

# Pakistan Cements

## 2QFY18 to remain dismal; eye margin recovery in 2H

Wednesday, January 10, 2018

### Cement sector Performance

	3M	6M	12M
Absolute %	3M	6M	12M
Relative to KSE %	-1%	-28%	-42%

Source: BMA Research

### Cement sector vs KSE100



Source: BMA Research

### BMA Cement Universe earnings estimates

	2QFY18E	YoYΔ%	1HFY18E
DGKC	5.78	-3%	12.26
ACPL	5.39	-10%	10.67
LUCK	8.89	-24%	18.22
KOHC	5.68	-27%	11.53
MLCF	1.66	-33%	3.43
PIOC	1.75	-50%	3.59

Source: BMA Research

- Cement sector recorded highest ever sales volume of 11.9mn tons in 2Q (up 15%/10% QoQ/YoY). Robust demand growth led to stability in prices during the quarter (North region: PKR480-520/bag, South region:PKR580-600/bag).
- We estimate earnings for BMA Cement universe to dip by 6%/21% QoQ/YoY in 2QFY18 (PAT: PKR8.3bn) mainly due to 3ppt drop in margins despite stable prices as a result of rising cost pressures.
- We expect diverse pricing and margin trends in both regions during 2H, where we eye slight price recovery in North region given environmental and legal challenges amid limited supply and increasing cost pressures while South may see some softness as demand/supply rebalances (5-8% expected in 4Q).
- As per the recent news flow, Punjab government's proposal to move cement plant construction to section 'C' of location policy has been approved (details below). We believe this may lead to delay in new capacity additions in the region (GWLC, PIOC, MLCF) thus making a strong case for price recovery.
- Our top picks are LUCK, DGKC and MLCF.

**2Q to remain dismal led by higher fuel cost:** We estimate earnings for BMA Cement universe (six companies representing 65% of the sector market cap) to dip by 6%/21% QoQ/YoY in 2QFY18 translating into a Profit After Tax (PAT) of PKR8.3bn. Cumulatively, earnings are expected to dip by 11% YoY in 1HFY18 (PAT: PKR17bn). Although, topline of the sector is expected to improve by 8% QoQ driven by highest ever volumetric sales and stable prices in both regions, the 13% QoQ jump in cost of production (mainly due to 8% QoQ higher coal prices) is expected to drag margins by 3ppt QoQ to 33% in 2QFY18. Other income of our universe is expected to grow by 26% QoQ mainly driven by DG Khan Cement's (DGKC) dividend income on its investment in associated companies whereas Pioneer Cement (PIOC) is expected to show some recovery in losses on short term investments made through mutual funds as market recovered in Dec'17. Financial charges, on the other hand, are expected to increase slightly (5% QoQ) as companies start to pay off fresh borrowings. We expect DGKC to be the outperformer during 2Q mainly due to the tax benefit (nil tax liability assumed for the quarter) followed by Attock Cement (ACPL). On the flip side, PIOC is expected to lag the industry (down 50% YoY).

### 2QFY18 earnings preview

(PKR mn)	2QFY18E	QoQΔ%	YoYΔ%	1HFY18E	YoYΔ%
Net Sales	36,763	8%	-3%	70,734	2%
COGS	24,571	13%	17%	46,260	21%
<b>Gross Profit</b>	<b>12,192</b>	<b>-1%</b>	<b>-28%</b>	<b>24,473</b>	<b>-22%</b>
<i>Gross margin</i>	33%			35%	
SGA	2,086	6%	-2%	4,051	-4%
Other Income	1,296	26%	-8%	2,322	-10%
Other charges	764	-4%	-49%	1,560	-38%
EBIT	10,638	1%	-27%	21,184	-23%
Financial charges	295	5%	62%	574	69%
<b>PBT</b>	<b>10,344</b>	<b>1%</b>	<b>-29%</b>	<b>20,610</b>	<b>-24%</b>
Taxation	2,057	43%	-48%	3,493	-55%
<b>PAT</b>	<b>8,287</b>	<b>-6%</b>	<b>-21%</b>	<b>17,116</b>	<b>-11%</b>

Source: BMA Research & Company Accounts

BMA Capital Management Ltd. 801 Unitower, I.I.Chundrigar Road, Karachi, 74000, Pakistan For further queries, please contact: bmaresearch@bmacapital.com or call UAN: 111-262-111

Syeda Humaira Akhtar, CFA, FRM  
humaira.akhtar@bmacapital.com  
+9221-111-262-111 Ext: 2065

REP-005

**Highest ever sales made in 2QFY18; robust growth to continue in 2H:** Cement sector witnessed buoyant demand in 2Q, whereby highest ever sales volume of 11.9mn tons was recorded during the quarter (up 15%/10% QoQ/YoY). On a cumulative basis, total dispatches in 1HFY18 witnessed a jump of 12% YoY to 22.2mn tons. Average utilization level of the industry stood at 101% during the quarter (95% in 1HFY18). Robust local demand growth (up 19%/14% QoQ/YoY to 10.78mn tons) led to stability in prices during 2Q (North region prices hovered in the range of PKR480-520/bag while South region remained firm at PKR580-600/bag range). Going forward, we expect demand to remain strong in 2HFY18 driven by increased focus on infrastructure spending before elections (pick-up can be witnessed from Mar'18 onwards post winter season)

**2H offers varying price and margin trends between regions:** While robust demand growth is expected to continue country-wide, price trends in both regions are expected to show divergent trends where we eye slight price recovery in North region given environmental and legal challenges in capacity additions amid limited supply (North utilization levels stood at 95% in 1HFY18) and rising cost pressures. On the other hand, South may see some softness as demand/supply rebalances (5-8% expected in 4Q) post addition of 2.8mn tons capacity by DGKC (prices, however, remained stable in the region despite addition of 2.5mn tons by LUCK and ACPL recently, hinting towards maturing price discipline amongst players).

**Environmental challenges may lead to margin improvement:** Following the latest incidents (decline in water level, smog), Punjab government proposed an amendment in Location Policy under Pakistan Environmental Protection Act (PEPA) whereby construction of cement plants is suggested to be moved to Schedule 'C' instead of existing Schedule 'A'. As per the recent newsflow, the proposal has been approved by Punjab's chief minister. The amendment will lead to requirement of mandatory review and approval by Environmental Protection Agency (EPA) before construction of any new cement plant in the region (clause '4' sub section 'e') as against prevailing policy of 'deemed approval' if no objection has been raised by EPA within four months of approval application. We believe, the recent measure may lead to delay in new capacity additions in the region (GWLC, PIOC, MLCF) thus making a strong case for price recovery. To this end, construction work on PIOC and MLCF's new plants has already been halted by EPA where MLCF has challenged the decision in court as it already holds 'deemed approval' for new plant construction (we expect a delay of 3 to 4 months from scheduled commencement timeline of Mar'19, already incorporated in estimates).

## Disclaimer

This research report is for information purposes only and does not constitute nor is it intended as an offer or solicitation for the purchase or sale of securities or other financial instruments. Neither the information contained in this research report nor any future information made available with the subject matter contained herein will form the basis of any contract. Information and opinions contained herein have been compiled or arrived at by BMA Capital Management Limited from publicly available information and sources that BMA Capital Management Limited believed to be reliable. Whilst every care has been taken in preparing this research report, no research analyst, director, officer, employee, agent or adviser of any member of BMA Capital Management Limited gives or makes any representation, warranty or undertaking, whether express or implied, and accepts no responsibility or liability as to the reliability, accuracy or completeness of the information set out in this research report. Any responsibility or liability for any information contained herein is expressly disclaimed. All information contained herein is subject to change at any time without notice. No member of BMA Capital Management Limited has an obligation to update, modify or amend this research report or to otherwise notify a reader thereof in the event that any matter stated herein, or any opinion, projection, forecast or estimate set forth herein, changes or subsequently becomes inaccurate, or if research on the subject company is withdrawn. Furthermore, past performance is not indicative of future results.

The investments and strategies discussed herein may not be suitable for all investors or any particular class of investor. Investors should make their own investment decisions using their own independent advisors as they believe necessary and based upon their specific financial situations and investment objectives when investing. Investors should consult their independent advisors if they have any doubts as to the applicability to their business or investment objectives of the information and the strategies discussed herein. This research report is being furnished to certain persons as permitted by applicable law, and accordingly may not be reproduced or circulated to any other person without the prior written consent of a member of BMA Capital Management Limited. This research report may not be relied upon by any retail customers or person to whom this research report may not be provided by law. Unauthorized use or disclosure of this research report is strictly prohibited. Members of BMA Capital Management and/or their respective principals, directors, officers and employees may own, have positions or effect transactions in the securities or financial instruments referred herein or in the investments of any issuers discussed herein, may engage in securities transactions in a manner inconsistent with the research contained in this research report and with respect to securities or financial instruments covered by this research report, may sell to or buy from customers on a principal basis and may serve or act as director, placement agent, advisor or lender, or make a market in, or may have been a manager or a co-manager of the most recent public offering in respect of any investments or issuers of such securities or financial instruments referenced in this research report or may perform any other investment banking or other services for, or solicit investment banking or other business from any company mentioned in this research report. Investing in Pakistan involves a high degree of risk and many persons, physical and legal, may be restricted from dealing in the securities market of Pakistan. Investors should perform their own due diligence before investing. No part of the compensation of the authors of this research report was, is or will be directly or indirectly related to the specific recommendations or views contained in the research report. By accepting this research report, you agree to be bound by the foregoing limitations.

BMA Capital Management Limited and / or any of its affiliates, which operate outside Pakistan, do and seek to do business with the company(s) covered in this research document. Investors should consider this research report as only a single factor in making their investment decision. BMA Research Policy prohibits research personnel from disclosing a recommendation, investment rating, or investment thesis for review by an issuer/company prior to the publication of a research report containing such rating, recommendation or investment thesis.

## Rating

Investors should carefully read the definitions of all rating used within every research reports. In addition, research reports carry an analyst's independent view and investors should ensure careful reading of the entire research reports and not infer its contents from the rating ascribed by the analyst. Ratings should not be used or relied upon as investment advice. An investor's decision to buy, hold or sell a stock should depend on said individual's circumstances and other considerations. BMA Capital Limited uses a three tier rating system: i) Buy, ii) Neutral and iii) Underperform (new rating system effective Jan 1'18) with our rating being based on total stock returns versus BMA's index target return for the year. A table presenting BMA's rating definitions is given below:

Buy	>20% expected total return
Neutral	0%-20% expected total return
Underperform	<0% expected total return

\*Total stock return = capital gain + dividend yield

### Old rating system

Overweight	Total stock return > expected market return + 2%
Marketweight	Expected market return $\pm$ 2%
Underweight	Total stock return < expected market return - 2%

## Valuation Methodology

To arrive at our period end target prices, BMA Capital uses different valuation methodologies including

- Discounted cash flow (DCF, DDM)
- Relative Valuation (P/E, P/B, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)