DEWAN CEMENT LIMITED

RATINGS (JUNE 2006)

DEWAN CEMENT LIMITED

ENTITY	NEW
Long Term	A
Short Term	A1

FINANCIAL DATA

PKR (mln)

	31-Mar-06*	30-June-05
Total Assets	7,748.0	7,356.2
Equity	2,722.0	1,762.9
Operating profits	417.6	315.1
Net Income	127.6	76.0
Gross Margin (%)	25.0	17.9
ROE (%)	7.6	4.2
Total Debt/ Equity (%)	135.1	136.8

* *Based on un-audited results for nine months ended March 31, 2006*

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RATING RATIONALE

ASSESSMENT

- The ratings reflect improving prospects of the company subsequent to acquisition by Dewan Mushtaq Group. The group has followed a well-conceived turnaround strategy involving strengthening of the capital structure, through further equity injection and debt re-profiling, and optimization of the production processes. Despite the anticipated decline in capacity utilization due to substantial capacity expansions across cement sector, any material impact either in sales or margins is unlikely. This is on account of the growing cement demand and likely continuation of producers' understanding. The ratings also, recognize DCM's association with a well-diversified financially strong group as a key factor.
- The new management took control of operations of the company in May 2004 from a sorry state of affairs. Since then the management is embarked upon a focused plan to improve the production and delivery processes of the company. The areas being addressed include a) complete overhaul of plant and machinery with the objective to achieve higher capacity utilization and to minimize unplanned shutdowns, b) de-bottlenecking to increase available capacity, c) efficient fuel utilization including developing multi-fuel – furnace oil, coal and gas – capability, and d) ensuring timely availability of cement at sales points by fostering good relationships with dealers and improving inventory management and delivery systems. These efforts have started bearing fruit, reflective in the company's improving gross margin (3QFY06: 25%, FY05: 18%), which is fast approaching the industry average. DCL, with close proximity to a major consumption center – Karachi – also enjoys a freight-cost advantage compared to its peers.
- The company is in the process of installing a new dry production line of grey cement, which would double the production capacity to 1.89mln tpa. The total estimated project cost of around PKR 2.5bln is to be financed in the debt equity ratio of 34:66. The equity portion of PKR 825mln has been injected and the debt draw down has started. The enhanced capacity, which is expected to be available in the beginning of 2007, would help the company in maintaining its system share of around 5%. The new plant due to its latest technology would enhance the cost efficiency with positive impact on margins. The management, subsequent to availability of new capacity, is considering a comprehensive BMR of existing plant to further improve its efficiency.
- Going forward, the growing trend in cement demand is expected to be maintained owing mainly to continuing growth in economy bolstering industrial and residential construction activities, reconstruction in earthquake affected areas and increasing allocation towards PSDP by the government. Nevertheless, given aggressive capacity expansion plans, supply overhang is expected in the medium-term putting pressure on margins. However, as no player has a material edge in terms of margins, the producers understanding is expected to hold. This, while ensuring a minimum level of margins, mitigates business risk to a great extent.
- The company's financial profile has undergone a marked improvement, primarily due to favorable debt restructuring involving a waiver of around PKR 4bln and realistic repayment terms and fresh injection of equity. Given the management's intention of restricted dividend distribution, if any, in the medium-term, the company's gearing, with modest increase due to further borrowings for ongoing expansion, is expected to remain at a comfortable level (end-Mar 06 debt-to-equity: 1.35times). Coverages, with enhanced cash flow generation ability on the back of improving profitability, are expected to remain sound. Moreover, a 2½years grace period for principal repayment of the expansion loan provides additional comfort.

BACKGROUND

- Dewan Cement Limited (DCL) – formerly Pakland Cement Limited, incorporated in 1980 and listed on the Karachi and Lahore stock Exchanges – is majority owned by Dewan Mushtaq Group through its different companies since 2004. The Group, an established conglomerate in the country, has interests in synthetic fibers, automotive and allied, sugar and allied, textiles, oil and gas, cement, and general trading sectors. It also enjoys the privilege of having business associations with renowned multinational corporations. The cement plant is located near Port Qasim, Sindh, mainly serving the country's south zone.
- Professionals, mainly serving the group in different capacities, dominate the company's BOD, with only one member of Dewan family. The chief executive officer, a chartered accountant by profession, joined the company in August 2004 and is supported by a team of experienced professionals.