The Pakistan Credit Rating Agency Limited

Rating Report

Engro Polymer & Chemicals Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
18-Jan-2019	AA-	A1+	Stable	Maintain	-
19-Jul-2018	AA-	A1+	Stable	Upgrade	-
25-Jan-2018	A+	A1+	Stable	Upgrade	-
30-Jun-2017	A	A1	Stable	Upgrade	-
30-Jun-2016	A-	A2	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

The ratings recognize Engro Polymer's established foothold in the local PVC and caustic soda market. EPCL is the only manufacturer of Poly Vinyl Chloride (PVC), having a market share of ~66% in domestic market. Growth of PVC demand in domestic market and improved vinyl chain dynamics lead to higher revenues and improved profitability. Keeping in view growth trajectory, EPCL announced a CAPEX of PKR 10.3bln, an addition of 100K tons capacity on PVC and 50K tons of VCM, on a tune of PKR 7.6bln of which PKR 5.4bln has been raised through the issuance of right shares. Remaining CAPEX will be funded through internally generated cash and debt. EPCL further plans to enter Hydrogen Per Oxide business through a green field manufacturing facility by investing US$ 23mln. The project will be funded through internal cash generation. During expansion, the strength of the balance sheet is likely to remain intact. The ratings also reflect EPCL's association with one of the country's leading conglomerate – Engro Corp.

The ratings are dependent upon holding sustained operations and continuity of improved margins. Successful execution of planned expansion, while, with the new debt to be acquired, maintenance of coverages would remain important to uphold ratings. Sustenance of import and anti-dumping duty is important for the sustainability of the risk profile of the company.

Disclosure

Name of Rated Entity	Engro Polymer & Chemicals Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-18),Methodology | Criteria | Rating Modifier(Jun-18),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
Related Research	Sector Study | Polyvinyl Chloride(Jun-18)
Rating Analysts	Muhammad Hassan | muhammad.hassan@pacra.com | +92-42-35869504

Profile

Legal Structure EPCL, established in 1997, started commercial production in 1999. The Company is listed on Pakistan Stock Exchange.

Background Engro Polymer and Chemicals Limited (EPCL), formerly known as Engro Asahi Polymer and Chemicals Limited, is the only Poly Vinyl Chloride (PVC) manufacturer in Pakistan. The company is the only fully integrated Chemical production facility in the country, located at Port Qasim, Karachi. EPCL was established in 1997 and achieved commercial production in 1999.

Operations EPCL is primarily involved in the manufacturing, marketing and distribution of PVC and its allied products with design annual capacity of 195,000 tons per annum (tpa). The company is backward integrated, producing VCM (Vinyl Chloride Monomer) for PVC. One of the by-products of the process is Caustic Soda, which adds meaningful diversification to the company's business.

Ownership

Ownership Structure Engro Polymer and Chemicals Limited (EPCL) is a subsidiary of Engro Corporation Limited (ECL) which is ultimately owned by DH Group. ECL holds majority stake in the company (56%). The other major shareholders of EPCL are Mitsubishi Corporation (10%).

Stability Ownership structure displays a composite outlook. Executive Directors, have strong knowledge of the industry and extensive experience in relevant fields and have the the power to direct relevant activities of the company. As EPCL is a subsidiary of Engro Corp and Engro Corp is a subsidiary of DH Corp.

Business Acumen Dawood Group is a conglomerate with over three generations of experience in commercial and social enterprises. Currently, the Group has interests in various sectors of the economy including Fertilizers, Foods, Power Generation, Technology, Financial Services, Chemical Storage, and Petrochemicals. Strong affiliation and technical track record with international JVs have added to the success of the companies within the Group.

Financial Strength Dawood Group's main holding companies are DH Corp and Dawood Lawrencepur Limited. The Groups' main investments in Engro Corp are consolidated in DH Corp while investments in energy sector are consolidated in Dawood Lawrencepur Limited. In addition, the Group's businesses include Cyan Limited (a listed entity, engaged in making equity investments in companies with high growth potential). Engro Corp has a strong consolidated asset base of ~ PKR373bln supported by an equity base of ~ PKR 181bln as at Sept-18. Consolidated Revenue stood at ~ PKR 115bln for 9MCY18.

Governance

Board Structure The Board of Directors (BoD) comprises eight members. Three members from the parent organization including the CEO, one senior executive from Engro Group and a member of Dawood family, while two members represent Mitsubishi Corporation. The remaining three members are independent non-executive directors. The chairman of the board, is the CEO of Engro Corporation.

Members' Profile Mr. Ghiasuddin Khan – the CEO of Engro Corp, is Non-Executive Chairman of EPCL. He helps set a cohesive direction to create growth and value for the group of companies by focusing on long-term strategy, digital transformation, and cross business opportunities.

Board Effectiveness The board has two committees in place; (i) Board Audit Committee (BAC) and (ii) Board Compensation Committee (BCC).

Financial Transparency A.F.Ferguson & Co. Chartered Accountants, are the auditors of the company since long. The said firm is rated an 'A' category firm by SBP. They expressed an unqualified opinion on EPCL's financial statements for year ended December 2017 and for half year ended June 2018.

Management

Organizational Structure Mr. Imran Anwer is the CEO of the company. He has hands-on experience in the domain of petrochemical industry. To oversee the management of the company, EPCL has constituted three committees (i) Management Committee, (ii) Corporate HSE Committee (iii) Committee for Organization & Employee Development, comprising various members of the management team - headed by the CEO.

Management Team The company operates through five major divisions headed by experienced professionals – reporting to CEO. The divisions are a) Manufacturing – headed by Mr. Jahangir Waheed, b) Human Resource and Corporate Services – headed by Mr. Salman Hafeez, c) Finance – headed by Syed Abbas Raza and d) Supply Chain – headed by Mr. Aneeq Ahmed, e) Marketing – headed by Mr. Abdul Qayoom.

Effectiveness The strong organizational structure ensures effective delegation of functional responsibility across various departments, facilitating a smooth flow of operations.

MIS The company deploys SAP as ERP solution. SAP implementation was divided into two phases. First phase comprises Materials Management, FICO and Sales & Distribution was implemented in CY15. During CY17, ECPL has successfully implemented phase 2 - including production planning and plant maintenance modules.

Control Environment EPCL maintains an effective control environment with defined policies and procedures. EPCL's internal audit function performs regular reviews on the financial, operational and compliance controls and reports directly to the audit committee for all critical issues.

Business Risk

Industry Dynamics Global PVC demand stood at 43MT in 2017 with a 4-year CAGR of 2.4%. Pipes and Fitting reiterated to dominate the PVC market. However, the future of PVC market in Pakistan is more influenced with the positive economic activity especially the launch of China-Pakistan Economic Corridor (CPEC), enhancing its application in the domestic market.

Relative Position Domestic PVC demand is met through EPCL (~66%) – as EPCL is the sole PVC producer in Pakistan, and through imports (~34%). EPCL has validated improved production. PVC production stood at 195K MT with the capacity utilization of 96%. Higher capacity utilization turned into higher volumetric sales backed by higher economic activities in the economy resulted in sustained market share of 80%.

Revenues EPCL ramped up its revenue stream (CY17: PKR 27,731mln, CY16: PKR 22,854mln), up by ~21%, mainly owing to higher volume and increase in the prices of its main product – PVC [Sales mix: PVC: ~82%, Caustic Soda: ~17%). Recently, in 9MCY18 the Company was able to earn sales revenue of PKR ~25.5bln.

Margins During 9MCY18, company's cost of sales increased (~21%) – less than proportionate. Resulting in improved gross margin (9MCY18: ~25%, 9MCY17: ~23%) and operating margin (9MCY18: ~21%, 9MCY17: ~18%).

Sustainability Going forward, EPCL plans to expand the production capacity of PVC by 100K MT which is expected to kick off in 3Q2020. After incorporating expansion, total PVC capacity will reach to 295K MT (Current Capacity: 195K MT).

Financial Risk

Working Capital EPCL's cash cycle remained robust as almost all sales are on cash basis while the company has a credit period facility of 180 days by its primary raw material suppliers.

Coverages The Company's cash flows remain a function of its profitability. This is improving, in turn, strong cashflows (FCFO: 9MCY18: PKR 7,066mln, 9MCY17: 4,714mln). Despite hike in interest rates, due to debt re-profiling in previous years, finance cost has reduced YoY which resulted in improved interest coverage ratio (9MCY18: 15.6x, 9MCY17: 8x).

Capitalization The Company's capital structure stood at 42.8% in 1HCY18 (1HCY17: 55.5%). The company repaid some of its debt in 3QCY18 which has decreased the leveraging to 32.3%. Secondly, with Right issue of PKR 5.4bln equity has increased which means that despite procurement of further debt company's leveraging is expected to remain at adequate level. Leveraging is expected to decrease once repayment starts. In addition, EPCL has issued a privately placed, secured Sukuk of PKR 8.75bln (inclusive of PKR 5bln green shoe option). Tenor of the Sukuk will be 7.5 years with initial 5.5 years as grace period. The issue has proposed profit (3MK+.90bps) payable quarterly in arrears.

PKR (mln)

Engro Polymer and Chemicals Limited

BALANCE SHEET	30-Sep-18	30-Dec-17	31-Dec-16	31-Dec-15
	9M	CY17	CY16	CY15
Non-Current Assets	**17,861**	**16,203**	**16,719**	**17,314**
Investments (Incl. associates)	**-**	**50**	**50**	**50**
Equity	-	50	50	50
Debt	-	-	-	-
Current Assets	**9,746**	**7,912**	**6,952**	**6,578**
Inventory	5,308	3,681	3,024	2,941
Trade Receivables	644	505	456	437
Others	3,794	3,726	3,471	3,200
Total Assets	**34,630**	**24,315**	**24,461**	**24,242**
Debt	**7,500**	**8,750**	**9,584**	**11,394**
Short-term	-	-	417	3,050
Long-term (Inlc. Current Maturity of long-term debt)	7,500	8,750	9,167	8,344
Other shortterm liabilities	11,379	7,845	8,909	7,545
Shareholder's Equity	**15,731**	**7,720**	**5,968**	**5,303**
Total Liabilities & Equity	**34,630**	**24,315**	**24,461**	**24,242**

INCOME STATEMENT	30-Sep-18	30-Dec-17	31-Dec-16	31-Dec-15
Turnover	**25,524**	**27,731**	**22,854**	**22,264**
Gross Profit	6,800	6,065	3,935	2,773
Other Income	150	(233)	(127)	(330)
Financial Charges	(452)	(821)	(930)	(1,082)
Net Income	**3,865**	**2,049**	**655**	**(649)**

Cashflow Statement	30-Sep-18	30-Dec-17	31-Dec-16	31-Dec-15
Free Cashflow from Operations (FCFO)	7,066	5,819	3,698	1,060
Net Cash changes in Working Capital	(486)	(3,363)	289	(1,260)
Net Cash from Operating Activities	6,143	1,894	3,102	(1,161)
Net Cash from InvestingActivities	(9,005)	(1,083)	(1,078)	(800)
Net Cash from Financing Activities	3,131	(503)	(1,807)	1,578
Net Inc/dec in Cash	270	308	217	(382)

Ratio Analysis	30-Sep-18	30-Dec-17	31-Dec-16	31-Dec-15
Performance				
Turnover Growth	25.2%	21.3%	2.7%	-6.5%
Gross Margin	26.6%	21.9%	17.2%	12.5%
Net Margin	15.1%	7.4%	2.9%	-2.9%
ROE	32.8%	26.5%	11.0%	-12.2%
Coverages				
Interest Coverage (FCFO/Gross Interest)	15.6	7.1	4.0	1.0
Core: (FCFO/Gross Interest+CMLTD+Uncovered Total STB)	7.9	7.1	1.0	0.1
Debt Payback (Total LT Debt Including UnCovered Total STBs) / (FCFO- Gross Interest)	1.1	1.8	4.2	-577.6
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	26.3	32.5	-23.7	-18.0
Capital Structure (Total Debt/Total Debt+Equity)	32.3%	53.1%	61.6%	68.2%

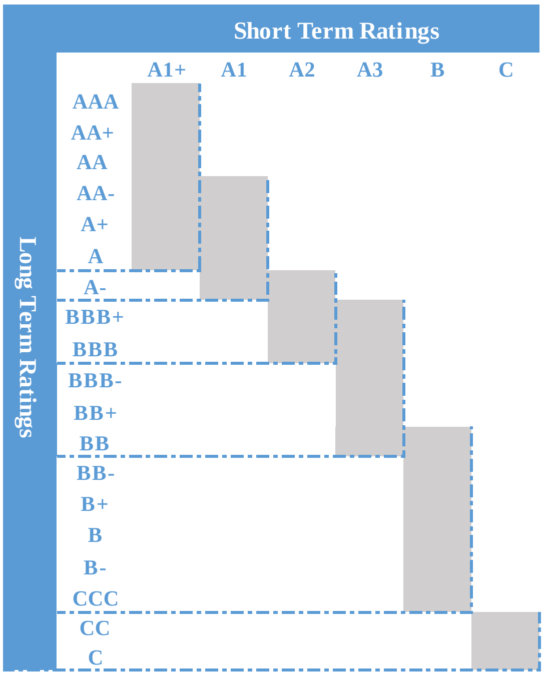
Rating Scale

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.

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**
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