The Pakistan Credit Rating Agency Limited

Rating Report

Fauji Cement Company Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
15-Mar-2022	A+	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Fauji Cement's ratings hinge on its sustained market presence in the cement sector. The Company captures an adequate market share of 8.07% in North & 6.06% overall. Company is currently operating with two production lines, with an annual capacity of 3.5mln tpa, in Jhang Bahtar, District Attock near Islamabad. The Cement sector's dispatches have recorded splendid growth and surged by 20% in FY21 as demand in the domestic market accelerated. Also the local industry's future demand outlook is positive, in view of the infrastructure projects in the pipeline. Export is another avenue. Industry-wide Export has gone up as a new export window is created in the Bangladesh market. Over the years, company has been able to maintain a growth trajectory. The Company's revenues witnessed an increase (1QFY22: PKR 6.9bln, FY21: PKR 24.2bln, FY20: PKR 17.2bln) attributed to an uptick in sales volumes, positive price indicators and, reinvigorating economy. The Company managed to recoup previous losses and reported profits of PKR 1.36bln and PKR 3.5bln in 1QFY22 and FY21 respectively. In order to propel growth in line with cement industry, management has announced further green field expansion of 6,500 TPD, near DG Khan. Estimated cost of project is ~PKR 32.4bln out of which ~63% will be debt financed. Financial Close has already achieved in April-21. The project is expected to be operational by FY 2024. The Company is in the process of merger with Askari Cement, transaction is approved by BoD however the scheme of amalgamation is submitted in High Court, for final approval. Company keeps a fairly low leveraged financial profile, however adding up of further leveraging due to expansion will potentially impact the financial risk profile of the Company, while expected to remain manageable. Further, the Ratings assigned to Fauji Cement also draw support from the strong financial profile of the Company's sponsor, Fauji Foundation having a presence across multiple sectors.

The ratings remain dependent on upholding company's market position along with sustenance of business volumes, margins and achieving optimal utilization of production capacities. Going forward, sustainability in profits for timely repayment of debt remains vital.

Disclosure

Name of Rated Entity	Fauji Cement Company 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	Bazah Tul Qamar | bazahtul.qamar@pacra.com | +92-42-35869504

Profile

Legal Structure Fauji Cement Company Limited (FCCL), is a public listed company established in 1992. The company is listed on Pakistan Stock Exchange (PSX). The Company has been set up with the primary objective of manufacturing, producing, preparing, treating, processing, refining, selling, transporting and exporting different kinds of CEMENT.

Background The Company started its operations in 1997 with the production capacity of 3700 tons per day (TPD), which was enhanced to over 11000 TPD, with addition of second production Line in 2011, with annual total production capacity of 3.5 million tons of cement. To optimize its capabilities, FCCL installed two Waste Heat Recovery Power Plants (WHRPPs) of 12 MW and 9 MW and a solar power plant of 17.5MW. In addition, the Company pursues a regular BMR Plan to improve the manufacturing process, enhance it capabilities by making it more efficient.

Operations FCCL is engaged in the production and sale of cement. Plant of Fauji Cement Company Limited (FCCL) is located at Jhang Bahtar, District Attock near Islamabad. The Company is one of the leading producers of a wide range of quality cement including ordinary Portland cement and other special cement(s) in Pakistan

Ownership

Ownership Structure FCCL is majority owned by sponsor group Fauji Foundation (48%). and 52% is owned by General public and Financial institutions.

Stability Fauji Foundation (also known as Fauji Group or FFG), is amongst the largest business conglomerate in Pakistan which "Earns to Serve" the interests of ex-servicemen, basically a Charitable Trust founded in 1954 for the welfare of the ex-servicemen and their dependents.

Business Acumen Fauji Foundation associated projects are Fauji Fertilizer Company Limited, Fauji Fertilizer Bin Qasim Limited, Pakistan Maroc Phosphore, S.A.,Moroco, Fauji Cement Company Limited, Mari Petroleum Company Limited, Fauji Kabirwala Power Company limited, Foundation Power Company Darahki Limited, Fauji Oil Terminal and Distribution Company Limited, Fauji Akbar Portia Marine Terminal Limited, Askari Bank Limited, Fauji Foods Limited, Fauji Fresh n Freeze Limited, Fauji Meat Limited and Infra-avest Foods Limited etc.. Besides these projects of Fauji Foundation, fully owned projects are Fauji Cereals, Foundation Gas, Overseas Employment Services, Fauji Foundation Experimental and Seed Multiplication Farm. The business acumen of the sponsor is considered strong as the FFG is in this business for very long and also associated with another group Company ‘Askari Cement Limited.

Financial Strength Financial Strength of the sponsors is considered strong enough, through above mentioned associated and fully owned projects.

Governance

Board Structure The overall control of the company vests in eight member’s board of directors - including the Chief Executive – Mr. Qamar Haris Manzoor. Other than Chief Executive, who is also the managing director, Mr. Waqar A Malik is the chairman of the board. All board members are from have diversified experience that bodes well for company.

Members’ Profile The board members’ have good business acumen on the back of significant local industry exposure in several sectors. The board meetings minutes are formally maintained reflecting good participation by the members present.

Board Effectiveness FCCL has three committees: 1) Audit committee 2) Human resource & Remuneration Committee (HR&R) and 3) Investment Committee; this is in compliance with the Code of Corporate Governance.

Financial Transparency KPMG Taseer Hadi & Co., Chartered Accountants conduct the external audit services for Fauji 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 June 30th, 2021.

Management

Organizational Structure The organizational structure is divided into different functions. Main function are; 1)Sales & Marketing, 2)Plant Operations and 3) Finance & Accounts. The internal audit department reports to the Audit Committee in line with the code of corporate governance.

Management Team Mr Qamar Haris Manzoor the CEO, has done his Masters in Chemical Engineer from US and holds over 35 years of experience in plant and project management.

Effectiveness The management is supported by five committees (i) Management, (ii) Production, (iii) Sales & Marketing, (iv) IT Steering and (v) Human Resource. The committee meetings are conducted on frequent basis to ensure smooth flow of processes and resolve operational bottlenecks. The necessary information is captured in minutes

MIS FCCL has implemented ERP solution in the Company. The technology infrastructure with reasonably conceived and implemented policies or procedures enables the management to generate various regular and customized reports of different frequency (daily, weekly, monthly and yearly) pertaining to sales, purchase, inventory, general ledger, payroll, costing & budget and Preventive maintenance and other important financial figures

Control Environment Fauji Cement has an in house internal audit function. HOD Internal Audit is reportable to Audit Committee and CEO. Internal Audit function is an integral part of the process and regularly apprises and monitors the implementation of financial controls and other procedures.

Business Risk

Industry Dynamics The Cement sector’s dispatches have recorded splendid growth and surged by 20% in FY21 as demand in the domestic market accelerated. Also the local industry’s future demand outlook is positive, in view of the infrastructure projects in the pipeline. Export is another avenue. Industry-wide Export has gone up as a new export window is created in the Bangladesh market.

Relative Position As at FY21, Fauji Cement market share stands at 8.07% in North and 6.06% in overall.

Revenues During 1QFY22, the Company recorded revenue of PKR 6.9bln (FY21: PKR 24.2bln) witnessing an increase of ~14.3% YoY. Sales mix remained tilted towards local market mainly due to healthy demand and secured margins in local market. During FY21, the Company's capacity utilization levels improved to ~98% (FY20: ~87%). Finance costs decreased to PKR 26.7mln in 1QFY22 (FY21: PKR 110mln), mainly due to reduction in short term borrowings.

Margins FCCL’s margins have improved over the past year (Gross: 1QFY22: ~30.4%, FY21: ~25%, FY20: 3.8%), Operating: 1QFY22: ~25.7%, FY21: ~21% FY20: -0.1%). Also, EBITDA margin witnessed substantial increase (1QFY22: ~19.4%, FY21: 15.1%, FY20:2.1%).

Sustainability The Company plans to maintain and enhance market share as one of its strategic goals. FCCL's board has approved setting up of a Green field Cement manufacturing plant of 2.05 Million ton per annum at Dera Ghazi Khan Punjab in March 2021, in order to achieve this goal.

Financial Risk

Working Capital During 1QFY22, FCCL working capital requirements represented by net cash cycle (net working capital days) - a function of inventory, receivables and payables - decreased to 23 days (FY21: 28 days). Cash cycle decreased on account of decrease in receivable days representing better recoveries. (1QFY22: 16 days; FY21: 19 days). The Company was able to manage the requirement primarily through internal resources on account of robust cashflows.

Coverages During 1QFY22, FCCL's FCFO increased by 47.2% YOY, standing at PKR 2,169mln. (FY21: PKR 5,892mln). Reduction in finance costs, the Company was able to maintain strong coverage ratios on account of strong cash flows and low leveraged structure. (Interest coverage: 1QFY22: 96.5x; FY21: 64x). Going forward, with the predicted gradual addition in debt, coverages are expected to be affected but will remain inbounds of adequacy.

Capitalization Over the last few years, the company operated at fairly low leveraged capital structure. However; on account of debt acquisition for expansion projects the debt to debt plus equity ratio is expected to increase in coming years. however, it is expected to be comfortably managed through healthy cash flows.

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Financial Summary
PKR mln

Fauji Cement Limited Cement	Sep-21 3M	Jun-21 12M	Jun-20 12M	Jun-19 12M
A BALANCE SHEET				
1 Non-Current Assets	21,647	21,598	22,225	23,290
2 Investments	5,481	4,398	-	-
3 Related Party Exposure	65	15	-	-
4 Current Assets	7,762	8,041	7,153	5,676
a Inventories	*1,803*	*1,189*	*1,188*	*944*
b Trade Receivables	*965*	*1,450*	*1,051*	*947*
5 Total Assets	34,956	34,052	29,377	28,965
6 Current Liabilities	5,121	4,143	2,986	2,443
a Trade Payables	*1,175*	*863*	*355*	*310*
7 Borrowings	1,179	2,568	2,702	1,627
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	4,022	4,065	3,885	3,997
10 Net Assets	24,634	23,276	19,804	20,899
11 Shareholders' Equity	24,634	23,276	19,804	20,899
B INCOME STATEMENT				
1 Sales	6,936	24,271	17,232	20,798
a Cost of Good Sold	*(4,826)*	*(18,207)*	*(16,583)*	*(15,475)*
2 Gross Profit	2,110	6,064	649	5,323
a Operating Expenses	(200)	(714)	(673)	(626)
3 Operating Profit	1,910	5,350	(24)	4,697
a Non Operating Income or (Expense)	*(24)*	*(133)*	*84*	*(178)*
4 Profit or (Loss) before Interest and Tax	1,886	5,217	61	4,519
a Total Finance Cost	*(27)*	*(110)*	*(234)*	*(107)*
b Taxation	*(500)*	*(1,636)*	*114*	*(1,588)*
6 Net Income Or (Loss)	1,359	3,471	(59)	2,824
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*2,169*	*5,892*	*1,275*	*4,602*
b Net Cash from Operating Activities before Working Capital Changes	*2,145*	*5,798*	*1,043*	*4,499*
c Changes in Working Capital	*751*	*(153)*	*(262)*	*956*
1 Net Cash provided by Operating Activities	2,896	5,644	781	5,454
2 Net Cash (Used in) or Available From Investing Activities	(1,434)	(5,142)	(545)	(2,026)
3 Net Cash (Used in) or Available From Financing Activities	(77)	89	(949)	(2,909)
4 Net Cash generated or (Used) during the period	1,385	592	(713)	520
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	14.3%	40.9%	-17.1%	-1.7%
b Gross Profit Margin	30.4%	25.0%	3.8%	25.6%
c Net Profit Margin	19.6%	14.3%	-0.3%	13.6%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	42.1%	23.6%	5.9%	26.7%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	22.3%	16.0%	-0.3%	13.5%
2 Working Capital Management				
a Gross Working Capital (Average Days)	36	37	44	33
b Net Working Capital (Average Days)	23	28	37	28
c Current Ratio (Current Assets / Current Liabilities)	1.5	1.9	2.4	2.3
3 Coverages				
a EBITDA / Finance Cost	102.1	76.3	8.2	71.6
b FCFO / Finance Cost+CMLTB+Excess STB	18.2	12.3	2.3	11.3
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.1	0.2	0.8	0.1
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	4.6%	9.9%	12.0%	7.2%
b Interest or Markup Payable (Days)	0.0	0.0	0.0	160.9
c Entity Average Borrowing Rate	5.3%	4.6%	9.7%	5.4%

Credit Rating

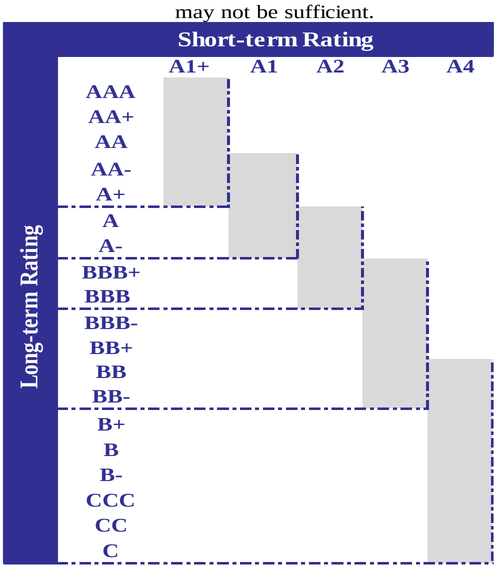
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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)

Proprietary Information