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
19-Jul-2019	AA-	A1+	Stable	Maintain	-
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	-
30-Jun-2015	A-	A2	Stable	Downgrade	-
30-Jun-2014	A	A1	Stable	Initial	-

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. The Company raised 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. 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. Also, the cost of expansion (imported component) will rise due to Rupee devaluation. However, this impact is curtailed to an extent through hedging.

The ratings are dependent upon holding sustained operations and margins. Successful and timely execution of expansion projects within stipulated time frame and cost parameters, maintenance of coverages would remain important to uphold ratings. Maintenance of strong financial profile and coverages is important.

Disclosure	
Name of Rated Entity	Engro Polymer & Chemicals Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	PACRA_Methodology_Corporate_FY19(Jun-19),PACRA_Crtieria_LT ST Relationship_FY19(Jun-19),PACRA_Criteria_Rating Modifiers_FY19(Jun-19)
Related Research	Sector Study | Chemical(Jun-19)
Rating Analysts	Muhammad Hassan | muhammad.hassan@pacra.com | +92-42-35869504

Profile

Legal Structure Engro Polymer and Chemicals Limited, established in 1997, started commercial production in 1999. The Company is listed on Pakistan Stock Exchange.

Background Engro Polymer and Chemicals Limited, 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.

Operations The Company 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. The Company also produces Caustic Soda.

Ownership

Ownership Structure Engro Polymer and Chemicals Limited is a subsidiary of Engro Corporation Limited which is ultimately owned by DH Group. ECL holds majority stake in the company (56%). The other major shareholder is Mitsubishi Corporation (11%).

Stability The Executive Director - Mr. Imran Anwer, 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 Engro Polymer and Chemicals 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.

Financial Strength Engro Corp has a strong consolidated asset base of ~ PKR406bln supported by an equity base of ~ PKR 192bln as at 3MCY19.

Governance

Board Structure The Board of Directors (BoD) comprise of 7 members including CEO. Four Board members are from the parent while one member represents Mitsubishi Corporation. There is one independent director. Mr. Ghiasuddin Khan – the CEO of Engro Corp - is Non-Executive Chairman of EPCL.

Members' Profile Members of the board have a good mix of skills and experience. Mr. Ghias Uddin Khan – the CEO of Engro Corp, is Non-Executive Chairman of Engro Polymer & Chemicals Limited. He helps set a cohesive direction to create growth and value for the group of companies by focusing on long-term strategy and digital transformation.

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 the Company's financial statements for year ended December 2018.

Management

Organizational Structure The Company operates through seven departments, each headed by an experienced manager. These departments include (i) Audit (ii) Public Affairs (iii) Manufacturing (iv) Marketing (v) Supply Chain (vi) Finance (vii) Human Resource. Each department head directly reports to the CEO.

Management Team A very well qualified and experienced management team is there to run the business operations efficiently. The CEO, Mr. Imran Anwer, is a Chartered Accountant with over 20 years of experience. Before becoming the CEO of Engro Polymer in 2015, he was VP Business Development and Finance at Engro Foods since 2005, prior to which he worked for PwC Karachi and Deloitte & Touche Jeddah.

Effectiveness There are five committees in place, each having a six members panel except inquiry committee - a) Management Committee, b) Corporate HSE Committee, overlooking the Company's health and safety standards, c) Committee for Organization & Employee Development, d) Inquiry Committee, implementing Harassment of Women at the Workplace Act 2010 and e) Salary and Compensation Committee.

MIS The Company has SAP as ERP solution. Going forward the Company's corporate objective is implementation of state of the art end to end ERP "SAP S4 HANA", including FIORI, Business Planning & Consolidation and Success Factors.

Control Environment The control environment is strengthened by the role of Internal Audit department that provides periodic detailed reports to the Audit Committee for review and assessment and to take necessary remedial actions, where needed. Separate Internal Audit reports for each financial process, including inventory management, payroll, procurement, accounts receivables and accounts payable along with risk rating matrix for each process are prepared and shared with the Audit Committee.

Business Risk

Industry Dynamics The international PVC market remained robust at 44mln tons in 2018, posting a growth of 3%, driven particularly by demand in Asia. South Asian PVC market posted a growth of 8% against last year. Despite strong growth, Pakistan's per capita PVC consumption remains much lower than regional averages, The main reason behind low per capita consumption of PVC is primarily because Pakistan uses PVC in conventional applications e.g. pipes and fittings, film packaging and shoes while increasing PVC consumption in China and India is attributable to construction sector, increasing housing demand and urbanization.

Relative Position Domestic PVC demand is met through Engro Polymer and Chemicals (~66%) – as the Company is the sole PVC producer in Pakistan, and the rest (~34%) is met through imports. PVC production stood at 203K MT with the capacity utilization of over 100%. In case of Caustic Soda, Engro Polymer and Chemicals Limited is one of the top three producers of Pakistan.

Revenues During CY18, the Company's top-line clocked in at PKR 35,272mln (CY17: PKR 27,731mln), posting a growth of ~27% on the back of increased sales volume of PVC.

Margins The Company's gross profit margin increased to ~25% during CY18 (CY17: 22%). Operating margins also increased to 20% (CY17: 15%). Despite increase in interest rates, the finance cost was kept under control due to improved operating cashflows. Consequently, the net margins a increased to 14% (CY17: 7.5%). Other income from insurance claim and short-term investments in T-Bills and PIBs also supported the margins.

Sustainability The Company has announced several new projects to further strengthen its position in the market. The projects include PVC/VCM expansion, caustic flakers plant, oxygen based VCM production and hydrogen per oxide. The Company is expected to complete the announced projects on time.

Financial Risk

Working Capital The Company has a short working capital cycle as most of its sales are on cash. During CY18 net working capital days of the Company increased to 18 (CY17: 7 days). The number of days increased as the trade payable days decreased to 24 (CY17: 44 days).

Coverages FCFO of the Company posted a healthy growth of ~52% on YoY basis. During CY18, FCFO of the Company clocked in at PKR 8,821mln (CY17: PKR 5,819mln) on the back of improved sales revenue and profitability. Finance cost decreased to PKR 606mln (CY17: PKR 821mln). As a result, the interest coverages improved to 15.5x during CY18 (CY17: 7x). Debt Coverages also jumped to 16x (CY17: 7x).

Capitalization The Company's leveraging reduced to 31% during CY18 (CY17: 53%). The company repaid some of its debt in 3QCY18 which has decreased the leveraging. Right issue of PKR 5.4bln, the 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, the Company has issued a privately placed, secured and listed Sukuk of PKR 8.75bln. Tenor of the Sukuk is 7.5 years with initial 5.5 years as grace period. The sukuk's profit (3MK+.90bps) is payable quarterly in arrears.

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Financial Summary
PKR mln

Engro Polymer & Chemicals Limited	Mar-19	Dec-18	Dec-17	Dec-16
Chemicals	3M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	22,688	19,589	16,203	16,719
2 Investments	6,994	7,703	150	740
3 Related Party Exposure	103	173	142	55
4 Current Assets	8,260	8,505	7,821	6,947
a Inventories	*4,837*	*3,581*	*3,681*	*3,024*
b Trade Receivables	*551*	*430*	*505*	*456*
5 Total Assets	38,044	35,970	24,315	24,461
6 Current Liabilities	11,058	10,832	7,731	6,226
a Trade Payables	*3,197*	*2,942*	*1,715*	*4,964*
7 Borrowings	8,607	7,500	8,750	6,584
8 Related Party Exposure	181	505	114	5,682
9 Non-Current Liabilities	579	390	-	-
10 Net Assets	17,618	16,744	7,720	5,968
11 Shareholders' Equity	17,618	16,744	7,720	5,968
B INCOME STATEMENT				
1 Sales	9,344	35,272	27,731	22,854
a Cost of Good Sold	*(7,131)*	*(26,536)*	*(21,665)*	*(18,919)*
2 Gross Profit	2,213	8,736	6,065	3,935
a Operating Expenses	(511)	(2,044)	(1,903)	(1,699)
3 Operating Profit	1,702	6,692	4,163	2,236
a Non Operating Income or (Expense)	*88*	*363*	*(233)*	*(138)*
4 Profit or (Loss) before Interest and Tax	1,790	7,055	3,930	2,098
a Total Finance Cost	*(268)*	*(606)*	*(821)*	*(930)*
b Taxation	*(427)*	*(1,531)*	*(1,060)*	*(525)*
6 Net Income Or (Loss)	1,094	4,917	2,049	643
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*2,059*	*8,821*	*5,819*	*3,698*
b Net Cash from Operating Activities before Working Capital Changes	*1,965*	*8,522*	*5,257*	*2,813*
c Changes in Working Capital	*(1,955)*	*1,097*	*(3,363)*	*289*
1 Net Cash provided by Operating Activities	9	9,619	1,894	3,102
2 Net Cash (Used in) or Available From Investing Activities	(2,366)	(11,963)	(1,083)	(1,078)
3 Net Cash (Used in) or Available From Financing Activities	1,072	2,873	(503)	(1,807)
4 Net Cash generated or (Used) during the period	(1,285)	529	308	217
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	6.0%	27.2%	21.3%	2.7%
b Gross Profit Margin	23.7%	24.8%	21.9%	17.2%
c Net Profit Margin	11.7%	13.9%	7.4%	2.8%
d Cash Conversion Efficiency (EBITDA/Sales)	23.1%	26.2%	22.0%	17.6%
e Return on Equity (ROE)	25.5%	40.2%	29.9%	10.8%
2 Working Capital Management				
a Gross Working Capital (Average Days)	46	42	50	37
b Net Working Capital (Average Days)	16	18	7	-42
c Current Ratio (Total Current Assets/Total Current Liabilities)	0.7	0.8	1.0	1.1
3 Coverages				
a EBITDA / Finance Cost	8.6	16.3	7.4	4.8
b FCFO / Finance Cost+CMLTB+Excess STB	8.2	15.5	7.1	2.9
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	1.2	0.9	1.8	3.2
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	32.8%	30.9%	53.1%	61.6%
b Interest or Markup Payable (Days)	79.6	41.7	60.1	4.8
c Average Borrowing Rate	12.5%	7.0%	9.0%	8.8%

Credit Rating Scale & Definitions

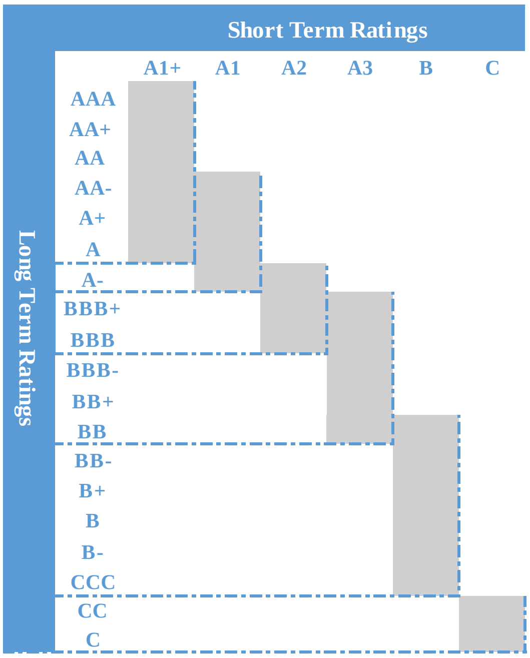
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings

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