The Pakistan Credit Rating Agency Limited

Rating Report

Kohat Cement Company Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
22-Nov-2018	A	A1	Stable	Maintain	-
04-May-2018	A	A1	Stable	Maintain	-
29-Dec-2017	A	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Kohat Cement's ratings reflect its strong market position in cement industry. The market share marginally diluted to 4.9% in the wake of lately commenced expansions by other cement players. However, the company has planned brown-field expansion of 2.3mln tpa, which will assist in defending its market share in the ongoing significant expansion trend in the Industry. The financing is planned with debt to equity ratio of 43:57 – majorly equity driven. The new line is expected to be fully commenced by 1QFY20 with an estimated cost of PKR 14.2bln. Management's plan to comfortably channel the increased supply of cement from expansion remains vital. The Company's topline remained largely same during FY18 – in line with industry trend. Industry wide margins declined driven by escalated input costs (coal price and import duty) and fluctuation in cement prices. The Company's margins declined but remained strong when compared with peers in industry which reflects efficient cost framework. Furthermore, the company's fairly low leveraging, healthy liquid investment book and presence of investment properties on the book provides further comfort to the ratings. Going forward, the Company's leveraging is expected to remain at moderate level.

The ratings are dependent on upholding of company's market position in addition to sustenance of business volumes and margins. The company's strong business performance in current stretched economic scenario - challenges on demand front - remains vital for ratings. Upholding of governance practices remains important for the ratings.

Disclosure

Name of Rated Entity	Kohat Cement Company 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 | Cement(Nov-18)
Rating Analysts	Sehar Fatima | sehar.fatima@pacra.com | +92-42-35869504

Profile

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

Background The Company was incepted in 1984. The Government of Pakistan in an open bidding in 1992 privatized the Company. The registered office and the factory are located in Kohat, whereas the Head Office is located in Lahore. In 1995, the company underwent an extensive BMR program and the capacity of the plant was enhanced to 1,800tpd. Afterwards, in 2005 a White Cement Plant was established followed by a Grey Cement Plant in 2007. Furthermore, a power plant with capacity of 22.6MW was added in 2009.

Operations Kohat Cement is engaged in the production and sale of cement. The Company's products include Grey Cement and White Cement which allows the company to have a broader product slate. The Company's white cement is used for concreting and ornamental applications, terrazzo floorings, fixing of tiles and marbles, and others.

Ownership

Ownership Structure Kohat Cement is majority owned by sponsor family through ANS Capital (Pvt.) Limited (55%) and through individuals (19%). Jubilee Life Insurance holds 3% stake in the company, rest is widely spread among FIs and general public.

Stability Ownership structure of the Company is seen as stable as no ownership changes are expected in the near future. Majority stake will rest with the ANS Capital (Pvt.) Limited.

Business Acumen The sponsors, especially the CEO, has interests vested in various sectors through holding company. This strengthens the sponsor's business acumen.

Financial Strength Given that Kohat cement is the flagship entity of the sponsors, willingness to support the company in case need arises is considered high; also supplemented by access to capital markets.

Governance

Board Structure Overall control vests in seven members' board including the Chief Executive – Mr. Aizaz Mansoor Shiekh. All board members are from sponsoring family, including one independent member Mr. M. Atta Tanseer Sheikh.

Members' Profile Kohat's Board members carry, requisite skills, competence, diversification in terms of knowledge background and experiences, which is considered positive. Board meetings minutes are formally maintained reflecting good participation by the members present.

Board Effectiveness Kohat Cement has two committees: 1) Audit committee and 2) Human resource & Remuneration Committee (HR&R); this is in compliance with the Code of Corporate Governance.

Financial Transparency KPMG Taseer Hadi & Co., Chartered Accountants conduct the external audit services for Kohat Cement. 'KPMG' is in '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, 2018.

Management

Organizational Structure Kohat has a multi-tier organizational structure. Currently, the organizational structure is divided into fourteen main functions: The functions reporting to CEO are as follows: 1) Sales & Marketing, 2) Administration, 3) HR, 4) Planning & Development, 5) Finance & Accounts. However, the functions reporting to Executive Director are: 1) Production, 2) Electrical, 3) Quality Control, 4) Power Plants, 5) Technical & Purchase, 6) Maintenance, 7) Works, and 8) Material and Mining.

Management Team Mr. Aizaz Mansoor, the CEO, is associated with the company since the last 26 years. The CEO is supported by a team of experienced individuals equipped with necessary technical skills and relevant industry exposure.

Effectiveness The Chief Executive Officer and Executive Director are supported by a team of experienced professionals at key management positions.

MIS The company's current operational modules include marketing, supply chain and financial modules with comprehensive MIS quality. Various system generated reports including the Cash flow/investment portfolio, daily management report, and daily production summary and sale variance report which are reviewed by top management. Kohat is taking initiatives on need basis and according to their management report they're in a process to develop IT strategy by FY19.

Control Environment Kohat Cement's plant is located in Kohat, in North Region. Accredited with PS 232 – 2008, ASTM C 150 Type I & III, EN 197 – 1/2000 CEM I 42.5 R ; Kohat Cement deploys rigorous quality check parameters during each level of manufacturing process to ensure good quality cement.

Business Risk

Industry Dynamics Cement industry is divided into North and South region – majority players operating in North region. Currently, cement industry is going through a phase of capacity expansion, majority of which were announced in FY16 due to surged cement demand especially driven by government announced Infrastructure projects and CPEC. Cement industry dispatches remained tilted towards locals sales, exports are minuscule part which are mainly to Afghanistan, India and through sea to some countries. Market dynamics has changed significantly in last year driven by escalation of international coal prices, rupee depreciation and unsustainable cement prices (especially in north region) on account of supply glut recently created. Cement players witnessed significant dip in margins on account of aforementioned factors. Currently, leveraging of industry is moderate but in increasing interest rates environment it is critical for cement players to vigilantly manage cost structure. 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. Cement demand is expected to stay nominal (at least for upcoming two years) as new government's prerogative for infrastructure will take some time to materialize. Therefore, upcoming capacity expansion utilization will be challenging factor.

Relative Position In FY18, Kohat's market share diluted to 4.9% (FY17: 5.6%) on account of lately commenced expansions by some cement players. The market share is expected to rise when Kohat's expansion will be operational by FY20.

Revenues During FY18, the company recorded revenue of PKR 13.4bln (FY17: PKR 13.5bln), witnessing a marginal decline of 0.7% YoY on the back of lower cement prices and higher input costs.Sales mix remained tilted towards local market (FY18: 97%; FY17: 96.5%) mainly due to healthy demand and secured margins in local market. The company's capacity utilization levels have remained stagnant at 87.5% (FY17: 87.5%). Other income declined marginally by -8% YoY to PKR 352mln (FY17: PKR 384mln). Finance costs increased to PKR 107mln (FY17: PKR 85mln) on account of escalation in the bank charges and commissions etc. Therefore, PAT stood at PKR 2.9bln (FY17: PKR 3.5bln), down by 16% YoY. During 1QFY19, the company secured topline of PKR 3.5bln.

Margins Kohat's margins have declined over the past year but still remained at a comfortable level (Gross: 1QFY19: 25%, FY18: ~32%, FY17: ~43%, Operating: 1QFY19: ~22%, FY18: 30%, FY17: 41%). Also, EBITDA margin witnessed deterioration (1QFY19: ~27%, FY18: 34%, FY17: 45%). Margins deterioration is a trend witnessed throughout the cement industry for FY18 primarily on account of escalation in international coal prices and instability in cement prices.

Sustainability Going forward, Kohat Cement announced capacity expansion of 2.3mln tpa – a brown field project. The project has an estimated cost of PKR 14.2bln with debt equity of 43:57 and is expected to be fully operational by FY20.

Financial Risk

Working Capital During FY18, Kohat's working capital requirements represented by net cash cycle (net working capital days) – a function of inventory, receivables and payables - decreased to 15days (end-Jun17: 19days). Cash cycle decreased on account of increase in creditor days representing efficiency (FY18: 20days; FY17: 11days).The company was able to manage the requirement primarily through internal resources on account of robust cash flows. Hence, company's reliance on STBs remained minimal, reflected from significant reduction in STB's YOY (FY18: NIL; FY17: PKR 200mln). Current ratio remained stagnant at 1.5x.

Coverages Despite surge in finance costs in FY18, Kohat was able to maintain adequate coverage ratios on account of strong cash flows and comparatively low leveraged structure. (Interest: end-Jun18:28x; end-Jun17:50x, debt service: end-Jun18:8x; end-Jun17:12x).

Capitalization Over the last few years, the company operated at fairly low leveraged capital structure. The debt to debt plus equity ratio stands at ~2 % (FY17: 6%). Going forward, the company's leveraging is expected to increase in pursuit of expansion. However, it is expected to be comfortably managed through healthy cash flows.

Cement

The Pakistan Credit Rating Agency Limited

Financials (Summary)

Kohat Cement Company Limited

PKR mln

BALANCE SHEET	30-Sep-18	30-Jun-18	30-Jun-17	30-Jun-16	30-Jun-15
	1Q	Annual	Annual	Annual	Annual
Non-Current Assets	**14,486**	**9,254**	**8,201**	**7,971**	**8,211**
Investments (Incl. associates)	**7,570**	**8,815**	**8,282**	**7,720**	**-**
Equity	-	-	-	-	-
Debt Securities	3,912	5,160	5,219	5,564	-
Investment Property	3,658	3,656	3,063	2,156	
Current Assets	**4,698**	**5,247**	**3,710**	**3,655**	**5,019**
Stores and Spares	2,315	2,120	1,333	1,453	1,032
Inventory	569	659	949	629	355
Others	1,815	2,469	1,427	1,573	3,632
Total Assets	**26,755**	**23,316**	**20,192**	**19,345**	**17,061**
Debt	**1,057**	**426**	**911**	**1,593**	**2,023**
Short-term	-	-	200	598	598
Long-term (Incl. Current Maturity of long-term debt)	1,057	426	711	995	1,425
Other Short-term liabilities	5,681	3,395	2,299	2,380	3,094
Other Long-term Liabilities	1,511	1,518	1,676	1,603	1,147
Shareholder's Equity	**18,505**	**17,977**	**15,306**	**13,770**	**10,797**
Total Liabilities & Equity	**26,755**	**23,316**	**20,192**	**19,345**	**17,061**
INCOME STATEMENT					
Turnover	**3,521**	**13,439**	**13,540**	**14,020**	**12,472**
Gross Profit	862	4,353	5,827	6,497	4,815
Operating Profit / (Loss)	765	4,025	5,535	6,209	4,607
Financial Charges	(11)	(107)	(85)	(78)	(94)
Net Income	**529**	**2,980**	**3,545**	**4,408**	**3,322**
Cashflow Statement					
Free Cashflow from Operations (FCFO)	739	3,030	4,273	4,261	3,382
Net Cash changes in Working Capital	148	(51)	(616)	(779)	(274)
Net Cash from Operating Activities	877	2,914	3,565	2,979	2,554
Net Cash from InvestingActivities	(2,097)	(3,160)	(1,305)	(1,350)	1,776
Net Cash from Financing Activities	630	(791)	(2,685)	(1,817)	39
Net Cash generated during the period	(590)	(1,036)	(425)	(188)	4,369
Ratio Analysis					
Performance					
Turnover Growth	3.0%	366.2%	-3.4%	12.4%	n.a
Gross Margin	24.5%	32.4%	43.0%	46.3%	38.6%
Net Margin	15.0%	22.2%	26.2%	31.4%	26.6%
ROE	3.1%	16.9%	22.6%	34.0%	30.8%
Coverages					
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB)	2.1	7.8	11.6	11.8	6.4
Interest Coverage (x) (FCFO/Gross Interest)	68.5	28.4	50.3	54.5	36.1
Debt Payback (Years) (Total Lt.Debt (excluding Covered Short Term Borrowings) / FCF	0.7	0.1	0.2	0.2	0.4
Liquidity					
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	-24	15	19	7	6
Capital Structure (Total Debt/Total Debt+Equity)	5.4%	2.3%	5.6%	10.4%	15.8%

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.

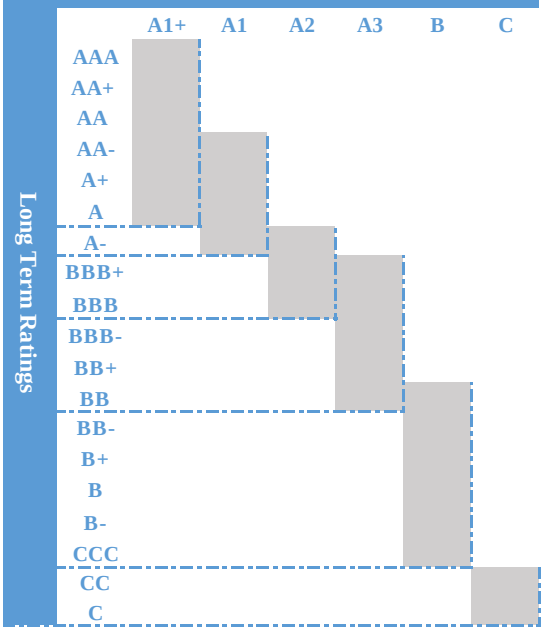
Long Term Ratings

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.

Short Term Ratings



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.

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