The Pakistan Credit Rating Agency Limited

Rating Report

Gharibwal Cement Limited

Report Contents

Rating History					
Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
02-Apr-2021	A	A2	Stable	Upgrade	-
03-Apr-2020	A-	A2	Stable	Maintain	-
27-Sep-2019	A-	A2	Stable	Maintain	-
29-Mar-2019	A-	A2	Stable	Maintain	-
16-Nov-2018	A-	A2	Stable	Maintain	-
04-May-2018	A-	A2	Stable	Maintain	-
20-Nov-2017	A-	A2	Stable	Maintain	-
06-Jun-2017	A-	A2	Stable	Maintain	-
04-Oct-2016	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect Gharibwal Cement's strength in its key markets. The Company has a market share of 4% in the north region with annual cement capacity of 2.1mln Tons. The company focuses on geographies closer to the plant location; Gujranwala division remained company's home market. Lately, company's distribution costs went up amid stressed north region dynamics. The cement sector achieved tremendous growth in despatches specifically local despatches post Covid-19 pandemic economic slowdown. The revival of economic activity based upon the PSDP funded projects including the construction of dams & CPEC related civil construction projects. However, stressed price dynamics in the north region remains challenging for the profit margins. Export is another avenue. Industry-wide exports (sizeable increase in South Region) have gone up as new export window is created in Bangladesh market where sector is exporting notable volumes of cement and clinker. Cement sector's local capacity utilization also recorded growth owing to accelerated local demand and the sector is entering into new era of expansions. This will further impact the credit profile and burden the financial matrix of company. The likelihood of impact is considered high where quantum is directly correlated with operational strength and supported equity base. Curtailed key policy rate will provide much-needed room to flourish to the sector. The company's capacity enhancement plans are on an accelerated path owing to north region dynamics. The company's business profile remained critical as per new era of expansions will change the industry's dynamics and company may lose its market share if it won't take part in the current expansion phase. Going forward, along with improvement in volumes, restoring operating and EBITDA margins at earlier healthier levels remains vital for the company. The financial profile remains adequate as long term leveraging expected to increase if expansion would be financed with debt mix. The ratings draw comfort from sponsor families, having prime focus of the company.

The ratings are dependent on upholding the company's business vis-à-vis financial risk profile in the current economic scenario. Industry's dynamics encompassing expanded supply, substantial decline in local demand amid country-wide lockdown will negatively affect the ratings. The proactive measures taken by management in diluted north region dynamics will remain vital for holding ratings at the current level.

Disclosure	
Name of Rated Entity	Gharibwal Cement Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-20),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria | Rating Modifier(Jun-20)
Related Research	Sector Study | Cement(Mar-21)
Rating Analysts	Anam Waqas Ghayour | anam.waqas@pacra.com | +92-42-35869504

Profile

Legal Structure Gharibwal Cement Limited – the flagship company of Gharibwal Group – was incorporated in 1960 as a Public Limited Company and commenced operations in 1965 and is listed on Pakistan Stock Exchange.

Background Way back in 1970s, the company was nationalized like other peers. Subsequently, after two decades (1992), in the wake of industries' privatization, Mr. Tausif Peracha and Mr. Abdur Rafiq Khan – a foreign entrepreneur – acquired a majority stake in Gharibwal Cement. Since then, both have been associated with the company.

Operations Gharibwal Cement's registered office is located in Pace Tower Lahore and production facility is located in Ismailwal, Tehsil Pind Dadan Khan, District Chakwal. Gharibwal Cement Limited enhanced grinding capacity by adding new vertical mill of cement, in which company has increased its capacity to 13,680 t.p.d of grinding mill.

Ownership

Ownership Structure e Gharibwal Cement is a family owned business with majority stake held by two families. Peracha family owns ~56% while Khan family holds 32% equity stake in the company; all through individuals. However, Mr. Muhammad Tousif Peracha (single key shareholder) is identified as the man at the last mile.

Stability A tacit understanding between shareholding families necessitates formal documentation.

Business Acumen Mr. Muhammad Tousif Peracha and Mr. Abdur Rafique Khan have been together for more than three decades and are partners in different business ventures internationally – mainly shipping and real estate business. They have no blood relation but had been family friends since many past years.

Financial Strength Gharibwal Group has interests in glass manufacturing, lubricants, and real estate projects locally and shipping and truck manufacturing in Nigeria.

Governance

Board Structure The overall control of the company vests in seven member's board of directors including the Chairman - Mian Nazir Ahmed Peracha, and the CEO - Mr. Muhammad Tousif Peracha. While two independent members. Out of five, there are two executive directors – the CEO and a director– and three non-executive directors.

Members' Profile Board members carry adequate experience; though a challenge to management decisions is limited.

Board Effectiveness Two committees, Audit, and Human Resource and Remuneration are in place to assist the board on relevant matters.

Financial Transparency M/s Kreston Hyder Bhimji and Co. Chartered accountants, 'A' category SBP panel member, the external auditors have given an unqualified opinion on the company's financial statements for the year ended Jun-20.

Management

Organizational Structure The organizational structure of the company is divided into eight key functions. These include i) Operations and Projects, ii) Procurement, iii) Finance, iv) Marketing/ Commercial, v) Technical Advisory, vi) Information Technology, vii) Administration/ HR, and viii) Internal Audit. The Director Operations and Projects, supported by GM Works and his team, resides at Plant. All functional heads report to the CEO except Internal Audit, who reports to the Audit Committee.

Management Team The management is equipped with the necessary knowledge and technical skills required.

Effectiveness The management is supported by four committees: – (i) Core Executive, (ii) Risk Management, (iii) Investor Relation, and (iv) Finance and Policy Committee.

MIS Deploys Microsoft Dynamic G.P 2015 as operating software; quality of MIS reporting considered good.

Control Environment Plant – a mix of European and Chinese technology. Gharibwal Cement has several sources to cater to its power requirements (138MW).

Business Risk

Industry Dynamics As per prime bifurcation of Cement industry into North & South, majority concentration lies in North region. Currently, the cement industry is on revival path after the downward tendency in reported despatches during FY20, the first half of the year witnessed high general inflation, rising utility prices, and tight fiscal consolidation affecting the purchasing power of people, and the second half was affected due to the outbreak of Covid-19 pandemic. However, it is worth mentioning that Cement Industry managed to survive this bumpy ride and induced growth in reported despatches by 1.98% for FY20. Market dynamics have changed significantly in last year, driven by a slowdown in an economic activity wherein plunge in international coal prices (1QFY21: $57, FY20: $67, FY19: $72), decreased FED & policy rate cut by ~525bps supported the industry, however, competitive cement prices (especially in the north region) remained a challenge to profit margins. The cement industry is entering into a new phase of capacity expansion. Industry leveraging is moderate however it is expected to increase on the back of new expansions. Going forward - with full capacity utilization - supply glut and pressurized cement prices would remain challenging for cement players. Cement demand is expected to accelerate on the account of various PSDP-funded projects including dams, civil construction projects, and public developmental projects, as Govt. has finally laid down the action plan to its announced pursuit for infrastructure.

Relative Position Gharibwal Cement is among middle-tier cement players with an operational capacity of 2.1mln tpa. Over the last few years, the company commenced some projects in order to gain overall efficiency which included raw material conveyer belt, setting up a WHRPP, and cement grinding mill.

Revenues The Topline mix is predominantly skewed towards local sales. The key reason being the plant's location, whereby local sales can secure margins, local sales are more profitable than exports. Export volumes have witnessed a downtrend – a key concern for north players – the contribution of exports in overall revenues is nominal; however local sales are forecasted to lift up in upcoming quarters of FY21 as there are several under-processed constructional projects, announced by GoP to boost economic activity. The Company's interest income was increased to PKR 364mln in FY20 (1QFY21: PKR 16mln; FY19: PKR 44.7mln; FY18: PKR 26.3mln) because of PKR 600mln loan to Baluchistan Glass – related party. Financial charges reported an inclining trend; attributable to payment of outstanding debt level and increase in the borrowing rate. Resultantly, the company reported a significant reduction in net income of PKR 131mln in FY20; however, it increased to PKR 263mln in 1QFY21 as rejuvenation in industry demand has been reported post-Covid-19 triggered economic slowdown.

Margins During FY20, gross margins reduced significantly as per industry-wide phenomenon, (gross: 1QFY21: 22%, FY20: 1%, FY19: 23%, FY18: 24%), (operating: 1QFY21: 18.5%, FY20: -3.1% FY19: 18%, FY18: 20%). This is on account of the economic shut down which led to a slump in demand during the worldwide economic slowdown on the back of the Covid-19 pandemic. Also, there had been industry-wide challenges on the sustainability of cement prices specifically in the north region. Hence, EBITDA margin reported as (1QFY21: 27%, FY20: 11%, FY19: 17.5%, FY16: 19.3%) – industry-wide trend.

Sustainability Going forward, the company is planning to focus on fully utilizing its current capacity and achieving overall efficiency in the manufacturing process. Going Forward, it will be important for Gharibwal to expand its installed capacities in order to sustain its market share.

Financial Risk

Working Capital Gharibwal Cement's working capital requirements are a function of its inventory and payables, for which the company currently relies on a mix of internal cash flows and effective management of payables. Net cash cycle improved to 18days at end-Jun20 and further stretched at end-Sep20 to report as (1)day; on account of delayed payments to creditors. The current ratio has marginally decreased to 1.1x (FY19: 1.4x).

Coverages Gharibwal Cement's absolute EBITDA has significantly declined to end-Jun20: PKR 994mln (end-Jun19: PKR 2,964mln, end-Jun18: PKR 3,135mln) owing to squeezed profitability, however, the situation gets improved in the subsequent quarter wherein reported EBITDA was PKR 774mln at end-Sep20. Consequently, Company's coverages reported as (Interest Coverage: 1QFY21: 7.6x, FY20: 0.6x, FY19: 5.0x; Core Coverage: 1QFY21: 7.8x; FY20: 1.9x).

Capitalization During FY20, the capital structure of the company remained moderate as the total debt to debt plus equity ratio remained at 19% (FY19: 24%). Net debt of the company decreased by 20% on a YoY basis from PKR 3.6bln to PKR 2.9bln, witnessed in FY20. Leveraging may be increased on the account of expansions in cement lines in the near future. During FY20, Company has incurred a loss before tax for the year ended June 30, 2020, therefore, it was decided not to make any dividend appropriation for the year.

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Financial Summary
PKR mln

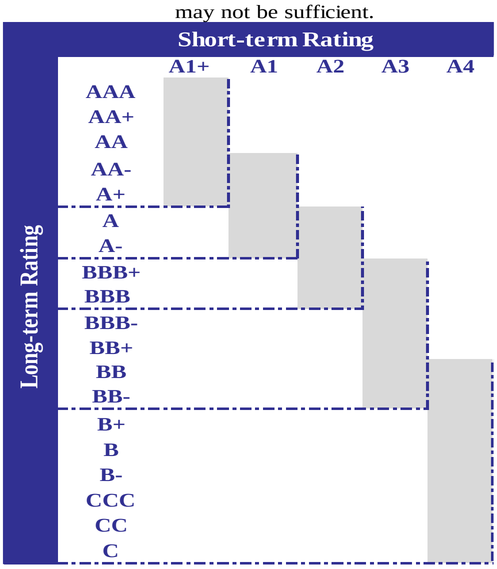
Gharibwal Cement Limited Cement	Sep-20 3M	Jun-20 12M	Jun-19 12M	Jun-18 12M
A BALANCE SHEET				
1 Non-Current Assets	20,116	20,352	18,315	19,251
2 Investments	-	-	-	-
3 Related Party Exposure	538	538	339	250
4 Current Assets	4,516	4,620	4,609	3,912
a Inventories	*488*	*528*	*899*	*1,202*
b Trade Receivables	*563*	*593*	*627*	*557*
5 Total Assets	25,171	25,510	23,262	23,413
6 Current Liabilities	3,543	4,082	3,390	3,701
a Trade Payables	*1,561*	*1,740*	*1,456*	*1,960*
7 Borrowings	3,133	3,112	4,009	4,338
8 Related Party Exposure	79	272	11	-
9 Non-Current Liabilities	3,646	3,539	3,370	2,313
10 Net Assets	14,769	14,506	12,481	13,061
11 Shareholders' Equity	14,769	14,506	12,481	12,491
B INCOME STATEMENT				
1 Sales	2,613	8,714	11,356	11,484
a Cost of Good Sold	*(2,041)*	*(8,628)*	*(8,716)*	*(8,772)*
2 Gross Profit	572	86	2,640	2,712
a Operating Expenses	(89)	(355)	(591)	(410)
3 Operating Profit	483	(268)	2,050	2,303
a Non Operating Income or (Expense)	*(10)*	*313*	*(62)*	*(90)*
4 Profit or (Loss) before Interest and Tax	473	45	1,988	2,213
a Total Finance Cost	*(102)*	*(607)*	*(608)*	*(430)*
b Taxation	*(108)*	*693*	*(643)*	*(274)*
6 Net Income Or (Loss)	263	131	736	1,510
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*690*	*336*	*2,661*	*2,285*
b Net Cash from Operating Activities before Working Capital Changes	*595*	*(113)*	*2,195*	*1,913*
c Changes in Working Capital	*(442)*	*1,266*	*(868)*	*577*
1 Net Cash provided by Operating Activities	153	1,153	1,327	2,490
2 Net Cash (Used in) or Available From Investing Activities	(10)	(191)	(170)	(1,337)
3 Net Cash (Used in) or Available From Financing Activities	(172)	(962)	(833)	(1,169)
4 Net Cash generated or (Used) during the period	(28)	0	324	(16)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	19.9%	-23.3%	-1.1%	2.3%
b Gross Profit Margin	21.9%	1.0%	23.3%	23.6%
c Net Profit Margin	10.1%	1.5%	6.5%	13.1%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	9.5%	18.4%	15.8%	24.9%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	7.1%	0.9%	5.9%	12.6%
2 Working Capital Management				
a Gross Working Capital (Average Days)	57	85	77	66
b Net Working Capital (Average Days)	-1	18	23	16
c Current Ratio (Current Assets / Current Liabilities)	1.3	1.1	1.4	1.1
3 Coverages				
a EBITDA / Finance Cost	7.8	1.9	5.5	8.2
b FCFO / Finance Cost+CMLTB+Excess STB	2.2	0.3	1.6	1.5
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	1.3	-16.9	1.9	2.2
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	17.9%	18.9%	24.4%	25.8%
b Interest or Markup Payable (Days)	137.9	49.5	49.6	39.5
c Entity Average Borrowing Rate	10.4%	14.7%	13.7%	8.7%

Credit Rating

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

Long-term Rating	
Scale	**Definition**
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk “CCC” Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. “CC” Rating indicates that default of some kind appears probable. “C” Ratings signal imminent default.
D	Obligations are currently in default.

Short-term Rating	
Scale	**Definition**
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



The correlation shown is indicative and, in certain cases, may not hold.

Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. ‘Stable’ outlook means a rating is not likely to change. ‘Positive’ means it may be raised. ‘Negative’ means it may be lowered. Where the trends have conflicting elements, the outlook may be described as ‘Developing’.

Rating Watch Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

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

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

Entities
a) Broker Entity Rating
b) Corporate Rating
c) Financial Institution Rating
d) Holding Company Rating
e) Independent Power Producer Rating
f) Microfinance Institution Rating
g) Non-Banking Finance Companies (NBFCs) Rating

Instruments
a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk Rating

Regulatory and Supplementary Disclosure
(Credit Rating Companies Regulations,2016)

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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(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)
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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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