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
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 profitability is fortified by cost-efficient operational framework translating in healthy EBITDA margins. The third manufacturing unit of the company has started its operations at Hub site which added 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. In addition to this, the company is eying 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 profile reflects moderate leveraging, however comfort can be drawn from good operating cashflows, supplemented by dividend stream. Association of the company with Nishat Group is a consideration.

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 slowdown in economic growth, interest rate fluctuation and delay in infrastructure projects may affect the ratings. Industry’s dynamics encompassing expected challenges of supply glut, 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	Sehar Fatima | sehar.fatima@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 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. DG Khan Cement's production facilities are located in North region (Khairpur and Dera Ghazi Khan). The company's third production site located at Hub which is lately commenced.

Ownership

Ownership Structure DG Khan Cement is majority owned (48.7%) by Nishat Group mainly through group companies (32%), followed by sponsor family members (~17%). Other shares are held by different Financial Institutions, Insurance Companies and General Public.

Stability Nishat group is considered one of the renowned business families of Pakistan. The group has diversified business interests in commercial banking, textile, cement, Insurance, hotel and properties, paper products, dairy and etc.

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

Financial Strength Nishat Group (Profit at end-Jun16: PKR 10bln; end-Jun15: PKR 10bln) has interests in commercial banking, textile, cement, Insurance, hotel and properties, paper products, dairy and etc. 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, including 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.

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. The company has internal audit function which reports directly to the board Audit Committee.

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

Business Risk

Industry Dynamics Cement industry is divided into North and South region – majority players operating in North region. Currently, cement industry is going through phase of capacity expansion. Cement industry dispatches remained tilted towards locals sales. Market dynamics has changed significantly in last year driven by escalation of international coal prices, increased FED and fluctuation in cement prices (especially in north region). Hence, Cement players witnessed significant dip in margins. Currently, leveraging of industry is moderate but in increasing interest rates environment it is critical for cement players to vigilantly manage cost structure. Going forward – with full utilization of lately commenced plants – industry is expected to face expanded capacity challenge. Cement prices and margins are expected to stay under stress. Cement demand is expected to stay nominal (at least for upcoming two years) as new government's prerogative for infrastructure will take some time to materialize. Therefore, upcoming capacity expansion utilization will be challenging factor.

Relative Position DG Khan Cement Company operates with a cement production capacity of 4.2mln tons p.a.; the third largest player, having 13% share of the country's cement capacity (operational).

Revenues During FY18, turnover was recorded at PKR 30.6bln (FY17: PKR 30.1bln), remained sustained; Volumetric sales analysis reveals that sales mix remained tilted towards local market (90%) and exports (10%) – in line with industry trend. Sales volume analysis revealed that local dispatches witnessed growth of 11.4% (FY17: ~18%), primarily due to the industry growth witnessed in FY18 of 15% (FY17: 8%). Capacity Utilization Levels remained robust (FY18: 107%, FY17: 107%) against capacity utilization of industry of 85% during FY18. During 1QFY19, the company recorded turnover of PKR 8.2bln.

Margins Gross and EBITDA margins declined to 28.5% and 29.6% (FY17: 39.3% and 39.0%) respectively mainly due to spike in international prices of coal, however, consistent dividend income (FY18: PKR 1.9bln; FY17: PKR 1.9bln) from strategic investments in group companies augmented the revenue stream. Finance costs of the company increased to PKR 519mln (FY17: PKR 383mln) on account of increase in long term financing. Hence, the company posted profits of PKR 8.8bln, up 11% YoY. During 1QFY19, gross and EBITDA margins further declined to 12.7% and 23.4% respectively. Dividend income from the related parties of PKR 1.3bln supported the bottom-line to stand at PKR 3.7bln.

Sustainability DG Khan Cement Company has strategic investments in nishat group companies. As at end-Jun18, the company had investment portfolio of PKR 32.3bln (as at end-Jun16: PKR 35.6bln) which equates to 42% of the company's equity base. These investments consists of 7.27% shareholding in MCB – leading commercial bank of the country, 8.61% share in Nihat Mills Limited – textile conglomerate of nishat group and 7.78% share in Adamjee Insurance Company Limited – one of the leading insurance companies of Pakistan. Furthermore, DGKCC has 55% shareholding in Nishat Paper Products Co. Ltd, 55.1% in Nishat Dairy (Pvt.) Ltd and 12.50% in Nishat Hotels and Properties Ltd.

Financial Risk

Working Capital During FY18, DGKCC's working capital requirements, represented by net cash cycle (net working capital days) – a function of inventory, receivables and payables – stood at -13days (end-Sep18: -11days, end-Jun17: -6days). The company manages its working capital requirements through mix of internal generation and short term borrowings.

Coverages During FY18, decline in FCFO (as at end-Jun18: PKR 7.2bln; at end-Jun17: PKR 8.6bln) and increase in finance cost - on account of increase in leveraging and KIBOR both - resulted in decreased interest coverage ratio. Hence, the core coverage ratio was below the comfortable level (1QFY19: 0.5x, FY18: 0.7x, FY17: 1.7x).

Capitalization The company is moderately leveraged at ~31% as at end-Sep18. Furthermore, the company has short term borrowing of PKR 14.9bln which is 42% of the total debt. Going forward, leveraging is not expected to increase as no announced projects are in pipeline.

PKR mln

DG Khan Cement Company Limited (DGKCC)

BALANCE SHEET	30-Sep-18	30-Jun-18	30-Jun-17	30-Jun-16	30-Jun-15
	1Q	Annual	Annual	Annual	Annual
Non-Current Assets	**76,425**	**76,554**	**62,507**	**39,635**	**30,047**
Investments (Incl. associates)	**33,590**	**33,278**	**35,608**	**30,767**	**37,774**
Equity	33,590	33,278	35,608	30,767	37,774
Mutual Funds	-	-	-	-	-
Investment Property	-	-	-	-	
Current Assets	**16,978**	**12,057**	**10,257**	**13,017**	**6,571**
Stores and Spares	7,814	5,114	4,939	4,006	3,636
Inventory	3,156	1,378	1,163	767	1,188
Others	6,008	5,565	4,154	8,244	1,746
Total Assets	**126,993**	**121,889**	**108,371**	**83,418**	**74,391**
Debt	**35,458**	**32,277**	**21,614**	**7,002**	**3,187**
Short-term	14,982	12,210	8,571	3,451	1,826
Long-term (Inlc. Current Maturity of long-term debt)	20,476	20,067	13,043	3,551	1,361
Other short-term liabilities	9,147	8,007	5,755	5,454	4,110
Other Long-term Liabilities	4,574	4,471	6,133	5,178	4,798
Shareholder's Equity	**77,814**	**77,134**	**74,869**	**65,783**	**62,296**
Total Liabilities & Equity	**126,993**	**121,889**	**108,371**	**83,418**	**74,391**
INCOME STATEMENT					
Turnover	**8,186**	**30,668**	**30,136**	**29,704**	**26,105**
Gross Profit	1,037	8,740	11,845	12,668	9,455
Operating Profit / (Loss)	691	7,217	10,314	11,146	8,236
Financial Charges	(612)	(519)	(383)	(130)	(282)
Net Income	**418**	**8,838**	**7,975**	**8,790**	**7,625**
Cashflow Statement					
Free Cashflow from Operations (FCFO)	1,517	7,182	8,629	10,098	8,363
Net Cash changes in Working Capital	(3,276)	2,117	(2,533)	1,126	1,904
Net Cash from Operating Activities	(1,781)	10,913	7,855	12,991	11,697
Net Cash from InvestingActivities	(1,094)	(18,073)	(26,408)	(7,778)	(9,581)
Net Cash from Financing Activities	408	3,706	6,861	(36)	(2,385)
Net Cash generated during the period	(2,466)	(3,455)	(11,691)	5,177	(269)
Ratio Analysis					
Performance					
Turnover Growth	8.7%	1.8%	1.5%	13.8%	n.a
Gross Margin	12.7%	28.5%	39.3%	42.6%	36.2%
Net Margin	5.1%	28.8%	26.5%	29.6%	29.2%
ROE	0.6%	12.1%	12.0%	14.1%	12.2%
Coverages					
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB)	0.5	0.7	1.7	7.9	9.0
Interest Coverage (x) (FCFO/Gross Interest)	2.5	13.8	22.5	77.4	29.7
Debt Payback (Years) (Total Lt.Debt (excluding Covered Short Term Borrowings) / FCF	7.6	4.2	2.1	0.4	0.2
Liquidity					
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	-11	-13	-6	-2	8
Capital Structure (Total Debt/Total Debt+Equity)	31.3%	29.5%	22.4%	9.6%	4.9%

Credit Rating Scale & Definitions

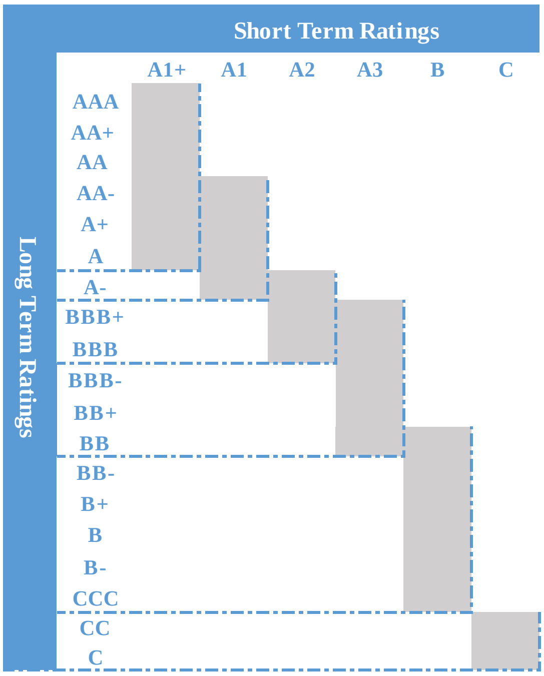
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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.

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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(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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