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
01-Mar-2024	AA-	A1+	Stable	Maintain	-
03-Mar-2023	AA-	A1+	Stable	Maintain	-
04-Mar-2022	AA-	A1+	Stable	Maintain	-
04-Mar-2021	AA-	A1+	Stable	Maintain	-
03-Apr-2020	AA-	A1+	Stable	Maintain	-
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 Company's ratings are derived from the entity's enduring presence in the local cement sector along with the sponsors distinguished financial and business acumen. The local cement industry witnessed a downtrend in total sale volumes of ~15.7% in FY23 as compared to the previous year. (FY23: ~44.5mln MT, FY22: ~52.8mln MT). Local dispatches dwindled by ~16.0% to ~40.01mln MT during FY23 from ~47.63mln MT in FY22. Likewise, Export dispatches declined by ~0.7mln MT during the period (FY23: ~4.56mln MT, FY22: ~5.25mln MT). The overall decline in the volumes was nurtured by soaring inflation in the country that led to demand constraints. Furthermore, the economic and political instability in the country during the year hindered the developmental activity in the country which contributed towards fall in consumption of cement. The Company's total sale volumes declined by ~20% during the fiscal year from ~5.36mln MT in FY22 to ~4.274mln MT during FY23. Based on the total sale volumes during FY23, the Company occupies 10% market share. Despite the decline in volumes, the Company reported a growth in Net Revenues of ~14.3% (FY23: PKR 70,495mln, FY22: PKR 61,653mln) primarily due to stable local cement prices that accounted for inflation to some extent. However, high energy and fuel prices coupled with lower demand resulted in a decline in gross margins. The transition in FY24 brought some relief for the cement sector in the form of growth in total industry volumes of 23.5 % during the first quarter (1QFY24: 11.9mln MT. 1QFY23: 9.6mln MT). Recovery in both local and exports contributed towards the positive shift. Likewise, the Company's total sale volumes increased by ~14.1% during the first quarter as compared to the same period previous year. (1QFY24: 1.086mln MT, 1QFY23: 0.952mln MT) resulting in Net Revenues of PKR 16,517mln (1QFY23: PKR 13,585mln). Going forward, negligible growth is expected during the remaining fiscal year due to slowdown in the economic activity and other infrastructure projects. The Company is adhering to cost efficient measures including the use of alternate fuels to sustain its margins. Furthermore, the Company is also evaluating export opportunities to the USA market which if materialized may contribute to the profitability. Unlike its peers in the industry, DGKC has no capacity expansion plans and is committed towards efficient capacity utilization and lowering its debt burden.

The Company's association with the Nishat Group coupled with strategic investments in group companies which deliver a stable dividend income further provides additional support. Furthermore, the Company's strong operational history which is evident from its market presence complements 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(Jul-23),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jul-23),Methodology | Rating Modifiers(Apr-23)
Related Research	Sector Study | Cement(Mar-23)
Rating Analysts	Hashim Yazdani | hashim.yazdani@pacra.com | +92-42-35869504

Profile

Legal Structure DG Khan Cement Company Limited (DGKC), a public limited company incorporated in Sep-1978, however, it was acquired by the Nishat group in 1992. The company obtained a listing on Pakistan Stock Exchange in 2001. The company's registered office is located at 53-A Lawrence Road Lahore.

Background Mian Mohammad Yahya (founder of Nishat Group), beginning with a cotton export house, soon branched out into ginning, cotton and jute textiles, chemicals, and insurance. DG Khan Cement is part of Nishat Group - renowned for the diversified group.

Operations DG Khan Cement is primarily engaged in the manufacturing and sale of Clinker, Ordinary Portland Cement, and Sulphate Resistant Cement. It has 4 production facilities located in North region; Khairpur (1 Line) and Dera Ghazi Khan (2 Lines) and located in South region; Hub (1 Line). As of June Dec 2023, DGKC's installed capacity stands at 6.72 MTPA of clinker. Additionally, it exports cement to Bangladesh, Sri Lanka, Afghanistan, China and USA.

Ownership

Ownership Structure DG Khan Cement is majority owned (49.7%) by Nishat Group mainly through group companies (32.90%), followed by sponsor family members (~16.80%). Other shareholding is mainly dispersed among General Public (23.70%), Financial Institutions (9.13%), Insurance Companies (2.07%), Modarbas and Mutual Funds (3.29%) and Others (12.11%) including Joint Stock Companies, Investment Companies, Pension Funds and Charitable Trust and Foundations.

Stability The Company's ownership has remained stable over the years with the controlling interest reserved with Nishat Group.

Business Acumen Nishat Group ("the Group") is one of the largest and leading business houses in Pakistan. It operates in Textile, Banking, Power, Cement, Agriculture & Dairy, Insurance, Paper packing products, Aviation, Automobile, Real Estate & Hospitality and Trading etc. With its proven history, the Company is the fourth largest player in the cement sector. This proves that the sponsors have evolved the Company over years through their competency and experience in the cement sector.

Financial Strength The major sponsoring company of DGKC, Nishat Mills is a leading textile manufacturer having different business segments including Spinning, Weaving, Dyeing, Home Textile, Terry and Garments. As on 30th June 2023, Nishat Mills equity base stands at PKR 136bln with PKR 193bln in Revenues during the FY23.

Governance

Board Structure The overall control of the company vests in seven-member board of directors (BoD) including 3 Non Executive, 2 Executive and 2 Independent members.

Members' Profile Mrs. Naz Mansha (wife of Mian Muhammad Mansha) is the Chairperson of the board. The remaining board members come from a diverse professional backgrounds and have a satisfactory association with the company's board

Board Effectiveness The board has formulated two committees including Audit committee and Human Resource Management Committee to assist the management in reviewing and assessing strategies and opportunities while mitigating risks. Furthermore, the board conducted seven meetings during FY23 with satisfactory presence of all its members.

Financial Transparency M/s. A.F. Ferguson & Co., Chartered Accountants, Chartered Accountants, the external auditor, have given unqualified opinion on the company's financial statements for the year ended June 31st, 2023.

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.

Management Team The CEO, Mr. Raza Mansha has been associated with the Company for more than 10 years. Simultaneously, he is also present on the board of other companies of the Group. He is accompanied by a team of qualified and experienced individuals having a long association with the Company.

Effectiveness The management has also many committees to monitors the operational performance of the company. The senior management developed critical success factors in which the board is also involved in monitoring.

MIS DG Khan Cement deploys an in-house built ERP solution implemented at head office, all manufacturing sites, and sales offices. Daily reporting includes Cement Production Report, Power Generation Report, Production Report (segregating production at each site), and daily dispatch report. The system generates monthly accounts that are accessible through the cloud also.

Control Environment The Company has devised and implemented an effective internal control framework which also includes an in dependent internal audit function. The Internal Audit function is responsible for providing assurance on the effectiveness and adequacy of internal control and risk management framework in managing risks within acceptable levels throughout the Company.

Business Risk

Industry Dynamics The country's total installed capacity of ~95mln MT is divided between North and South zones. During FY23, total industry volumes stood at 44.5mln MT (FY22: 52.8mln MT) reporting a decline of 15.7%. Local dispatches declined by 16.0% to 40.01mln MT during FY23 from 47.63mln MT in FY22. Similarly, Export volumes dwindled by 0.7mln MT during the period (FY23: 4.56mln MT, FY22: 5.25mln MT). The decline in overall volumes was a result of soaring inflation in the country that led to demand constraints. However, during the latest quarter 1QFY24, the industry volumes increased by ~24% to 11.9mln MT from 9.6mln MT during 1QFY23 on back of recovering demand and economic conditions.

Relative Position The Company has an installed capacity of 6.7MTPA, which is the fifth largest in the country. Furthermore, the Company total dispatches were recorded at 4.273mln MT during FY23, representing 10% market share.

Revenues During FY23, the Company's total sale volumes including local and export stood at 4.273mln MT (FY22: 5.358mln MT) resulting in Net Revenues of PKR 64,983mln (FY22: 58,043mln) observing a significant increase of ~12% backed by successful price hikes during the period. Total dispatches during 1QFY24 were recorded at 1.086mln MT (1QFY23: 0.952mln MT) with significant improvement in export volumes. Hence, the Company reported Net Revenues of PKR 16,517mln (1QFY23: PKR 13,585mln) witnessing an increase of 21.6%.

Margins Margins were adversely impacted by the ongoing economic slowdown coupled with rising costs of inputs. During FY23, the Company's Gross Profit Margin declined to 14.7% (FY22: 18.0%) after remaining stable for the previous two years. Net Profit margins were on a declining trend post FY21 as a result of the Company's high markup cost. Hence, Net Profit Margins turned negative to -5.6% from 5.1% during FY22. Favorable conditions during the 1QFY24 resulted in somewhat better results (GPM: 19.5%, NPM: 4.0%).

Sustainability Going forward, the management is focused on sustaining its cost leadership and performance uptrend, while comfortably servicing long-term debt. The company is not considering expanding its capacity as of now. However, the management is actively pursuing export opportunities and has recently started exporting cement to USA.

Financial Risk

Working Capital As on end Sep 2023, DGKC's Gross Working Capital days increased to 60 days as on Sep 2023 (June 2023: 49days, June 2022: 37 days) on account of rise in inventory days. The rise in inventory was a result of lower demand during FY23 due to the economic slowdown coupled with inflation. The company manages its working capital requirements through mix of internal generation and short term borrowings.

Coverages During FY23, coverages of the Company suffered a blow owing to a rise in Finance Cost as a result of revision in policy rates with peaking at 22%. Hence, the Interest Coverage (FCFO/Finance Cost) for FY23 stood at 1.6x (FY22: 3.0x).

Capitalization The Company's leveraging stood at 36.6% as on Sep 2023 (June 2023: 40.1%) resulting from Long Term Borrowings of PKR 18,099 along with CMLTB of PKR 7,168mln. Furthermore, STB's of PKR 13,196mln to support working capital requirements.

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Financial Summary
PKR mln

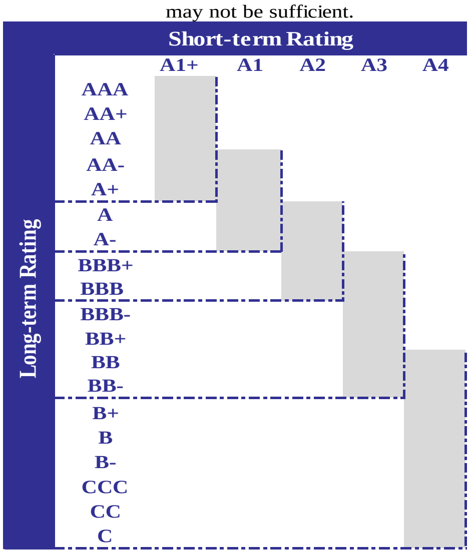
D.G Khan Cement Company Limited	Sep-23	Jun-23	Jun-22	Jun-21
Cement	3M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	81,766	82,320	82,883	85,078
2 Investments	177	169	80	98
3 Related Party Exposure	24,298	22,469	22,751	29,580
4 Current Assets	27,615	29,756	30,849	23,139
a Inventories	*10,372*	*8,873*	*5,982*	*2,729*
b Trade Receivables	*1,303*	*1,193*	*1,468*	*1,676*
5 Total Assets	133,856	134,713	136,562	137,895
6 Current Liabilities	16,373	15,593	13,545	15,500
a Trade Payables	*6,968*	*6,530*	*3,871*	*7,376*
7 Borrowings	38,463	43,026	47,163	44,761
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	12,329	11,903	5,936	4,157
10 Net Assets	66,690	64,192	69,918	73,478
11 Shareholders' Equity	66,690	64,192	69,918	73,478
B INCOME STATEMENT				
1 Sales	16,517	64,984	58,044	45,108
a Cost of Good Sold	*(13,304)*	*(55,428)*	*(47,616)*	*(37,036)*
2 Gross Profit	3,213	9,556	10,428	8,072
a Operating Expenses	(794)	(2,697)	(2,500)	(2,597)
3 Operating Profit	2,419	6,858	7,928	5,475
a Non Operating Income or (Expense)	*751*	*3,046*	*1,663*	*2,217*
4 Profit or (Loss) before Interest and Tax	3,170	9,905	9,591	7,692
a Total Finance Cost	*(2,087)*	*(6,742)*	*(3,571)*	*(2,921)*
b Taxation	*(422)*	*(6,799)*	*(3,048)*	*(1,050)*
6 Net Income Or (Loss)	661	(3,636)	2,972	3,721
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*4,404*	*10,528*	*10,461*	*7,870*
b Net Cash from Operating Activities before Working Capital Changes	*2,174*	*4,530*	*7,265*	*4,745*
c Changes in Working Capital	*2,248*	*1,974*	*(11,198)*	*1,416*
1 Net Cash provided by Operating Activities	4,422	6,504	(3,932)	6,161
2 Net Cash (Used in) or Available From Investing Activities	401	(1,747)	1,462	(2,962)
3 Net Cash (Used in) or Available From Financing Activities	7,736	(4,884)	(4,865)	2,375
4 Net Cash generated or (Used) during the period	12,559	(126)	(7,336)	5,574
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	1.7%	12.0%	28.7%	18.6%
b Gross Profit Margin	19.5%	14.7%	18.0%	17.9%
c Net Profit Margin	4.0%	-5.6%	5.1%	8.2%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	40.3%	19.2%	-1.3%	20.6%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Shareholders' Equity)]*	3.9%	-5.6%	4.2%	5.2%
2 Working Capital Management				
a Gross Working Capital (Average Days)	60	49	37	45
b Net Working Capital (Average Days)	23	20	2	-3
c Current Ratio (Current Assets / Current Liabilities)	1.7	1.9	2.3	1.5
3 Coverages				
a EBITDA / Finance Cost	1.7	1.7	3.4	3.1
b FCFO / Finance Cost+CMLTB+Excess STB	1.0	0.4	0.6	0.4
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	2.9	7.5	4.3	7.4
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	36.6%	40.1%	40.3%	37.9%
b Interest or Markup Payable (Days)	70.3	94.8	90.9	64.2
c Entity Average Borrowing Rate	19.1%	14.8%	7.9%	6.2%

Credit Rating

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 Rating	
Scale	**Definition**
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 Rating	
Scale	**Definition**
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
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

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 some material identifiable event with indeterminable rating implications. 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 rating 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) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) 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.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

a) Broker Entity Rating
b) Corporate Rating
c) Debt Instrument Rating
d) Financial Institution Rating
e) Holding Company Rating
f) Independent Power Producer Rating
g) Microfinance Institution Rating
h) Non-Banking Finance Companies Rating

Regulatory and Supplementary Disclosure

(Credit Rating Companies Regulations,2016)

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 | Clause 11-(A)(p).
(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 | 17-(a)
(19) PACRA reviews all the outstanding ratings periodically, on annual basis; Provided that public dissemination of annual review and, in an instance of change in rating will be made; | Chapter III | 17-(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 | 17-(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 | 17-(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 | 14-3(f)(vii)

Proprietary Information