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
24-Mar-2023	A-	A2	Stable	Maintain	Yes
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 0.945mln tons per annum. The company's market share stands at ~1% 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. In FY22, cement sales witnessed a substantial decline due to uncertainty in government policies and recorded high inputs cost. Cement production declined by 3.6% and overall cement industry utilization stood at 56 per cent in FY22, compared to 72 per cent in the last year. With revenues of PKR 4,145 million in 1HFY23, company has reported net loss of PKR 122 million due to significant pressure on costs and teething problems of recently completed BMR. Going forward, along with improvement in volumes, managing direct & indirect costs and improvement in gross, operating and EBITDA margins remains vital for the company. Rating watch incorporates lease expiry of quarries and reported losses primarily due to pressures on cost. The financial risk profile would remain a predominant determinant in the ratings of the company. The quantum of debt has recently increased to finance BMR projects. Timely repayment of debt is imperative to hold the ratings, however, comfort can be attained from its significant portion incurred on concessionary fixed rates. Given the hike in policy rate, it is imperative that the company relies on internal cash generation for its working capital management. Fecto Cement has obtained exploration license for mining in Khushab but its capacity enhancement program is currently stalled owing to poor macroeconomic indicators as well as strained financial metrics intrinsic to the company. The company’s business profile remains critical as new era of expansions is changing the industry’s dynamics and company may lose its market share as expansion is put on hold

The ratings are dependent on improvement of company’s business volumes and margins. The company's improved business performance in current economic scenario – effective cost management, capacity expansion & retention of market share - 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-22),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jun-22),Methodology | Rating Modifiers(Jun-22)
Related Research	Sector Study | Cement(Mar-22)
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 ~0.945mln tons per annum, the company currently holds ~1% 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 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 FY22.

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, 2022.

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. After BMR, the fuel requirement is met mainly through local coal from Darra mines. 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 Cement sector's production capacity is recorded around ~69mln MT in FY21 (~64mln MT in FY20), an increase of ~8.8% YoY. Expansion plans for enhancing the sector capacity up to ~87mln MT by FY24 are underway. In FY22, cement sales witnessed a substantial decline due to uncertainty in government policies and recorded high cost of fuel, electricity, coal and other raw materials. Cement production declined by 3.6% in FY22 and overall cement industry utilization stood at 56 per cent in FY22, compared to 72 per cent in the last year. The fall in capacity utilization was also partially reflected in exports as higher international coal prices, elevated freight costs and reduced demand for cement and clinker from Afghanistan and Bangladesh put a considerable dent in exports market. Exorbitant increase in the input costs in FY22 necessitated increase in selling prices which in turn increased the revenues despite reported volumetric decrease as mentioned above. For FY22-23, it is expected that the trend will continue and local cement demand would drop by 10-15 per cent due to higher high cost of production and low consumer buying power.

Relative Position Fecto Cement's market share is ~1% categorizing it as a small player. With capacity to produce 945,000 tons of clinker per annum.

Revenues During 1HFY23, turnover was recorded at PKR 4.145bln a significant increase of ~35 % YOY (1HFY22: PKR 3.076bln). Main reason for such increase is improved selling prices in local market necessitated by significant increase in input costs. During the half year under review, overall cement and clinker dispatches reduced by 20.76% as compared to same period last year. Cost of sales amounting to PKR 3.97 billion mainly comprising energy cost, resulted in gross profit of PKR 174 mln during 1HFY23 as against gross profit of PKR 413 million reported in 1HFY22.

Margins During 1HFY23, Fecto's margins declined (Gross Margin: 1HFY23: 4.2%, FY22: 12.9%, FY21: 5.8% Operating Margin: 1HFY23: (0.4%), FY22: 7.8%, FY21: (0.6%), Net Profit Margin: 1HFY23: (2.9%), FY22: 4.2%, FY21: (1.4%). Margins declined due to increase in fuel and energy costs at gross level and increase in finance cost on account of higher utilization of financing facilities at net level.

Sustainability Going forward, the company expects to reap benefits from BMR of existing plant through production and energy efficiency. With the installation of solar, it has also become less dependent on WAPDA by around 2 MW.

Financial Risk

Working Capital During 1HFY23, Fecto's working capital requirements represented by net cash cycle improved to 120days (end-Jun22: 126 days; end-Jun21: 191days). This was primarily due to decrease in inventory days from 156 in June 22 to 144 in Dec 22. The liquidity profile as depicted by the current ratio stood at (1HFY23: 3.2x; FY22: 2.5x; FY21: 3.4x), which indicates adequate liquidity management however, company has shown increased reliance on external borrowings in the form of running finance and other short-term facilities to manage its WC requirements. The company's short-term trade leverage stands at 13% indicating room to borrow but with the recent increase in policy rate, it is imperative that company becomes self-reliant to manage its liquidity as reliance on external sources has become very expensive.

Coverages During 1HFY23, FCFO and EBITDA have declined to PKR 110 million and PKR 122 million respectively from PKR 716 mln and PKR 745 mln in June 22 mainly due to increase in inputs cost. Resultantly interest coverage has also fallen from 4.7x in June22 to 0.8x in Dec 22.

Capitalization During 1HFY23, Company's debt to equity ratio stood at 38.6% (June22: 30.6%; June 21: 30.8%). The company has negative spread over Kibor of -3.5% as most of the loans it has obtained are from State Bank at concessionary rates under different schemes.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Fecto Cement Ltd Infrastructure | Cement	Dec-22 6M	Jun-22 12M	Jun-21 12M	Jun-20 12M
A BALANCE SHEET				
1 Non-Current Assets	3,089	3,195	2,418	1,861
2 Investments	-	-	-	-
3 Related Party Exposure	499	456	497	492
4 Current Assets	3,639	3,299	3,118	2,481
a Inventories	*1,871*	*1,294*	*1,623*	*1,277*
b Trade Receivables	*138*	*75*	*44*	*25*
5 Total Assets	7,226	6,950	6,033	4,834
6 Current Liabilities	1,154	1,329	926	556
a Trade Payables	*604*	*706*	*501*	*124*
7 Borrowings	2,281	1,652	1,545	725
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	162	218	95	44
10 Net Assets	3,629	3,751	3,467	3,508
11 Shareholders' Equity	3,629	3,751	3,467	3,508
B INCOME STATEMENT				
1 Sales	4,145	6,775	4,961	3,464
a Cost of Good Sold	*(3,971)*	*(5,901)*	*(4,674)*	*(4,179)*
2 Gross Profit	174	874	287	(715)
a Operating Expenses	(192)	(345)	(317)	(336)
3 Operating Profit	(18)	528	(29)	(1,052)
a Non Operating Income or (Expense)	*33*	*56*	*42*	*46*
4 Profit or (Loss) before Interest and Tax	15	584	12	(1,006)
a Total Finance Cost	*(141)*	*(155)*	*(76)*	*(29)*
b Taxation	*5*	*(142)*	*(4)*	*264*
6 Net Income Or (Loss)	(122)	287	(67)	(770)
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*110*	*716*	*84*	*(1,031)*
b Net Cash from Operating Activities before Working Capital Chan	*18*	*586*	*84*	*(1,017)*
c Changes in Working Capital	*(587)*	*119*	*(343)*	*267*
1 Net Cash provided by Operating Activities	(570)	706	(259)	(750)
2 Net Cash (Used in) or Available From Investing Activities	(61)	(873)	(542)	56
3 Net Cash (Used in) or Available From Financing Activities	124	443	555	366
4 Net Cash generated or (Used) during the period	(507)	276	(246)	(328)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	22.4%	36.5%	43.2%	-26.9%
b Gross Profit Margin	4.2%	12.9%	5.8%	-20.7%
c Net Profit Margin	-2.9%	4.2%	-1.4%	-22.2%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital	-11.5%	12.3%	-5.2%	-22.1%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total A*	-6.9%	8.2%	-2.2%	-21.4%
2 Working Capital Management				
a Gross Working Capital (Average Days)	149	159	214	268
b Net Working Capital (Average Days)	120	126	191	259
c Current Ratio (Current Assets / Current Liabilities)	3.2	2.5	3.4	4.5
3 Coverages				
a EBITDA / Finance Cost	0.9	4.9	1.5	-36.5
b FCFO / Finance Cost+CMLTB+Excess STB	0.4	2.0	0.3	-15.0
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance	-20.7	2.3	68.0	-0.1
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	38.6%	30.6%	30.8%	17.1%
b Interest or Markup Payable (Days)	59.6	44.0	63.6	201.9
c Entity Average Borrowing Rate	13.5%	8.4%	7.3%	8.7%

Credit Rating

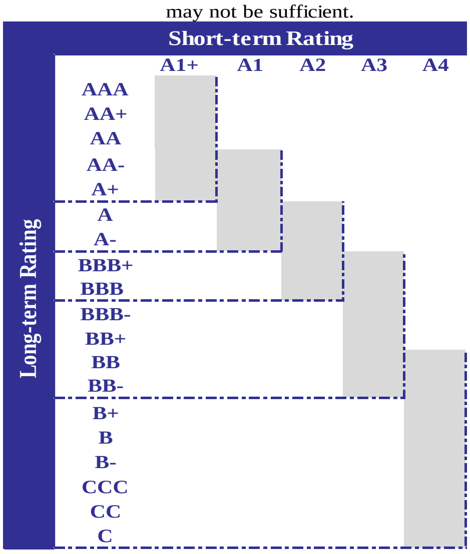
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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):

a) Broker Entity Rating
b) Corporate Rating
c) Debt Instrument Rating
d) Financial Institution Rating
e) Holding Company Rating
f) Independent Power Producer Rating
g) Microfinance Institution Rating
h) Non-Banking Finance Companies 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 | Clause 11-(A)(p).
(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