The Pakistan Credit Rating Agency Limited

Rating Report

Ghani Chemical Industries Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
07-Feb-2020	A-	A2	Negative	Maintain	YES
30-Oct-2019	A-	A2	Negative	Maintain	-
30-Apr-2019	A-	A2	Developing	Maintain	YES
28-Dec-2018	A-	A2	Stable	Maintain	-
20-Jun-2018	A-	A2	Stable	Maintain	-
01-Nov-2017	A-	A2	Stable	Maintain	-
27-Feb-2017	A-	A2	Stable	Maintain	-
02-Nov-2016	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings recognize Ghani Chemical Industries Limited's (Ghani Chemicals) prominent position in the industrial and medical gases sector. The industry largely possesses an oligopolistic structure, benefiting the players. Recent slowdown in demand for industrial gases from key sectors, in line with the overall economic slowdown, has kept product prices depressed, reflected in a decline in the Company's margins at gross and operating level. Simultaneous increase in working capital needs on account of slow recovery from customers in the health sector led to higher short-term borrowings, which increased finance cost substantially, eroding profitability. Resultantly, cashflows and coverages have remained under pressure, highlighting increased financial risk. Ghani Chemicals’ third 110TPD plant has been set up and is expected to commence commercial operations in 2HFY20. The Company has utilized borrowing to make payment for the new plant, exerting further pressure on already stretched coverages. Smooth functioning of the new plant and timely generation of incremental cashflows remains critical to the Company’s performance. The sponsors have provided support to the Company for expansion and working capital management in the past.

The ratings are dependent on the Company's ability to effectively utilize enhanced capacities. At the same time, management of financial risk, particularly debt coverages, remains important, wherein any further deterioration would have negative implications for the ratings. Sustained market share and, in turn, improved margins would support ratings. Ghani Chemicals' holding company - Ghani Global Holdings Limited - has recently announced that it is planning to divest its stake in the Company, wholly or partially. The final decision regarding this is yet to be announced. Considering the expected change in ownership structure and subsequent possible change in the Company's policies, PACRA has placed the entity ratings of Ghani Gases on ‘Rating Watch'.

Disclosure

Name of Rated Entity	Ghani Chemical Industries 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 | Industrial Gases(Oct-19)
Rating Analysts	Muhammad Hassan | muhammad.hassan@pacra.com | +92-42-35869504

Profile

Legal Structure Ghani Chemical Industries Limited (Ghani Chemicals) is an unlisted, public limited concern incorporated in 2015.

Background Ghani Chemicals was established as a private limited company in Nov-15, as part of the Ghani Global Group of Companies, for the purpose of setting up a a chemical manufacturing plant in Hattar Economic Zone. However, due to economic and political challenges, the said project was postponed. Up till Jul-19, the Company had not started commercial operations. In Jul-19, as part of the Scheme of Compromises, Arrangement and Reconstruction undertaken by the Ghani Global Group of Companies, the manufacturing undertaking of Ghani Gases Limited, along with all assets and liabilities, was transferred to Ghani Chemicals. The Company is a subsidiary of Ghani Global Holdings Limited (formerly "Ghani Gases Limited").

Operations Ghani Chemicals is engaged in the manufacturing, sale and trading of medical and industrial gases and chemicals including Liquid Nitrogen, Liquid Oxygen, Argon and Calcium Carbide. The Company was previously operating with two production facilities for manufacturing of liquid industrial and medical gases with combined capacity of ~220TPD. A third 110TPD plant was set up in Aug-19, which is yet to begin commercial operations. The total production capacity of the Company now stands at ~330TPD.

Ownership

Ownership Structure The majority stake in Ghani Chemicals (~99%) is presently held by the Group holding company, Ghani Global Holdings Limited, which is majorly owned by the Ghani Family (~56%). However, the sponsors are now planning to divest their stake, partially or wholly, in the Company. The final decision regarding this has not yet been announced.

Stability The recent restructuring undertaken by the Ghani Group has resulted in the transition of Ghani Gases Limited – formerly a manufacturing entity – into the Group holding company, Ghani Global Holdings Limited. Stability of the ownership presently remains uncertain due to the upcoming possible change in ownership structure.

Business Acumen The sponsors have over five decades of entrepreneurial experience in vastly diversified sectors including industrial gases, engineering, mining, glass, real estate, automobiles and food.

Financial Strength The Ghani Group, which includes Ghani Global Holdings Limited, Ghani Global Glass Limited and Ghani Chemical Industries Limited, had total equity of ~PKR 6bln at end-FY19. The Group has adequate financial muscle and has shown willingness and ability to support the Company in the past.

Governance

Board Structure The oversight of the Company lies with a four-member Board of Directors, chaired by Mr. Masroor Ahmad Khan. The remaining Board comprises two members of the sponsoring family including the CEO and one Group employee.

Members' Profile Mr. Masroor Ahmad Khan – Chairman – has been associated with the family business since 1985. With over three decades of experience, he holds managerial and directorial positions in various Group companies. Most Directors have been associated with the Board since the inception of the Company and have extensive experience in diversified sectors.

Board Effectiveness Board meetings of the Company are held quarterly in compliance with the principles of corporate governance for public, unlisted companies. However, minutes remain undocumented. Addition of independent directors to the Board would add quality to its independent oversight function.

Financial Transparency M/s, Rizwan & Co. Chartered Accountants is the external auditor of the Company. The auditor is QCR listed, however, does not appear on the State Bank of Pakistan's panel of auditors. The auditor gave an unqualified opinion on the Company's financial statements for the year ended June 30, 2019.

Management

Organizational Structure The Company's overall operations are segregated into six broad functional divisions with divisional heads reporting directly to the CEO.

Management Team Mr. Hafiz Farooq Ahmad holds the office of CEO. The Company's management team comprises qualified and experienced professionals with a diversified range of skills related to the industrial gases industry and other sectors.

Effectiveness Ghani Chemicals maintains adequate IT infrastructure and related controls with regular presentation of reports to senior management. Management committees are in place to attend to relevant matters with documentation of minutes.

MIS The Company recently deployed Oracle ERP solution which has resulted in quality enhancement of its reporting system.

Control Environment MIS reports are presented on a regular basis to the senior management including inventory, finance and production. Recent implementation of Oracle technology ensures timely availability of information for efficient decision making.

Business Risk

Industry Dynamics Pakistan's overall production capacity for industrial gases currently stands at ~825TPD, with the major capacity lying with Ghani Chemicals and Pakistan Oxygen (formerly Linde Pakistan). While Ghani Chemicals recently undertook expansion with its third plant, Pakistan Oxygen has announced its capacity expansion for FY20. Meanwhile, demand for industrial gases remains sluggish as industrial activity has been curbed in line with the overall economic slowdown. This trend is expected to continue in the short-term, at least, and may put pressure on the margins of industry players.

Relative Position Pakistan Oxygen currently holds the leading position in industrial gases' industry with a market share of ~45%, whereas Ghani Chemicals follows with a share of ~37%. Ghani Chemicals' share may increase once its new plant becomes operational.

Revenues The Company's topline is led by industrial gases, mainly Liquid Oxygen and Liquid Nitrogen, followed by chemicals segment mainly including Calcium Carbide. During FY19 and 3MFY20, net sales of the Company showed sluggish growth of ~12% and ~7% respectively. This was a factor of prices of industrial and medical gases largely remaining depressed over the period, as demand from key sectors including steel and shipbreaking remained sluggish. This was also reflected in a slight decline in volumetric sales of gases. Meanwhile, revenue from chemicals' segment showed YoY increase driven by increased prices of imported Calcium Carbide due to the currency devaluation.

Margins An increase in the cost of importing Calcium Carbide as well low prices of key products contributed to a substantial YoY decline in the Company's gross margins in FY19 (FY19: ~25%, FY18: ~31%). However, gross margin improved to ~36% in 3MFY20 (3MFY19: ~31%) as cost of importing Calcium Carbide declined owing to the currency appreciation. The full benefit of this did not translate into operating margins due to a simultaneous increase in power and distribution distribution costs (3MFY20: ~18%, 3MFY19: ~17%). Meanwhile, increased need of borrowing to support working capital needs due to slow recovery of receivables resulted in a ~63% YoY surge in the Company's finance cost. Thus, the Company posted a net profit of ~PKR 24mln (3MFY19: ~PKR 37mln) while net margin deteriorated to ~4% (3MFY19: ~7%).

Sustainability Given the economic slowdown, the impact of the new plant's operations on revenue and gross margins remains uncertain. Further, the plant is being financed through a debt:equity mix of ~65:35 which will result in increased finance cost burden and put further pressure on the profitability of the Company.

Financial Risk

Working Capital Ghani Chemicals' working capital requirements emanate from its need to finance its inventory of imported Calcium Carbide and offering relaxed credit terms to its customers. The Company's net cash cycle remained stagnant YoY in 3MFY20 at 85 days. Meanwhile, the increased cost of importing Calcium Carbide as well as slow recovery of receivables from key customers has increased reliance on short-term borrowing. This has led to depletion of borrowing cushion at trade assets level.

Coverages Free cash flows increased from ~PKR 102mln to ~PKR 168mln YoY in 3MFY20 due to some improvement in profitability. While interest coverage remained stagnant YoY at 2.4x, core coverage showed slight improvement (3MFY20: 1.2x, 3MFY19: 1.0x), considered low. Going forward, timely recovery of receivables, receipt of tied up tax refunds and cash flows from the new plant, in line with debt repayments, is critical to avoid further pressure on coverages.

Capitalization Ghani Chemicals' leveraging rose to ~55% in 3MFY20 (3MFY19: ~47%) due to an increase in short-term borrowing as well as increase in long-term borrowing to finance equipment for the new plant. Leveraging is expected to show further increase in Dec-19 as the Company has made partial use of borrowing to make the payment. Meanwhile, the Company's Sukuk, issued in FY17, had an outstanding value of ~PKR 704mln at end-Dec19.

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Ghani Chemical Industries Limited	Sep-19	Jun-19	Jun-18
Industrial Gases	3M	12M	12M
A BALANCE SHEET			
1 Non-Current Assets	3,506	3,411	163
2 Investments	-	-	-
3 Related Party Exposure	1	1	3
4 Current Assets	1,754	1,754	10
a Inventories	*38*	*44*	-
b Trade Receivables	*661*	*607*	-
5 Total Assets	5,262	5,166	176
6 Current Liabilities	426	311	1
a Trade Payables	*165*	*107*	*0*
7 Borrowings	2,212	2,276	28
8 Related Party Exposure	259	246	-
9 Non-Current Liabilities	343	336	-
10 Net Assets	2,021	1,997	148
11 Shareholders' Equity	2,021	1,997	148
B INCOME STATEMENT			
1 Sales	577	2,301	-
a Cost of Good Sold	*(371)*	*(1,722)*	-
2 Gross Profit	206	579	-
a Operating Expenses	(100)	(401)	(0)
3 Operating Profit	106	178	(0)
a Non Operating Income	*(1)*	*11*	*(0)*
4 Profit or (Loss) before Interest and Tax	105	189	(0)
a Total Finance Cost	*(70)*	*(213)*	*(1)*
b Taxation	*(10)*	*(41)*	-
6 Net Income Or (Loss)	24	(65)	(1)
C CASH FLOW STATEMENT			
a Free Cash Flows from Operations (FCFO)	*168*	*228*	*(0)*
b Net Cash from Operating Activities before Working Capital Changes	*114*	*37*	*(0)*
c Changes in Working Capital	-	*(78)*	*(7)*
1 Net Cash provided by Operating Activities	114	(41)	(7)
2 Net Cash (Used in) or Available From Investing Activities	(116)	(244)	(43)
3 Net Cash (Used in) or Available From Financing Activities	(41)	221	26
4 Net Cash generated or (Used) during the period	(43)	(64)	(24)
D RATIO ANALYSIS			
1 Performance			
a Sales Growth (for the period)	0.3%	N/A	N/A
b Gross Profit Margin	35.7%	25.1%	N/A
c Net Profit Margin	4.2%	-2.8%	N/A
d Cash Conversion Efficiency (EBITDA/Sales)	25.1%	13.9%	N/A
e Return on Equity (ROE)	4.9%	-6.0%	N/A
2 Working Capital Management			
a Gross Working Capital (Average Days)	107	103	N/A
b Net Working Capital (Average Days)	85	95	N/A
c Current Ratio (Total Current Assets/Total Current Liabilities)	4.1	5.6	10.5
3 Coverages			
a EBITDA / Finance Cost	2.1	1.5	N/A
b FCFO / Finance Cost+CMLTB+Excess STB	1.2	0.5	N/A
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	3.3	83.0	-71.5
4 Capital Structure (Total Debt/Total Debt+Equity)			
a Total Borrowings / Total Borrowings+Equity	55.0%	55.8%	15.8%
b Short-Term Borrowings / Total Borrowings	0.5	0.5	0.0
c Average Borrowing Rate	11.2%	16.7%	0.0%

Credit Rating Scale & Definitions

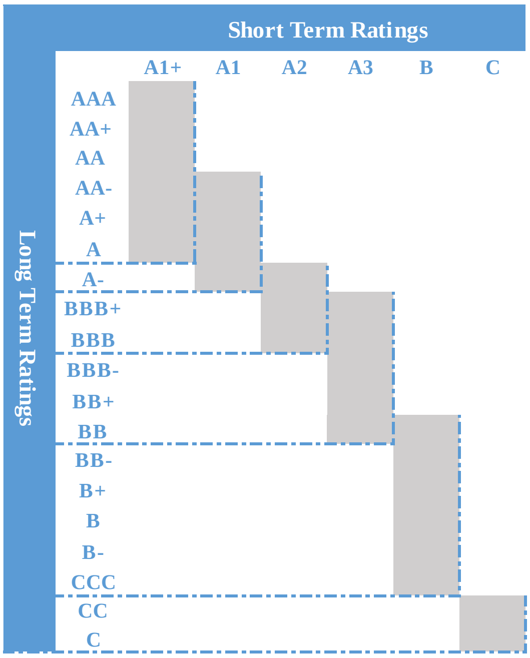
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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