



The Pakistan Credit Rating Agency Limited

## Rating Report

### D.G. Khan Cement Company Limited

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#### Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
28-Sep-2019	AA-	A1+	Stable	Maintain	-
30-Mar-2019	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. As of 9MFY19, the company's two existing manufacturing units (Khairpur Site and DG Khan Site) are operating at a capacity utilization levels of ~89% (FY18: ~114%). Last year, the company added a new plant at South region-Hub of 2.9 M tpa capacity which assisted the company in improving its market share amid industry wide capacity expansions. Upcoming industry wide expansions of ~7mln tpa (North Region only) commissioning in next six months and slowdown in the 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 has taken a dip. Resultantly, EBITDA margins of the company squeezed. The company's bottom line is supported by the established dividend stream of the company from investments in Nishat Group companies - mainly MCB Bank. Revival in profitability and EBITDA is crucial, going forward. 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 improvement of the company's business vis-à-vis financial risk profile. 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	PACRA_Methodology_Corporate_FY19(Jun-19),PACRA_Criteria_LT ST Relationship_FY19(Jun-19),PACRA_Criteria_Rating Modifiers_FY19(Jun-19)
Related Research	Sector Study   Cement(Sep-19)
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** 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 Baluhsitan 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 (76%) operational capacity exists in North region. Industry has achieved its majority capacity expansions in last two years of around 14mln tons per annum. During FY19, north region witnessed 5% and 18% decline in local and export dispatches respectively attributable to contractionary fiscal policy, slowdown in large infrastructural activities and low demand from Afghanistan and India (export avenues). South region witnessed uptrend in dispatches which is correlated with longevity of export window available through sea. Industry dynamics has changed significantly driven by unsustainable cement prices (especially in north region) on account of supply glut recently created, muted demand and rupee depreciation. Cement players witnessed significant dip in margins on account of aforementioned factors. Currently, leveraging of industry is moderate (31% as at end-Mar19) but increased interest rates has amplified the stress on financial risk profile of players. 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 as demand front deemed to stay weak for at least upcoming one year.

**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. During 9MFY19, The company's capacity utilization levels dropped to ~87% (FY18: ~114%) - on back of economic slowdown and demand constraint.

**Revenues** During 9MFY19, DG Khan Cement reported revenue of PKR 30.3bln (FY18: PKR 30.7bln, 9MFY19: PKR 23.3bln), demonstrating YOY growth of ~30% due to addition of Line-III. Company started exporting to Bangladesh as the South plant started production after Jul-18. Volumetric sales analysis reveals that sales mix remained tilted towards local market (9MFY19: 94%; FY18: 90%); trend followed by majority industry players. Dividend income (9MFY19: PKR 3.4bln, FY18: PKR 1.9bln; 9MFY18: PKR 2.5bln) from strategic investments in group companies strengthened the revenue stream. Finance costs increased significantly to PKR 2.3bln (FY18: PKR 519mln, 9MFY18: 318mln) on account of increase in short term borrowing and ballooning interest rates. Hence, the net profit stood at PKR 2.6bln (9MFY18: PKR 4.9bn), down by ~47% YoY.

**Margins** During 9MFY19, the international coal prices witnessed a downstick due to cutdown of imports by China - are expected to remain range bound in medium term; which may provide room for margins. However due to the massive Pak rupee depreciation and fluctuating cement prices, the company's margins suffered; Gross and EBITDA margin declined to ~16% (FY18: 28%, 9MFY18: ~31%) and ~20% (FY18: ~30%, 9MFY18: ~32%) respectively.

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

## Financial Risk

**Working Capital** During 9MFY19, DGKCC's working capital requirements, represented by net cash cycle (net working capital days) – a function of inventory, receivables and payables – stood at -1days (end-Jun18: -13days) which is considered better. The company manages its working capital requirements through mix of internal generation and short term borrowings. At 9MFY19, the company reported STBs of PKR 17.9bln (FY18: PKR 12.2bln) as the company's internal cash flow coming down; primarily due to greater working capital requirements.

**Coverages** During 9MFY19, EBITDA clocked in at PKR 6.0bln (FY18: PKR 9.1bln, 9MFY18: PKR 7.5bln) down by ~20% YOY. Hence, declined free cash flows YOY (9MFY19: PKR 5.6bln; FY18: PKR 7.1bln, 9MFY18: 6.7bln). Interest coverage ratio deteriorated as compared to previous year at 2.6x and 14.6x at 9MFY19 and FY18 respectively. Going forward, coverages of the company are expected to remain range bound.

**Capitalization** During 9MFY19, long-term debt stood at PKR 21.5bln (FY18: PKR 20.1bln) subsequently debt to debt plus equity ratio increased to ~34% (FY18: ~30%). The company has short term borrowing of PKR ~18bln which is ~45% of the total debt. Going forward, the leveraging is expected to stay range bound as line-III is already added and no further debt is planned by the company.



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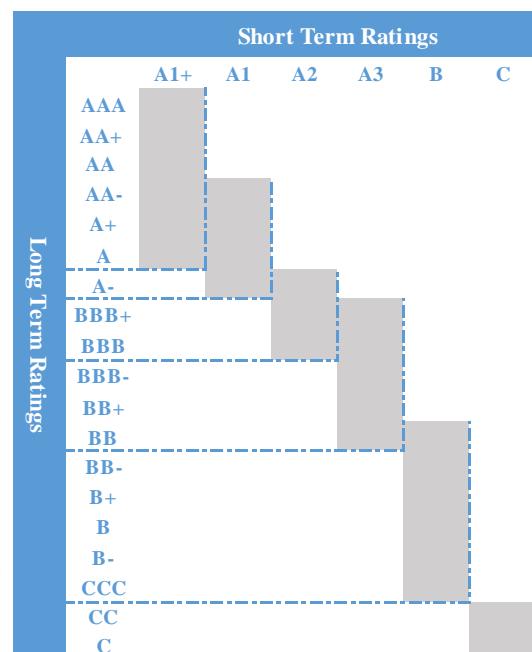
*Financial Summary  
PKR mln*

DG Khan Cement Infrastructure   Cement	Mar-19 9M	Jun-18 12M	Jun-17 12M	Jun-16 12M
<b>A BALANCE SHEET</b>				
1 Non-Current Assets	77,641	76,554	62,507	39,635
2 Investments	-	-	-	-
3 Related Party Exposure	31,039	33,284	36,614	30,790
4 Current Assets	18,990	12,051	9,251	12,994
a Inventories	3,640	1,378	1,163	767
b Trade Receivables	1,625	188	220	202
<b>5 Total Assets</b>	<b>127,670</b>	<b>121,889</b>	<b>108,371</b>	<b>83,418</b>
6 Current Liabilities	8,326	8,007	5,755	5,454
a Trade Payables	3,532	3,559	1,527	1,821
7 Borrowings	39,370	32,277	21,615	7,002
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	4,067	4,471	6,133	5,178
<b>10 Net Assets</b>	<b>75,907</b>	<b>77,134</b>	<b>74,869</b>	<b>65,783</b>
<b>11 Shareholders' Equity</b>	<b>75,907</b>	<b>77,134</b>	<b>74,869</b>	<b>65,783</b>
<b>B INCOME STATEMENT</b>				
1 Sales	30,376	30,668	30,136	29,704
a Cost of Good Sold	(25,410)	(21,928)	(18,292)	(17,036)
<b>2 Gross Profit</b>	<b>4,965</b>	<b>8,740</b>	<b>11,845</b>	<b>12,668</b>
a Operating Expenses	(1,495)	(1,523)	(1,530)	(1,522)
<b>3 Operating Profit</b>	<b>3,470</b>	<b>7,217</b>	<b>10,314</b>	<b>11,146</b>
a Non Operating Income or (Expense)	1,192	672	1,227	1,465
<b>4 Profit or (Loss) before Interest and Tax</b>	<b>4,662</b>	<b>7,889</b>	<b>11,541</b>	<b>12,611</b>
a Total Finance Cost	(2,260)	(519)	(383)	(130)
b Taxation	222	1,468	(3,183)	(3,691)
<b>6 Net Income Or (Loss)</b>	<b>2,625</b>	<b>8,838</b>	<b>7,975</b>	<b>8,790</b>
<b>C CASH FLOW STATEMENT</b>				
a Free Cash Flows from Operations (FCFO)	5,641	7,182	8,629	10,098
b Net Cash from Operating Activities before Working Capital Changes	5,268	8,796	10,388	11,864
c Changes in Working Capital	(6,329)	2,117	(2,533)	1,126
<b>1 Net Cash provided by Operating Activities</b>	<b>(1,062)</b>	<b>10,913</b>	<b>7,855</b>	<b>12,991</b>
<b>2 Net Cash (Used in) or Available From Investing Activities</b>	<b>13,208</b>	<b>(6,000)</b>	<b>(17,837)</b>	<b>(4,376)</b>
<b>3 Net Cash (Used in) or Available From Financing Activities</b>	<b>(454)</b>	<b>3,706</b>	<b>6,861</b>	<b>(36)</b>
<b>4 Net Cash generated or (Used) during the period</b>	<b>11,693</b>	<b>8,618</b>	<b>(3,120)</b>	<b>8,578</b>
<b>D RATIO ANALYSIS</b>				
<b>1 Performance</b>				
a Sales Growth (for the period)	32.1%	1.8%	1.5%	13.8%
b Gross Profit Margin	16.3%	28.5%	39.3%	42.6%
c Net Profit Margin	8.6%	28.8%	26.5%	29.6%
d Cash Conversion Efficiency (EBITDA/Sales)	19.9%	29.6%	39.0%	43.0%
e Return on Equity (ROE)	4.6%	11.6%	11.3%	13.7%
<b>2 Working Capital Management</b>				
a Gross Working Capital (Average Days)	31	18	14	14
b Net Working Capital (Average Days)	-1	-13	-6	-2
c Current Ratio (Total Current Assets/Total Current Liabilities)	2.3	1.5	1.6	2.4
<b>3 Coverages</b>				
a EBITDA / Finance Cost	2.8	18.4	34.0	120.3
b FCFO / Finance Cost+CMLTB+Excess STB	0.5	0.7	1.5	8.0
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	6.2	4.2	2.2	0.4
<b>4 Capital Structure (Total Debt/Total Debt+Equity)</b>				
a Total Borrowings / Total Borrowings+Equity	34.2%	29.5%	22.4%	9.6%
b Interest or Markup Payable (Days)	91.4	257.6	229.3	0.0
c Average Borrowing Rate	8.0%	1.8%	2.4%	2.1%

## 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		Short Term Ratings
<b>AAA</b>	<b>Highest credit quality.</b> Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	<b>A1+</b> The highest capacity for timely repayment.
<b>AA+</b>	<b>Very high credit quality.</b> 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.	<b>A1</b> A strong capacity for timely repayment.
<b>AA</b>		<b>A2</b> A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
<b>AA-</b>		<b>A3</b> An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
<b>A+</b>	<b>High credit quality.</b> 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.	<b>B</b> The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
<b>A</b>		<b>C</b> An inadequate capacity to ensure timely repayment.
<b>A-</b>		
<b>BBB+</b>	<b>Good credit quality.</b> 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.	
<b>BBB</b>		
<b>BBB-</b>		
<b>BB+</b>	<b>Moderate risk.</b> 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>BB</b>		
<b>BB-</b>		
<b>B+</b>	<b>High credit risk.</b> 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.	
<b>B</b>		
<b>B-</b>		
<b>CCC</b>	<b>Very high credit risk.</b> 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.	
<b>CC</b>		
<b>C</b>		
<b>D</b>	Obligations are currently in default.	



**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 surveil the opinion due to lack of requisite information.

**Harmonization** A change in rating due to revision in applicable methodology or underlying scale.

**Disclaimer:** PACRA's ratings are an assessment of the credit standing of entities/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA's opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security's market price or suitability for a particular investor.

## **Regulatory and Supplementary Disclosure**

(Credit Rating Companies Regulations,2016)

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(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)

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- (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 principle 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)

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- (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](http://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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