The Company's Free Cash Flows from Operations (FCFO) stood at ~PKR 290 mln in 1QFY20, (1QFY19: ~PKR 1282 mln). The interest coverage ratio reduced to 1.4x in 1QFY20, (1QFY19: ~PKR 2.6 x), due to significant increase in finance cost.

Capitalization The capital structure of the company is highly leveraged and stood at ~58% in 1QFY20. The leveraging of the Company is mainly attributable to increase in both short term borrowing (for working capital) and long term borrowings, utilized mainly for installation of universal paper sack line and flexible packaging project.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

CHERAT PACKAGING LIMITED Paper and Packaging	Sep-19 3M	Jun-19 12M	Jun-18 12M	Jun-17 12M	Jun-16 12M
A BALANCE SHEET					
1 Non-Current Assets	5,143	5,174	4,798	1,833	1,663
2 Investments	-	-	-	-	-
3 Related Party Exposure	141	155	476	871	512
4 Current Assets	6,664	6,023	4,095	2,863	2,510
a Inventories	*3,431*	*3,129*	*2,009*	*1,495*	*1,342*
b Trade Receivables	*1,861*	*1,569*	*1,054*	*899*	*718*
5 Total Assets	11,948	11,351	9,369	5,566	4,685
6 Current Liabilities	933	711	833	574	727
a Trade Payables	-	*94*	*125*	*44*	*39*
7 Borrowings	6,228	5,835	3,757	771	420
8 Related Party Exposure	-	-	-	-	-
9 Non-Current Liabilities	312	338	263	204	221
10 Net Assets	4,475	4,466	4,516	4,017	3,316
11 Shareholders' Equity	4,475	4,466	4,516	4,017	3,316
B INCOME STATEMENT					
1 Sales	2,377	8,093	7,092	6,444	6,889
a Cost of Good Sold	*(2,075)*	*(6,693)*	*(5,993)*	*(5,187)*	*(5,307)*
2 Gross Profit	302	1,401	1,098	1,256	1,582
a Operating Expenses	(68)	(223)	(173)	(179)	(133)
3 Operating Profit	234	1,177	925	1,077	1,449
a Non Operating Income or (Expense)	*(1)*	*(11)*	*(31)*	*(40)*	*(68)*
4 Profit or (Loss) before Interest and Tax	233	1,167	893	1,037	1,381
a Total Finance Cost	*(203)*	*(507)*	*(128)*	*(64)*	*(72)*
b Taxation	*(8)*	*(97)*	*(54)*	*(271)*	*(390)*
6 Net Income Or (Loss)	22	563	711	702	919
C CASH FLOW STATEMENT					
a Free Cash Flows from Operations (FCFO)	*290*	*1,282*	*922*	*892*	*1,392*
b Net Cash from Operating Activities before Working Capital Changes	*73*	*918*	*866*	*856*	*1,312*
c Changes in Working Capital	*(414)*	*(2,059)*	*(922)*	*(517)*	*(77)*
1 Net Cash provided by Operating Activities	(341)	(1,140)	(56)	339	1,235
2 Net Cash (Used in) or Available From Investing Activities	(52)	(670)	(3,157)	(412)	(380)
3 Net Cash (Used in) or Available From Financing Activities	393	1,815	3,207	71	(848)
4 Net Cash generated or (Used) during the period	0	5	(7)	(2)	7
D RATIO ANALYSIS					
1 Performance					
a Sales Growth (for the period)	17.5%	14.1%	10.1%	-6.5%	--
b Gross Profit Margin	12.7%	17.3%	15.5%	19.5%	23.0%
c Net Profit Margin	0.9%	7.0%	10.0%	10.9%	13.3%
d Cash Conversion Efficiency (EBITDA/Sales)	13.3%	17.8%	15.0%	18.1%	21.4%
e Return on Equity (ROE)	2.0%	12.5%	16.7%	19.1%	27.7%
2 Working Capital Management					
a Gross Working Capital (Average Days)	201	175	140	132	101
b Net Working Capital (Average Days)	198	170	136	130	99
c Current Ratio (Total Current Assets/Total Current Liabilities)	7.1	8.5	4.9	5.0	3.5
3 Coverages					
a EBITDA / Finance Cost	1.6	2.9	8.6	19.4	20.9
b FCFO / Finance Cost+CMLTB+Excess STB	1.0	1.9	4.4	8.9	5.1
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	8.0	3.7	3.5	0.7	0.3
4 Capital Structure (Total Debt/Total Debt+Equity)					
a Total Borrowings / Total Borrowings+Equity	58.2%	56.6%	45.4%	16.1%	11.2%
b Interest or Markup Payable (Days)	81.4	142.4	215.3	132.0	45.4
c Average Borrowing Rate	13.4%	10.5%	5.4%	10.1%	16.8%

Rating Scale | Corporate

2019

Credit Rating Scale & Definitions

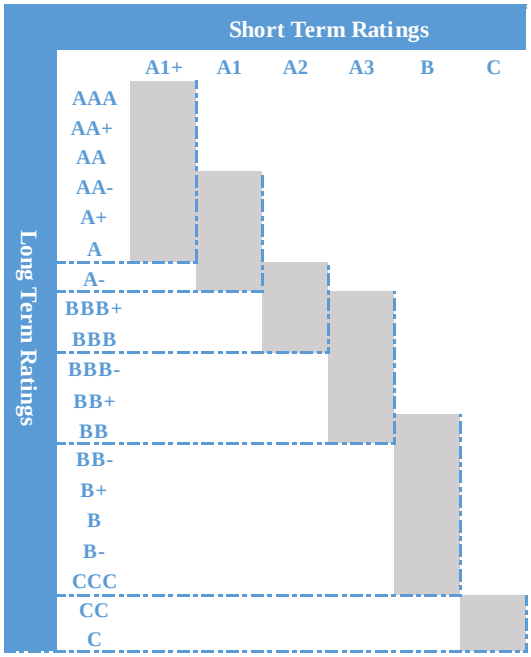
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings

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

Rating Team Statements
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest
(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)
Probability of Default
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)
Proprietary Information