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
04-May-2018	AA-	A1+	Stable	Initial	-

Rating Rationale and Key Rating Drivers

DG Khan Cement's rating 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 profitability is fortified by cost-efficient operational framework translating in strong EBITDA margins. The company has planned commencement of its third manufacturing unit (Hub Site) in Jun-18 which will add capacity of 2.7mln tpa to the company's existing capacity. This will assist the company in improving its market share amid industry wide capacity expansions going on. In addition to this, the company is eyeing new export fronts and exploring new opportunities to channel exports in cost-efficient manner. The business profile of the company is strengthened by high capacity utilization, strong local demand, rebounding dispatches on exports front. Furthermore, the established dividend stream of the company from investments in Nishat Group companies continues to augment the bottom-line of the company. The company's financial risk remains low mainly reflected from moderately leveraged capital structure and robust equity base. The rating derive benefit/comfort from (i) the company's association with Nishat Group, (ii) strong local demand on the back of rising economic and infrastructure activity.

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 any unfavorable change in demand and expansion matrix, thereby exerting pressure on prices and margins, may negatively impact 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 Rating Methodology(Jul-17),Methodology | Correlation between long-term and short-term rating scale(Jun-17),Methodology | Criteria Modifiers(Jun-17)
Related Research	Sector Study | Cement(Nov-17)
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DG KHAN CEMENT COMPANY LIMITED (DGKCC) PROFILE	
Incorporated	1992
Major Business	DG Khan Cement is engaged in manufacturing, marketing and sale of Ordinary Portland Cement
Legal Status	Listed
Head Office	Lahore

OWNERSHIP & GROUP PROFILE — STRONG

- DG Khan Cement is owned by Nishat Group through associated companies (32%) and sponsor family members (~17%)
- Nishat Group is one of the renowned business families of the country. The group has diversified business interests in different sectors such as commercial banking, textile, cement, Insurance, hotel and properties, paper and products, dairy and etc.

GOVERNANCE — STRONG

- 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 including one independent director.
- 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.
- The auditors of the company M/s. A.F. Ferguson & Co., Chartered Accountants, issued an unqualified audit opinion pertaining to annual financial statements for FY17.

MANAGEMENT — STRONG

- The CEO, Mr. Raza Mansha 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 Director Finance, Mr. Aftab Ahmed Khan, is a fellow member ICAP and has been associated with the company since last 25 years. The CFO, Mr. Inayat Ullah Niazi is associated with the company since last 35 years. The Director Finance and CFO serve as directors on board of various Nishat Group companies.
- The organizational structure is divided into four functional departments, namely: (1) Finance, (2) Marketing, (3) Technical & Operations, and (4) Information Technology. The Internal Audit department reports to the audit committee.

SYSTEMS & CONTROLS — STRONG

- DG Khan Cement has two manufacturing units located in 'Khairpur and DG Khan' – both categorized in North Region. The third manufacturing unit of the company is under construction at Hub Site. Plants are of European technology.
- Accredited with local and international certifications, DG Khan Cement ensure production of quality cement.
- DG Khan Cement deploys an Oracle based ERP solution implemented at head office, all manufacturing sites and sales offices.

PERFORMANCE — STRONG

- DG Khan Cement's sales have maintained growth trajectory in last few years. During FY17, turnover was recorded at PKR 30.1bln (FY16: PKR 29.7bln), demonstrating marginal growth of 1.5%; Volumetric sales analysis reveals that sales mix remained tilted towards local market (87%) and exports (13%) – in line with industry trend
- Sales volume analysis revealed that local dispatches witnessed marginal growth of 1.3% (FY16: ~15%) primarily due to lower industry growth witnessed in FY17 of 8% only (FY16: 17%); Capacity Utilization Levels remained robust (FY17: 107%, FY16: ~99%) against capacity utilization of industry of 87% during FY17
- Gross and EBITDA margins declined to 39.3% and 39% (FY16: 42.6% and 43%) respectively mainly due to spike in international prices of coal; however, Dividend income (FY17: PKR 1.9bln; FY16: PKR 1.8bln) from strategic investments in group companies augmented the revenue stream. Finance costs of the company increased to PKR 383mln (FY16: PKR 130mln) on account of increase in long term debt. Hence, the company posted profits of PKR 7.9bln, down 9% YoY
- During 1HFY18, the company's revenues stood at PKR 15.7bln; Gross and EBITDA margins declined further to 33.3% and 33.5% respectively; investment portfolio (as at end-Dec17: PKR 36bln) constitutes 48% of the equity base of the company
- Going forward, the company's third manufacturing site (2.7mln tpa capacity) is expected to come online in Jun-18. This manufacturing unit will come online at Hub Site and will cater the market needs of lower Punjab and Sindh. The cost of project is PKR 43bln and is financed by 45:55 debt to equity ratio. The equity portion was financed by internally generated cash flows by the company.

FINANCIAL RISK — STRONG

- During FY17, DGKCC's working capital requirements, represented by net cash cycle (net working capital days) – a function of inventory, receivables and payables – stood at -4days (end-Jun16: -2days). The company manages its working capital requirements through mix of internal generation and short term borrowings.
- Core coverages ratio stood at 1.5x and 1.7x at end-Dec17 and end-Jun17 respectively
- The company is moderately leveraged at ~28% as at end-Dec17. Furthermore, the company has short term borrowing of PKR 8.8bln which is 31% of the total debt. Going forward, leveraging is not expected to increase.

Cement

The Pakistan Credit Rating Agency Limited — Financials (Summary)

PKR mln

DG Khan Cement Company Limited (DGKCC)

BALANCE SHEET	31-Dec-17	30-Jun-17	30-Jun-16
	1H	Annual	Annual
Non-Current Assets	**69,131**	**62,507**	**39,635**
Investments (Incl. associates)	**36,197**	**35,608**	**30,767**
Equity	36,197	35,608	30,767
Mutual Funds	-	-	-
Investment Property	-	-	-
Current Assets	**10,474**	**10,257**	**13,017**
Stores and Spares	6,296	4,939	4,006
Inventory	602	1,163	767
Others	3,576	4,154	8,244
Total Assets	**115,802**	**108,371**	**83,418**
Debt	**28,498**	**21,614**	**7,002**
Short-term	8,820	8,571	3,451
Long-term (Inlc. Current Maturity of long-term debt)	19,678	13,043	3,551
Other short-term liabilities	6,227	5,755	5,454
Other Long-term Liabilities	6,300	6,133	5,178
Shareholder's Equity	**74,778**	**74,869**	**65,783**
Total Liabilities & Equity	**115,802**	**108,371**	**83,418**
INCOME STATEMENT			
Turnover	**15,764**	**30,136**	**29,704**
Gross Profit	5,250	11,845	12,668
Operating Profit / (Loss)	4,494	10,314	11,146
Financial Charges	(193)	(383)	(130)
Net Income	**3,734**	**7,975**	**8,790**
Cashflow Statement			
Free Cashflow from Operations (FCFO)	4,563	8,629	10,098
Net Cash changes in Working Capital	(26)	(2,533)	1,126
Net Cash from Operating Activities	5,507	7,855	12,991
Net Cash from InvestingActivities	(7,756)	(26,408)	(7,778)
Net Cash from Financing Activities	3,313	6,861	(36)
Net Cash generated during the period	1,064	(11,691)	5,177
Ratio Analysis			
Performance			
Turnover Growth	7.3%	1.5%	13.8%
Gross Margin	33.3%	39.3%	42.6%
Net Margin	23.7%	26.5%	29.6%
ROE	5.1%	11.0%	14.1%
Coverages			
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB)	1.5	1.7	7.9
Interest Coverage (x) (FCFO/Gross Interest)	23.7	22.5	77.4
Debt Payback (Years) (Total Lt.Debt (excluding Covered Short Term Borrowings) / FC	2.8	2.1	0.4
Liquidity			
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	-6	-4	-2
Capital Structure (Total Debt/Total Debt+Equity)	27.6%	22.4%	9.6%

The Pakistan Credit Rating Agency Limited

ENTITY CREDIT RATING SCALE & DEFINITIONS

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity; 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 or 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.** "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.

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. Rating Watch may carry designation – Positive (rating may be raised, negative (lowered), or developing (direction is unclear). A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled.

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 or 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'.

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, a suspended 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, or e) the entity/issuer defaults.

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)
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