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
29-Mar-2019	A	A1	Stable	Maintain	-
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 good market position in cement industry. The company's existing market share in north region is 7%. The company has planned brown-field expansion of 2.3mln tpa, which will increase company's market share to 10% in north's operational capacity. The financing is planned with debt to equity ratio of 43:57 – majorly equity driven. The new line is expected to be commenced by 1QFY20 with an estimated cost of PKR 14.2bln. Management's prudent plan to comfortably channel the increased supply of cement from expansion remains vital. During 1HFY19, industry dynamics reflect weakening on account of global fluctuation in prices of raw material (coal), depreciation of Pak Rupee, lower retention prices (especially in north region) and higher financing expenses. Lately, the coal prices showed downward trend due to cutdown of imports by China- are expected to remain range bound in medium term. Industry wide exports (sizeable increase in South Region) have gone up due to muted growth in local demand. A new export window is created in Bangladesh market. Previously, cement exports were seen at its peak after financial crisis in 2008. Upcoming industry wide expansions of 11.7mln tpa (North Region only) commissioning by Sep-19 and slowdown in the growth of local demand seems a challenge. The demand needs to be up to secure companies' margin. Consequently, company's margins witnessed decline but remained strong when compared to peers. The company's fairly low leveraging, healthy liquid investment book and presence of investment properties on the book provides 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 registered office and the factory are located in Kohat, whereas the Head Office is located in Lahore.

Operations Kohat Cement is engaged in the production and sale of cement. The Company's products include Grey Cement and White Cement.

Ownership

Ownership Structure Kohat Cement is majority owned by sponsor family through ANS Capital (Pvt.) Limited (55%) and through individuals (19%), 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, most function reports directly to the CEO.

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 etc are reviewed periodically. 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. 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. Cement industry undergoing expansions with majority capacities commencing operations in FY20. During 1HFY19, domestic dispatches inched down by 1%, exports up by 72% and total cement dispatches inched down by 4%. Previously, cement exports were seen at its peak after financial crisis in 2008. Currently, exports to Afghanistan and India also witnessed downtrend by ~22% and ~5% YoY. However, exports via sea to Bangladesh witnessed uptrend of 58%. Margins of industry players came under pressure driven by escalation of international coal prices (8HFY19: $96, FY18: $90, FY17: $77, F16: $53), rupee depreciation and unsustainable cement prices (especially in north region) due to slowdown in local demand. Lately, the coal prices showed downward trend due to cut down of imports by China- are expected to remain range bound in medium term. Currently, leveraging of industry is moderate but in increasing interest rates environment it is critical for cement players to vigilantly manage cost structure. Cement demand is expected to stay nominal (at least for upcoming one year) as new government's prerogative for infrastructure will take some time to materialize.

Relative Position As of Jan-19, 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 in FY20.

Revenues During 1HFY19, the company recorded revenue of PKR 8.3bln a 22% increase YOY (FY18: PKR 13.4bln, 1HFY18: PKR 6.8bln, FY17: PKR 13.5bln) on the back of 48% surge in exports YOY (1HFY19: PKR 3.56mln, 1HFY18: PKR 2.41mln). However local dispatches witnessed a meager decline of 1.4% YOY (1HFY19: PKR 19.56mln, 1HFY18: PKR 19.84mln). The company's capacity utilization levels have remained positive and stagnant (FY18: 87.5% , FY17: 87.5%). The raw material costs witnessed a 38% increase YOY as the South African coal prices increased by ~10% in 1HFY19 coupled with depreciation of rupee. During 1HFY19, finance cost stood at PKR 24mln (FY18: PKR 107mln, 1HFY18: PKR 37mln, FY17: 85mln). However in Dec-18, Kohat's long term financing increased significantly (1HFY19: PKR 5.0bln, FY18: PKR 426mln, 1HFY18: PKR 568mln) which was planned for brown-field expansion. Going forward, as per the hike in current policy rates the interest payments will be a significant cost for kohat cement. Consequently, net profit decreased by a 7% YOY to stand at PKR 1.5bln (FY18: PKR 2.9bln, 1HFY18: PKR 1.6bln, FY17: PKR 3.5bln).

Margins Kohat's margins have declined over the past year but still remained at comfortable level (Gross: 1HFY19: 29%, FY18: ~32%, FY17: ~43%, Operating: 1HFY19: ~26%, FY18: 30%, FY17: 41%). Also, EBITDA margin witnessed deterioration (1QFY19: ~26%, FY18: 30%, FY17: 41%). In recent times, margins deterioration is a trend witnessed throughout the cement industry due to macroeconomic factors such as increase in global commodity prices (coal), intervention of government in tightening the Fiscal and Monetary policies (Lower PSDP allocation), a sharp hike in energy costs, and a massive 33%-rupee depreciation against US dollar (Jan18 – Jan19).

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 in FY20.

Financial Risk

Working Capital During 1HFY19, Kohat's working capital requirements represented by net cash cycle (net working capital days) – a function of inventory, receivables and payables - stood at a negative of 7days (end-Jun18: 15days; end-Jun17: 19days). This is driven by delay in payables consequently conserving cash (Avg Days Payables : 1HFY19: 35days; 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 (1HFY19: NIL, FY18: NIL; FY17: PKR 200mln). Current ratio inched down to 1.0x (FY18: 1.5x, 1HFY18: 2.0x, FY17: 1.6x) but remained at comfortable level.

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 (debt service coverage: end-Dec18: 4.0x, end-Jun18: 9.0x; end-Jun17: 11.9x).

Capitalization Over the last few years, the company operated at fairly low leveraged capital structure. However during 1HFY19, upon debt intake for brownfield expansion the debt to capital ratio increased to 21% (FY18: ~2%, FY17: 6%). Going forward, the company's leveraging is not expected to increase any further and cash flows are likley to strengthen from commencement of new line.

Cement
Financials (Summary) in PKR mln
The Pakistan Credit Rating Agency Limited

Kohat Cement
Listed Public Limited

	A BALANCE SHEET	Dec-18	Jun-18	Jun-17	Jun-16
		6M	12M	12M	12M
1	**Non-Current Assets**	**19,287**	**9,254**	**8,201**	**7,971**
2	**Investments**	-	-	-	-
a	Equity Instruments	-	-	-	-
b	Debt Instruments	-	-	-	-
3	**Current Assets**	**4,806**	**5,247**	**3,710**	**3,655**
a	Inventory	452	659	949	629
b	Trade Receivables	790	646	344	259
c	Others	3,564	3,943	2,417	2,767
4	**Total Assets**	**30,059**	**23,316**	**20,192**	**19,345**
5	**Borrowings**	**5,032**	**426**	**911**	**1,593**
a	Short-Term	-	-	200	598
b	Long-Term (Incl. CMLTB)	5,032	426	711	995
6	Other Short-Term Liabilities	4,821	3,395	2,299	2,380
7	Other Long-Term Liabilities	1,475	1,518	1,676	1,603
8	**Shareholder's Equity**	**18,731**	**17,977**	**15,306**	**13,770**
9	**Total Liabilities & Equity**	**30,059**	**23,316**	**20,192**	**19,345**
	B INCOME STATEMENT				
1	**Sales**	**8,392**	**13,439**	**13,540**	**14,020**
2	**Gross Profit**	2,407	4,353	5,827	6,497
3	Non Operating Income	(0)	51	(18)	43
4	Total Finance Cost	(24)	(107)	(85)	(78)
5	**Net Income**	**1,527**	**2,979**	**3,542**	**4,408**
	C CASH FLOW STATEMENT				
1	Free Cash Flow from Operations (FCFO)	1,892	3,030	4,273	4,261
2	Total Cashflows (TCF)	1,892	3,030	4,273	4,261
3	Net Cash changes in Working Capital	1,641	(51)	(616)	(779)
4	Net Cash from Operating Activities	3,466	2,914	3,565	2,979
5	Net Cash from InvestingActivities	(8,715)	(3,160)	(1,305)	(1,350)
6	Net Cash from Financing Activities	4,087	(791)	(2,685)	(1,817)
7	Net Cash generated during the period	(1,162)	(1,036)	(425)	(188)
	D RATIO ANALYSIS				
1	**Performance**				
a	Sales Growth (for the period)	25%	-1%	-3%	#DIV/0!
b	Gross Profit Margin	29%	32%	43%	46%
c	Net Profit Margin	18%	22%	26%	31%
d	Return of Equity	17%	18%	24%	32%
2	**Working Capital Management**				
a	Gross Working Capital (Inventory Days + Receivable Days)	27.7	35.3	29.4	19.9
b	Net Working Capital (Inventory Days + Receivable Days - Payable Days)	-7.0	15.3	18.5	5.2
3	**Coverages**				
a	Debt Service Coverage (FCFO / Finance Cost+CMLTB+Excess STB)	3.9	9.0	11.9	12.3
b	Interest Coverage (FCFO / Finance Cost)	161.6	57.7	56.4	68.5
c	Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	1.3	0.1	0.2	0.2
4	**Capital Structure (Total Debt/Total Debt+Equity)**				
a	Capital Structure (Current Borrowings / Total Borrowings)	-7	15	19	5
b	Capital Structure (Total Borrowings / Total Borrowings+Equity)	21%	2%	6%	10%

Mar-19

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.

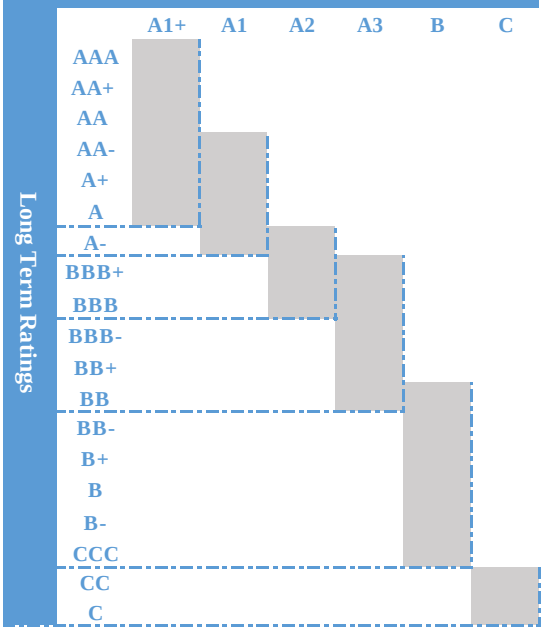
Long Term Ratings

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.

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2) **Conflict of Interest**
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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

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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.
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(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)
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(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)
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(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)
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