The Pakistan Credit Rating Agency Limited

Rating Report

Engro Polymer & Chemicals Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
12-Jul-2024	AA	A1+	Stable	Maintain	-
14-Jul-2023	AA	A1+	Stable	Maintain	-
16-Jul-2022	AA	A1+	Stable	Upgrade	-
17-Jul-2021	AA-	A1+	Positive	Maintain	-
18-Jul-2020	AA-	A1+	Stable	Maintain	-
19-Jul-2019	AA-	A1+	Stable	Maintain	-
18-Jan-2019	AA-	A1+	Stable	Maintain	-
19-Jul-2018	AA-	A1+	Stable	Upgrade	-

Rating Rationale and Key Rating Drivers

Engro Polymer and Chemicals Limited's ("EPCL" or "The Company") ratings reflect an established foothold in the manufacturing of Poly Vinyl Chloride (PVC) resin, and Chlor Alkali products (Caustic Soda, Sodium Hypochlorite, and Hydrochloric Acid). EPCL is the sole manufacturer of PVC resin in the domestic market., The Company has successfully completed a series of capacity expansion and efficiency projects over the years. Moreover, some projects including High-Temperature Direct Chlorination (HTDC) and digitization of EDC and VCM plants are near completion and expected to come online during CY24. Globally, the PVC industry faced multi-faceted challenges during CY23 as the prices went down back to pre-COVID levels on the back of suppressed demand in North America and China owing to high inflation and slow economic recovery, eventually creating an oversupply situation. On the flip side, Ethylene (key raw material for PVC) prices remained volatile due to supply crunches and OPEC+ decisions, resulting in a significant decline in core delta, hence lowering the margins and profitability. On the domestic front, the demand remained subdued primarily attributable to high inflation and elevated interest rates resulting in reduced spending in the construction sector. However, EPCL has shown resilience by retaining its market share of 89% with sustainability in its topline. To combat macroeconomic challenges, management is focusing on strengthening its PVC export volumes and developing the market for downstream applications of PVC through its wholly-owned subsidiary Think PVC (Pvt.) Limited. On the diversification front, the management is expected to achieve mechanical completion of the Hydrogen peroxide plant in CY24, which will add further diversity to EPCL's product mix. During CY23, the Company's debt increased amidst ongoing diversification and efficiency projects, though, it is being aptly managed by having a mix of concessionary loans (TERF and LTFF) and conventional borrowings. The policy rate has been decreased up to 20.5%, which will further optimize the debt service cost in the future as long-term borrowings dominate the total borrowings. Moreover, a slight increase in the working capital cycle and a reduction in core coverages of the company was observed in CY23. EPCL's association with one of the country's leading conglomerates – Engro Corp – and the very strong financial profile of the sponsors lend further support to the ratings.

The ratings are dependent upon the company's ability to sustain its position as a market leader, further strengthen its sales volumes through exports, and maintain sufficient margins and profitability. Further, adherence to the agreed financial discipline remains crucial. Timely completion of the remaining planned expansion projects, while retaining stable coverages would remain important. Adequate management of its capital structure and debt payback remains imperative.

Disclosure

Name of Rated Entity	Engro Polymer & Chemicals Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Correlation Between Long-term & Short-term Rating Scales(Jul-23),Methodology | Rating Modifiers(Apr-24),Methodology | Corporate Rating(Jul-23)
Related Research	Sector Study | Chemical(Jul-23)
Rating Analysts	Sohail Ahmed Qureshi | sohail.ahmed@pacra.com | +92-42-35869504

Profile

Legal Structure Engro Polymer and Chemicals Limited ('EPCL' or 'The Company'), was established in 1997 and is listed on Pakistan Stock Exchange.

Background Engro Polymer and Chemicals Limited, formerly known as Engro Asahi Polymer and Chemicals Limited, is the only Poly Vinyl Chloride (PVC) manufacturer in Pakistan. The Company has the only fully integrated chemical production facility in the country, located at Port Qasim, Karachi.

Operations The Company is primarily involved in the manufacturing, marketing, and distribution of PVC with an annual capacity of 295KT. The Company also produces Caustic Soda and its allied products. The Company meets its electricity requirement through a captive generation capacity of ~60MW.

Ownership

Ownership Structure Engro Polymer and Chemicals Limited is a subsidiary of Engro Corporation Limited which is ultimately owned by DH Group. Engro Corporation holds a majority stake in the company (~56%). The other major shareholder is Mitsubishi Corporation (~11%)

Stability The ownership structure of the Company displays a composite outlook, with a defined shareholding pattern of all parties.

Business Acumen Dawood Group is a conglomerate with over three generations of experience in commercial and social enterprises. Currently, the Group has interests in various sectors of the economy including Fertilizers, Foods, Power Generation, Technology, Financial Services, Chemical Storage, and Petrochemicals.

Financial Strength Dawood Group's main holding company is DH Corp. The Group's main investments in Engro Corp are consolidated in DH Corp. DH Corp had a strong equity base of ~ PKR 28,919Mln in March 2024 signifying a robust strength.

Governance

Board Structure The Board of Directors (BoD) comprises 8 members including the CEO - the only Executive Director, one member represents Mitsubishi Corporation, three are Independent Directors and the remaining are Non-Executive Directors. Mr. Ahsan Zafar Syed (the CEO of Engro Corp) - Chairman of EPCL possesses over 3 decades of professional experience.

Members' Profile Members of the board have a good mix of skills and experience. Mr. Ahsan Zafar Syed – the CEO of Engro Corp, is the Non-Executive Chairman of Engro Polymer & Chemicals Limited. He helps set a cohesive direction to create growth and value for the group of companies by focusing on long-term strategy and digital transformation.

Board Effectiveness The board has two committees in place; (i) Board Audit Committee and (ii) Board People's Committee. Board Committees are chaired by independent directors to ensure transparent governance.

Financial Transparency A.F.Ferguson & Co. Chartered Accountants are the auditors of the Company. The said firm falls is listed in category 'A' of SBP's panel of auditors. They expressed an unqualified opinion on the Company's financial statements for the year ended CY23.

Management

Organizational Structure The Company operates through eight departments, each headed by an experienced manager. These departments include (i) Internal Audit (ii) Manufacturing (iii) Commercial (iv) Supply Chain (v) Finance, (vi) Human Resources, (vii) Business Development, and (viii) Digital Transformation. Each department head directly reports to the CEO.

Management Team A well-qualified and experienced management team is there to run the business operations efficiently. The newly appointed CEO, Mr. Abdul Qayoom, has a degree in chemical engineering with diverse corporate experience spanning over two decades.

Effectiveness The strong organizational structure ensures effective delegation of functional responsibility across various departments, facilitating a smooth flow of operations. There is a management committee headed by the CEO to oversee and resolve all operational and managerial issues.

MIS EPCL has successfully transitioned from SAP ECC 6.0 to S4/HANA. This would help the Company in managing complex processes and larger data sets through the system as compared to the previous version. EPCL's Digital Strategy is based on projects that will automate most of the processes and bring AI, Computer Vision, and Data Analytics into use to improve the safety, reliability, and efficiency of the processes.

Control Environment The control environment is strengthened by the role of the Internal Audit department which provides detailed periodic reports to the Audit Committee for review and assessment and to take necessary remedial actions, where needed.

Business Risk

Industry Dynamics Pakistan has gigantic potential for the growth of the chemical sector as it is an integral part of our daily lives and industrial progress. Over the years, the local market has made considerable progress in basic inorganic chemicals like Polyvinyl Chloride, Caustic soda, Soda Ash, and Hydrogen peroxide and has expanded its production capacities to cater to the market demand. The PVC industry in Pakistan is gradually diversifying, and the range of finished products is expanding to include PVC flooring, garden furniture, roofing, wall panels, and ceilings. The outlook for demand growth in the region is positive, driven by increasing per capita consumption, construction activities, and the introduction of new applications. It is estimated that PVC demand in Pakistan will grow by 4.5% between 2022 and 2032. As the PVC market continues to evolve and mature, it provides opportunities for further diversification and growth.

Relative Position The majority of domestic PVC demand is met through Engro Polymer and Chemicals. It is the only producer of PVC in Pakistan. The plant has an annual production capacity of ~295,000MT.

Revenues After growing for five consecutive years, albeit at varying rates, the revenue remained almost static during CY23 and clocked in at PKR 81,224mln (CY22, PKR 82,060mln). EPCL's sales further declined during 3MCY24 and were recorded at PKR 16,565. CY23 brought multi-faceted challenges for the domestic PVC market. Declining international PVC prices, accompanied by soaring inflation and a slowdown in the local economy coupled with elevated interest rates have all hindered the growth of PVC sales.

Margins The Company's gross margin decreased to 25.5% in CY23 (CY22, 28.9%). The operating profit stood at 22.5% (CY22, 26.6%). Net profit margin witnessed a significant decline in CY23 and stood at 11.4% (CY22: 14.3%), primarily attributable to increased production costs owing to rise in raw material costs and elevated interest rates that have been the major contributor to dilution of bottom line. However, EPCL has managed to sustain healthy margins despite macroeconomic challenges and recorded a PAT of PKR 9,231mln in CY23.

Sustainability The Company is working on several efficiency & diversification projects, which include High-Temperature Direct Chlorination and hydrogen peroxide which are expected to come online in CY24. The Board of Engro Polymer & Chemicals Limited (EPCL) in its meeting dated April 18th, 2022 has approved a CAPEX of USD 4 million for conducting Basic Engineering followed by a Front End Engineering Design (FEED) study in relation to debottlenecking its VCM production facility to 300 KT per annum (the "Project").

Financial Risk

Working Capital In CY23, the inventory days of Engro Polymer & Chemical stood at 62 days (CY22:51 days; CY21:49 days). Meanwhile, in CY23, trade receivable days increased to 10 days (CY22: 8 days; CY21: 4 days). Gross working capital days reached 71 days (CY22: 59; CY21: 53 days). The trade payable days during CY23 decreased tp at 15 days (CY22: 18 days; CY21: 20 days). Resultantly net working capital days clocked in at 56 days (CY22:41 days; CY21: 33 days).

Coverages The company's FCFO decreased to PKR 14,430mln during CY23 (CY22, PKR 19,899mln, CY21, PKR 20,714mln). The interest coverage ratio clocked at 4.9x during CY23 (CY22: 10.0x, CY21: 14.3x). Furthermore, the debt coverage ratio was reduced to 1.7x (CY22: 2.2x, CY21:2.9x) on the back of increase in borrowings, and dilution in the profitability matrix owing to increase in finance costs of the company.

Capitalization EPCL borrowings comprise long-term debt, short-term debt, and CMLTD. In CY23, the company's leverage stood at ~54.2% (CY22: 51.3%). Total borrowings were recorded at PKR ~34,187mln (CY22, PKR 28,587mln). Long-term debt dominates the debt book of the company comprising ~71% of total borrowings. EPCL has also availed concessionary borrowings to optimize the finance costs.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Engro Polymer & Chemical Limited	Dec-23	Dec-22	Dec-21
Chemical	12M	12M	12M
A BALANCE SHEET			
1 Non-Current Assets	46,593	43,308	39,542
2 Investments	3,345	15,377	16,924
3 Related Party Exposure	8,555	3,912	2,474
4 Current Assets	29,630	21,361	18,883
a Inventories	*16,621*	*10,416*	*12,591*
b Trade Receivables	*1,612*	*2,676*	*834*
5 Total Assets	88,123	83,958	77,822
6 Current Liabilities	21,985	25,444	18,179
a Trade Payables	*2,887*	*3,790*	*4,342*
7 Borrowings	34,187	28,587	25,827
8 Related Party Exposure	-	-	-
9 Non-Current Liabilities	3,048	2,793	3,857
10 Net Assets	28,902	27,134	29,959
11 Shareholders' Equity	28,902	27,134	29,959
B INCOME STATEMENT			
1 Sales	81,224	82,060	70,020
a Cost of Good Sold	*(60,495)*	*(58,354)*	*(45,984)*
2 Gross Profit	20,730	23,706	24,035
a Operating Expenses	(2,429)	(1,898)	(1,059)
3 Operating Profit	18,301	21,808	22,976
a Non Operating Income or (Expense)	*(7)*	*(2,011)*	*(1,046)*
4 Profit or (Loss) before Interest and Tax	18,295	19,797	21,930
a Total Finance Cost	*(4,197)*	*(3,083)*	*(1,902)*
b Taxation	*(4,867)*	*(5,004)*	*(4,926)*
6 Net Income Or (Loss)	9,231	11,710	15,103
C CASH FLOW STATEMENT			
a Free Cash Flows from Operations (FCFO)	*14,430*	*19,870*	*20,714*
b Net Cash from Operating Activities before Working Capital	*9,898*	*17,559*	*19,360*
c Changes in Working Capital	*(7,876)*	*1,682*	*(6,024)*
1 Net Cash provided by Operating Activities	2,023	19,241	13,336
2 Net Cash (Used in) or Available From Investing Activities	3,006	(7,883)	(9,717)
3 Net Cash (Used in) or Available From Financing Activities	(11,288)	(14,039)	(12,109)
4 Net Cash generated or (Used) during the period	(6,259)	(2,680)	(8,489)
D RATIO ANALYSIS			
1 Performance			
a Sales Growth (for the period)	-1.0%	17.2%	98.2%
b Gross Profit Margin	25.5%	28.9%	34.3%
c Net Profit Margin	11.4%	14.3%	21.6%
d Cash Conversion Efficiency (FCFO adjusted for Working C	8.1%	26.3%	21.0%
*e Return on Equity [Net Profit Margin * Asset Turnover * (T*	32.9%	41.0%	53.9%
2 Working Capital Management			
a Gross Working Capital (Average Days)	71	59	53
b Net Working Capital (Average Days)	56	41	33
c Current Ratio (Current Assets / Current Liabilities)	1.3	0.8	1.0
3 Coverages			
a EBITDA / Finance Cost	4.9	10.0	14.3
b FCFO / Finance Cost+CMLTB+Excess STB	1.7	2.2	2.9
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Fi	2.6	1.6	1.3
4 Capital Structure			
a Total Borrowings / (Total Borrowings+Shareholders' Equit	54.2%	51.3%	46.3%
b Interest or Markup Payable (Days)	38.3	58.3	94.6
c Entity Average Borrowing Rate	15.3%	11.0%	7.0%

Credit Rating

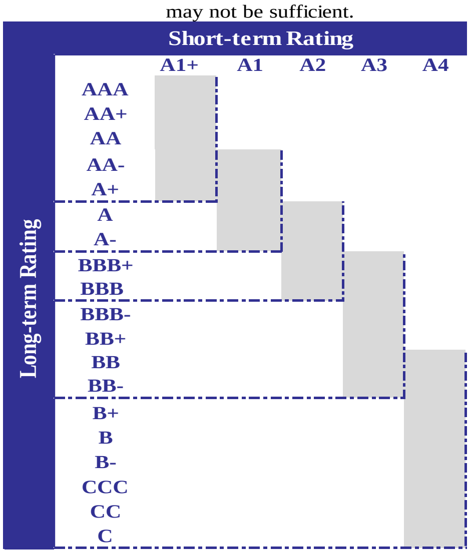
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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):

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

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(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)

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(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 | 17-(a)
(19) PACRA reviews all the outstanding ratings periodically, on annual basis; Provided that public dissemination of annual review and, in an instance of change in rating will be made; | Chapter III | 17-(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 | 17-(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 | 17-(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 | 14-3(f)(vii)
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