The Pakistan Credit Rating Agency Limited

CHERAT CEMENT COMPANY LIMITED

	NEW [NOV-16]	PREVIOUS [NOV-15]
Entity		
Long Term	A	A
Short Term	A1	A1
Outlook	Stable	Stable

REPORT CONTENTS

NOVEMBER 2016

Rating Rationale

The ratings reflect Cherat Cement's improving business profile in line with increasing local demand exhibiting strong sector fundamentals. Once operational, upcoming capacity expansion is likely to add impetus to the performance of the company. In FY16, the company's revenue maintained its growth trajectory. Capacity utilization, while showing an increase [FY16: 94%, FY15: 88%], is reaching close to optimal level from existing capacity. Higher margins – a factor of lower cost, mainly of fuel and power – positively impacted bottom-line. Cherat Cement's expansion project is at an advance stage: expected CoD Nov16. EBITDA margins are expected to remain healthy post expansion on the back of steady demand growth in the company's existing markets. The project debt: equity has been revised down to 38:62. This, coupled with, higher internal cash generation helped to maintain strong debt servicing ability. Given timely commissioning of new line, expected incremental cashflows are likely to keep financial risk low over the medium term.

Key Rating Drivers

The ratings are dependent on the management's ability to sustain healthy capacity utilization along with EBITDA margins post expansion. Any significant deterioration in the company's cashflows due to demand fluctuation or pricing pressure, impacting coverages, will be rating negative.

Profile
- Cherat Cement Company Limited – a Ghulam Faruque Group Company – commenced operations in 1985; listed on Pakistan Stock Exchange
- Engaged in manufacturing and sale of Ordinary Portland Cement
- With a production facility located in District Nowshehra, Cherat Cement operates with a cement capacity of 1.1mln tpa; market share: 2.4%
- Installation of new plant at the same site is underway; expected CoD Nov16
- Post expansion, market share will increase to 5%

Ownership
- Ghulam Faruque Group (GFG) holds majority stake in the company through associated companies and family members; Financial Institutions and Mutual Funds also hold equity stake
- GFG – a medium sized group – mainly maintains interests in cement, sugar and packaging

Governance & Management
- Eight members board including the CEO, Mr. Azam Faruque; Seven non-executive directors, including one independent director, out of which four are family members
- Governance quality bodes well owing to sound business acumen and technical stature of board members
- Mr. Faruque, is associated with the company since 1992 and has diversified experience including corporate and financial sectors; Well-tiered organization structure with a professional management team

Systems & Controls
- Plant technology: European; Strong technology infrastructure (SAP based ERP solution); comprehensive MIS reporting
- Total power needs: ~32MW (existing line: ~15MW, new line: 17MW), met through multiple sources including WHR, WAPDA; FO-based generators as back up

Business Risk
- Revenues maintained growth trajectory (FY16: PKR 7.1bln, FY15: PKR 6.6bln); owing to volumetric growth mainly attributable to increase in local demand
- Margins witnessed improvement – primarily due to lower fuel and power costs; EBITDA margin continued to improve YoY (FY16: 33%, FY15: 30%), though relatively low than peers
- Finance costs – excluding interest during construction (IDC) which is capitalized – increased by 15% YoY; owing to increase in debt level
- Other income mainly comprising – dividend income from strategic investment – supported the bottom-line. Hence, Cherat Cement posted 10% increase in profits to PKR 1.4bln during the year.
- Investment portfolio, comprising 8% equity base at end-Jun16, witnessed absolute decline of PKR 224mln – a factor of redemption of debt securities. Presently the company maintains strategic investments: Cherat Packaging (PKR 702mln; Stake: ~7%) and UniEnergy (PKR 7.7mln; a JV arrangement)

Financial Risk
- Working capital requirements – function of inventory – declined in line with inventory levels; Cash cycle reduced to 16days at end-Jun16 (end-Jun15: 31days); Current ratio, remained adequate at end-Jun16
- With accumulation of expansion related debt, the interest (coverages rationalized); going forward, coverages both interest and debt service, are expected to remain strong owing to healthy cashflow generation
- Capacity expansion (1.3mln tpa) is at an advance stage; the project with an estimated cost of PKR 9.7bln has debt: equity of 38:62 – revised down due to healthy internal cash generation
- Moderately leveraged capital structure; likely to remain range bound

PKR mln

Cherat Cement Company Limted

BALANCE SHEET	30-Jun-16	30-Jun-15	30-Jun-14
	Annual	Annual	Annual
Non-Current Assets	**12,747**	**6,863**	**3,394**
Investments (Incl. associates)	**710**	**934**	**1,374**
Equity	710	334	132
Mutual Funds	-	600	1,242
Current Assets	**2,005**	**1,666**	**1,663**
Stores and Spares	813	703	763
Inventory	485	743	788
Others	707	220	112
Total Assets	**15,462**	**9,464**	**6,431**
Debt	**4,231**	**251**	**303**
Short-term	208	88	99
Long-term (Inlc. Current Maturity of long-term debt)	4,023	163	204
Other short-term liabilities	1,562	699	741
Other Long-term Liabilities	529	489	522
Shareholder's Equity	**9,140**	**8,026**	**4,864**
Total Liabilities & Equity	**15,462**	**9,464**	**6,431**
INCOME STATEMENT			
Turnover	**7,079**	**6,565**	**6,451**
Gross Profit	2,634	1,984	2,103
Operating Profit / (Loss)	2,208	1,614	1,773
Financial Charges	(44)	(38)	(29)
Net Income	**1,405**	**1,288**	**1,316**
Cashflow Statement			
Free Cashflow from Operations (FCFO)	1,734	1,581	1,766
Net Cash changes in Working Capital	572	90	(9)
Net Cash from Operating Activities	2,290	1,607	1,741
Net Cash from InvestingActivities	(5,572)	(3,109)	(1,379)
Net Cash from Financing Activities	3,286	1,503	(371)
Net Cash generated during the period	5	1	(8)
Ratio Analysis			
Performance			
Turnover Growth	7.8%	1.8%	2.5%
Gross Margin	37.2%	30.2%	32.6%
Net Margin	19.8%	19.6%	20.4%
ROE	19.1%	19.1%	30.3%
Coverages			
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB)	8.4	20.1	25.4
Interest Coverage (x) (FCFO/Gross Interest)	10.5	41.8	61.4
Debt Payback (Years) (Total Lt.Debt (excluding Covered Short Term Borrowings) / FCFC	2.6	0.1	0.1
Liquidity			
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	16	31	35
Capital Structure (Total Debt/Total Debt+Equity)	31.6%	3.0%	5.9%

The Pakistan Credit Rating Agency Limited

STANDARD 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. This capacity is highly unlikely to be adversely affected by foreseeable events.
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-	**Speculative.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic change over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**Highly speculative.** Significant 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	**High default 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.

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. Rating Watch may carry designation – Positive (rating may be raised, negative (lowered), or developing (direction is unclear). A watch should be resolved with in foreseeable future, but may continue if underlying circumstances are not settled.

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'.

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, or e) the entity/issuer defaults.

Regulatory and Supplementary Disclosure

Name of Issuer Cherat Cement Company Limited
Sector Cement
Type of Relationship Solicited

Purpose of the Rating Independent Risk Assessment

Rating History

Notification Date	Long Term	Short Term	Outlook	Action
03-Nov-16	A	A1	Stable	Maintain
03-Nov-15	A	A1	Stable	Upgrade
24-Feb-15	A-	A2	Stable	Initial

Related Criteria and Research

Rating Methodology: Corporate Rating Methodology
Sector Research: Cement Sector Overview - 2016

Rating Analysts

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Rating Team Statement

Rating Procedure
Rating is an opinion on relative credit worthiness of an entity or debt instrument. It does not constitute recommendation to buy, hold or sell any security. The rating team for this assignment does not have any beneficial interest, direct or indirect in the rated entity/instrument.

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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 ii) fee mandate - signed with the payer, which can be different from the entity
PACRA ensures that the credit rating assigned to an entity or instrument should 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

Surveillance
PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the rated entity/ issuer, the security arrangement, the industry etc, is disseminated to the market, in a timely and effective manner, after appropriate consultation with the entity/issuer
PACRA reviews all the outstanding ratings on annual basis or as and when required by any stakeholder (including creditor) or upon the occurrence of such an event which requires to do so
PACRA initiates immediate review of the outstanding rating(s) upon becoming aware of any information that may be reasonable be expected to result in any change (including downgrade) in the rating

Reporting of Misconduct
PACRA has framed and implemented whistle-blower policy encouraging all employees to intimate the compliance officer any unethical practice or misconduct relating to the credit rating by another employees of the company that came to his/her knowledge. The Compliance Officer reports to the BoD and SECP

Confidentiality
PACRA has framed a confidentiality policy to prevent abuse of the non-public information by its employees and other persons involved in the rating process, sharing and dissemination of the non-public information by such persons to outside parties
Where feasible and appropriate, prior to issuing or revising a rating, PACRA informs the issuer of the critical information and principal considerations upon which a rating will be based and provide the opportunity to clarify any likely factual misperception or other matter that PACRA would wish to be made aware of in order to produce a fair rating. PACRA duly evaluates the response. Where in a particular circumstance PACRA has not informed the entity/issuer prior to issuing or revising a rating, it informs the entity/issuer as soon as practical thereafter

Prohibition
 PACRA reports and ratings constitute opinions, not recommendations to buy or to sell

Probability of Default (PD)

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