The Pakistan Credit Rating Agency Limited

Rating Report

Pioneer Cement Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
29-Jun-2020	A	A2	Negative	Downgrade	-
27-Sep-2019	A	A1	Negative	Maintain	-
29-Mar-2019	A	A1	Stable	Maintain	-
18-Dec-2018	A	A1	Stable	Maintain	-
07-May-2018	A	A1	Stable	Maintain	-
28-Dec-2017	A	A1	Stable	Maintain	-
21-Jun-2017	A	A1	Stable	Maintain	-
02-Nov-2016	A	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflects the squeeze in the financial profile of the company. This emanates from the rise in the leveraging scale, as a result of the expansion related debt, which was exacerbated by the cost overrun. Company obtained a loan, after the syndicate, to fund the gaps. The planned COD was delayed, not yet announced. The management has represented that Pre-COD production is coming and COD would be achieved soon. Also, 12MW WHRPP and 24MW coal power plant are part of this project; currently facing delay where performance guarantee tests are done. Delay was seen due to restricted travelling of plant supplier's team for finalization of related modalities. After CoD of these projects, the company expects sizable savings in operational expenses in FY21 and on wards. In the absence of any fresh equity injection into the company, the coverages have been dampened. Furthermore, significant decline in sales has been observed along with Company's margins. During 9MFY20 Pioneer Cement recorded Gross Loss of PKR 58mln followed by Net Loss of PKR 523mln. The management represented volumetric sales recorded good growth in March and April-20; same growth trend expected in future. Slashed key policy rate will provide notable savings in finance costs which along with improved FCFO will enhance coverage. The Company’s sales are majorly driven by local market fundamental - trend followed by all cement players in north region. However, slow local demand and expanded capacity resulted in depressed cement prices (especially in north region). Local capacity utilization already recorded dip to 65% in 1HFY20 (FY19: 68%). This will be further impacted amid COVID-19 outbreak and country wide lock down observed. Though construction sector began operations but low demand has been seen. Curtailed key policy rate will provide much needed breathing space to the sector. The Company's business performance in muted; local demand remains vital with focus on sustaining margins. Optimal capacity utilization and adequate channeling of volumes from upcoming new line are necessary to support financial risk profile.

The revision in ratings captures the strains in the financial profile. It is important to (i) improve equity base in line with the enhanced leveraging, ii) cash flows generation iii) margins, and (ii) optimal utilization of existing and upcoming line. Timely repayment of mark up and principal is essential for the ratings. The company's business performance in current stretched economic scenario - challenges on demand front - remained vital.

Disclosure

Name of Rated Entity	Pioneer Cement Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-19),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria | Rating Modifier(Jun-19)
Related Research	Sector Study | Cement(Mar-20)
Rating Analysts	Usama Zubair | usama.zubair@pacra.com | +92-42-35869504

Profile

Legal Structure Pioneer Cement is a listed Company with its shares traded on Pakistan Stock Exchange Limited (PSX). The Company's shares are quoted under the Cement Sector.

Background Pioneer Cement was incorporated in 1986. It is headquartered in Lahore, Pakistan and the manufacturing facility is located at Chenki-District Khushab. Its location in central Punjab allows easy and fast approach to market. The main markets of the company are adjoining areas of Punjab and Khyber-Pakhtunkhwa. Pioneer operates with two production lines having a combined annual cement capacity of 2.09mln tons (CoD: Line I - 1994, Line II - 2006).

Operations Pioneer Cement is engaged in the manufacturing and sale of Ordinary Portland Cement. The company has a limited product slate and currently it is selling Ordinary Portland Cement (OPC).

Ownership

Ownership Structure Vision Holding Middle East Limited (VHMEL) is an offshore SPV of Vision Holding Trust (VHT). VHMEL holds majority stake (47%) in Pioneer Cement and remaining shares of the company are held by various financial institutions and general public.

Stability Ownership structure of the Company is seen as stable as no ownership changes are expected in near future. Majority stake will rest with the Vision Holding Middle East Limited (VHMEL).

Business Acumen Vision holding trust is 100% owned by Mr. Habibullah Khan – a renowned foreign entrepreneur. Apart from Cement, trust maintains interest in several sectors. The sponsors having a diversifiable universe of investments is considered to be a positive sign.

Financial Strength Given that Pioneer is a flagship entity of the sponsor, willingness to support the company in case the needs arises is considered high; also supplemented by access to capital markets.

Governance

Board Structure The overall control of the company vests in eight member board of directors (BoD), including the CEO and three independent directors. Mr. Sajid Feroze was appointed Chief Executive Officer of the Company by the Board of Director in place of Mr. Arif Hamid Dar w.e.f March 01, 2020.

Members' Profile Board members carry requisite technical skills which is abetted by diversified professional background of board members. Board meeting minutes are formally maintained and the attendance is considered good which bodes well for overall governance framework of the company.

Board Effectiveness The board has two committees to oversee the company's financial matters. These committees include: 1) Audit, and 2) Human Resource & Remuneration (HR&R). This is in compliance with the Code of Corporate Governance.

Financial Transparency M/s EY Ford Rhodes Chartered Accountants conducted the external audit services for Pioneer. They're in a 'A' category of SBP list of external auditors and has a QCR rating. They have expressed unqualified opinion on the financial statements for the year ended 30th June, 2019.

Management

Organizational Structure Pioneer Cement has a lean organization structure with the company's operations grouped under nine key functions. These include i) Administration, ii) Corporate Affairs, iii) Finance, iv) Human Resource, v) Information Technology, vi) Marketing, vii) Operations, viii) Supply Chain and ix) Internal Audit. All functional heads report to the CEO except for internal audit, which reports directly to the Audit committee of the board (in compliance with the requirement of law for listed companies).

Management Team Mr. Sajid Feroze was appointed Chief Executive Officer of the Company by the Board of Director in place of Mr. Arif Hamid Dar w.e.f March 01, 2020.

Effectiveness The CEO is supported by experienced professionals at key management positions having a long-term association with the company.

MIS Pioneer has deployed an oracle based ERP solution. The company's current operational modules include i) Inventory, ii) Purchasing, iii) Payables, iv) Receivables, v) Cash Management, vi) Fixed Assets, vii) General Ledger, and viii) Order Management

Control Environment Pioneer's plant comprises of two lines wherein, Line I is a European technology (FLSmidth), and Line II is a mix of European and Chinese technology. Accredited with ISO 9001: 2008 and ISO 14001:2004 certification, Pioneer deploys advance technology to ensure production of quality cement.

Business Risk

Industry Dynamics Cement industry is divided into North and South region – majority (76%) operational capacity exists in North region. Industry has achieved its majority capacity expansions in last two years of around 14mln tons per annum. During FY19, north region witnessed 5% and 18% decline in local and export dispatches respectively attributable to contractionary fiscal policy, slowdown in large infrastructural activities and low demand from Afghanistan and India (export avenues). South region witnessed uptrend in dispatches which is correlated with longevity of export window available through sea. Industry dynamics has changed significantly driven by unsustainable cement prices (especially in north region) on account of supply glut recently created, muted demand and ruppee depreciation. Cement players witnessed significant dip in margins on account of aforementioned factors. Currently, leveraging of industry is moderate (31% as at end-Mar19) but increased interest rates has amplified the stress on financial risk profile of players. Going forward – with full utilization of lately commenced plants – industry is expected to face expanded capacity challenge. Cement prices and margins are expected to stay under stress as demand front deemed to stay weak for at least upcoming one year.

Relative Position Pioneer Cement is a mid-tier cement player, operating in north region. The company has operational cement capacity of 2.0mln tons per annum with existing market share of 4.5% in the north region. Furthermore, the company has announced clinker capacity expansion of 2.4mln tpa.

Revenues During 9MFY20, Revenue of PKR 5.9bln was recorded (9MFY19: PKR 7.5bln), down by 21% YoY. Sales mix remained tilted towards local market - in line with industry trend followed in north region. The company's annualized capacity utilization level increased to 68.3% (FY19: 63%) – in line with the average capacity utilization level of the industry. Finance costs stood at PKR 265mln (9MFY19: PKR 288mln). Consequently, company suffered a loss of PKR 523mln (9MFY19: Profit: PKR 825mln) YoY.

Margins Pioneer's margins have significantly declined over the past year (gross: -1%, 9MFY19: 23.5%, operating: 9MFY20: -6.3%, 9MFY19: 18.4%). EBITDA margin also witnessed a dip YoY (9MFY20: 1.2%, 9MFY19: 26.5%) against industry average of 27%. Margins deterioration is a trend witnessed in performance of all players operating in north region primarily on account of instability in cement prices, muted local demand, increase in FED on coal import and rupee depreciation.

Sustainability The progress work on the under construction projects is at full swing. Most of the materials and equipment have already been received at the factory. Mechanical and electrical work is being carried out on parallel basis. The management is confident to achieve the commercial operations within the stipulated timelines. The production line will have an annual clinker capacity of 2.4mln tons. In addition to this, the company will establish coal based power plant (24MW) and WHRP. The estimated cost of these projects is PKR 25bln. The debt equity proportion will be 72:28 and new cement line is expected to commence in upcoming few months.

Financial Risk

Working Capital Pioneer's working capital requirements represented by net cash cycle (net working capital days) – a function of inventory, receivables and payables - decreased to negative 66days (FY19: negative 54days). Cash cycle decreased on account of increase in payable days (9MFY20: 114days; FY19: 46days). The requirements were met through a mix of internal cash generation and short term borrowings. As at end- Mar20, STBs stood at PKR 4.9bln (FY19: PKR 4.8bln) attributable to enhanced working capital requirements.

Coverages During 9MFY20, FCFO significantly reduced to PKR29mln (FY19: PKR 1.9bln). Interest and Core coverage declined to negative 0.1x and negative 0.004x (end-Jun19:7.2x and 0.9x respectively) attributable to low FCFO.

Capitalization In pursuit of expansion, the total leveraging (9MFY20: 66.5%, FY19: 61.7%) increased tremendously as the Company acquired long term finance. Short term borrowings to total borrowings stood at 19.3% (FY19: 22.5%). The borrowing of the company is ~PKR25bln, out of which ~PKR4.8bln is short term debt. Approaching year end, long term debt is expected to increase given utilization of the remaining un-drawn and availing the syndicate-II facility to cover-up cost overrun.

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Financial Summary
PKR mln

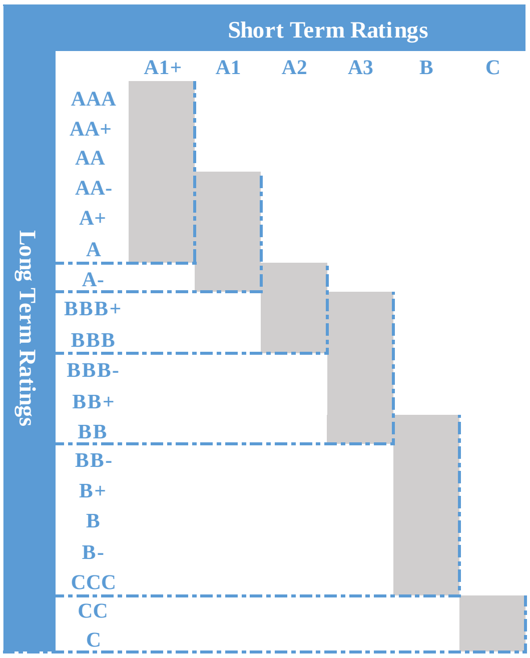
Pioneer Cement Cement	Mar-20 9M	Jun-19 12M	Jun-18 12M	Jun-17 12M
A BALANCE SHEET				
1 Non-Current Assets	40,910	36,164	22,962	12,281
2 Investments	723	812	1,086	2,694
3 Related Party Exposure	-	-	-	-
4 Current Assets	6,052	5,302	5,064	2,785
a Inventories	*553*	*326*	*470*	*236*
b Trade Receivables	*728*	*483*	*434*	*225*
5 Total Assets	47,685	42,277	29,111	17,760
6 Current Liabilities	6,419	3,092	1,636	802
a Trade Payables	*3,363*	*1,601*	*868*	*182*
7 Borrowings	25,397	21,452	10,705	2,307
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	3,070	4,412	3,141	2,404
10 Net Assets	12,798	13,321	13,629	12,248
11 Shareholders' Equity	12,798	13,321	13,629	12,248
B INCOME STATEMENT				
1 Sales	5,973	9,734	10,121	10,631
a Cost of Good Sold	*(6,031)*	*(7,599)*	*(7,311)*	*(6,203)*
2 Gross Profit	(58)	2,135	2,811	4,428
a Operating Expenses	(317)	(325)	(264)	(179)
3 Operating Profit	(375)	1,809	2,546	4,250
a Non Operating Income or (Expense)	*(40)*	*(215)*	*(239)*	*(145)*
4 Profit or (Loss) before Interest and Tax	(414)	1,594	2,308	4,104
a Total Finance Cost	*(265)*	*(271)*	*(95)*	*(35)*
b Taxation	*156*	*(533)*	*(569)*	*(1,152)*
6 Net Income Or (Loss)	(523)	790	1,644	2,918
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*29*	*1,863*	*1,521*	*2,915*
b Net Cash from Operating Activities before Working Capital Changes	*(2,282)*	*2,068*	*1,325*	*2,907*
c Changes in Working Capital	*2,344*	*1,422*	*254*	*(1,164)*
1 Net Cash provided by Operating Activities	62	3,490	1,579	1,743
2 Net Cash (Used in) or Available From Investing Activities	(3,981)	(13,591)	(9,051)	(2,429)
3 Net Cash (Used in) or Available From Financing Activities	3,943	9,819	7,656	335
4 Net Cash generated or (Used) during the period	24	(282)	184	(351)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	-18.2%	-3.8%	-4.8%	13.5%
b Gross Profit Margin	-1.0%	21.9%	27.8%	41.7%
c Net Profit Margin	-8.8%	8.1%	16.2%	27.4%
d Cash Conversion Efficiency (EBITDA/Sales)	1.2%	24.8%	30.9%	44.9%
e Return on Equity (ROE)	-5.3%	5.9%	12.7%	25.5%
2 Working Capital Management				
a Gross Working Capital (Average Days)	48	32	25	13
b Net Working Capital (Average Days)	-66	-14	6	7
c Current Ratio (Total Current Assets/Total Current Liabilities)	0.9	1.7	3.1	3.5
3 Coverages				
a EBITDA / Finance Cost	0.3	9.4	34.9	157.0
b FCFO / Finance Cost+CMLTB+Excess STB	0.0	0.5	3.3	20.4
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	-84.4	11.5	5.8	0.5
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	66.5%	61.7%	44.0%	15.8%
b Interest or Markup Payable (Days)	0.0	0.0	0.0	0.0
c Average Borrowing Rate	1.4%	1.6%	1.4%	2.1%

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