



Rating Action

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PACRA SEES TOUGH ROAD AHEAD FOR THE CEMENT INDUSTRY

Pakistan's economy grew impressively during last five years with an average GDP growth rate of around 7%. Cement industry has a positive correlation with the GDP growth rate. The major domestic demand drivers for the sector are Public Sector Development Programs (infrastructure), real estate and industrial construction. The conducive economic environment not only fueled the local demand but also provided impetus for capacity expansion. Resultantly, the industry added significant capacity recently, while several new production lines are scheduled to commence operations shortly. During this period, the cement manufacturers also established export operations by catering to the growing demand of regional economies. This, while stabilizing the local cement prices, had a positive impact on capacity utilization and margins.

The sector is currently facing stern challenges emanating from a wide spectrum of socio-economic risks including contracting economic activities, slowdown in GDP growth and construction activities, and high input costs. These negative developments, alongwith the prevailing credit crunch and rising interest rates, have further constrained the industry's prospects.

Although the local demand dwindled significantly in 1QFY09 (around 15% decline), strong growth in exports has provided support to the industry in the form of largely sustained capacity utilization and price stability. However, given the global economic recession, export demand is expected to come down. This would negatively impact the margins and put pressure on local prices that could lead to a price war among producers. The looming supply overhang scenario in the sector could potentially worsen the situation. Furthermore, regional markets – mainly India and China – could also emerge as competitors in the export market, following a slowdown in their domestic economies and enhanced production capacity.

Profitability of the sector has come under pressure due to high energy cost (comprising around 50% of total raw material costs) and increasing financial expenses. Although international energy prices have declined recently, any beneficial impact on margins has largely been negated by substantial depreciation in Pak Rupee. PACRA, therefore, believes that the performance of the cement companies could weaken further impacting their financial profile. Keeping these developments in view, the outlook on the sector is negative. The negative outlook implies that PACRA perceives downward pressure on the ratings within the industry, especially for highly leveraged entities.



PACRA, as a part of its ongoing surveillance, is monitoring all developments very closely, and may take a client specific rating action wherever it is deemed appropriate.

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