The Pakistan Credit Rating Agency Limited

Rating Report

Fecto Cement Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
25-Mar-2022	A-	A2	Stable	Maintain	Yes
02-Apr-2021	A-	A2	Stable	Maintain	Yes
22-Apr-2020	A-	A2	Stable	Maintain	Yes
27-Sep-2019	A-	A2	Stable	Maintain	-
30-Mar-2019	A-	A2	Stable	Maintain	-
18-Dec-2018	A-	A2	Stable	Maintain	-
07-May-2018	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Fecto Cement has a single manufacturing capacity, located in north region, with an annual cement capacity of 0.8mln tons. The company's market share stands at 1.6% in operational cement capacity. The Company’s sales are majorly driven by local market fundamentals – an industry wide phenomenon. However, Fecto also exports a minuscule part to Afghanistan - viable export market given geographical location of the company. The Cement sector’s dispatches have recorded splendid growth and surged by 21% in FY21 as demand in the domestic market accelerated. Cement sector's local capacity utilization also recorded growth owing to accelerated local demand and the sector has entered into new era of expansions of ~18mlntpa. Leveraging levels on industry level are expected to go up owing to expansions. The company has reported growth in its profitability in 1HFY22 and has obtained exploration license for mining in Khushab but its capacity enhancement program is at a very preliminary stage. The company’s business profile remains critical as new era of expansions will change the industry’s dynamics and company may lose its market share if expansion is put on hold. Going forward, along with improvement in volumes, managing direct & indirect costs, sustaining improved operating and EBITDA margins remains vital for the company. Rating watch incorporates lease expiry of quarries and no formal announcement of greenfield expansion as yet the finalization for which including project financing and other related matters remain critical. The financial risk profile would remain a predominant determinant in the ratings of the company. Currently the quantum of debt is not high. Any aggressive leveraging would take the ratings downward. Currently, the long-term financing is used to finance BMR projects including installation of solar plant & up-gradation of Silos & cooling system on plants.

The ratings are dependent on improvement of company’s business volumes and margins. The company's improved business performance in current economic scenario – challenges on quarry leases, capacity expansion, effective cost management & relative position, - remain vital for ratings.

Disclosure

Name of Rated Entity	Fecto Cement Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating(Jun-21),Criteria | Correlation Between Long-term & Short-term Rating Scales(Jun-21),Criteria | Rating Modifiers(Jun-21)
Related Research	Sector Study | Cement(Mar-21)
Rating Analysts	Uswa Sikandar | uswa.sikandar@pacra.com | +92-42-35869504

Profile

Legal Structure Fecto Cement Ltd is a listed Company. Its shares are traded on Pakistan Stock Exchange Limited (PSX). The Company's shares are quoted under the Cement Sector as pick symbol 'FECTC'.

Background Incepted in 1972, Fecto Cement Limited (FECTCO) is part of the Fecto group. The group is diversified into import, export and trading of electrical wires, cables, home appliances and automobiles and later, expanded to industrial sectors by establishing a cement plant, sugar mills, tractor plant as well as paper sack and hardboard manufacturing units. Fecto Cement Limited is headquartered in Karachi, Pakistan and the cement plant is established near Islamabad. The quality standards of the company are ISO 9001:2000.

Operations Fecto Cement Limited is engaged in manufacturing, marketing and selling cement and clinker in Pakistan. With an installed capacity of ~0.8mln tons per annum, the company currently holds 1.6% share in the country's operational cement capacity.

Ownership

Ownership Structure Fecto Group hold majority stake (75%) in Fecto Cement through Mr. Yasin Fecto (75%) rest is widely spread among FIs and general public. Hence, Mr. Yasin has controlling stake in the company and identified as the man at the last mile.

Stability The shareholding had lately been transferred to Mr. Yasin Fecto by his family and siblings. The company's ownership structure is not expected to change in foreseeable future.

Business Acumen The business acumen of the company is considered adequate on account of long term association with cement sector.

Financial Strength The financial strength of the group is considered adequate.

Governance

Board Structure The overall control of the company vests in seven member board of directors (BoD), including the CEO. The BoD comprises three independent directors and three non-executive directors. Whereas Mr. Yasin Fecto is the representative of sponsor and executive director. During the year, there was no change in the board members. Fecto Cement has a balanced board structure.

Members' Profile Fecto's board members carry necessary technical stature which is required for effective decision making.

Board Effectiveness The board meeting minutes are formally maintained, and the attendance is considered adequate. High attendance of the members was observed during the meetings held in FY21.

Financial Transparency M/s. Rahman Sarfaraz Rahim Iqbal Chartered Accountant conducted the external audit services for Fecto. They're 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, 2021.

Management

Organizational Structure Fecto Cement has a lean organization structure with the company's operations grouped under eight key functions. These include 1) Procurement, 2) Production, 3) Sales & Marketing, 4) Information Technology, 5) Finance, 6) Corporate Affairs, 7) Human Resource, and 8) Internal Audit.

Management Team The CEO, Mr. Yasin Fecto, is a son of Mr. Ghulam Muhammad Fecto and is associated with the company since 1990s. Mr. Yasin holds a master's degree and has experience of cement and packaging sectors.

Effectiveness The CEO is supported by a team of experienced individuals having long association with the company. Mr. Abdul Samad, a fellow member of ICAP, is the CFO of company and has over 25 years of experience.

MIS The Company has a core operating software. The implemented modules are integrated and include financial, purchase, inventory, sales and payroll. Fecto Cement generates comprehensive MIS reports which include Production, Dispatches, Power and fuel consumption (with year to date comparisons), and Receivable and Payable status on monthly basis.

Control Environment Fecto Cement's production facility is located in the vicinity of 'Islamabad'– North Region – providing easy access to limestone reserves. However, the lease license of quarries has expired for more than 5 years and the company is now dependent upon outsider suppliers to maintain stocks for smooth functioning of core operations. The company has also acquired a mining license for green-field expansion in Khushab, Punjab. The company currently operates with one line; plant is of European Technology. Accredited with ISO 9001: 2008 and ISO 14001: 2004 certifications, Fecto Cement deploys good technology to ensure production of quality cement. The fuel requirement is met mainly through coal imported from Afghanistan and blended with local coal. Fecto Cement's total electricity (power) requirement stands between 13 and 14MW. The company utilizes around 5.5MW electricity from Waste Heat Recovery Plant, around 1.5 to 2 MW from solar plant and depends on national grid for the remaining requirement.

Business Risk

Industry Dynamics Although domestic cement dispatches have grown by 2% from 23.6 million tonnes to 24.1 million tonnes for the half year ended 31 December 2021 due to CPEC related projects and increase in local construction activity, export volumes have declined by 32% from 5.0 million tonnes to 3.4 million tonnes. This was primarily due to political instability in Afghanistan and influx of cheaper Iranian cement into the country, imposition of heavy antidumping duty on Pakistan's cement products by South African government, global economic slowdown and Pakistani cement and clinker becoming less competitive in international market due to rising cost of production. Energy constitutes ~60% of the total energy cost of cement production. Coal, being a cheap source of energy, is extensively used by the cement companies in their manufacturing process and accounts for ~40% of the total production cost of cement. Pakistan imports coal from South Africa, Indonesia, Ukraine, Russia, and Afghanistan which implies its exposure to exchange rate movements as well as fluctuations in international coal prices which have risen exorbitantly high recently.

Relative Position Fecto Cement's market share is 1.6% categorizing it as a small player. With capacity to produce 780,000 tons of clinker per annum.

Revenues During 1HFY22, turnover was recorded at PKR 3.076bln a significant increase of 32% YOY (1HFY21: PKR 2.3bln). Main reason for such increase is improved selling price in local market coupled with increased sales volume. Net local sales revenue of the company increased by 38.73%. Export revenue reduced by 49.17% as against reduction in volume by 51.83%. Export retention prices remained depressed during the period. Cost of sales amounted to PKR 2.7 bln during 1HFY22, mainly comprising energy cost, resulted in gross profit of PKR 413 mln during 1HFY22 as against gross profit of PKR 287 million reported in FY21.

Margins During 1HFY22, Fecto's margins improved (Gross Margin: 1HFY22: 13.4%, FY21: -5.8%, FY20: -20.7%, FY19: 12.5%, Operating Margin: 1HFY22: 9.1%, FY21: 0.3%, FY20: -29%, FY19: 3%, EBITDA Margin: 1HFY22: 11.64%, FY21: 2.24%, FY20: -27%, FY19: 4.8%). This is due to the increase in local selling price and sales volume despite increase in electricity cost and coal prices.

Sustainability Going forward, the company has planned a green field expansion in Khushab region of 7000 tpd. The company will also start reaping benefits from BMR of existing plant in form of production and energy efficiency, the first phase of which got completed in last December. With the installation of solar, it has also become less dependent on WAPDA by around 2 MW.

Financial Risk

Working Capital During 1HFY22, Fecto's working capital requirements represented by net cash cycle (net working capital days) decreased to 253days (end-Jun21: 297days; end- Dec20: 301days). This was primarily due to decrease in inventory days from 318 in June 21 to 278 in Dec 21. The liquidity profile as evident by the current ratio remained manageable to ensure adequate liquidity levels over the period under review (1HFY22: 4.2x; FY21: 3.4x). The company's short-term trade leverage stands at 10% indicating room to borrow and adequate working capital management of the company

Coverages During 1HFY22, FCFO and EBITDA have improved to PKR 337 million and PKR 358 million respectively from PKR 84 mln and PKR 111 mln in June 21 mainly due to improvement in local selling price. Resultantly interest coverage has also improved from 1.2x in June21 to 4.9x in Dec 21.

Capitalization Earlier the company had been operating on a deleveraged structure. However, the company has recently obtained loans from State Bank owing to installation of solar plant amounting to PKR 500 million and BMR of existing Plant amounting to PKR 745 million. In addition, the company has also obtained salary refinancing loan amounting to PKR 122 million. During 1HFY22, Company's debt to equity ratio stood at 38.7% (June21: 30.8%; June 20: 17.1%; June19: 1%).

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Financial Summary
PKR mln

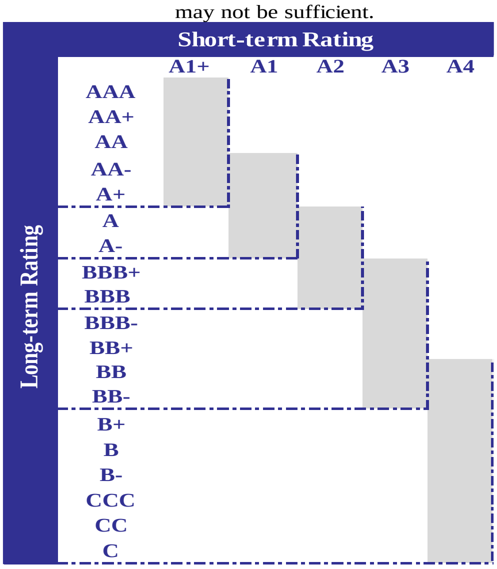
Fecto Cement Ltd Infrastructure | Cement	Dec-21 6M	Jun-21 12M	Jun-20 12M	Jun-19 12M
A BALANCE SHEET				
1 Non-Current Assets	3,139	2,418	1,861	1,966
2 Investments	-	-	-	-
3 Related Party Exposure	462	497	492	549
4 Current Assets	3,335	3,118	2,481	2,552
a Inventories	*1,597*	*1,623*	*1,277*	*1,258*
b Trade Receivables	*43*	*44*	*25*	*68*
5 Total Assets	6,936	6,033	4,834	5,067
6 Current Liabilities	799	926	556	336
a Trade Payables	*427*	*501*	*124*	*51*
7 Borrowings	2,287	1,545	725	43
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	234	95	44	356
10 Net Assets	3,617	3,467	3,508	4,332
11 Shareholders' Equity	3,617	3,467	3,508	4,332
B INCOME STATEMENT				
1 Sales	3,076	4,961	3,464	4,740
a Cost of Good Sold	*(2,663)*	*(4,674)*	*(4,179)*	*(4,146)*
2 Gross Profit	413	287	(715)	594
a Operating Expenses	(166)	(317)	(336)	(494)
3 Operating Profit	247	(29)	(1,052)	101
a Non Operating Income or (Expense)	*34*	*42*	*46*	*35*
4 Profit or (Loss) before Interest and Tax	281	12	(1,006)	136
a Total Finance Cost	*(70)*	*(76)*	*(29)*	*(5)*
b Taxation	*(61)*	*(4)*	*264*	*(41)*
6 Net Income Or (Loss)	150	(67)	(770)	89
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*337*	*84*	*(1,031)*	*84*
b Net Cash from Operating Activities before Working Capital Changes	*285*	*84*	*(1,017)*	*79*
c Changes in Working Capital	*(412)*	*(343)*	*267*	*(94)*
1 Net Cash provided by Operating Activities	(127)	(259)	(750)	(15)
2 Net Cash (Used in) or Available From Investing Activities	(748)	(542)	56	(173)
3 Net Cash (Used in) or Available From Financing Activities	745	555	366	(121)
4 Net Cash generated or (Used) during the period	(130)	(246)	(328)	(308)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	24.0%	43.2%	-26.9%	-3.3%
b Gross Profit Margin	13.4%	5.8%	-20.7%	12.5%
c Net Profit Margin	4.9%	-1.4%	-22.2%	1.9%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	-2.4%	-5.2%	-22.1%	-0.2%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	8.9%	-2.2%	-21.4%	2.0%
2 Working Capital Management				
a Gross Working Capital (Average Days)	280	320	402	329
b Net Working Capital (Average Days)	253	297	393	313
c Current Ratio (Current Assets / Current Liabilities)	4.2	3.4	4.5	7.6
3 Coverages				
a EBITDA / Finance Cost	5.2	1.5	-36.5	70.8
b FCFO / Finance Cost+CMLTB+Excess STB	2.2	0.3	-15.0	7.0
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	2.3	68.0	-0.1	0.5
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	38.7%	30.8%	17.1%	1.0%
b Interest or Markup Payable (Days)	51.9	63.6	201.9	0.0
c Entity Average Borrowing Rate	9.2%	7.3%	8.7%	12.0%

Credit Rating

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 Rating	
Scale	**Definition**
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 Rating	
Scale	**Definition**
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
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



The correlation shown is indicative and, in certain cases, may not hold.

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 some material identifiable event with indeterminable rating implications. 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 rating 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) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) 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.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

Entities

a) Broker Entity Rating
b) Corporate Rating
c) Financial Institution Rating
d) Holding Company Rating
e) Independent Power Producer Rating
f) Microfinance Institution Rating
g) Non-Banking Finance Companies (NBFCs) Rating

Instruments

a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk Rating

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)
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