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
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's ratings reflect the company's strong position in the cement industry emanating from its third highest market share of ~10% in terms of installed cement capacity. The cement sector's despatches have recorded splendid growth over the five-month period (Aug-Dec); surged around 16% to 28.6mln tons in the first half of the current fiscal year 20-21 as demand in the domestic market accelerated due to the attractive incentives announced by the government for the construction sector. Export is another avenue. Industry-wide exports (sizeable increase in South Region) have gone up as a new export window is created in Bangladesh market where the sector is exporting notable volumes of cement and clinker. DG Khan - through its Hub plant is exporting a sizeable amount of clinker to Bangladesh and the company is also exploring other export opportunities to achieve the optimal level of capacity utilization. A significant drop in coal prices on the back of reduced demand during Covid-19, stayed within the range of $57-$67 along with the much-debated cut on FED duty supported the performance. Therefore; the company managed to recoup previous losses and reported profits of ~PKR 800mln for half-yearly financial statements after the two periods where the company's bottom line turned red i-e; FY20 & its following quarter. The profitability of the company took a significant dip where deteriorated margins were attributable to a challenging environment resultant of Covid-19 impressions that led to reduced demand and depressed prevailing cement prices in FY20. Industry's dynamics encompassing expected phase of expansion which will stretch the leveraging levels and pose the challenge to maintain profit margins and coverages in order to reflect positively on the ratings. The Company is in the process of installation of new WHR (operational in January) and CFPP at the hub site (expected to be completed by end of FY21). Going forward, it would be important to keep an eye on the sustainability of the current bust in demand to channelize the augmented supply on the back of expanded capacities; resultant in the aforementioned plant expansions.

The rating takes into account the association company with Nishat Group. Future performance seems to be promising as a revival in profitability and EBITDA is insight on the account of a significant increase in reported sector's local and export despatches and being the top player of the industry – DGKC is going to capture a significant chunk to boost its profit margins which are evident from half-yearly results. The ratings are a reflection of a strong business profile and dependent upon the market standing post completion of expansions.

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-20),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria | Rating Modifier(Jun-20)
Related Research	Sector Study | Cement(Mar-20)
Rating Analysts	Anam Waqas Ghayour | anam.waqas@pacra.com | +92-42-35869504

Profile

Legal Structure DG Khan Cement Company Limited (DGKC), a public limited company incorporated in Sep-1978, however, it 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 Lawrance Road Lahore.

Background Mian Mohammad Yahya (a 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.

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 the general public & other corporates.

Stability The ownership of the Company remained the same for many years. Going forward, as the DG Khan Cement is the Flagship Company of the group, the sponsor will ensure the stability of the Company.

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

Financial Strength Nishat’s total market capitalization as of Jun 30th, 2020 is about PKR 285bln (USD 1.7bln), along with the regular human workforce of ~41000. While ~67% market capitalization occupied by banking sector, cement ~13%, textile ~10%, power ~6%, insurance ~4%. 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 (BoD) including the CEO. The Chairperson – Mrs. Naz Mansha is the mother of Mr. Raza Mansha, the CEO and both represent the sponsoring family. 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. The most recent changes witnessed in two positions, one board member Mr. Mahmood Akhtar & Mr. Usama Mehmud joined the board in 2019.

Board Effectiveness The board meetings are formally held with an agenda shared with board members prior to the meeting. The attendance of the directors in board meetings is considered good.

Financial Transparency M/s. A.F. Ferguson & Co., Chartered Accountants, the external auditor, has given an unqualified opinion on the company’s financial statements for the year ended June 30th, 2020.

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, is a graduate of the University of Pennsylvania and is associated with the company for around 25 years. The CFO, Mr. Inayat Ullah Niazi, Commerce Graduate and CA (Inter) is associated with the company for the last 36 years. The CFO also serves on boards of cross group companies.

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 DG Khan Cement Company has four cement manufacturing units which are located in areas of plentiful limestone reserves in Khairpur (district Chakwal), two at DG Khan and the third one is Hub. The company deploys state-of-art technology and cement produced complies with different applicable standards.

Business Risk

Industry Dynamics As per prime bifurcation of Cement industry into North & South, majority concentration lies in North region. Currently, the cement industry is on a revival path after the reported halt in despatches during Apr-May20. The first half of FY20 witnessed high general inflation, and tight fiscal consolidation affecting the purchasing power of people, and the second half was affected due to the outbreak of Covid-19 pandemic. However, it is worth mentioning that Cement Industry managed to survive this bumpy ride and reported slight growth in despatches of 1.98% for FY20. Market dynamics have changed significantly, driven by a slowdown in an economic activity wherein plunge in international coal prices (1QFY21: $57, FY20: $67, FY19: $72), decreased FED & policy rate cut by ~625bps supported the industry, however, competitive cement prices (especially in the north region) remained a challenge to profit margins. The cement industry is entering into a new phase of capacity expansion. Industry leveraging is moderate however it is expected to increase on the back of new expansions. Going forward - with full capacity utilization - pressurized cement prices would remain challenging for cement players. Cement demand is expected to accelerate on the account of various PSDP-funded projects including dams, civil construction projects, and public developmental projects, as Govt. has finally laid down the action plan to its announced pursuit for infrastructure.

Relative Position DG Khan Cement Company operates with a cement production capacity of 7.1mln tons p.a.; the third-largest player, having ~10% share of the country’s cement capacity (operational) as of Jun-20.

Revenues DG Khan Cement’s sales showed an upward trend in sales volumes during FY20, up by ~14% on a YoY basis while local despatches posted status quo on the back of macro-economic challenges however exports volumes demonstrated remarkable growth of ~87% specifically contributed by clinker exported volumes. During 1QFY21, Company witnessed subdued volumes (Local despatches: (4.4%) & Total Export despatches: (85%) – in line with the market trend as per economic slowdown due to globally declared pandemic. During the last few periods, the trend of exports of DG Khan Cement has been shifted towards Bangladeshi markets since India imposed ~200% duty on the imports from Pakistan and Afghanistan market had been flooded by cheap Iranian cement but the Company managed to export a bit to Afghanistan. The local market has witnessed a remarkable increase in demand owing to the revival of the constructional industry and numerous GoP public development programs; therefore sales mix remained skewed towards local markets. During FY20, Capacity utilization levels reported as 75% (FY19: 84%).

Margins During FY20, there was a drop in coal prices – average FY20: USD ~67/M. ton, average FY19: USD ~71/ton, average 1QFY21: USD 57/ton, however; Pak rupee depreciation and reduced demand deteriorated the company’s margins. Gross and EBITDA margin declined to 4.2% (1QFY21: 9.6%; FY19: 13%) and 9% (1QFY21: 12%; FY19: 19%) respectively. During 1QFY21, the Company recorded a turnover of PKR 10.5bln. The company showed improvement on account of the post-Covid19 revival of the industry. Hence, the net loss figure dropped down to PKR 351mln.

Sustainability Going forward, management is focused on sustaining its cost leadership and performance uptrend, while comfortably servicing long-term debt. The company is planning to participate in the current phase of expansions, which is currently under deliberation while considering the boom in the construction industry.

Financial Risk

Working Capital During 1QFY21, DGKC’s working capital requirements, represented by net cash cycle (net working capital days) – a function of inventory, receivables, and payables – stood at 16days (end-Jun20: 54days; end-Jun19: 18days) which is considered better. As of end-Sep20, the company reported STBs of PKR 19.4bln (FY20: PKR 23.5bln).

Coverages As of end-Sep-20, EBITDA clocked in at PKR 1.2bln (FY20: PKR 3.2bln) that led to decreased FCFO reported as (1QFY21: PKR 997mln; FY20: PKR 1,616mln). Therefore; the Interest coverage ratio deteriorated as compared to the previous year at 1.3x and 0.3x at 1QFY21 and FY20 respectively.

Capitalization During 1QFY21, long-term debt increased to PKR 22.7bln (FY20: PKR 21.9bln) subsequently debt to debt plus equity ratio increased to ~40% (FY20: 42%; FY19: 37%). The company has short-term borrowing of PKR 19.4bln - ~43% of the total debt. The Company did not announce any dividend for FY20 in comparison to last year's declared dividend of PKR 1.0/share.

The Pakistan Credit Rating Agency Limited

Financial Summary

PKR mln

DG Khan Cement Infrastructure | Cement	Sep-20 3M	Jun-20 12M	Jun-19 12M	Jun-18 12M
A BALANCE SHEET				
1 Non-Current Assets	84,279	83,607	80,041	76,554
2 Investments	104	93	130	164
3 Related Party Exposure	27,913	25,648	27,276	33,120
4 Current Assets	16,269	20,204	18,494	12,051
a Inventories	*2,008*	*4,353*	*3,714*	*1,378*
b Trade Receivables	*2,027*	*2,286*	*1,192*	*188*
5 Total Assets	128,565	129,551	125,941	121,889
6 Current Liabilities	11,420	12,079	8,908	8,007
a Trade Payables	*4,119*	*4,325*	*3,261*	*3,559*
7 Borrowings	45,444	47,517	41,324	32,277
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	3,232	3,311	4,781	4,471
10 Net Assets	68,468	66,644	70,928	77,134
11 Shareholders' Equity	68,468	66,644	70,928	77,134
B INCOME STATEMENT				
1 Sales	10,514	38,033	40,517	30,668
a Cost of Good Sold	*(9,507)*	*(36,447)*	*(35,154)*	*(21,928)*
2 Gross Profit	1,008	1,586	5,362	8,740
a Operating Expenses	*(763)*	*(2,442)*	*(1,934)*	*(1,523)*
3 Operating Profit	245	(856)	3,428	7,217
a Non Operating Income or (Expense)	*69*	*1,753*	*1,867*	*672*
4 Profit or (Loss) before Interest and Tax	314	897	5,295	7,889
a Total Finance Cost	*(771)*	*(4,653)*	*(3,304)*	*(519)*
b Taxation	*107*	*1,598*	*(381)*	*1,468*
6 Net Income Or (Loss)	(351)	(2,159)	1,610	8,838
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*997*	*1,616*	*6,920*	*7,182*
b Net Cash from Operating Activities before Working Capital Changes	*106*	*(3,134)*	*3,974*	*6,794*
c Changes in Working Capital	*3,371*	*2,791*	*(5,505)*	*2,117*
1 Net Cash provided by Operating Activities	3,477	(343)	(1,531)	8,911
2 Net Cash (Used in) or Available From Investing Activities	(1,405)	(5,083)	(5,444)	(16,071)
3 Net Cash (Used in) or Available From Financing Activities	2,010	2,520	(872)	3,706
4 Net Cash generated or (Used) during the period	4,082	(2,906)	(7,847)	(3,455)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	10.6%	-6.1%	32.1%	1.8%
b Gross Profit Margin	9.6%	4.2%	13.2%	28.5%
c Net Profit Margin	-3.3%	-5.7%	4.0%	28.8%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	41.5%	11.6%	3.5%	30.3%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	-2.0%	-3.3%	2.3%	12.1%
2 Working Capital Management				
a Gross Working Capital (Average Days)	52	90	48	28
b Net Working Capital (Average Days)	16	54	18	-2
c Current Ratio (Current Assets / Current Liabilities)	1.4	1.7	2.1	1.5
3 Coverages				
a EBITDA / Finance Cost	1.6	0.7	2.3	18.4
b FCFO / Finance Cost+CMLTB+Excess STB	0.2	0.1	0.4	0.7
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	44.9	-13.1	8.7	4.2
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	39.9%	41.6%	36.8%	29.5%
b Interest or Markup Payable (Days)	70.2	56.2	90.3	257.6
c Entity Average Borrowing Rate	7.1%	10.8%	8.8%	1.8%

Credit Rating

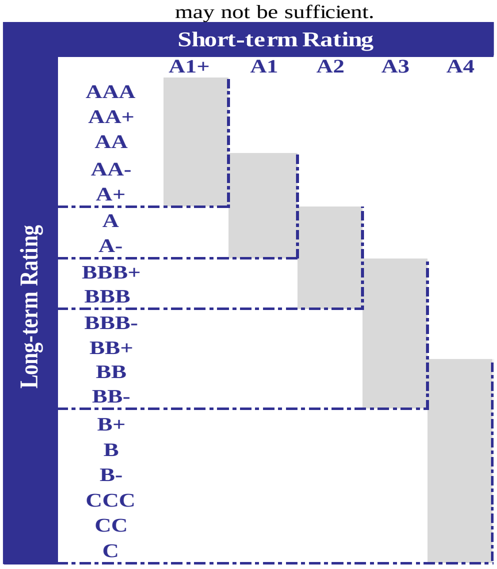
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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):

Entities

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

Instruments

a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk 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.
(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)
Proprietary Information
(23) All information contained herein is considered proprietary by PACRA. Hence, none of the information in this document can be copied or, otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without PACRA's prior written consent