The Pakistan Credit Rating Agency Limited

Rating Report

D.G. Khan Cement Company Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
	AA-	A1+	Stable	Maintain	-
16-Nov-2018	AA-	A1+	Stable	Maintain	-
04-May-2018	AA-	A1+	Stable	Initial	-

Rating Rationale and Key Rating Drivers

DG Khan Cement's ratings reflect company's strong position in the cement industry emanating from its third highest market share in terms of capacity. The company's two existing manufacturing units (Khairpur Site and DG Khan Site) are operating at full capacity. The company lately added a new plant at South region-Hub of 2.9 M tpa capacity which is helping the company in improving its market share amid industry wide capacity expansions. Upcoming industry wide expansions of ~11.7mln tpa (North Region only) commissioning by Sep-19 and slowdown in the growth of local demand seems a challenge. The demand needs to be up to secure companies' margin. Export is another avenue. Industry wide exports (sizeable increase in South Region) have gone up due to muted growth in local demand. A new export window is created in Bangladesh market. Previously, cement exports were seen at its peak after financial crisis in 2008. DG Khan through its Hub plant is exporting sizeable amount of clinker to Bangladesh. The company is eying new export fronts and exploring new opportunities to channel exports in cost-efficient manner because the Bangladesh market won't stay for longer. The profitability of the company was on average as compared to peers, because of the underutilization of the new Hub plant and mainly cost structure. Resultantly, EBITDA margins of the company squeezed. Lately, the coal prices showed downward trend due to cutdown of imports by China are expected to remain range bound in medium term. The company's bottom line supported by the established dividend stream of the company from investments in Nishat Group companies - mainly MCB Bank. The company's financial profile reflects moderate leveraging; cashflows and coverages impacted because of declined profitability and increase in debt. The rating takes into account the association company with Nishat Group.

The ratings are dependent on upholding of the company's business vis-à-vis financial risk profile. Any significant deterioration in the sector's outlook particularly slowdown in economic growth, interest rate fluctuation and delay in infrastructure projects may affect the ratings. Industry's dynamics encompassing expected challenges of substantial decline in local demand or deterioration in cement prices will negatively affect the ratings.

Disclosure

Name of Rated Entity	D.G. Khan Cement Company Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-18),Methodology | Criteria | Rating Modifier(Jun-18),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
Related Research	Sector Study | Cement(Nov-18)
Rating Analysts	Saliha Sajid | saliha.sajid@pacra.com | +92-42-35869504

Profile

Legal Structure DG Khan Cement Company Limited (D.G. Khan) is a public limited company by shares incorporated in Pakistan in 1978 under the companies Act, 1913. The company is listed on Pakistan Stock Exchange (PSX). The company's registered office is located in 53-A, Lawrence Road, Lahore.

Background Mian Mohammad Yahya (a founder of Nishat Group), beginning with a cotton export house, he soon branched out into ginning, cotton and jute textiles, chemicals, cement and insurance. D.G Khan cement is a part of Nishat Group - renowned business group of Pakistan.

Operations DG Khan Cement is primarily engaged in the manufacturing and sale of Clinker, Ordinary Portland Cement and Sulphate Resistant Cement.

Ownership

Ownership Structure DG Khan Cement is majority owned (48.9%) by Nishat Group mainly through group companies (32%), followed by sponsor family members (~17%). Other is mainly owned by general public.

Stability The ownership of the Company remained the same for many years. Going forward, as the DG Khan Cement is Flagship Company of group, the sponsor will ensure the stability of the Company.

Business Acumen The business acumen of the shareholders is considered very strong.

Financial Strength Nishat's total assets are about PKR 2 trillion (USD 16 billion), net worth is about PKR 440 billion (USD 4 billion) and revenue generation is about PKR 275 billion (USD 2.5 billion) in 2017. The group has a history of successfully managed and distinguished corporate structures.

Governance

Board Structure The overall control of the company vests in seven member board of directors. Two board members (including CEO) hold executive positions while four are non-executives and one independent director.

Members' Profile Board member's business acumen is considered very strong because of their long association with the company and presence on board of other group companies. Mr. Mahmood Akhtar joined board on March 5th, 2019 because of demise of one director of DG Khan Cement.

Board Effectiveness There are Audit and Human Resource Committee in place to assist the board. Audit Committee reports to the board in line with code of corporate governance.

Financial Transparency M/s. A.F. Ferguson & Co. Chartered Accountants, 'A' SBP panel member, the external auditors have given unqualified opinion on the company's financial statements for the year ended Jun-18.

Management

Organizational Structure DG Khan Cement has a multi-tier organizational structure, divided into four key functions, namely (i) Finance, (ii) Marketing, (iii) Technical and Operations, and (iv) IT. Each function is headed by a separate director who, in turn, reports to the CEO except internal audit function.

Management Team The CEO, Mr. Raza Mansha, is a graduate from University of Pennsylvania and is associated with the company in capacity of CEO since 2003. Mr. Raza is involved in all strategic and key business and financial decisions of the company. The management is equipped with strong technical skills and enjoys long association with the company.

Effectiveness The company has executive committee in place. All the heads meet on regular basis to discuss the company matters and to ensure smooth running of operations.

MIS Daily reporting encompass daily, monthly and yearly comparisons along with month to date and year to date figures from each manufacturing site. System generates monthly accounts which are accessible through cloud.

Control Environment DG Khan Cement deploys an Oracle based ERP solution implemented at head office, all manufacturing sites and sales offices. DG Khan Cement has two manufacturing units located in 'Khairpur and DG Khan' – both categorized in North Region and third in Hub Baluhistan in South region. Plants are of European technology. Accredited with local and international certifications.

Business Risk

Industry Dynamics Cement industry is divided into North and South region – majority players operating in North region. Cement industry undergoing expansions with majority capacities commencing operations in FY20. During 1HFY19, domestic dispatches inched down by 1%, exports up by 72% and total cement dispatches inched down by 4%. Previously, cement exports were seen at its peak after financial crisis in 2008. Currently, exports to Afghanistan and India also witnessed downtrend by ~22% and ~5% YoY. However, exports via sea to Bangladesh witnessed uptrend of 58%. Margins of industry players came under pressure driven by escalation of international coal prices (8HFY19: $96, FY18: $90, FY17: $77, F16: $53), rupee depreciation and unsustainable cement prices (especially in north region) due to slowdown in local demand. Lately, the coal prices showed downward trend due to cut down of imports by China- are expected to remain range bound in medium term. Currently, leveraging of industry is moderate but in increasing interest rates environment it is critical for cement players to vigilantly manage cost structure. Cement demand is expected to stay nominal (at least for upcoming one year) as new government's prerogative for infrastructure will take some time to materialize.

Relative Position DG Khan Cement Company operates with a cement production capacity of 7.1mln tons p.a.; the third largest player, having 13% share of the country's cement capacity (operational) as at Jan-19.

Revenues During FY18, DG Khan Cement reported revenue of PKR 30.7bln (FY17: PKR 30.1bln), demonstrating marginal growth of 1.9% due to economical slowdown. Volumetric sales analysis reveals that sales mix remained tilted towards local market (90%) and exports (10%) – in line with industry trend. Dividend income (FY18: PKR 1.9bln; FY17: PKR 1.9bln) from strategic investments in group companies strengthened the revenue stream. Finance costs increased to PKR 519mln (FY17: PKR 383mln) on account of increase in short term borrowing and long term debt. Other expenses of PKR 2.4bln mainly impairment charged on operating fixed assets deteriorated the profits. Tax benefit from the green filed expansion helped the bottom line. Hence, the net profit stood at PKR 8.8bln, up by ~11% YoY. During 1HFY19, the Company recorded turnover of PKR 19.8bln. Company started exporting to Bangladesh as the South plant started production after Jul-18. Dividend income from the related parties of PKR 1.1bln supported the bottom-line. Hence, the net profit figure stood at PKR 1.7bln.

Margins During FY18, the uptick in coal prices – average FY18 (ex-Richards Bay): USD ~90/M. ton, average FY17 (ex-Richards Bay): USD ~77/ton, average FY16 (ex-Richards Bay): USD 57/ton and Pak rupee depreciation resulted in decrease in the company's margins; Gross and EBITDA margin declined to 28.5% (FY17: 39.3%) and 25.7% (FY17: 38.3%) respectively. In 1HFY19, Gross and EBITDA margins deteriorated to 16.0% and 14.9% respectively as compared to FY18. Lately, the coal prices showed downward trend due to cutdown of imports by China - are expected to remain range bound in medium term; which may provide room for margins.

Sustainability Going forward, management is focused on sustaining its cost leadership and performance uptrend, while comfortably servicing long-term debt.

Financial Risk

Working Capital During 1HFY19, DGKCC's working capital requirements, represented by net cash cycle (net working capital days) – a function of inventory, receivables and payables – stood at -7days (end-Jun18: -13days) which is considered better. The company manages its working capital requirements through mix of internal generation and short term borrowings. At 1HFY19, the company reported STBs of PKR 14.4bln (FY18: PKR 12.2bln) as the company's internal cash flow coming down; primarily due to greater working capital requirements.

Coverages During 1HFY19, EBITDA clocked in at PKR 3.9bln (FY18: PKR 9.1bln). Hence, declined free cash flows YOY (1HFY19: PKR 3.3bln; FY18: PKR 7.1bln). Ineterest coverage ratio deteriorated as compared to previous year at 2.6x and 14.6x at 1HFY19 and FY18 respectively. Going forward, coverages of the company are expected to remain range bound.

Capitalization During 1HFY19, long-term debt increased to PKR 22.1bln (FY18: PKR 20.1bln) subsequently debt to debt plus equity ratio increased to ~33% (FY18: 30%). The company has short term borrowing of PKR 14.4bln which is ~40% of the total debt. During FY18, the Company announced dividend @ PKR 4.25/share with a cumulative value of PKR 1.86bln.

Cement
Financials (Summary) in PKR mln
The Pakistan Credit Rating Agency Limited

DG Khan Cement Company
Listed Public Limited

A	BALANCE SHEET	Dec-18	Jun-18	Jun-17	Jun-16
		6M	12M	12M	12M
1	**Non-Current Assets**	**77,594**	**76,554**	**62,507**	**39,635**
2	**Investments**	**30,398**	**33,284**	**36,614**	**30,790**
a	Equity Instruments	29,398	32,284	35,614	30,790
b	Debt Instruments	1,000	1,000	1,000	-
3	**Current Assets**	**15,507**	**12,051**	**9,251**	**12,994**
a	Inventory	2,714	1,378	1,163	767
b	Trade Receivables	1,362	188	220	202
c	Others	11,432	10,485	7,868	12,026
4	**Total Assets**	**123,500**	**121,889**	**108,371**	**83,418**
5	**Borrowings**	**36,459**	**32,277**	**21,615**	**7,002**
a	Short-Term	14,389	12,210	8,571	3,451
b	Long-Term (Incl. CMLTB)	22,069	20,067	13,044	3,551
6	Other Short-Term Liabilities	8,471	8,007	5,755	5,454
7	Other Long-Term Liabilities	4,090	4,471	6,133	5,178
8	**Shareholder's Equity**	**74,480**	**77,134**	**74,869**	**65,783**
9	**Total Liabilities & Equity**	**123,500**	**121,889**	**108,371**	**83,418**

B	INCOME STATEMENT	Dec-18	Jun-18	Jun-17	Jun-16
1	**Sales**	**19,767**	**30,668**	**30,136**	**29,704**
2	**Gross Profit**	3,185	8,740	11,845	12,668
3	Non Operating Income	713	672	1,227	1,465
4	Total Finance Cost	(1,348)	(519)	(383)	(130)
5	**Net Income**	**1,742**	**8,838**	**7,975**	**8,790**

C	CASH FLOW STATEMENT	Dec-18	Jun-18	Jun-17	Jun-16
1	Free Cash Flow from Operations (FCFO)	3,307	7,182	8,629	10,098
2	Total Cashflows (TCF)	4,373	9,184	10,607	11,969
3	Net Cash changes in Working Capital	(2,494)	2,117	(2,533)	1,126
4	Net Cash from Operating Activities	774	10,913	7,855	12,991
5	Net Cash from InvestingActivities	(2,895)	(18,073)	(26,408)	(7,778)
6	Net Cash from Financing Activities	151	3,706	6,861	(36)
7	Net Cash generated during the period	(1,971)	(3,455)	(11,691)	5,177

D	RATIO ANALYSIS	Dec-18	Jun-18	Jun-17	Jun-16
1	**Performance**				
a	Sales Growth (for the period)	29%	2%	1%	14%
b	Gross Profit Margin	16%	28%	39%	43%
c	Net Profit Margin	9%	29%	26%	30%
d	Return of Equity	5%	12%	11%	14%
2	**Working Capital Management**				
a	Gross Working Capital (Inventory Days + Receivable Days)	26.0	17.5	14.2	17.2
b	Net Working Capital (Inventory Days + Receivable Days - Payable Days)	-7.3	-12.7	-6.0	1.3
3	**Coverages**				
a	Debt Service Coverage (FCFO / Finance Cost+CMLTB+Excess STB)	0.5	0.7	1.5	8.0
b	Interest Coverage (FCFO / Finance Cost)	2.6	14.6	25.0	95.2
c	Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	7.3	4.2	2.2	0.4
4	**Capital Structure (Total Debt/Total Debt+Equity)**				
a	Capital Structure (Current Borrowings / Total Borrowings)	-7	-13	-6	1
b	Capital Structure (Total Borrowings / Total Borrowings+Equity)	33%	30%	22%	10%

Rating Scale

Credit Rating Scale & Definitions

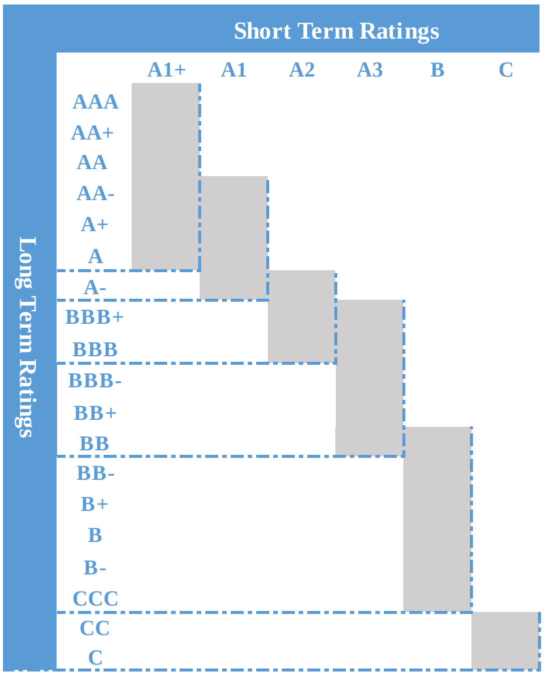
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings

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 Ratings

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 conditions.
B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
C	An inadequate capacity to ensure timely repayment.



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, a) some material identifiable event and/or b) deviation from expected trend. 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 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) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) 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.

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.
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(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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