

DEWAN CEMENT LIMITED (DCL)

RATINGS (JANUARY 2008)

DEWAN CEMENT LIMITED

ENTITY	NEW	PREVIOUS
Long Term	A-	A
Short Term	A2	A1
TFC		
Secured, listed (PKR 5bln)	A	

FINANCIAL DATA

	PKR (mln)	
	30-Jun-07	30-Jun-06
Total Assets	22,187.5	14,485.9
Equity	8,795.1	4,130.3
Operating profits	434.3	1,197.3
Net Income	206.6	356.6
Gross Margin (%)	14.1	24.9
ROE (%)	2.3	8.6
Total Debt/Equity (%)	102.5	195.1

ANALYSTS

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TFC ISSUE

The company is in the process of issuing a secured TFC of PKR 5bln including a green shoe option of PKR 2bln for a tenure of 6 years inclusive of a grace period of 1.5 years at a rate of 6 months KIBOR + 200bps. The proceeds of the TFC would be utilized for debt re-profiling. The instrument is initially secured by ranking charge, which would be upgraded to first pari passu charge on the present fixed assets of DCL with 25% margin within 30 days of pre-IPO disbursement. Considering the secured nature of the instrument, it has been assigned a one-notch higher rating than the long-term entity rating.

ASSESSMENT

■ The ratings reflect the relatively high business risk in the cement sector, which has been lately magnified by the emerging capacity overhang in the industry. Given the current scenario and DCL's ongoing capacity expansion, it would be difficult for the company to achieve higher capacity utilization at reasonable margins in the near-term. Meanwhile, the ratings recognize the management's preemptive measures in managing potential financial risk through debt re-profiling. The company's association with a well-diversified group is also a key rating factor.

■ In line with the sector, DCL experienced a substantial increase in net profitability during FY06, mainly because of higher capacity utilization and strong margins. However, with commencement of new capacities, the trend did not persist in FY07 despite growing cement demand. This, in turn, led to substantial decline in DCL's performance during FY07 and 1QFY08. The company's relatively high financial cost further dampened profitability. Meanwhile, Dewan Hattar Cement Limited has been merged with and into DCL. Although this would provide some operational synergies, there is little likelihood of any mitigation of pressure on margins because the plant is situated in the North zone, which has significantly higher capacity surplus compared to South zone.

■ For the last many years, cement producers have worked with tacit understanding in terms of capacity utilization and pricing. This arrangement has been beneficial to the industry owing to reduced price competition, ensuring relatively high margins. However, with additional capacities, increasing the supply surplus, the sector has experienced weakening of the "cartel" arrangement, negatively impacting output prices and margins. While domestic cement demand continued to show consistent growth, to achieve higher capacity utilization, the industry is putting greater emphasis on tapping export markets. In this regard, the recent development regarding prospects of exports to India is likely to reduce the industry's business risk to some extent in the near-term and is expected to have a positive impact on the local market in the shape of price stability.

■ The management of DCL is making concerted efforts for timely commencement of additional capacity at the Port Qasim site. The new line, enhancing the capacity to 2.9mln tpa has been delayed and is expected to start production in the early part of 2008. Although one of DCL's cement plants is in close proximity to a major consumption center – Karachi – enjoys freight-cost advantage over peers, currently the benefit is masked down by relatively high cost plant operations. The management, subsequent to availability of new capacity at its Karachi site, is considering optimization of the existing plant to improve its cost efficiency.

■ DCL intends to capitalize on emerging export opportunities in second half of 2008 after availability of enhanced production capacity. Meanwhile, the company has recently started its export operations to India, which comprises a nominal portion of its total cement production and would not help the company in steering through the imminent business risk, originating mainly pressure on margins.

■ The equity base of the company registered an increase on the back of recent merger, which in turn improved gearing. However, with reduction in profitability, the company's cash flows and in turn, financial coverages have come under pressure in FY07 and 1QFY08. To manage its liquidity crunch, the management is in the final stage of issuing Term Finance Certificates amounting to PKR5bln.

KEY RATING DRIVERS

■ These ratings are entirely dependent on timely completion of debt re-profiling and the company's ability in successfully utilizing its expanded capacity for improving margins and cash flows. However, any significant reduction in margins and/or failure in restructuring of debt on favorable terms would have negative implications for the ratings.

PROFILE

■ Dewan Cement Limited (DCL) – incorporated in 1980 and listed on the Karachi and Lahore stock Exchanges – is majority owned by Dewan Mushtaq Group (DMG) through its different companies and individuals since 2004. DCL has three cement plants (two plants of 1mlntpa in Hatter, and one plant of 0.9mln tpa in Karachi), providing access to both South and North zones.

■ The group, an established conglomerate in the country, has interests in synthetic fibers, automotive, 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. Dewan Muhammad Yousuf Farooqui, the group Managing Director, is spearheading the expansion and diversification program of the group. He is also the Chief Executive Officer of DCL. Professionals, mainly serving the group in different capacities, dominate DCL's BOD, with three members of Dewan family.