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CEMENT
PAKISTAN

PAKISTAN CEMENT SECTOR REVIEW

Initiating Coverage



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Introduction

Favorable Economic Backdrop

Pakistan's GDP growth rate has been consistently over 6.5% for the last three years and is expected to be 7.0% in the current fiscal year. The correlation of per capita cement consumption to nominal GDP has stood at 0.9186 over the last couple of years, which suggests that higher economic growth translates into greater cement consumption. Cement sales are expected to grow at 1.3x of the nominal GDP growth in FY07.

Government's Commitment to Infrastructure Development

High GDP growth, accompanied by growing allocation to the Public Sector Development Program (PSDP) by the government, has translated into greater construction activity and thereby cement demand.

Industry Cycle Set For a Profitable Turn

The demand supply situation reverses periodically. After every three to four years, a round of expansions raises the supply in excess of demand. Demand eventually rises to close the gap and a fresh round of expansions starts. Currently the capacity expansions in the industry that started in FY06 are nearing its end. This suggests that capacity will remain stagnant for the next three to four years. Given favorable economic environment backed by government's commitment on PSDP, we envisage growing demand in cement at a CAGR of 18% during the next three years. Such a situation bodes well for manufacturer's profits because sales will keep rising without further investment in plants, thereby, increasing company valuations. At the end of FY07, industry capacity is expected to be 35.2mntpa. Total sales are estimated to be 24mntpa. Overall industry capacity has shown a CAGR of 18% from FY02 to FY07 whereas sales have shown a CAGR of 17% from FY02 to FY07. Going forward, we expect industry demand to grow at a CAGR of 11-12% during the next three years.

Export Market Looking Attractive

In the last few years, Pakistan exports were mainly concentrated to Afghanistan. Recently, Pakistan has started exploring its sea port for exports. Exports to neighboring countries like India, however, can be conducted through the land route and the excess demand situation in India makes this option extremely attractive. Potential export market can grow exponentially from modest 2.5mntpa to over 7.0mntpa by FY09. Target markets include neighboring countries along with Middle East, Africa and Iraq.

Leverage Affects Both Ways

Large amount of fixed operating costs due to the recent capital expenditure have raised operating leverage. As of FY06, cement industry leverage ratio stands at 58%. Moreover, long term loans acquired to finance these expansions have also introduced fixed financial costs, raising the companies' financial leverage. Both these factors together contribute to a high degree of total leverage. Any change in sales has a magnified effect on the companies' bottom line due to this factor. A price war, therefore, can be detrimental to the sector's profitability.

Cartel Reformation Benefits All

The existing cartel or so-called marketing arrangement is an important element of the cement sector. The cartel ensures that prices are stable and high enough to benefit all. A breakup

in the cartel, however, may hurt the sector's profitability. The cement industry is fairly fragmented with 27 players. During the last sixty years various forms of cartels have been witnessed in the cement sector. However, those cartels never proved to be long lasting due to low concentration in the sector (as explained by Concentration Ratio and Herfindahl Index). Therefore, we do expect that the current formation of the cartel in the offering might not prove to be a long lasting one.

Mergers and Acquisition

The possibility of industry consolidation suggests that small cement companies may become acquisition targets by large ones. Especially those big players who missed the expansion opportunity in the South are expected to target small Southern plants. This will allow them to avail the export market through the sea route. Industry will not witness massive capacity expansions in the next three to four years and the overall industry capacity is expected to be 40mntpa in FY10. Therefore, we believe that this situation will be best suited for Mergers and Acquisitions (M&A). Industry Concentration of 40% and Herfindahl Index of 713 also suggests that the cement industry will be M&A story in the next three years.

What Can Go Wrong?

We have underpinned risk areas, which may jeopardize the sector's growth momentum:

- An unexpected slump in economic growth may impede the growth in construction activities and thereby cement demand.
- Any change in the government's infrastructure development efforts and lower than expected allocation to PSDP may also hamper current demand.
- A cartel breakup can possibly trigger price war that may affect companies' bottom line.
- Coal is the most crucial fuel component in the cement manufacturing process. On an average, 67% of the manufacturing cost is fuel cost. Any hike in international coal prices can have serious impact on the companies' gross margins and the high degree of leverage will serve to compound this effect on net profits.

Valuation Model

Our valuation model is the Discounted Cash Flow model using Free Cash Flow to Firm (FCFF). The Discounted Dividend model is not appropriate for this sector because the dividend history for some of the selected companies is volatile.

Extensive detail in disclosure of income and expense accruals required for Residual Income models was not available, which render these models inappropriate too.

Although we do state and compare enterprise value of our selected companies, we do not use its multiple (EV/EBITDA) as a preferred method of valuation because our focus is on equity value rather than total firm value. Moreover, FCFF is more strongly linked with valuation theory than EBITDA.

We believe that the Free Cash Flow method is the most appropriate for this sector because the sector's free cash flows corresponds with earnings.

Table 1: Valuation Summary

Company	Recommendation	Current	Fair Value	Upside	EPS (PRs)		P/E (x)		ROE (%)		DPS (PRs)	
		Price (PRs)	(PRs)	(%)	FY07E	FY08E	FY07E	FY08E	FY07E	FY08E	FY07E	FY08E
LUCK	NEUTRAL	102.90	115.00	11.76	6.43	9.05	16.00	11.37	19.92	22.45	1.00	1.00
DGKC	NEUTRAL	101.30	100.00	(1.28)	7.11	8.90	14.25	11.38	8.08	9.34	1.50	1.50
MLCF	BUY	18.75	28.00	49.33	1.02	1.60	18.38	11.72	3.99	6.13	0.00	1.00
PIOC	BUY	29.05	39.00	34.25	0.64	2.25	45.39	12.91	4.48	13.99	0.00	0.50
FCCL	BUY	19.00	24.00	26.32	2.43	2.61	7.82	7.28	23.60	21.48	1.00	1.00

Economic Environment

Cement consumption strongly correlated with economic growth Cement consumption worldwide is highly correlated with macroeconomic growth and the same case applies to Pakistan. Pakistan has witnessed robust economic growth in the last few years. The country's GDP has grown at a CAGR of 7.55% over the past 3 years and future prospects are positive with GDP growth of 7.0% expected in FY07 which augurs well for cement consumption.

Table 2: Economic data

	FY02	FY03	FY04	FY05	FY06	FY07E
GDP growth (%)	3.1	4.8	7.5	8.6	6.6	7.0
Consumer prices (%)	3.5	3.1	4.6	9.3	7.9	6.5
Private consumption (%)	1.6	0.5	11.5	13.1	8.1	6.1
Growth in Construction Activity (%)	1.6	4	-10.7	18.6	9.2	-
Trade balance (PRs bn)	(73.7)	(62.1)	(188.8)	(369.6)	(515.4)	(838.3)
3 month T-bill rates (%)	5.68	1.87	2.37	6.88	8.51	-

Source: State Bank of Pakistan, Federal Bureau of Statistics & IGI Research

Construction activity benefiting from economic growth The strong economic performance has led to upsurge in construction activity and resultantly cement demand. Building and construction expenditure in the country stood at PRs107.2bn in FY06.

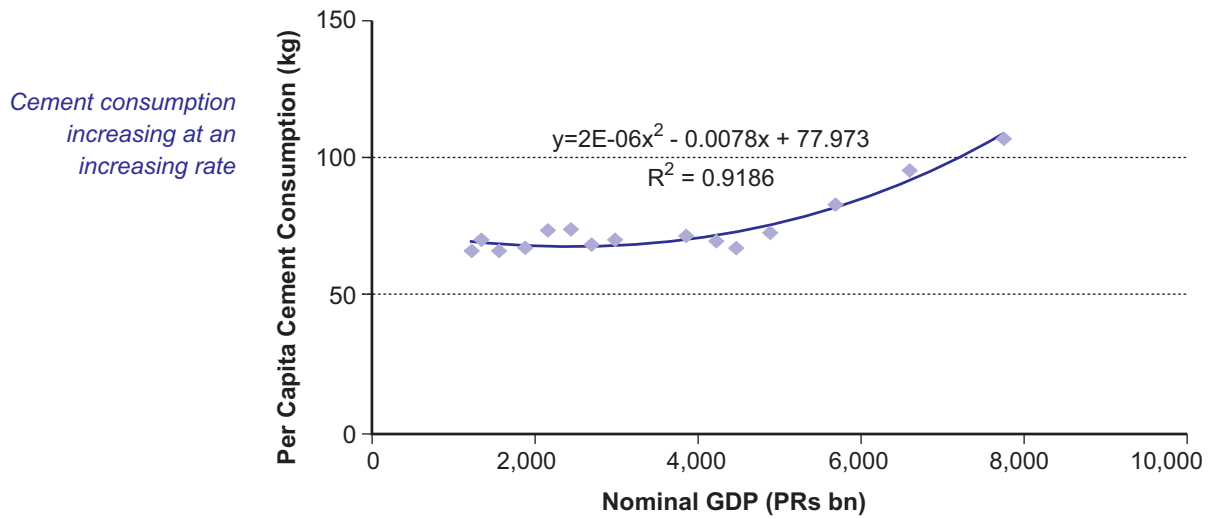
Table 3: Real GDP Growth

	FY02	FY03	FY04	FY05	FY06	%
World	3.1	4.1	5.3	4.9	5.1	
United States	1.6	2.5	3.9	3.2	3.4	
Euro Area	0.9	0.8	2.1	1.3	2.4	
Japan	0.1	1.8	2.3	2.6	2.7	
China	9.1	10	10.1	10.2	10	
India	4.3	7.2	8	8.5	8.3	
Indonesia	4.5	4.8	5.1	5.6	5.2	
Thailand	5.3	7	6.2	4.5	4.5	
Pakistan	3.1	4.8	7.5	8.6	6.6	

Source: State Bank of Pakistan

We have regressed per capita cement consumption against nominal GDP of the country for the period FY92 to FY06. We find a strong positive correlation ($r^2=0.9186$) between the two. The regression is an upward sloping second-degree polynomial that suggests that going forward as nominal GDP grows, per capita cement consumption would grow at an increasing rate. We have no doubts about the latter since cement consumption per capita is one of the lowest in the world.

Chart 1: Per Capita Cement Consumption vs. Nominal GDP

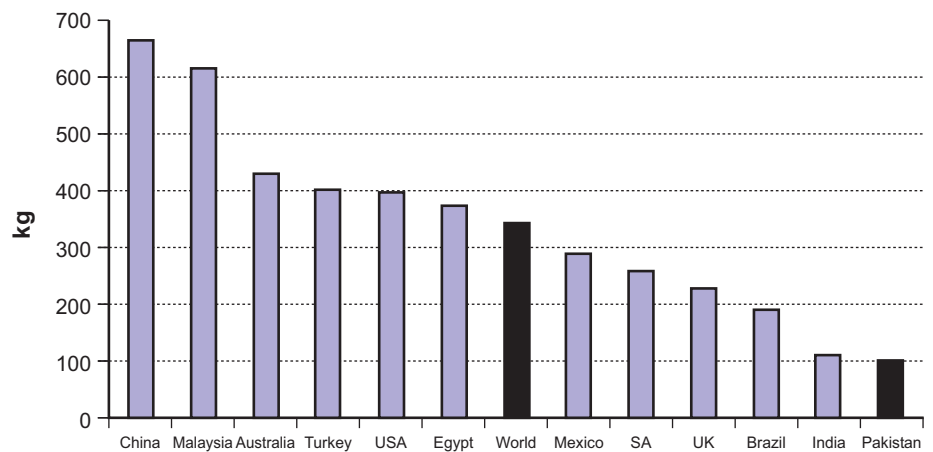


Source: SBP and APCMA

Per capita cement consumption is low-room for further penetration exists

Generally, cement consumption closely follows production in a country. Therefore, exports form a small proportion of sales. The main reasons behind this are the easy availability of raw materials across the world as well as the relation between cement consumption and economic growth.

Chart 2: Cement Consumption Per Capita (Selected Countries)

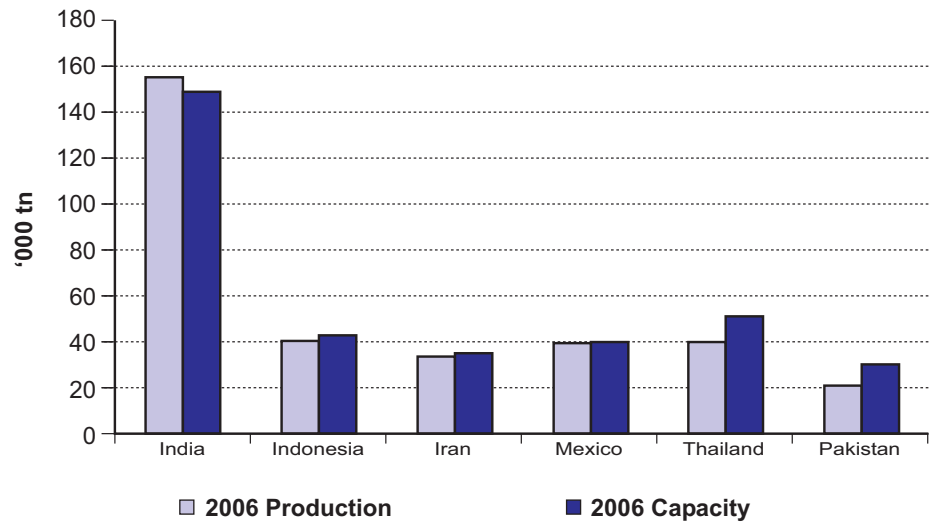


Source: Global Cement Review: 6th Edition

Demand less than installed capacity suggesting export potential

Pakistan has historically produced less cement than its installed capacity. This suggests that it does have a capacity to export to neighboring countries. Looking at other countries we find that Iran and Indonesia have the same situation. India, on the other hand, produces and consumes more than its installed capacity. This suggests that Pakistan can find potential demand in India so as to utilize its idle capacity.

Chart 3: Cement Production vs. Cement Capacity



Source: Bloomberg

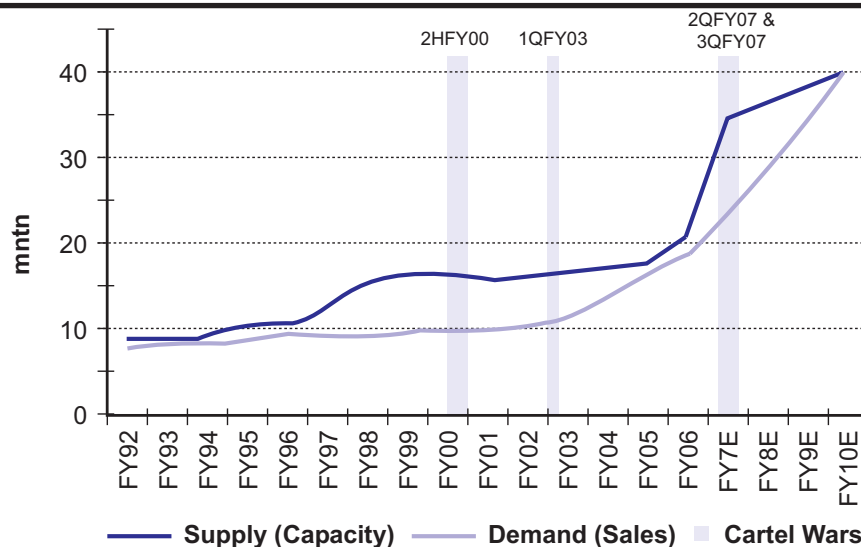
In the next few years, we expect robust economic growth and therefore, higher cement demand. By the end of FY10 we expect overall demand and supply gap to converge at 40mntpa.

Market Dynamics

Demand-supply gap varies cyclically

The cement industry in Pakistan has an oligopolistic structure. The product is homogenous and the number of sellers is large. However, the entry or exit of a single player can affect pricing. There is no single dominant industry leader and a few large players are deemed to be price setters.

Chart 4: Demand-Supply Gap



Source : APCMA and IGI Research

Oligopolistic market structure

At the end of FY07 industry capacity is expected to be 35.2mntpa, whereas demand would be lagging behind at 24mntpa. Overall industry capacity has shown a CAGR of 18% from FY02 to FY07 whereas sales have shown a CAGR of 17% from FY02 to FY07. The demand supply situation reverses periodically. After every three to four years a round of expansions raises the supply in excess of demand. Demand eventually rises to close the gap and a fresh round of expansions starts.

Current phase is one of widening gap

Currently the capacity expansion in the industry that started in FY06 is nearing its end. This suggests that capacity will remain fairly stable for the next three to four years. Demand, however, is expected to increase at an increasing rate. The coming years will see a narrowing gap between demand and supply. Such a situation bodes well for manufacturer's profits because sales will keep rising without further investment in plants.

Kohat, Gharibwal, DG Khan and Maple Leaf are the remaining players with major enhancements that are expected to come online by the end of FY07. DG Khan and Maple Leaf are coming up with the capacities of 6,700 tons per day in May 2007 and June 2007 respectively.

Regulated by the SECP

The primary regulator of the cement manufacturers is the Securities and Exchange Commission of Pakistan (SECP) and the Ministry of Industries and Production. However, there is a trade association to protect the interests of the cement manufacturers called the All Pakistan Cement Manufacturers' Association (APCMA). Cement end-users have also formed an Association of Builders and Developers (ABAD).

APCMA has a significant influence on industry dynamics as it has the representation of owners and top management of major cement manufacturers.

- APCMA or Cartel headquarters!** Players within the association call it a marketing arrangement whereas players outside the industry call it a cartel. Members of APCMA through consensus set cement prices to be enforced throughout the country and allocate production quota for every company. Whenever, one major or few minor players disagree with APCMA, the cartel breaks. However, it always bounces back on track after negotiations because over time cement manufacturers have learnt that it is the best way to make their companies profitable.
- Uniform prices set through consensus** On the other hand, APCMA is comprised of cement end-users, mainly large builders. Hike in cement prices or some other pressures transferred from cement manufacturers results in a hue and cry from their side. Generally, prices are uniform in the industry and all manufacturers follow prices set by leaders. However, like any oligopolistic structure, price wars can and often do occur. Historically, price wars have occurred in this industry for a variety of reasons.
- Industry recovering from a price war** Currently the industry is recovering from a price war that started in FY06. The element that triggered this price war was market saturation as a result of major plant expansions that started coming online in FY06.

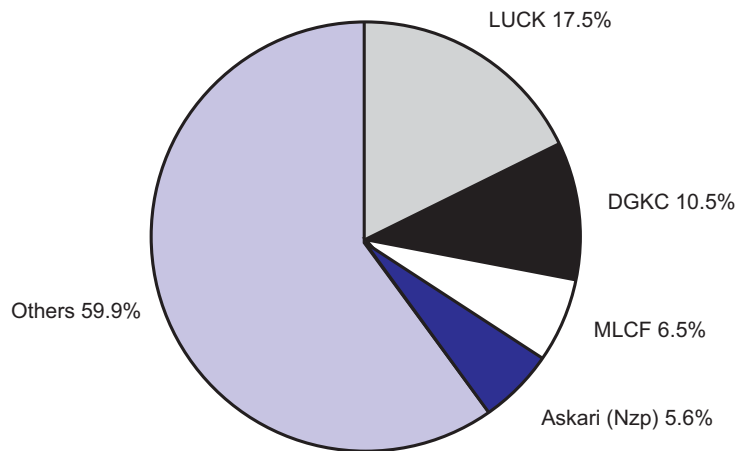
In this price war, DGKC was the player that first undercut the prevailing industry price in order to offload its excess production capacity. At that time, only LUCK and PIOC had fully functional expansions while others like MLCF and DGKC had incomplete expansions. Now in the second half of FY07, most expansions are complete. Presently, the industry is moving back to equilibrium and implicit price agreements have again come in place.

Table 4: 4-Firm Concentration (1HFY07)

	Sales (mntn)	Sales Share (%)
LUCK	1.93	17.5
DGKC	1.16	10.5
MLCF	0.71	6.5
Askari(Nzp)	0.61	5.6
Others	6.60	59.9
Total	11.03	40.1

Source: Planning Commission of Pakistan

Chart 5: 4-Firm Concentration



Source: Company Reports and APCMA

Low concentration in the industry justifies consolidation

In order to judge the level of concentration in the industry, we use two concentration indices: 4-firm concentration ratio and the Herfindahl Index (HI). The 4-firm ratio stands at 40% as of 1HFY07 whereas HI is 713. Both measures indicate a low level of concentration as well as the fact that mergers in the industry are entirely justified.

The possibility of a large scale merger in the industry also creates interest in this sector, particularly at this point in time when valuations are attractive.

Table 5: Herfindahl Index

Firm	Sales ('000tn)	Sales Share	Sq.of Mkt Share
Lucky Cement Ltd	1,935	0.18	0.03075
D.G.Khan Cement	1,161	0.11	0.01107
Maple Leaf Cement	719	0.07	0.00425
Askari Cement (Nzp)	613	0.06	0.00309
Fauji Cement Co	570	0.05	0.00267
Bestway Cement	542	0.05	0.00241
Attock Cement Pak.	521	0.05	0.00223
Pioneer Cement Ltd	513	0.05	0.00216
Askari Cement (Wah)	503	0.05	0.00207
Bestway Cem (CHK)	489	0.04	0.00196
Pakistan Cement	460	0.04	0.00174
Saadi Cement Ltd	426	0.04	0.00149
Cherat Cement Co.	396	0.04	0.00129
Pakland Cement Ltd	345	0.03	0.00097
Fecto Cement	336	0.03	0.00093
Kohat Cement Co	266	0.02	0.00058
Zaman Cement Ltd	250	0.02	0.00051
Dandot Cement Ltd.	185	0.02	0.00028
GharibWal Cement	156	0.01	0.00020
Javedan Cement	154	0.01	0.00020
Thatta Cement	141	0.01	0.00016
Dadabhoy Cement	116	0.01	0.00011
Mustehkum Cement	97	0.01	0.00008
Zeal Pak Cement	84	0.01	0.00006
Essa Cement Ltd	41	0.00	0.00001
A.C. Rohri Cement	15	0.00	0.00000
Pakistan Slag Cem	-	-	-
Total	11,037	1.00	0.07128

Source: APCMA and IGI Research

The possibility of industry consolidation suggests that small cement companies may become acquisition targets by large ones. Especially those big players who missed the expansion opportunity in the South are expected to target small Southern plants. This will allow them to avail the export market through the sea route. We believe FCCL is one large player that is likely to go for such an acquisition. FCCL did not undertake any expansion in the latest phase of expansions, which means that due to relatively stable capacity its market share may go down. In order to retain its market share, acquiring a smaller plant appears to be a viable option.

Demand Drivers

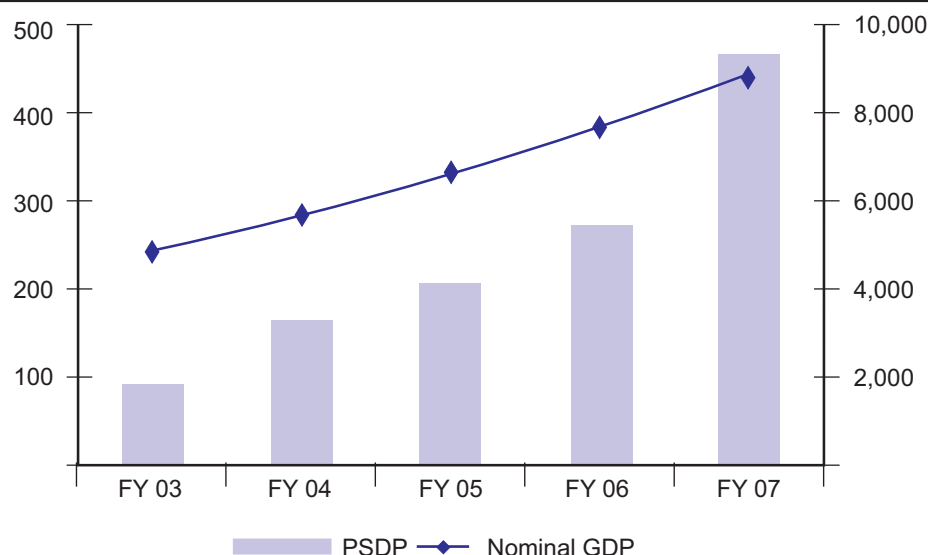
Cement demand is significantly affected by the Public Sector Development Program (PSDP), construction of dams, elevated and concrete roadways, residential construction as well as exports.

Public Sector Development Program

PSDP allocation in GDP is increasing The government's demand for cement depends upon the budget allocation to PSDP. Over the past few years, PSDP has been growing faster than the GDP, which indicates that its share in GDP is also increasing.

The federal PSDP as a percentage of GDP was 3.9% in FY06 and is projected to reach 4.3% in FY07. The government is committed to increase this ratio to 6.3% by FY10. This will result in further increase in construction activities and thereby cement demand.

Chart 6: PSDP Allocation in GDP (PRs bn)



Source: SBP, Planning Commission of Pakistan and IGI Research

According to the Annual Plan of Economic Framework and Public Sector Development Program (PSDP), the size of the PSDP budget for FY07 is PRs435bn, which is an increase of 59.9% over the previous year's PSDP of PRs272bn.

Infrastructure development-the largest part of PSDP Within the Federal PSDP, 49% has been allocated to infrastructure development. This indicates that in the coming years, the government is likely to spend a lot in the development of water and energy projects. Plans for the construction of numerous power plants, dams and canal linings have been made.

In the current fiscal year, a major portion of PRs50bn has been allocated to Earthquake Reconstruction. This allocation is expected to decline over time to zero, which will permit greater allocation for infrastructure development increasing its share in the PSDP. Out of PRs50bn that is allocated for infrastructure development, PRs12.5bn will be used in the cement consumption that amounts for 3.5mntn cement consumption. Therefore, current fiscal year PSDP accounts for 15% of the total industry demand.

Table 6: Federal PSDP Distribution

	PRs bn	%Share
Infrastructure	132.3	49.0
Social Sectors	130.8	48.4
Others	6.9	2.6
Total	270.0	100.0

Source: Planning Commission of Pakistan

Table 7: Comparative Allocation of PSDP in FY06 & FY07

	PSDP Allocation FY06 (Revised)	PSDP Allocation FY07	% Change
Federal PSDP	204.0	270.0*	32.4
A. Federal Prog.	132.0	170.7	29.3
B. Special Areas Prog.	14.0	16.9	20.7
C. Special Prog.	18.0	34.4	91.1
D. Corporations (WAPDA & NHA)	40.0	48.0	20.0
Provincial Development Prog.	68.0	115.0	69.1
Earthquake Reconstruction	-	50.0	-
Total (PSDP)	272.0	435.0	59.9
A. Foreign Aid	65.3	63.2	(3.2)
B. Local	206.7	371.8	79.9

Source: Planning Commission of Pakistan

Dams

Effect of dam construction on cement demand is exaggerated

Construction of dams is one of the most controversial topics in the cement industry. Hype about a dam construction has historically caused positive interest in cement stocks. However, we believe that their impact on cement demand is somewhat exaggerated. Even the largest planned dam like Kalabagh is expected to consume around 4.5-5mntn over a span of four to five years. This indicates that hypothetically even if Kalabagh Dam were to commence construction today, it will generate additional cement demand of 1mntn per year that is not even 5% of the total industry demand.

For argument sake, if we assume that all proposed dams start construction simultaneously, even then they will not be able to create 10% increase in total demand per year. According to the Ministry of Water and Power, currently major dams under consideration are Kalabagh and Bhasha-DiAmer. Both dams are expected to consume 4.5-5mntn cement each. Other than the above two dams, no other dam expected to start in the next four years will consume more than 1mntn cement per annum. Moreover, political issues often cause delay and problems in dam constructions. The next table shows cement demand generated if all dams were to start construction as per plan. This seems highly unlikely due to political controversies encountered in dam construction.

Table 8: Cement Demand in Dams

	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16
Bhasha-DiAmer	0.56	0.56	0.56	0.56	0.56	0.56	0.56	0.56	0.56
Kalabagh	-	1.00	1.00	1.00	1.00	1.00	-	-	-
Munda	0.17	0.17	0.17	0.17	0.17	0.17	-	-	-
Akhori	0.17	0.17	0.17	0.17	0.17	0.17	-	-	-
Nai-Gaj	0.11	0.11	0.11	0.11	0.11	0.11	0.11	0.11	0.11
Total	1.00	2.00	2.00	2.00	2.00	2.00	0.67	0.67	0.67

Source: WAPDA, Ministry of Water & Power, IGI Research

It is also expected that the cement factories situated close to the proposed dam locations will benefit the most. However, if quota allocation occurs, proximity will not be beneficial.

Table 9: Dams

Dam	Location	Construction Period	Cement Required (mn tn)	Factories Near Dam
Bhasha-Di Amer	Chilas	2008-15	4.5-5.0	Askari, Bestway, Dewan Hattar
Kalabagh	Kalabagh, near Mianwali	2009-13	4.5-5.0	Maple Leaf, Pioneer, Askari, Fauji
Munda	Swat	2008-13	0.8-1.0	Askari, Bestway, Dewan Hattar
Akhori	near Attock	2008-13	0.8-1.0	Maple Leaf, Pioneer, Askari, Fauji, Fecto, Cherat
Nai-Gaj	near Dadu	2009-15	0.8-1.0	Zeal Pak, AC Rohri, Thatta

Source: WAPDA, Ministry of Water & Power, IGI Research

Exports

Exports through land concentrated in Afghanistan Pakistan face an unusual scenario when it comes to exports. Neighboring countries accessible through land route include Afghanistan, India, Iran and China.

The bulk of Pakistan's exports are concentrated in Afghanistan. More recently, India is starting to become an attractive market to export, at least for the next two years. Both these countries have supply shortages. On the other hand, Iran and China are self sufficient. If Northern companies decide to export to countries other than these, they have to use the port in the South, which increases their freight costs from the plant to the port and puts them on a slight disadvantage to their Southern counterparts.

Afghanistan

For the last few years, Pakistan has been exporting to Afghanistan. Nevertheless, the major obstacle is the ever-changing political as well as the law and order situation in Afghanistan. This instability frequently changes the dynamics of the market. Cement demand in the Afghanistan market is expected to be 1.5-2mntpa for the next five years.

India

Exports to India have very recently been explored with DGKC taking the lead with exports of 1,500tn of SRC. We expect that the North zone manufacturers will export OPC to India through Wagha Border by road in the future.

The Indian cement market is around five times greater in terms of capacity as compared to Pakistan. However, India is currently facing an excess demand situation. The expansion phase has already begun and it is expected that it will take two to three years to come up with additional capacities. Therefore, likelihood exists that for the next two to three years, Pakistan cement manufacturers may be able to find at least 3-4mntpa exports to India. Currently Pakistan's cement is cheaper as compared to Indian as Pakistan cement price in Indian market is about IRs200 whereas Indian manufacturers are offering a price of IRs240. Moreover, Pakistan cement quality is also superior. Therefore, Pakistan manufacturers are likely to find no problems on the demand side. The only obstacle may be Indian manufacturers' retaliation to Pakistan's exports.

BOT Terminal

Exports through sea route constrained in the absence of BOT terminal The currently available facilities on the port allow loading of less than 1mntpa of cement. The government is considering construction of a BOT terminal; however, implementation of this idea may take a few years time. Currently most of the manufacturers with surplus capacities are lobbying in favor of the construction of BOT Terminal.

The BOT Terminal will enable manufacturers to load 5 to 10mntpa of cement depending on the size of the terminal. A proactive step in this regard is LUCK's decision to import baulkers for loading cement on ships. Negotiations with the government are underway for obtaining storage space on the port. LUCK plans to build 25,000 to 30,000tn silos for the storage of cement.

Middle East (UAE) Market

Middle East market-an untapped export market Some cement manufacturers are of the view that it will not be easy to find external markets. However, the fact remains that there is a huge market available not only in the Middle East but also in some of the African countries. These countries do not have cement manufacturing capabilities internally due to lack of investment. This creates a major opportunity for Pakistan's manufacturers to explore these markets in which investors are reluctant to make long-term investments.

Supply

Major expansions in the past year Industry wide capacity determines the demand-supply gap. The demand supply situation reverses periodically. After every three to four years, a round of expansions raises the supply in excess of demand. Demand eventually rises to close the gap and a fresh round of expansions starts. Currently the capacity expansion in the industry that started in FY06 is nearing its end. This suggests that capacity will remain stagnant for the next three to four years.

In the past few years, industry capacity has almost doubled. Total industry capacity is expected to reach 35.2mntpa by year end FY07. The companies under our coverage have been the industry's largest expanders. This is evident from Table 10 below. Market share of our selected companies has increased from 36% in FY05 to 49% in FY07. As other smaller manufacturers bring their enhanced capacities online, the market share of our selected companies is expected to experience a slight decline to 44% in FY08. After that it is expected to stabilize.

	FY02	FY03	FY04	FY05	FY06	FY07E	FY08E	FY09E
LUCK	1.44	1.44	1.44	1.44	5.22	6.48	6.48	6.48
DGKC	1.65	1.65	1.65	1.65	1.95	4.02	4.02	4.02
MLCF	1.46	1.46	1.46	1.46	1.49	3.51	3.51	3.51
PIOC	0.60	0.60	0.60	0.60	2.00	2.00	2.00	2.00
FCCL	0.90	0.90	0.90	0.90	1.09	1.11	1.11	1.11
Others	9.13	9.34	10.25	10.85	10.44	18.09	21.40	21.97
North Zone	11.75	11.75	12.40	13.00	15.81	27.60	30.62	31.19
South Zone	3.43	3.64	3.89	3.89	6.40	7.60	7.90	7.90
Total	15.18	15.39	16.30	16.90	22.21	35.21	38.52	39.09

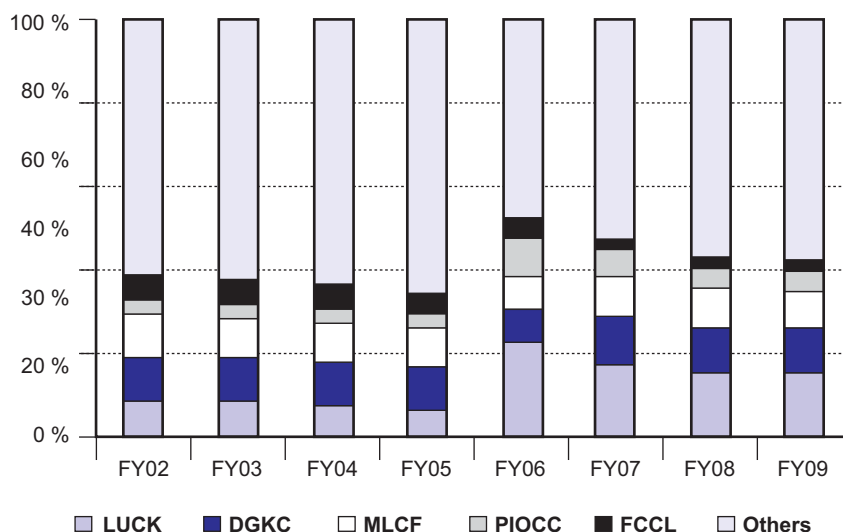
Source: Company Reports, APCMA and IGI Research

Capacity plays a very important role in industry dynamics, especially in an oligopolistic structure. Currently the industry is mainly comprised of two types of players. The first type comprises of the aggressive expanders fighting for market share. LUCK has clearly emerged as the leader in this regard beating the long-standing leader DGKC. The second type comprises of followers trying hard to maintain their market share. Both types of players need to undertake expansions in order to achieve their respective goals (i.e. to gain or maintain market share). Those that are unable to expand have the risk of eventually being acquired by a larger player.

LUCK initiated capacity expansions in FY06 For a brief time at the end of FY06 the cement industry appeared to be somewhat concentrated with LUCK alone having more than 23% of market share (of capacity). However, this was only due to LUCK's initiative to expand before everyone else. As other expansions came along during the year, LUCK's share is destined to come down. It is expected that at the end of FY07 LUCK's market share will come down to less than 19% and later stabilize around the 16.7% level.

Chart 7: Total Capacity (Market Share)

LUCK is market leader in terms of capacity

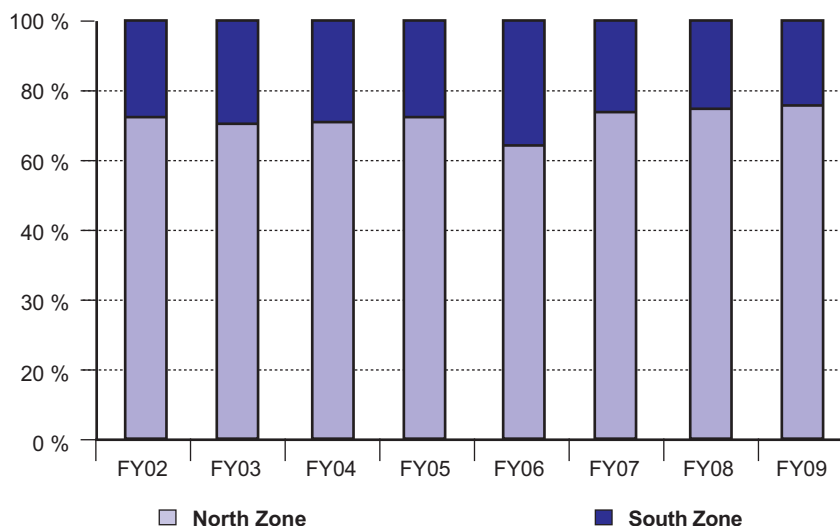


Source: Source: Company Reports, APCMA and IGI Research

Most plants concentrated in the North

Plant locations can have a significant impact on selling and distribution costs of companies (read section on costs). Most cement manufacturing plants are concentrated in the North zone. LUCK is the only large manufacturer to have significant capacity in both the North and South regions.

Chart 8: Total Capacity (North vs. South)



Source: Source: Company Reports, APCMA and IGI Research

Pakistan's sea coast lies in its extreme South. Plant location can, therefore, also determine the export markets a company chooses to target. Locating in the South means that exporting through the sea route is less expensive (read section on sales).

Industry focus shifting to South for expansions

In terms of future outlook of capacity expansions, we believe that the industry will shift its focus towards the Southern region. Pakistan is divided into two parts when it comes to cement distribution, North and South. North comprises of the provinces of NWFP and Punjab while the South is divided into the provinces of Sindh and Balochistan. It is interesting to

note that over the years, Pakistan's cement capacity has mainly been concentrated in the North with around 75-80% of total capacity. However, the current excess capacity situation, limited avenues to export through land and high transportation costs of the Northern manufacturers are driving them to expand in the South so that they can use the sea and explore the Middle Eastern, African and other countries. In the next round of expansion, which is expected to start three or four years later; we may witness the share of South breaching the 25% of industry capacity. However, currently with BOT terminal issue on the hold, planned dam construction mainly in the North and exports to India expected to improve, expansion in the South is a risky idea unless a company has its own arrangements to load at the sea port similar to LUCK.

We expect industry capacity to reach 40mntpa by the end of FY10. After that industry capacity is expected to stabilize. Changes in the shares of capacity may change as companies get merged and acquired by others. However, fresh expansions are unlikely for at least the next two to three years.

Industry Comparison

Cement sales on rise Strong economic growth has spelled well for Pakistan's cement manufacturers and cement sales have been on a constant rise. CAGR of cement sales for the past years, FY02 to FY06 has been 17%.

Table 11: Total Sales						mntn
	FY02	FY03	FY04	FY05	FY06	1HFY07
LUCK	0.78	1.10	1.12	1.42	2.19	1.93
DGKC	1.09	1.43	1.48	1.82	2.13	1.16
MLCF	0.96	1.00	1.12	1.32	1.47	0.71
PIOC	0.39	0.50	0.48	0.71	0.83	0.51
FCCL	0.59	0.64	0.83	0.90	1.06	0.56
Others	6.09	6.71	8.61	10.15	10.70	6.13
North Zone	7.54	9.15	10.74	12.99	14.76	9.12
South Zone	2.39	2.25	2.91	3.35	3.64	1.91
Total	9.93	11.41	13.66	16.35	18.41	11.03

Source: Company Reports and IGI Research

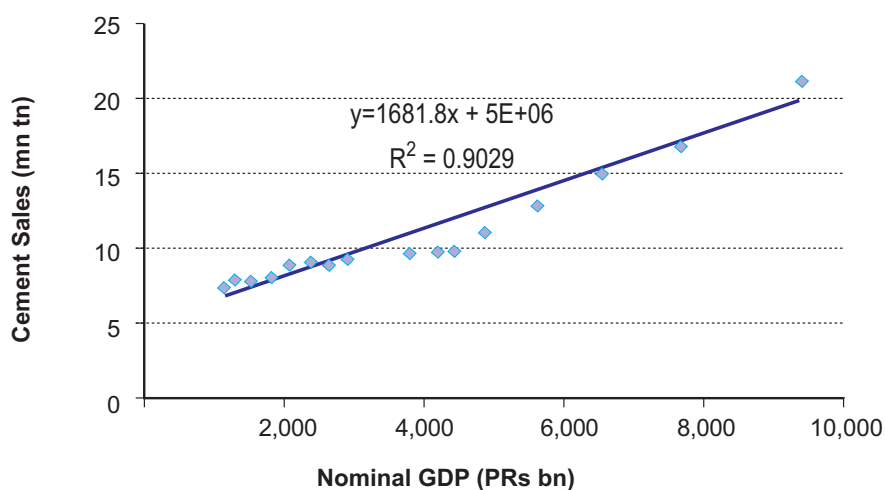
Sales growth is affected by two factors: Volumetric growth and price per bag. There is considerable disparity in terms of individual company sales growth. This is because in some companies there is neither capacity expansion nor any volumetric sales growth but their sales are affected by sales prices.

Volume

Cement sales highly correlated to Nominal GDP Cement dispatches have been on a record high in recent years. Cement demand is directly related to economic growth. In periods of high GDP growth, cement sales growth also goes up. In periods of economic downturn, cement sales growth declines.

We have regressed cement sales against nominal GDP for the years FY92 to FY06. We find that the two show highly positive correlation with $R^2=0.9029$. According to our estimates cement sales are likely to increase at 1.3x the growth in nominal GDP in FY07.

Chart 9: Cement Sales vs. Nominal GDP



Source: SBP and APCMA

Price per Bag

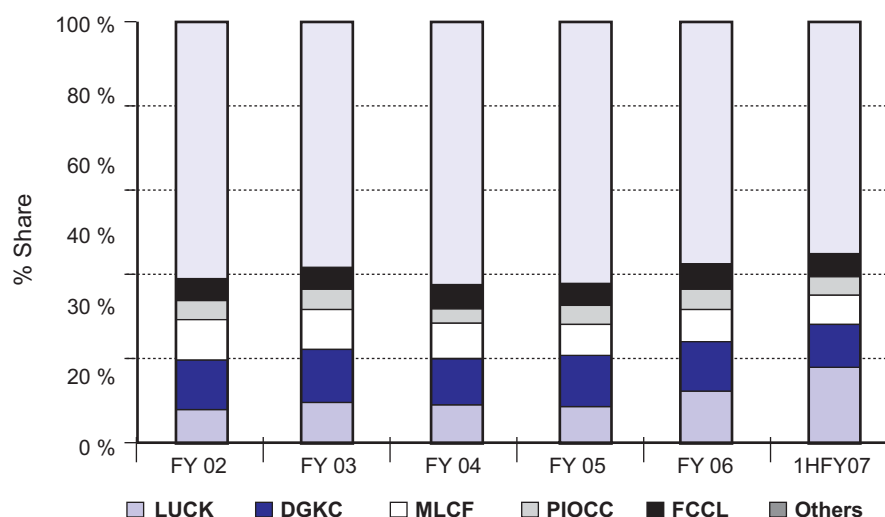
Price per bag is set collusively Manufacturers jointly set cement sales prices. Price wars can and often do occur to disrupt the pricing agreement. Over time cement manufacturers have learnt that price wars hurt every player's profitability. Consequently, price wars do not last for long and eventually the pricing agreement is reinforced.

Currently, the industry is reviving the pricing agreement after a price war that was initiated in May 2006. This war was triggered by DGKC's price cuts in an effort to gain market share after expansion of its capacity.

Market Shares

Changing market shares- LUCK the new leader In terms of individual companies, DGKC was the long-standing market leader in terms of sales. However, as a result of its recent capacity expansion program, LUCK has been able to grab the lion's share of cement sales. As of 1HFY07, LUCK's market share is 17.54% while DGKC's is 10.52%.

Chart 10: Total Sales (Market Share)



Source : APCMA, Company Reports and IGI Research

Local Sales

Local sales show CAGR of 15% Local sales have shown a CAGR of 15% over the years FY02 to FY06. The bulk of these sales come from the Northern region.

Table 12: Local Sales

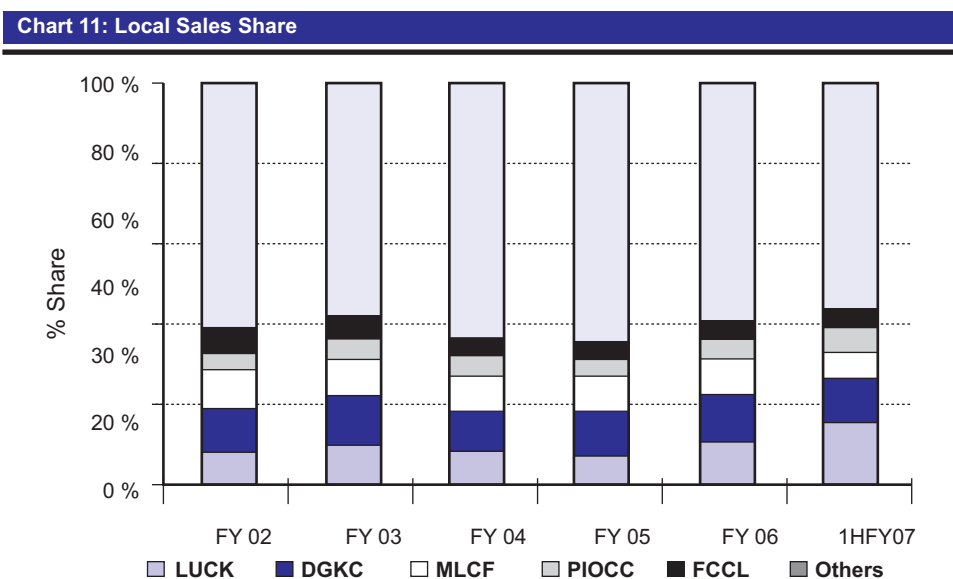
	FY02	FY03	FY04	FY05	FY06	1HFY07
LUCK	0.77	1.05	1.00	1.14	1.86	1.55
DGKC	1.09	1.39	1.31	1.53	1.96	1.09
MLCF	0.96	1.00	1.12	1.32	1.47	0.71
PIOC	0.39	0.50	0.47	0.55	0.71	0.45
FCCL	0.58	0.61	0.71	0.79	0.95	0.50
Others	6.02	6.40	7.89	9.43	9.93	5.65
North Zone	7.43	8.72	9.65	11.48	13.35	8.38
South Zone	2.39	2.25	2.88	3.30	3.55	1.59
Total	9.83	10.97	12.54	14.78	16.90	9.97

Source: Company Reports, APCMA & IGI Research

In terms of individual companies, LUCK has experienced the greatest increase in sales. This is mainly due to LUCK’s presence in both North and South regions. Consequently, its share of the total local sales has increased from 11% in FY06 to 15.6% in 1HFY07. DGKC’s sales have grown at CAGR of 16% over the years FY02 to FY06. It too has gained market share from others, however, at a slower pace than LUCK. PIOC has also shown slight improvement in market share from 3.7% in FY05 to 4.3% in FY06. We expect the situation to change in the future for MLCF because of its capacity expansion. However, FCCL is expected to lose market share further because it has failed to expand in the current phase of expansions. We expect FCCL to acquire a smaller company in order to retain its market share.

	FY02	FY03	FY04	FY05	FY06	1HFY07
LUCK	7.9	9.6	8.0	7.7	11.0	15.6
DGKC	11.1	12.7	10.5	10.4	11.6	11.0
MLCF	9.8	9.2	9.0	9.0	8.7	7.2
PIOC	4.0	4.6	3.8	3.7	4.3	4.6
FCCL	5.9	5.6	5.7	5.4	5.6	5.0
Others	61.2	58.3	63.0	63.8	58.8	56.7
North Zone	75.6	79.5	77.0	77.6	79.0	84.0
South Zone	24.4	20.5	23.0	22.4	21.0	16.0
Total	100.0	100.0	100.0	100.0	100.0	100.0

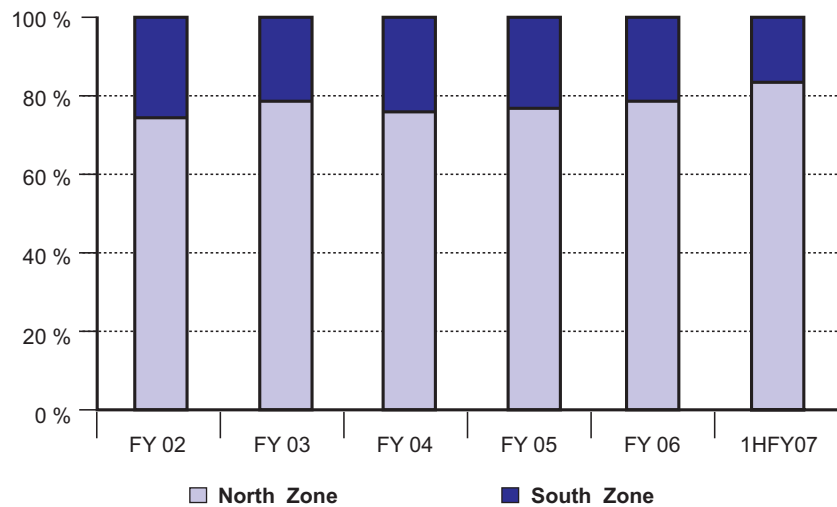
Source: Company Reports, APCMA & IGI Research



Source : APCMA, Company Reports and IGI Research

Share of sales in the South has declined Sales in the Southern region form less than 20% of total local sales. The main reason is that plants are mostly concentrated in the North. As more and more manufacturers start expanding in the South we expect its share in sales to rise.

Chart 12: Market Share of Local Sales (North vs. South)



Source : APCMA, Company Reports and IGI Research

Exports

Exports through sea present significant potential

Globally, cement manufacturing countries utilize their production internally and exports form a very small part of total sales. Pakistan is no exception.

Pakistan cement industry is going through a very interesting phase when it comes to exports. In the past Pakistan did not export in large quantities and export sales were a very small portion of overall sales. However, in the current scenario when demand in the country is hovering around 66% of the installed capacity, it is expected that most manufacturers would operate on capacity utilization levels above 85% and increase their share of export sales.

Historically, Pakistan has mainly been involved in exporting to neighboring countries through land with little emphasis on export through sea. Currently the only available neighboring country for significant amount of export is Afghanistan, however, demand in the Afghan market is just about 1.5mntpa and more importantly its political instability adds further uncertainty to demand. Recently, India has emerged as an attractive country to export as current demand is slightly higher than supply in India and it is expected that for next two to three years it will be a good market for exports until its new local capacities come online. Other neighbors like Iran and China are self sufficient though sometimes less popular kinds of cement like White Cement or SRC are exported to these countries. However, OPC, which constitutes more than 99% of cement produced in Pakistan, is not exported to these countries.

Table 14: Exports

	2002	2003	2004	2005	2006	1HFY07
LUCK	5175	46706	116920	277268	334869	381448
DGKC	6863	41486	169870	289754	165692	67908
MLCF	0	0	0	0	0	0
PIOC	987	1013	3100	166486	118028	57674
FCCL	15202	26150	113314	110210	113410	68736
Others	78393	314967	715089	721452	773160	485092
North Zone	106060	428602	1088218	1516370	1409492	741963
South Zone	560	1720	30075	48800	95667	318895
Total	106620	430322	1118293	1565170	1505159	1060858

Source: Company Reports & IGI Research

	FY02	FY03	FY04	FY05	FY06	1HFY07
LUCK	4.9	10.9	10.5	17.7	22.2	36.0
DGKC	6.4	9.6	15.2	18.5	11.0	6.4
MLCF	0.0	0.0	0.0	0.0	0.0	0.0
PIOC	0.9	0.2	0.3	10.6	7.8	5.4
FCCL	14.3	6.1	10.1	7.0	7.5	6.5
Others	73.5	73.2	63.9	46.1	51.4	45.7
North Zone	99.5	99.6	97.3	96.9	93.6	69.9
South Zone	0.5	0.4	2.7	3.1	6.4	30.1
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: Company Reports & IGI Research

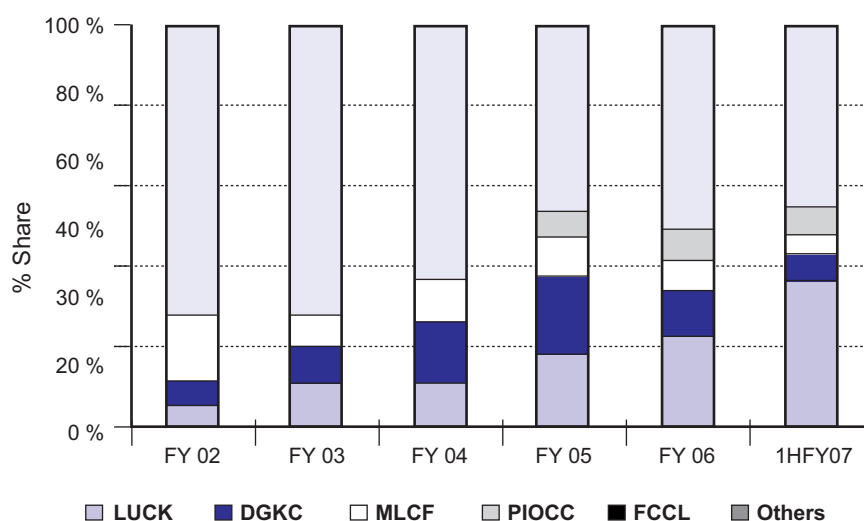
Absence of BOT terminal constrains export growth

In terms of individual companies, the most dramatic increase in exports has come from LUCK. This is mainly due to its expansion in the South as well as measures to load cement onto ships in the absence of a BOT Terminal.

It is surprising that only recently the Northern manufacturers have started to realize the untapped potential of expanding in the South mainly due to the availability of sea route through which they can explore various markets. However, even if these manufacturers start expanding in the South, unless the issue of BOT terminal is resolved, these companies will not be able to tap the export market.

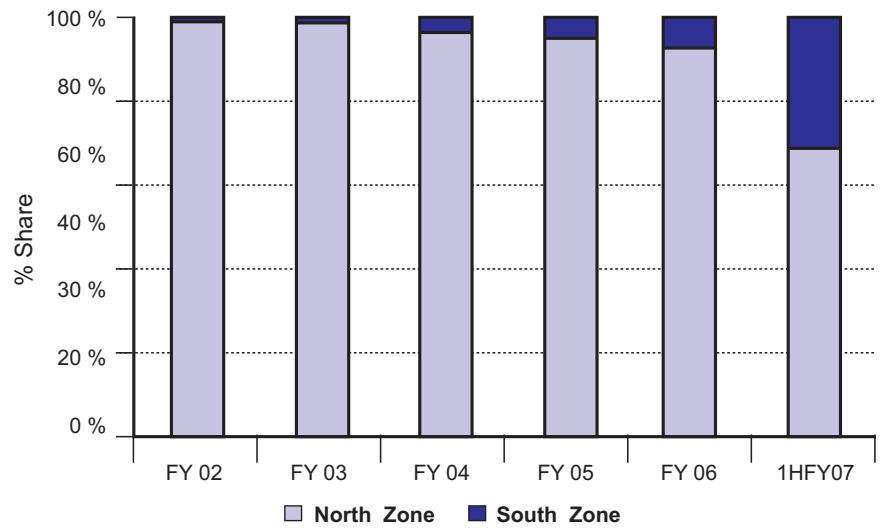
Chart 13: Export Share

South has increased share in exports



Source : APCMA, Company Reports and IGI Research

Chart 14: Export Share (North vs. South)



Source : APCMA, Company Reports and IGI Research

Costs

Cost of sales can broadly be divided into three categories:

- Manufacturing cost
- Administrative cost
- Selling & distribution cost

Table 16: COGS/tn						PRs
	FY04	FY05	FY06	FY07E	FY08E	FY09E
LUCK	1,529	1,912	2,169	2,196	2,201	2,271
DGKC	1,739	2,247	2,203	2,795	2,481	2,558
MLCF	1,951	2,083	2,367	2,303	2,371	2,455
PIOC	1,935	1,905	2,264	2,392	2,458	2,545
FCCL	1,883	1,933	1,968	2,159	2,366	2,450

Source: Company Reports & IGI Research

The COGS per ton for most manufacturers is similar. Only FCCL has clearly exhibited lower than average COGS per ton. This has more to do with older plants with lower depreciation rather than manufacturing efficiency.

Manufacturing costs-largest component of COGS

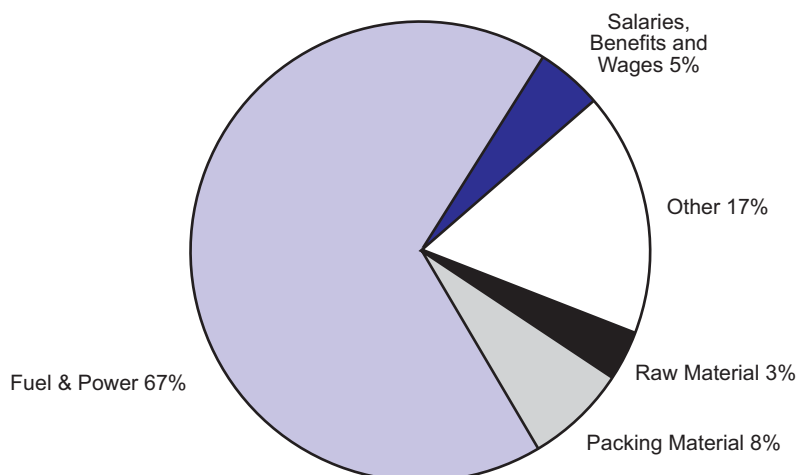
The most important and largest component cost is manufacturing cost. Fuel costs in turn form the largest component of manufacturing costs. Since most manufacturers have shifted to the dry process of manufacture, fuel used is mainly coal. The other components of manufacturing costs are materials, packaging and labor which together contribute around 20% of manufacturing costs.

Table 17: COGM/tn						PRs
	FY04	FY05	FY06	FY07E	FY08E	FY09E
LUCK	1,541	1,902	2,190	2,185	2,203	2,271
DGKC	1,735	2,252	2,231	2,802	2,483	2,556
MLCF	1,943	2,090	2,369	2,294	2,373	2,455
PIOC	1,946	1,905	2,219	2,395	2,457	2,546
FCCL	1,866	1,941	1,966	2,173	2,369	2,448

Source: Company Reports & IGI Research

The average manufacturing cost per ton for our selected companies has the following breakup:

Chart 15: Manufacturing Cost Breakup



Source : Company Reports and IGI Research

Manufacturing costs are extremely vulnerable to fuel costs

As is evident from the above chart, manufacturing costs are extremely vulnerable to fuel prices. Coal is the fuel used in most manufacturing plants but its prices have increased by more than 50% in the past three years. However, it is still cheaper and fairly more stable when compared to oil. Shifting to the dry process has meant that cement manufacturing costs are not exposed to volatile oil prices. It is important to note that coal is considered a substitute to oil in many instances. If oil prices rise, coal prices may also exhibit upward pressure. We have therefore carried out a sensitivity analysis of impact of coal prices on fair values of cement manufacturers. (For details of individual company's sensitivity to coal prices read stock summaries).

Fuel consumption depends upon the manufacturing plant's age. On an average, new plants consume 135-145kg of coal to produce 1tn of clinker whereas old plants consume 150-155kg of coal to produce the same quantity.

High sulfur content in locally extracted coal makes it unsuitable for cement production. Therefore, coal is usually imported from Indonesia and South Africa through sea. Coal cost averages at PRs4,700 per ton for Southern plants and PRs5,500 per ton for Northern plants due to additional transportation cost from port to the plant for Northern manufacturers. During the past 3 years, international coal prices increased by more than 50%. In FY04 the average coal price was around US\$40 per ton and currently it is trading around US\$70 per ton. Nevertheless, coal is still relatively cheaper than furnace oil. The sensitivity of cement share prices to coal is given in the next table. In the base case we have considered coal prices to grow at a CAGR of 4% for the next 4-years.

Table 18: Share Price Sensitivity to Coal Prices

CAGR of Coal Prices upto FY10	PRs						
	(8)	(4)	-	4	8	12	16
LUCK	152	141	128	115	101	85	69
DGKC	120	114	107	100	93	85	76
MLCF	44	39	34	28	22	16	9
PIOC	59	53	46	39	31	23	15
FCCL	29	27	26	24	23	21	19

Source: Company Reports & IGI Research

LUCK has lowest S&D costs due to its presence in both North & South The other important cost of sales component is selling and distribution cost. This cost can vary depending on the plant location. We find that due to LUCK's presence in both North and South regions, its S&D cost per bag is the lowest.

Table 19: Selling & Distribution Cost per Bag						PRs
	FY01	FY02	FY03	FY04	FY05	FY06
LUCK	1.20	0.95	0.82	0.72	0.54	0.37
DGKC	0.93	0.79	0.73	1.06	1.45	0.58
MLCF	0.53	0.35	0.52	0.46	0.48	0.70
PIOC	2.57	3.00	2.78	2.93	2.27	2.35
FCCL	3.69	1.34	1.17	1.23	1.17	1.49
Average	1.78	1.28	1.20	1.28	1.18	1.10

Source: Company Reports & IGI Research

Profitability

Table 20: Operating Profit Growth

	FY04	FY05	FY06	FY07E	FY08E	FY09E
LUCK	165.15	25.17	114.01	4.08	46.82	16.54
DGKC	113.39	41.71	110.14	(33.24)	17.93	36.07
MLCF	248.60	11.39	60.43	(66.08)	144.17	24.26
PIOC	779.04	79.55	107.15	(57.16)	70.81	19.83
FCCL	18.83	(1,344.25)	105.59	(43.76)	6.14	10.85

Source: Company Reports & IGI Research

Cement manufacturers saw a spectacular rise in operating profits in FY06 on the back of a steep and unprecedented rise in cement sales price per bag. However, a price war in FY07 as a result of capacity enhancements caused a steep drop in 2QFY07 and 3QFY07. The complete year's profits are, therefore, expected to be dismal.

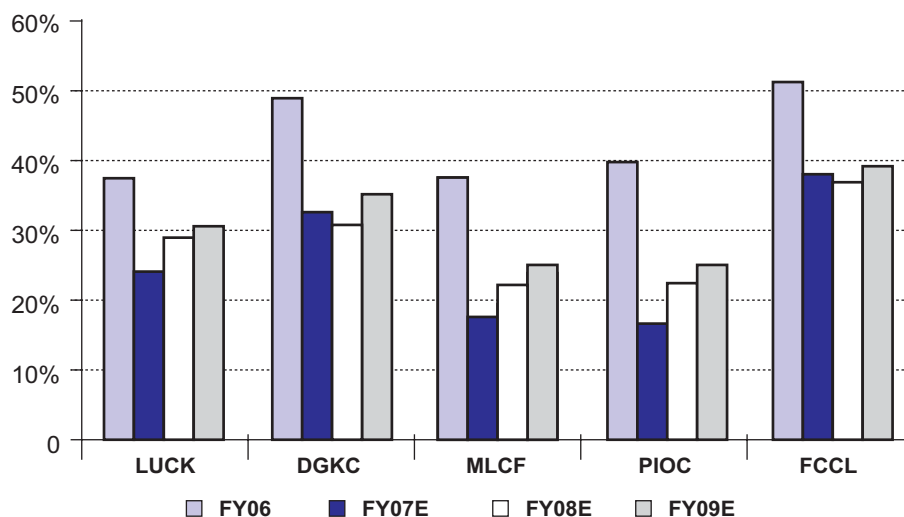
GPM for FY07 being squeezed by price war & rise in fuel costs

Gross Profit Margin (GPM) of cement manufacturers reached a record high in FY06 and was mainly driven by higher sales price. In the current fiscal year, GPM is expected to get squeezed from both directions. Sales price per bag has come down as a result of price wars and cost of sales has increased mainly due to rise in fuel costs (coal).

GPM expected to improve in future

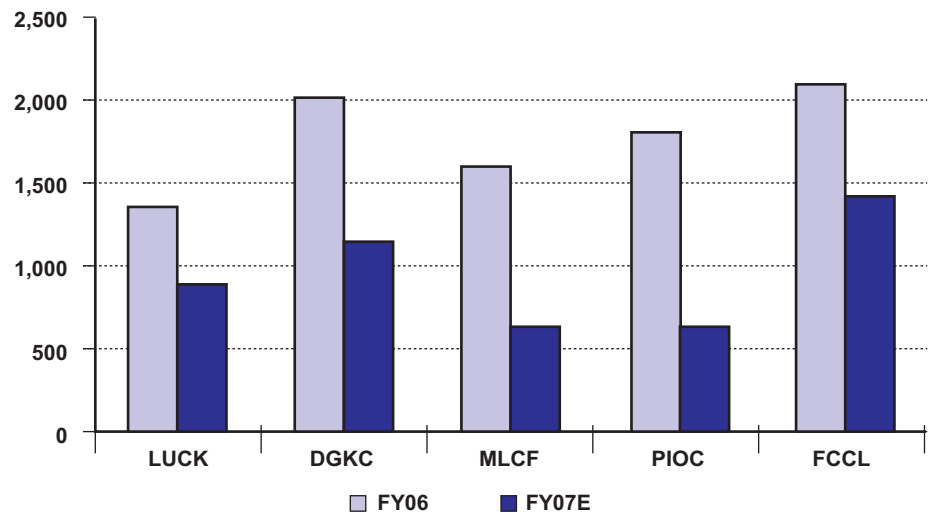
We expect GPM to improve in the future as the pricing agreement is already beginning to revive, which will give a positive boost to the companies' top line. Moreover, most companies are operating relatively new plants and efficiencies will improve, driving down cost of sales, as manufacturers move along the learning curve. The same argument applies to EBITDA per ton.

Chart 16: Gross Profit Margin



Source : Company Reports and IGI Research

Chart 17: EBITDA Per Ton



Source : Company Reports and IGI Research

Returns peaked in FY06 Profitability measures such as Return on Equity (ROE) and Return on Assets (ROA) also peaked in FY06. A dip in FY07 and subsequent recovery is expected in the ensuing years. In terms of individual companies, our most favored scrip is LUCK that has continued to show healthy returns even when the industry as a whole experienced a slump in FY07. This is due to LUCK's first mover's advantage in expansion.

FCCL's highest ROE is deceptive FCCL's returns appear to be high; however, the numbers are deceptive. These are more a result of accumulated losses and resultant lower equity size, rather than superior profits. Moreover, FCCL has lower financial charges compared to others because in the absence of plant expansions it did not need to take up fresh financing.

Table 21: Return on Equity (ROE) %

	FY04	FY05	FY06	FY07E	FY08E	FY09E
LUCK	15.86	16.10	27.38	19.92	22.45	23.25
DGKC	12.93	18.05	12.55	8.08	9.34	11.36
MLCF	14.23	11.56	14.51	4.88	5.87	9.21
PIOC	77.81	20.49	29.11	6.61	13.57	15.90
FCCL	16.20	20.84	36.67	20.72	20.37	20.96

Source: Company Reports & IGI Research

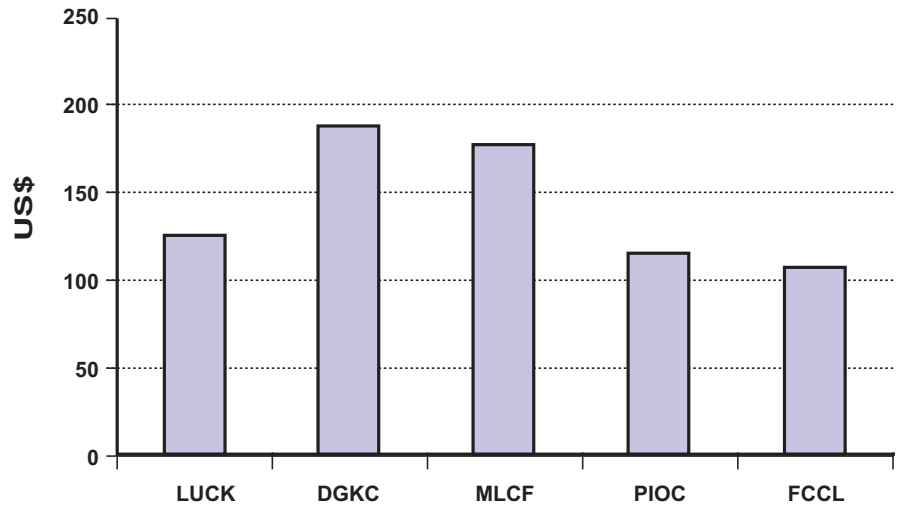
Table 22: Return on Assets %

	FY04	FY05	FY06	FY07E	FY08E	FY09E
LUCK	9.74	5.58	8.20	6.75	10.04	13.04
DGKC	7.08	9.34	7.05	4.65	5.57	7.42
MLCF	6.88	6.98	5.64	1.75	2.07	3.59
PIOC	9.93	4.82	8.04	1.87	4.20	5.62
FCCL	5.32	8.20	19.42	12.17	13.43	15.88

Source: Company Reports & IGI Research

Attractive EV/tn of sales for LUCK, PIOC & FCCL Using Enterprise Value per ton of sales we find that overall all our selected scrips are attractively priced. The lowest and most attractive are LUCK, PIOC and FCCL.

Chart 18: EV per ton of Sales (FY07E)



Source : Company Reports and IGI Research

Leverage

Traditionally, cement manufacturers have had a high level of gearing. Most plant expansions are debt financed. It has also been a common practice to repay loans through yet another loan.

Pakistan cement manufacturers are generally highly geared Long Term Debt-to-Equity ratio on an average is quite high. The only consistent exception to this has been DGKC. PIOC started with exorbitantly high level of gearing in 2003 and has managed to bring it down since. In some cases this ratio can be misleading when companies have low levels of equity due to accumulated losses.

Table 23: Long Term Debt-to-Equity Ratio %

	FY04	FY05	FY06	FY07E	FY08E	FY09E
LUCK	27.17	127.70	144.05	91.30	44.39	22.54
DGKC	36.28	54.79	38.73	38.42	26.18	18.26
MLCF	60.37	34.41	109.02	114.93	115.72	84.71
PIOC	579.62	202.33	151.32	127.46	97.16	70.10
FCCL	185.60	104.80	43.65	30.03	14.08	0.00

Source: Company Reports & IGI Research

For an alternative indication of financial risk we take a look at the companies' debt-to-asset ratio. We find that on an average companies finance half of their assets through debt financing. An exception again is FCCL, which did not take fresh financing for reasons discussed earlier.

Table 24: Debt-to-Asset Ratio %

	FY04	FY05	FY06	FY07E	FY08E	FY09E
LUCK	16.69	93.49	145.23	110.65	67.22	42.83
DGKC	19.88	28.34	21.75	22.10	15.61	11.93
MLCF	29.19	20.75	42.35	41.16	40.82	32.98
PIOC	73.93	47.62	41.80	36.13	30.06	24.78
FCCL	60.89	41.25	23.12	17.64	9.28	0.00

Source: Company Reports & IGI Research

LUCK has highest debt servicing capacity Carrying a large amount of debt can be less troubling if the company is profitable and can service the debt with ease. To judge this factor we compare interest coverage ratio of our selected companies. It is evident that LUCK has been the best performer when it comes to interest coverage. DGKC has also been fairly impressive. FCCL has made the most remarkable recovery; however, it is fair to mention that FCCL's debt costs have been low in the past due to the loan it got from the Fauji Foundation at a surprisingly low rate of interest.

Table 25: Interest Coverage Ratio x

	FY04	FY05	FY06	FY07E	FY08E	FY09E
LUCK	16.01	15.15	12.75	4.04	4.01	6.15
DGKC	7.43	8.29	9.08	3.94	4.48	5.79
MLCF	3.14	6.00	5.79	1.76	1.49	2.01
PIOC	3.03	4.26	5.74	2.02	3.13	4.15
FCCL	-0.19	4.31	7.73	4.52	5.43	8.00

Source: Company Reports & IGI Research

High degrees of leverage suggest risk exposure to changes in sales Gearing can also be assessed through the companies' degree of leverage. Through forecasts of FY07, we find that LUCK, DGKC and FCCL have fairly similar level of total leverage. However, MLCF and PIOC have exceptionally high levels of total leverage.

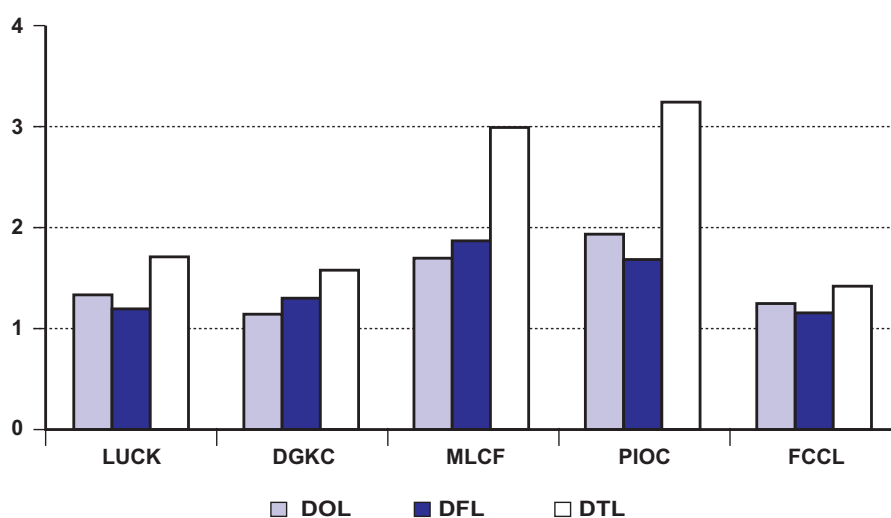
Degree of Total Leverage (DTL) measures the sensitivity of net profits to changes in sales. A high DTL means that a unit increase in sales will cause a large change in profits. This means that due to the presence of large amount of fixed costs, both positive and negative impacts of sales are magnified. The biggest losers can also turn out to be the biggest gainers.

DTL is a product of Degree of Operating Leverage (DOL) and Degree of Financial Leverage (DFL). DOL measures the impact of change in sales on EBIT due to the presence of fixed operating costs. DFL measures the impact of change in EBIT on EPS due to the presence of fixed financial or interest charges.

MLCF is the most vulnerable to changes in sales On an individual basis, we find that MLCF is the most vulnerable to slight changes in sales. This means that reinforcement of pricing agreement and the resultant rise in prices will have the greatest positive impact on MLCF. On the other hand, if the pricing agreement breaks down again and prices decline, MLCF will be the worst hit.

The same argument applies to PIOC. Overall, in the current scenario wherein sales price is increasing, MLCF and PIOC should be the most attractive choice.

Chart 19: Leverage



Source : Company Reports and IGI Research

Stock Summaries

Lucky Cement Limited

Initiating Coverage

Recommendation: NEUTRAL

Fair Value: PRs115

Investment Consideration

- Current market leader in terms of capacity with 6.5mntpa or 16.5% market share of total industry capacity.
- Capturing highest sales share in the industry with 15.6% share of local sales and 36% share of exports sales.
- Strong group backing in the form of 33% shareholding of Younus Brothers Group.
- One of the first manufacturers to come up with expansions in both North and South regions; more importantly the only one to come up with expansions in the South.
- Proactive move to make arrangements for exporting around 2mntpa cement through sea rather than deferring exports till the resolution of BOT terminal issue, like others did, imported its own baulkers and sucker machines to facilitate massive handling at port.
- Lowest selling and distribution cost in the industry due to its manufacturing capabilities in North as well as in South.
- Planning for storage capacity at the port of 25,000-30,000tn silos to boost export capability.
- Greatest exposure to fuel costs which form 81% of manufacturing cost-the highest in the industry.

KATS Code	LUCK
Bloomberg Code	LUCK PA
Reuters Code	LUKC.KA
Current Price (PRs per share)	102.90
Average Daily Volume (shares) ('000)	10,925.49
Market Capitalization (PRs mn)	27,101.29
Paid-up Capital (PRs bn)	2.63
Shares Outstanding (mn)	263.375
Free Float (%)	30
Weightage in KSE-100 (%)	0.89
Average Price (PRs per share)	94.84

Chart 20: LUCK: Price Performance



Source : Company Reports and IGI Research

Table 26: Estimates

	FY04	FY05	FY06	FY07E	FY08E	FY09E
Net Income (PRs '000)	683,208	826,587	1,935,950	1,692,661	2,383,717	3,098,063
Dividend per Share (PRs)	0.7	-	-	1.0	1.0	1.5
Earning per Share (PRs)	2.6	3.1	7.4	6.4	9.1	11.8
Book Value per Share (PRs)	16.4	19.5	26.8	32.3	40.3	50.6
Price/Book (x)	1.6	2.1	3.1	3.2	2.5	2.0
Price/Earning (x)	10.0	13.1	11.3	15.9	11.3	8.7
Dividend Yield (%)	2.7	0.0	0.0	1.0	1.0	1.5

Source : Company Reports and IGI Research



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Introduction

LUCK is part of the Younus Brothers group Lucky Cement Limited (LUCK) is a Younus Brothers group project. Younus brothers group has 35% shares in the company whereas the free float is 30%. LUCK has manufacturing facilities in the following locations:

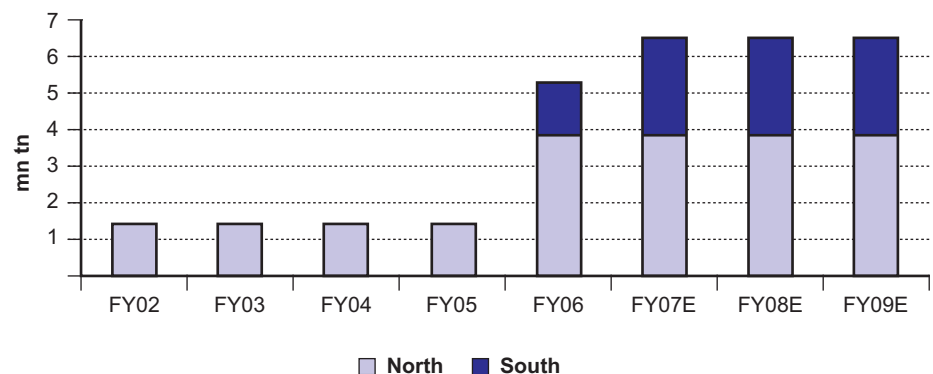
- Main Indus Highway between D.I.Khan & Bannu in Pezu, District Lakki Marwat, NWFP (13,000tpd capacity)
- Super Highway, near Karachi (8,600tpd capacity)

LUCK is currently operating at a capacity of 21,600tpd that is approximately 6.5mntpa and going forward LUCK is expected to benefit from economies of scale. In the North, LUCK has 13,000tpd capacity while in the South; two new plants are operating to produce 4,300tpd each.

Market Share

Largest share in sales at 17.5% Due to its timely decision to expand LUCK has been able to grab the long held position of market leader from DGKC. It is now the largest cement manufacturer with production facilities in North and South of Pakistan. It has emerged as the leader in exports market as well as in the domestic market in terms of capacity and sales.

Chart 21: LUCK: Regional Capacity

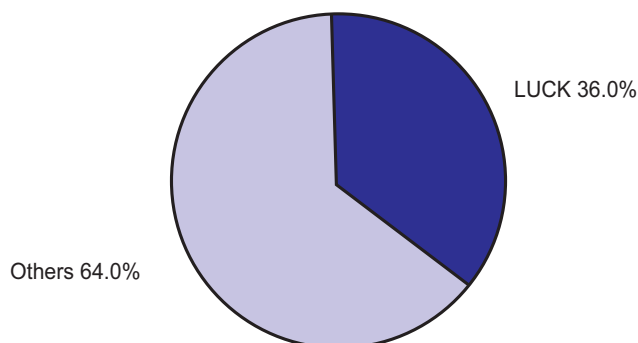


Source : Company Reports and IGI Research

Exports

Expansion in South affords greater export avenues This is one feature that makes LUCK stand above the rest, namely its timely decision to expand and more importantly where to expand. LUCK expanded in both regions; however, its expansion in the relatively untapped Southern region has enabled it to enjoy the position of a leading exporter. Exports are easier for LUCK because it can cut down on the transportation costs that Northern manufacturers have to bear in order to bring their products near the seacoast for shipping. During 1HFY07, total exports of cement were 1.06mntn, out of which 0.381mntn was done by LUCK.

Chart 22: LUCK: Exports Share (1HFY07)



Source: Company Reports, APCMA and IGI Research

The One to Initiate

First mover in terms of expansion in the recent past

LUCK at the moment is in a position to enjoy and capitalize on the first mover's advantage. It was the first manufacturer to undertake a capacity expansion program in recent years, after which other players followed suit. Moreover, LUCK also incurred the least cost of expansion as its machinery was purchased from China whereas other domestic manufacturers chose to purchase European machinery. In the near future, LUCK has no plans to expand any further suggesting that its capital expenditure and financing costs will decline.

BOT Terminal Issue

BOT terminal constraints export sales

The lack of loading capacity at ports constrains Pakistan's cement exports through sea. Major cement manufacturers with excess capacities are conducting negotiations with the government for a BOT Terminal, which will boost the loading capacity on the port from the current 0.5mntpa to 5-10mntpa depending on the size of the terminal.

LUCK, in this regard, has gone one-step further and acquired baulkers with capacities ranging from 16,000 to 25,000tn, which will enable it to load 7,000 to 7,500tpd. Currently, it can load 3,000-3,500tpd. It is planning to buy 25 such baulkers. LUCK is also in pursuit of acquiring land on the port to build 25,000 to 30,000 silos for cement storage. All these measures will enable LUCK to export 2mntpa through sea.

Product Differentiation

Attempt to differentiate its product in a homogenous market

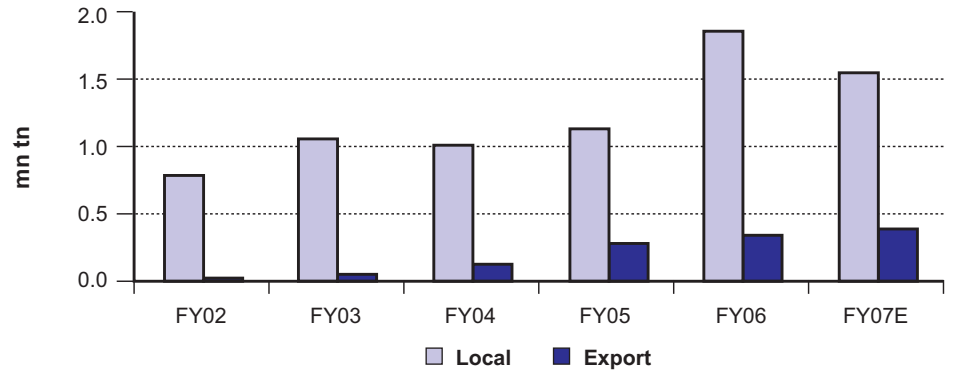
In a homogenous market the fight for market share has forced players to differentiate and develop niches. LUCK has introduced Ready Mix, which has customized composition to suit customer preferences. Furthermore, the company has also introduced on-site delivery service. After the earthquake which hit Northern Pakistan in October 2005 demand for this product has been increasing. Currently, the new initiatives of LUCK might add an insignificant portion of total production; however, the company is committed to establish a brand identity which can contribute up to 10% to the bottom line.

Sales

Share of export sale is rising

LUCK sales are predominantly to the local market. Even then the proportion of exports sales to total sales is the highest in the sector. It is the market leader in both local and export sales.

Chart 23: LUCK: Sales Breakup



Source: Company Reports, APCMA and IGI Research

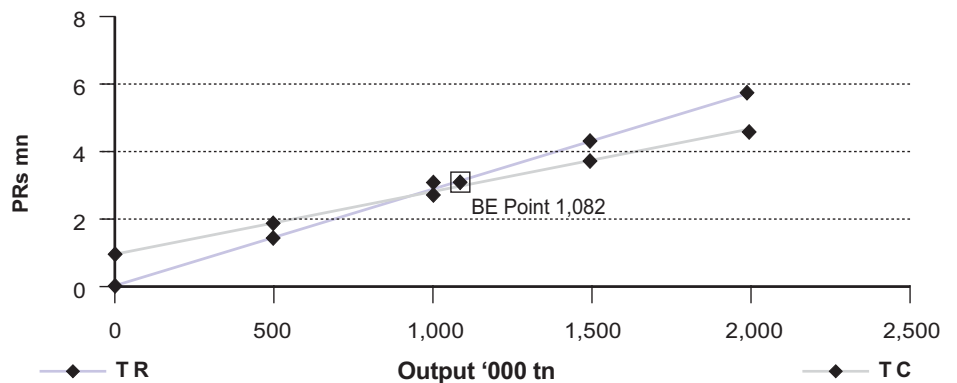
Phenomenal growth in sales in FY06

Sales growth of more than 90% was phenomenal in FY06 and we expect the trend to continue in FY07 but in FY08 and FY09 we expect a slight decline as all other manufacturers will bring their additional capacities online by then and it will be impossible for LUCK to maintain current growth levels consistently without expansions. However, in the current situation LUCK has a distinct advantage with its enhanced capacity already on line while others are still in expansionary phase.

Breakeven Analysis

Our breakeven analysis suggests that with a constant sales price figure of PRs210 per bag, the company quantity breakeven point stands at 1,081,522tn level of sales. Our analysis is based on the assumption that the fixed costs are constant and that sales equal production. Nevertheless, it is a reasonable supply side measure that depicts the level of output that must be achieved in order to reach a no-loss-no-gain situation.

Chart 24: LUCK: Break-Even Analysis



Source: Company Reports and IGI Research

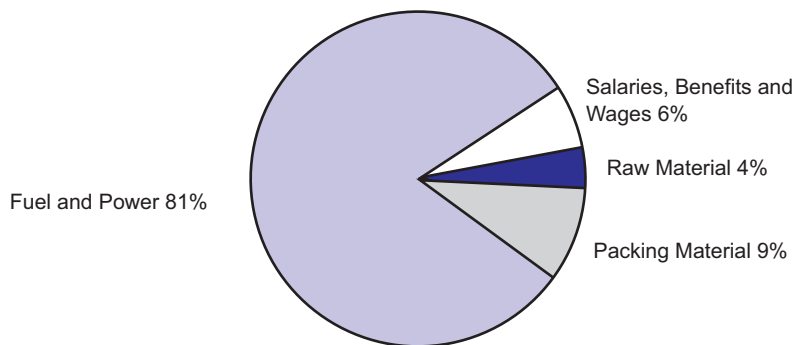
LUCK's level of break-even is the highest in our selection. The average level of breakeven for our selected companies is 606,376tn. This is due to its relatively higher amount of fixed manufacturing costs. These numbers also suggest somewhat inefficient manufacturing capabilities.

Cost Reduction

Least cost of expansion and low financial charges

LUCK came up with the least expensive expansion when compared to others in the industry. Enterprise Value per ton of capacity is expected to be US\$89 in FY07, which indicates low cost of expansion.

Chart 25: LUCK: Manufacturing Cost



Source: Company Reports and IGI Research

Manufacturing costs exposed to fuel costs

LUCK's manufacturing cost has a greater proportion of fuel cost as compared to our selected companies. This suggests that it is more vulnerable to changes in fuel costs, particularly coal.

S&D costs are the lowest

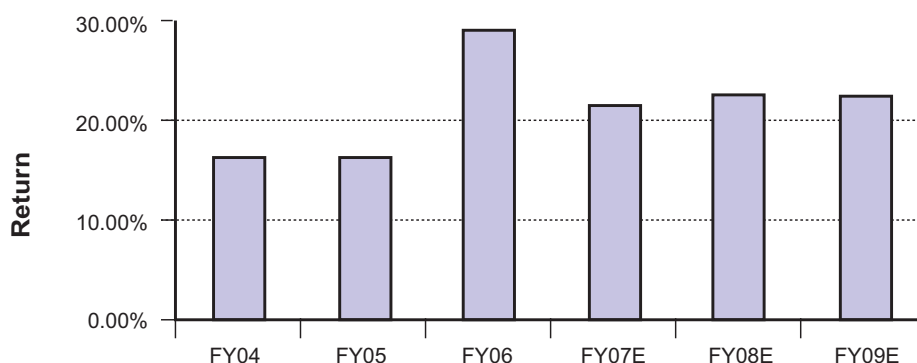
LUCK is the most efficient when it comes to Selling and Distribution (S&D). It has the lowest S&D cost per bag because of its presence in both North and South regions.

Profitability

Operating profit growth of 114% in FY06

The company has shown operating profit growth of 114% in 2006. In FY07, we expect subdued growth in operating profits due to the cartel war in the second and third quarter of the current fiscal year and rising fuel cost. Both these factors are expected to reduce gross margins for manufacturers across the board.

Chart 26: LUCK: Return on Equity



Source: Company Reports and IGI Research

ROE has been low historically but is expected to improve in future

Return on Equity was less than 20% in FY04 and FY05, however, in FY06 it breached that mark significantly and we expect it to remain more than 20% till FY09. The dividend payout has not been high as a result of the extensive expansions that LUCK has gone through in

the recent years, however, in future we expect LUCK to make up for that. It is always hard for a company with expansions to show high returns when new assets especially machinery is being depreciated. However, LUCK on the back of its extensive sales is expected to provide return on assets in excess of 10% consistently till FY09 after a slight dip in FY07.

Recent Results

Profitable result of 1HFY07 contrary to the entire industry

The most recent result announcement was the half-yearly result of FY07 in December 2006. Sales grew by 64.2% compared to 1HFY06, which is simply outstanding as all the other companies in our focus registered decline in sales and we believe LUCK has been able to accomplish this on the basis of its expansion in the South. Profit before Tax (PBT) declined to PRs1,009mn as compared to PRs1,125mn in the same period last year, which is a decline of 10.3%. Profit After Tax (PAT) reached PRs791.5mn (EPS PRs3.01) in 1HFY07 from PRs855.1mn (EPS PRs3.25) in 1HFY06, which is a decline of 7.4%.

Valuation and Recommendation

We suggest a 'NEUTRAL' recommendation on LUCK

LUCK is the largest cement manufacturer the country and has a short-term advantage of timely expansion and a long-term advantage of plant location. Currently, LUCK is trading at a PE multiple of 16.0x on FY07E earnings. We believe that the growth story in the stock is already reflected in its existing share price and therefore, offering only an upside potential of 11.76% to our fair value of PRs115. We believe that stock will become an attractive proposition at PRs98 or below. We suggest a 'NEUTRAL' recommendation on LUCK.

Table 27: LUCK: FCF Valuation

	FY07E	FY08E	FY09E	FY10E	Terminal
Free Cash Flow					
EBITDA	3,766,929	5,140,617	5,842,592	6,017,823	
Less: Cash Tax Payable on EBIT	922,695	1,354,631	1,578,636	1,634,101	
Less: Change in Working Capital	1,472,938	438,004	(247,335)	167,494	
Less: Capital Expenditure	1,303,193	181,743	12,307	49,161	
Free Cash Flow	68,104	3,166,239	4,498,984	4,167,067	
WACC	13.10%	13.10%	13.10%	13.10%	
PV of Free Cash Flow	66,915	2,749,671	3,454,462	2,828,952	4,333,750
Terminal Value					
Terminal Growth Rate	4.00%				
Terminal WACC	13.10%				
Estimated Terminal Free Cash Flow	4,333,750				
Terminal Value	47,612,263				
PV of Terminal Value today	32,323,166				
DCF Valuation					
Sum of PV of forecasted FCF	9,100,000	21.97%			
PV of Terminal Value	32,323,166	78.03%			
Enterprise Value	<u>41,423,166</u>	100.00%			
Less: Net Debt	11,121,288	26.85%			
Equity Value	<u>30,301,878</u>	73.15%			
No. Shares in '000	263,375				
Per Share Equity Value	115.05				

Table 28: Sensitivity Table

Discount Rate	NPV of FCF	PV of Term Val.	Enterprise Value	Equity Value	Equity Value Per Share (PRs)
8.1%	10,030,967	82,683,006	92,713,973	81,592,685	309.80
9.1%	9,832,908	64,579,596	74,412,503	63,291,215	240.31
10.1%	9,641,029	52,468,790	62,109,820	50,988,532	193.60
11.1%	9,455,078	43,816,945	53,272,023	42,150,735	160.04
12.1%	9,274,811	37,341,374	46,616,185	35,494,897	134.77
13.1%	9,100,000	32,323,166	41,423,166	30,301,878	115.05
14.1%	8,930,426	28,328,147	37,258,572	26,137,284	99.24
15.1%	8,765,881	25,078,635	33,844,516	22,723,228	86.28
16.1%	8,606,168	22,388,788	30,994,956	19,873,668	75.46
17.1%	8,451,099	20,129,548	28,580,647	17,459,359	66.29
18.1%	8,300,496	18,208,507	26,509,003	15,387,715	58.43

Table 29: Sensitivity Analysis

Discount Rate	Terminal growth rate					
	3.0%	3.5%	4.0%	4.5%	5.0%	
WACC	11.6%	103.91	109.67	116.06	123.19	131.20
	12.1%	103.57	109.33	115.72	122.85	130.86
	12.6%	103.23	108.99	115.38	122.52	130.53
	13.1%	102.90	108.66	115.05	122.19	130.20
	13.6%	102.58	108.34	114.73	121.86	129.88
	14.1%	102.26	108.02	114.41	121.54	129.56
	14.6%	101.95	107.70	114.09	121.23	129.24

Table 30: LUCK: Sensitivity Analysis-Coal Prices

CAGR of Coal Prices upto FY10	Percentage Change in Coal Prices						
	(8)	(4)	-	4	8	12	16
Fair Value (PRs)	152	141	128	115	101	85	69
FY08-EPS (PRs)	10.35	9.92	9.48	9.05	8.62	8.12	7.75

Table 31: Valuation Summary

Lucky Cement Company Ltd.	FY04	FY05	FY06	FY07E	FY08E	FY09E
Income Statement						
						PRs'000
Net Sales	2,907,807	3,980,109	7,984,529	13,205,200	15,244,619	16,773,865
Cost of Goods Sold	1,807,353	2,600,589	5,073,797	10,118,429	10,780,066	11,588,270
Operating Profit	1,034,104	1,294,348	2,770,075	2,883,215	4,233,010	4,933,023
EBITDA	1,248,388	1,533,378	3,185,250	3,766,929	5,140,617	5,842,592
Net Income	683,208	826,587	1,935,950	1,692,661	2,383,717	3,098,063
Balance Sheet						
						PRs'000
Current Assets	1,978,092	1,342,511	4,455,494	5,479,796	4,871,818	5,793,357
Operating Assets	4,007,262	7,645,504	16,363,715	19,117,894	18,812,500	17,957,429
Long Term Loans	1,150,000	6,530,163	10,156,595	7,732,202	4,686,637	2,975,961
Total Equity	4,307,096	5,133,683	7,069,633	8,498,919	10,619,261	13,322,261
Per Share						
Number of Share ('000)	263,375	263,375	263,375	263,375	263,375	263,375
Book Value (PRs)	16	19	27	32	40	51
Earning Per Share (EPS) (PRs)	3	3	7	6	9	12
DPS (PRs)	1	-	-	1	1	2
Sales Per Share (PRs)	11	15	30	50	58	64
Price per Sales per Share (PSR) (x)	2	3	3	2	2	2
Price Earning Ratio (PER) (x)	10	13	11	16	11	9
Price Per Cash Flow (PCF) (x)	(64)	(1)	(5)	395	9	6
Price to Book Value (PBR) (x)	2	2	3	3	3	2
Profitability						
						%
Gross Profit Margin	37.84	34.66	36.45	23.38	29.29	30.91
Operating Profit Margins	35.56	32.52	34.69	21.83	27.77	29.41
EBITDA Margins	42.93	38.53	39.89	28.53	33.72	34.83
EBIT Margins	35.53	32.55	34.70	21.84	27.77	29.41
Pre- Tax Margins	33.31	30.40	31.97	16.43	20.85	24.63
Net Profit Margins	23.50	20.77	24.25	12.82	15.64	18.47
Return On Equity (ROE)	15.86	16.10	27.38	19.92	22.45	23.25
Return On Assets (ROA)	9.74	5.58	8.20	6.75	10.04	13.04
Return On Common Stockholders Equity (ROCE)	15.86	16.10	27.38	19.92	22.45	23.25
Dividend Payout	26.90	0.00	0.00	15.56	11.05	12.75
Retention Rate	73.10	100.00	100.00	84.44	88.95	87.25
Asset Turnover	41.47	26.88	33.80	52.67	64.22	70.59
Liquidity						
Current Ratio	2.12	0.63	0.94	0.76	0.70	0.95
Acid Test Ratio	1.09	0.08	0.45	0.21	0.06	0.17
Quick Ratio	1.94	0.57	0.85	0.64	0.56	0.78
Days' R/B	19.68	18.21	27.20	18.25	18.25	18.25
Days' Inventories	34.79	16.25	31.04	32.69	32.88	32.86
Days' Payables	45.49	67.82	78.79	55.67	49.09	58.01
Operating Cycle	8.97	-33.37	-20.56	-4.73	2.04	-6.90
Solvency						
						%
Debt to Total Assets	38.58	65.33	70.07	66.10	55.26	43.93
Total Debt to Equity	62.81	188.43	234.14	194.97	123.52	78.36
Long Term Debt to Equity	26.70	127.20	143.67	90.98	44.13	22.34
Net Debt to Equity	16.68	151.78	157.31	136.34	87.97	42.34
Interest Coverage Ratio (x)	95.29	59.72	33.45	4.77	4.73	8.30
Asset to Equity	162.81	288.43	334.14	294.97	223.52	178.36
Others						
Net Debt (PRs '000)	718,384	7,791,944	11,121,288	11,587,485	9,341,580	5,640,149
Market Value of Equity (PRs '000)	6,810,878	10,803,643	21,915,434	22,526,464	22,526,464	22,526,464
Enterprise Value (EV) (PRs '000)	7,529,262	18,595,587	33,036,722	34,113,949	31,868,043	28,166,613
EV/ EBITDA (x)	6	12	10	9	6	5
EV/ Ton of Sales (PRs)	6,722	13,092	15,044	7,402	6,638	5,632
EV/Ton in US\$	110	215	247	121	109	92
EV/ Share (PRs)	29	71	125	130	121	107
EV/ Ton of Capacity (PRs)	5,010	12,914	13,268	5,441	4,918	4,347
EV/Ton in US\$	82	212	218	89	81	71
Gross Price per Ton (Ex-Fact) (PRs)	3,812	3,919	4,876	4,172	4,534	4,759
Gross Price per Bag (Ex-Fact) (PRs)	191	196	244	209	227	238
Net price per ton (PRs)	2,596	2,802	3,636	2,865	3,175	3,354
Net price per bag (PRs)	130	140	182	143	159	168
CGS per ton (PRs)	1,802	1,995	2,497	2,384	2,431	2,495
CGM per ton (PRs)	1,815	1,985	2,519	2,373	2,433	2,496
CGS per Bag (PRs)	90	100	125	119	122	125
CGM per Bag (PRs)	91	99	126	119	122	125
Working Capital (PRs '000)	1,047,210	(800,252)	(296,541)	(1,714,193)	(2,075,848)	(332,429)
Change in Working Capital (PRs '000)	1,206,833	(1,847,462)	503,711	(1,417,652)	(361,655)	1,743,420
Capital Expenditure (PRs '000)	40,828	3,876,131	9,133,183	3,637,687	602,001	54,283

DG Khan Cement Company Limited

Initiating Coverage

Recommendation: NEUTRAL

Fair Value: PRs100

Investment Consideration

- Strong group backing with Mansha group having 33% of the total share holding.
- Highest cost of expansion but one of the most technologically advanced plants in the industry.
- First one to explore exports to the Indian market recently with 1,500tn cement export through sea.
- Lost its long held position of market leader in terms of capacity and sales to LUCK and the situation is expected to remain the same, at least for the next three years. At the end of FY07 its share in total capacity will be 11.4%.
- Second highest sales share in the industry with 10.52% share in total sales, 11% share in local market and 6.4% share in exports.
- One to initiate recent cartel war by price-cutting in order to maintain market share and get improved quota allocation once its new capacity comes underway.
- Doubled its capacity from 2.1mntpa to 4.2mntpa; new capacity is expected to come online in May 2007.

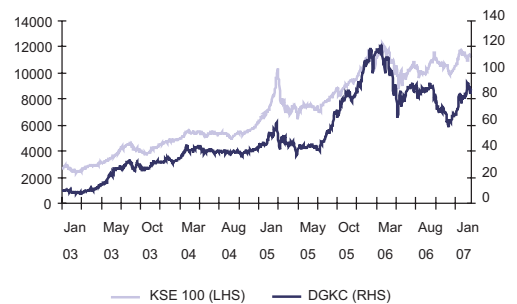
KATS Code	DGKC
Bloomberg Code	DGKC PA
Reuters Code	DGKH.KA
Current Price (PRs per share)	101.30
Average Daily Volume (shares) ('000)	19,881.28
Market Capitalization (PRs mn)	25,683.72
Paid-up Capital (PRs bn)	2.53
Shares Outstanding (mn)	253.5411
Free Float (%)	54.55
Weightage in KSE-100 (%)	0.84
Average Price (PRs per share)	89.27

Table 32: Estimates

	FY04	FY05	FY06	FY07E	FY08E	FY09E
Net Income (PRs '000)	829,844	1,682,078	2,418,455	1,802,049	2,256,628	3,031,960
Dividend per Share (PRs)	1.5	1.4	1.5	2.4	1.5	2.0
Earning per Share (PRs)	5.0	9.1	13.1	7.1	8.9	12.0
Book Value per Share (PRs)	38.3	50.5	104.5	87.9	95.3	105.3
Price/Book (x)	0.9	0.9	0.8	1.2	1.1	1.0
Price/Earning (x)	6.6	4.7	6.1	14.3	11.4	8.5
Dividend Yield (%)	4.6	3.1	1.9	2.4	1.5%	2.0%

Source : Company Reports and IGI Research

Chart 27: DGKC: Price Performance



Source : Company Reports and IGI Research

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IGI
Securities

Introduction

Strong backing of Mansha group DG Khan Cement (DGKC) is a Mansha group project. Mansha Group has 33% shares in DGKC and the company has 54.55% free float. Mansha Group acquired DGKC in 1992 under the privatization initiative of the government. Starting from the privatization, the focus of the management has been on increasing installed capacity as well as utilization level of the plant. DGKC is in the process of setting up a new cement production line of 6,700tpd clinker in Khairpur, near Kalar Kahar, Distt. Chakwal. This is expected to come online in May 2007 and its old plant is in Khofli Sattai, Distt. Dera Ghazi Khan.

Market Share

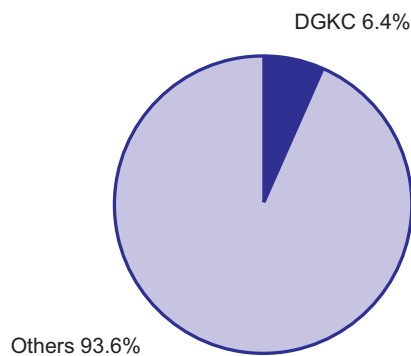
Recently lost market leader status to LUCK DGKC was a longstanding market leader until major expansions from LUCK wrestled the top spot away from DGKC. DGKC is currently producing at a capacity of 2.1mntpa. Moreover, in May 2007 their new plant will start operations that will double their current capacity to 4.2mntpa. With this additional capacity DGKC is expected to maintain its second place in terms of market shares for at least 2 to 3 years.

Consistently utilizing its capacity to the fullest DGKC is one of the very few players in the industry that are producing more than their installed capacity for the last few years. The major reason behind this is DGKC’s superior technology. The new plants use European technology. Furthermore, DGKC also utilizes more man-hours. The industry-wide norm is to quote capacity using 300 days 24x7. In FY06 DGKC worked 328 days, 24x7 due to which it was able to achieve greater than 100% capacity utilization.

Exports

Limited export sales DGKC’s plant location makes it difficult to export through sea especially when no BOT Terminal is available. However, in the near future DGKC has plans to explore the Northern market and increase its share of exports to Afghanistan. Recently DGKC initiated exports to India with 1,500tn cement exported through sea. We expect that in future DGKC may opt for exports to India through land route via Wagha Border.

Chart 28: DGKC: Exports Share (1HFY07)



Source: Company Reports, APCMA and IGI Research

The Cartel

Initiated the recent price war The most recent price war that broke the cement industry's cartel in 2QFY07 and continued in 3QFY07 was initiated by DGKC's price-cutting. In order to utilize its capacity and gain market share, DGKC undercut the agreed-upon price and triggered the price war. DGKC is of the view that their new plant of 2.1mntpa capacity will not be able to get the required market share if they keep on operating within the cartel. However, with industry-wide new capacities coming online in mid 2007, the cartel is expected to revive.

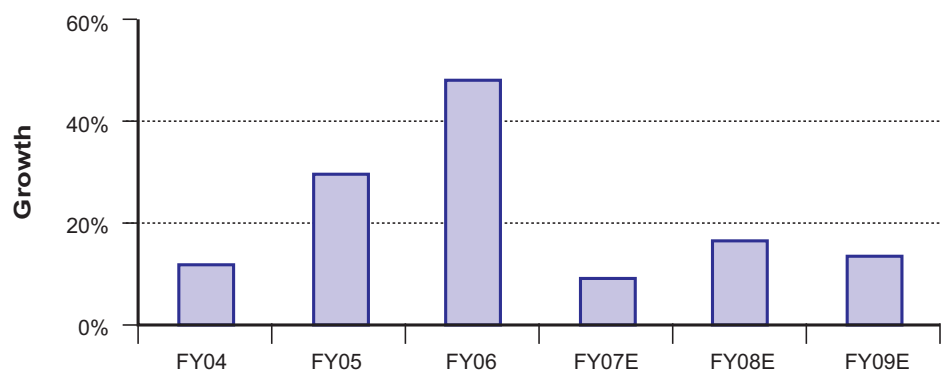
Sales

Market share is decreasing due to late expansion In terms of local sales DGKC seems to be losing its market share. The main reason for that is a slightly delayed expansion when compared to local peers. In FY02, DGKC had 11.1% share of total local sales. Its share remained at 11% in FY06 after slight deviation in the middle years. Meanwhile, the shares of other competitors have changed. LUCK had crossed it by more than 30% in FY07. It does not seem likely that DGKC will be able to become market leader again in the next 2 to 3 years unless it undertakes further expansions. From our discussions with management, we have learnt that no further expansion plans are likely in the next few years. However, we expect DGKC to remain a competitive market player and retain its second largest market share.

Uniform capacity utilization DGKC in the past years has been operating on a uniform utilization of around 85% and in the future with additional capacity it is expected to utilize 80% of its capacity. However, FY06 was an exception because in order to keep its local sales share intact it had to produce on 111% capacity, which it did successfully and made up for its slightly late decision to expand.

Producing in excess of capacity to maintain market share Sales growth was recorded at 49% in FY06. We expect sales growth to be much lower in FY07 as DGKC is constrained by capacity. In an effort to maintain its local market share of 11% DGKC has successfully been producing at more than 100% of its capacity. It will be prove to be difficult for DGKC to show impressive sales growth at the end of FY07. However, in FY08 it is expected to post a total sales growth of around 20% as it will be producing with additional capacity of 2.1mntpa along with existing capacity of 2.1mntpa making it 4.2mntpa.

Chart 29: DGKC: Sales Growth

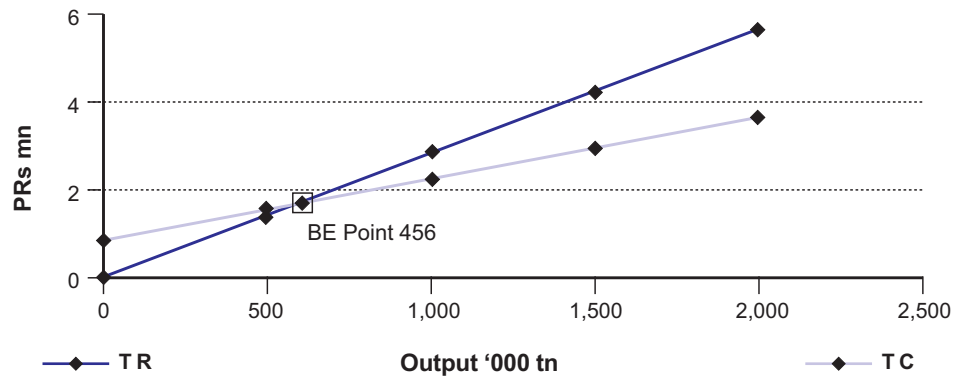


Source: Company Reports, APCMA and IGI Research

Breakeven Analysis

Our breakeven analysis suggests that with a constant sales price figure of PRs215 per bag, the company breakeven point stands at 456,003tn level of sales. Our analysis is based on the assumption that the fixed costs are constant and that sales equal production. Nevertheless, it is a reasonable supply side measure that depicts the level of output that must be achieved in order to reach a no-loss-no-gain situation.

Chart 30: DGKC: Break-Even Analysis



Source: Company Reports, APCMA and IGI Research

DGKC's level of break-even is lower than our selected average of 606,376tn. This is due to its higher contribution margin of 42% suggesting highly efficient manufacturing capabilities. The average contribution margin for our selected companies is 37%.

Profitability

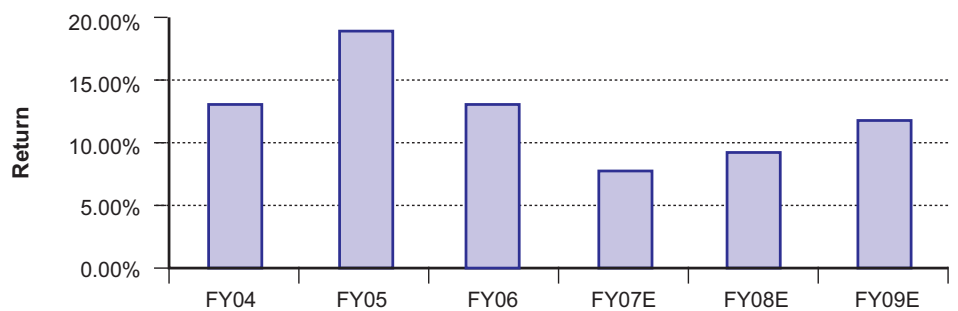
Operating profit expected to decline in FY07

The company showed operating profit growth of 126% in FY06. Operating profit growth is expected to show a sharp decline in FY07 as DGKC suffers from the consequences of a self initiated cartel war. Reasonable operating profit growth is likely in FY08 as DGKC may gain the desired market share, which was the motive behind the cartel war. In FY09 growth is expected to show further improvement.

Low return on equity as well as assets

In FY07 slightly lower return on equity is expected. However, consistent improvement in returns is expected in the following years. The same case applies to return on assets (ROA). ROA will experience a decline in FY07 but later improve on the back of rising profits.

Chart 31: DGKC: Return on Equity



Source: Company Reports and IGI Research

Recent Results

Recent half yearly results have been dismal due to price wars The most recent result announcement was the half-yearly result of FY07 for December 2006. Sales declined by 11.9% from PRs3.68bn in 1HFY06 to PRs3.24bn in 1HFY07. PBT declined to PRs1.017bn as compared to PRs1.596bn in the corresponding period last year, which is a decline of 36.2%. PAT declined to PRs854mn (EPS PRs3.4) as compared to PRs1,132mn (EPS PRs4.74) in 1HFY06, which is a decline of 24.5%.

Valuation and Recommendation

We suggest a 'NEUTRAL' recommendation on DGKC Currently DGKC is trading at a PE multiple of 14.2x on FY07E earnings. Our fair value for DGKC based on DCF valuation is PRs100. Currently the scrip is trading at 1.28% premium to our fair value. We suggest a 'NEUTRAL' recommendation on DGKC.

Table 33: DGKC: FCFF Valuation

	FY07E	FY08E	FY09E	FY10E	Terminal
Free Cash Flow					
EBITDA	3,297,120	4,222,742	5,403,475	5,997,556	
Less: Cash Tax Payable on EBIT	922,510	1,084,723	1,449,497	1,641,814	
Less: Change in Working Capital	95,025	(260,211)	(219,778)	(86,381)	
Less: Capital Expenditure	3,944,473	1,362,637	114,781	39,426	
Free Cash Flow	(1,664,887)	2,035,593	4,058,975	4,402,697	
WACC	13.86%	13.86%	13.86%	13.86%	
PV of Free Cash Flow	(1,664,887)	2,035,593	4,058,975	4,402,697	4,578,805
Terminal Value					
Terminal Growth Rate	4.00%				
Terminal WACC	13.86%				
Estimated Terminal Free Cash Flow	4,578,805				
Terminal Value	46,452,668				
PV of Terminal Value today	30,884,800				
DCF Valuation					
Sum of PV of forecasted FCFF	6,119,919	16.54%			
PV of Terminal Value	30,884,800	83.46%			
Enterprise Value	37,004,719	100.00%			
Less: Net Debt	11,556,907	31.23%			
Equity Value	25,447,812	68.77%			
No. Shares in '000	253,541				
Per Share Equity Value	100.37				

Table 34: Sensitivity Table

Discount Rate	NPV of FCF	PV of Term Val.	Enterprise Value	Equity Value	Equity Value Per Share (PRs)
8.9%	6,956,867	35,570,499	42,527,382	30,970,475	122.15
9.9%	6,778,459	34,562,017	41,340,492	29,783,585	117.47
10.9%	6,605,795	33,590,880	40,196,693	28,639,786	112.96
11.9%	6,438,636	32,655,388	39,094,042	27,537,135	108.61
12.9%	6,276,755	31,753,930	38,030,704	26,473,797	104.42
13.9%	6,119,935	30,884,983	37,004,938	25,448,031	100.37
14.9%	5,967,971	30,047,105	36,015,097	24,458,190	96.47
15.9%	5,820,668	29,238,928	35,059,618	23,502,711	92.70
16.9%	5,677,841	28,459,156	34,137,019	22,580,112	89.06
17.9%	5,539,312	27,706,561	33,245,897	21,688,990	85.54
18.9%	5,404,914	26,979,977	32,384,915	20,828,008	82.15

Table 35: Sensitivity Analysis

Discount Rate	Terminal growth rate					
	3.0%	3.5%	4.0%	4.5%	5.0%	
WACC	12.4%	90.09	95.42	101.31	107.81	115.06
	12.9%	89.77	95.11	100.99	107.50	114.74
	13.4%	89.46	94.80	100.68	107.19	114.43
	13.9%	89.15	94.49	100.37	106.88	114.12
	14.4%	88.85	94.19	100.07	106.58	113.82
	14.9%	88.55	93.89	99.77	106.28	113.52
	15.4%	88.26	93.60	99.48	105.99	113.23

Table 36: DGKC: Sensitivity Analysis-Coal Prices

CAGR of Coal Prices upto FY10	Percentage Change in Coal Prices						
	(8)	(4)	-	4	8	12	16
Fair Value (PRs)	120	114	107	100	93	85	76
FY08-EPS (PRs)	9.91	9.58	9.24	8.9	8.56	8.22	7.89

Table 37: Valuation Summary

D. G. Khan Company Ltd.	FY04	FY05	FY06	FY07E	FY08E	FY09E
Income Statement						
						PRs'000
Net Sales	3,882,756	5,279,560	7,955,665	8,649,127	10,435,792	12,748,899
Cost of Goods Sold	2,497,262	3,330,769	3,992,822	5,940,810	7,231,156	8,420,643
Operating Profit	1,278,289	1,811,406	3,806,538	2,541,394	2,997,092	4,078,111
EBITDA	1,745,418	2,876,181	4,455,020	3,297,120	4,222,742	5,403,475
Net Income	829,844	1,682,078	2,418,455	1,802,049	2,256,628	3,031,960
Balance Sheet						
						PRs'000
Current Assets	2,881,143	4,196,769	9,909,895	10,352,338	11,110,728	11,643,880
Operating Assets	6,128,083	6,637,237	7,521,723	8,741,512	21,934,242	22,441,571
Long Term Loans	2,177,143	4,899,225	7,372,468	8,479,430	6,230,518	4,762,985
Total Equity	6,419,119	9,317,998	19,268,200	22,292,603	24,168,920	26,693,797
Per Share						
Number of Share ('000)	167,631	184,394	184,394	253,541	253,541	253,541
Book Value (PRs)	38	51	104	88	95	105
Earning Per Share (EPS) (PRs)	5	9	13	7	9	12
DPS (PRs)	2	1	1	2	2	2
Sales Per Share (PRs)	23	29	43	34	41	50
Price per Sales per Share (PSR) (x)	1	2	2	3	2	2
Price Earning Ratio (PER) (x)	7	5	6	14	11	8
Price Per Cash Flow (PCF) (x)	(13)	(4)	(1)	(15)	13	6
Price to Book Value (PBR) (x)	1	1	1	1	1	1
Profitability						
						%
Gross Profit Margin	35.68	36.91	49.81	31.31	30.71	33.95
Operating Profit Margins	32.92	34.31	47.85	29.38	28.72	31.99
EBITDA Margins	44.95	54.48	56.00	38.12	40.46	42.38
EBIT Margins	36.23	47.71	51.42	33.33	32.48	35.53
Pre- Tax Margins	29.77	40.18	43.35	23.68	24.03	27.98
Net Profit Margins	21.37	31.86	30.40	20.84	21.62	23.78
Return On Equity (ROE)	12.93	18.05	12.55	8.08	9.34	11.36
Return On Assets (ROA)	7.08	9.34	7.05	4.65	5.57	7.42
Return On Common Stockholders Equity (ROCE)	12.93	18.05	12.55	8.08	9.34	11.36
Dividend Payout	30.30	14.95	11.44	33.89	16.85	16.72
Retention Rate	69.70	85.05	88.56	66.11	83.15	83.28
Asset Turnover	33.14	29.30	23.19	22.32	25.75	31.21
Liquidity						
Current Ratio	1.10	1.37	1.65	1.64	1.31	1.51
Acid Test Ratio	0.05	0.06	0.03	0.02	0.02	0.04
Quick Ratio	0.98	1.34	1.61	1.58	1.26	1.45
Days' R/B	11.31	8.40	6.99	7.30	7.30	7.30
Days' Inventories	43.63	11.07	20.69	20.13	20.09	20.07
Days' Payables	43.11	79.81	80.18	75.40	75.93	72.29
Operating Cycle	11.83	-60.34	-52.50	-47.98	-48.54	-44.93
Solvency						
						%
Debt to Total Assets	45.20	48.28	43.83	42.46	40.37	34.66
Total Debt to Equity	82.50	93.35	78.04	73.80	67.71	53.05
Long Term Debt to Equity	33.92	52.58	38.26	38.04	25.78	17.84
Net Debt to Equity	62.70	69.73	59.98	58.12	51.54	36.63
Interest Coverage Ratio (x)	743.22	828.54	907.72	393.93	448.40	578.64
Asset to Equity	182.50	193.35	178.04	173.80	167.71	153.05
Others						
Net Debt (PRs '000)	4,024,570	6,497,668	11,556,907	12,955,511	12,456,147	9,778,701
Market Value of Equity (PRs '000)	5,474,813	7,987,929	14,858,434	20,377,103	20,377,103	20,377,103
Enterprise Value (EV) (PRs '000)	9,499,383	14,485,597	26,415,341	33,332,614	32,833,250	30,155,804
EV/ EBITDA (x)	5	5	6	10	8	6
EV/ Ton of Sales (PRs)	6,384	7,992	12,586	11,324	9,972	7,938
EV/Ton in US\$	105	131	206	186	163	130
EV/ Share (PRs)	57	79	143	131	129	119
EV/ Ton of Capacity (PRs)	5,757	8,031	13,316	12,969	8,167	7,501
EV/Ton in US\$	94	132	218	213	134	123
Gross Price per Ton (Ex-Fact) (PRs)	3,829	4,067	5,220	4,252	4,534	4,754
Gross Price per Bag (Ex-Fact) (PRs)	191	203	261	213	227	238
Net price per ton (PRs)	2,609	2,913	3,791	2,938	3,170	3,356
Net price per bag (PRs)	130	146	190	147	158	168
CGS per ton (PRs)	1,896	2,026	2,072	2,156	2,444	2,442
CGM per ton (PRs)	1,892	2,030	2,096	2,161	2,446	2,441
CGS per Bag (PRs)	95	101	104	108	122	122
CGM per Bag (PRs)	95	102	105	108	122	122
Working Capital (PRs '000)	252,708	1,140,911	3,894,459	4,024,057	2,632,301	3,917,508
Change in Working Capital (PRs '000)	(281,713)	888,203	2,753,548	129,598	(1,391,755)	1,285,207
Capital Expenditure (PRs '000)	319,521	866,237	1,248,427	1,634,066	14,025,713	1,381,126

Maple Leaf Cement Factory Limited

Initiating Coverage

Recommendation: BUY

Fair Value: PRs28

Investment Consideration

- A diversified product portfolio including OPC, SRC and White Cement. Plans to introduce Oil Well Cement as well.
- One of the oldest players in the country, operating since 1952.
- The only company in our selection and one of the very few in the industry still having wet process production capacity. MLCF has capacity of 1000tpd on wet process out of total capacity of 5000tpd.
- Additional capacity of 6,700tpd (i.e.2mntpa) will come online in June 2007.
- MLCF's location is not favorable to export, therefore, over the years it has not shown any interest in exports. More recently it initiated export of White Cement to Middle Eastern countries.
- Third largest in terms of capacity and sales for a long time and will remain so for at least next three years after recent expansions.
- At the end FY07 its share will be 9.1% of total industry capacity. Currently it has 6.5% share of total industry sales.
- Located in proximity to the Kalabagh Dam. If no quota allocation for cement supply to Kalabagh Dam occurs, it would benefit the most.
- Highly leveraged compared to the industry. Extraordinarily sensitive to changes in cement prices.

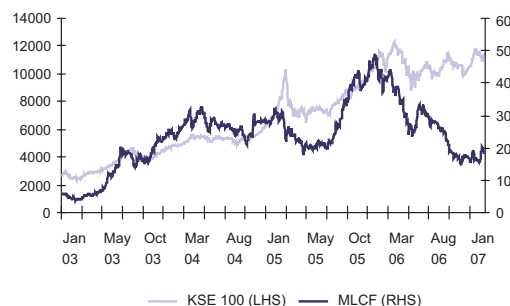
KATS Code	MLCF
Bloomberg Code	MLCF PA
Reuters Code	MPLF.KA
Current Price (PRs per share)	18.75
Average Daily Volume (shares) ('000)	3,368.93
Market Capitalization (PRs mn)	5,583.95
Paid-up Capital (PRs bn)	2.97
Shares Outstanding (mn)	297.8107
Free Float (%)	40
Weightage in KSE-100 (%)	0.18
Average Price (PRs per share)	28.28

Table 38: Estimates

	FY04	FY05	FY06	FY07E	FY08E	FY09E
Net Income (PRs '000)	487,472	727,450	1,059,240	303,282	477,242	798,752
Dividend per Share (PRs)	1.5	-	2.4	-	1.0	1.0
Earning per Share (PRs)	2.7	2.4	3.6	1.0	1.6	2.7
Book Value per Share (PRs)	19.0	21.1	24.5	25.5	26.1	27.8
Price/Book (x)	1.1	1.2	1.4	0.7	0.7	0.7
Price/Earning (x)	8.0	10.5	9.5	18.4	11.7	7.0
Dividend Yield (%)	6.9	0.0	6.9	0.0	5.3	5.3

Source : Company Reports and IGI Research

Chart 32: MLCF: Price Performance



Source : Company Reports and IGI Research

IGI

Securities

Shayan Hasan Jafry
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Introduction

One of the oldest plants operating in the industry Maple Leaf Cement Factory Limited (MLCF) is one of the oldest plants operating in the industry. It was established in 1952 at Iskanderabad, Dadukhel District, Mianwali near Kalabagh. MLCF is a part of Kohinoor Maple Leaf Group (KMLG). The KMLG was born as a result of trifurcation of the Saigol group of companies. Saigol group has 56% share holding of MLCF and the free float of the company is 40%.

Diversified Product Portfolio

Produce white cement in addition to the regular grey cement Currently MLCF has the most diversified portfolio in the industry. It produces OPC, White cement, SRC and more recently it plans to come up with Oilwell cement. MLCF is amongst the only three players producing white cement in the industry. It has also doubled the capacity of their White Cement in the recent past. Pakistan's WC market is shrinking because of the availability of a variety of new substitutes. However, the product has significant demand abroad.

Capacity and Expansion

Capacity expansion expected to come online in FY07 Currently MLCF has a production capacity of 1.5mntpa (i.e.5,000tpd), which has the following components:

- 3,500tpd of OPC using dry process
- 1,000tpd of OPC using wet process
- 500tpd of WC using dry process

Like all other major players in the industry, MLCF has also gone through a phase of massive expansions to add additional capacity of 6,700tpd (i.e. 2mntpa) that will come online in June 2007.

MLCF is taking measures to abandon the wet process and produce every type of cement through dry process. These plans are expected to materialize by the end of FY07. With the commencement of new plant of 6700tpd, the total capacity will become 3.5mntpa that will make MLCF the third largest market share holder after LUCK and DGKC in terms of capacity.

Location and Export

Export of White Cement is increasing Plants of MLCF are situated in Iskanderabad, Mianwali which makes it slightly difficult to explore the international markets as compared to other cement manufacturers in the South. MLCF recently started exporting WC through sea to South Africa, Saudi Arabia and other Middle East countries. With the decreasing demand of WC in Pakistan it is expected that MLCF will gradually shift towards the international markets for its white cement. However, MLCF's location and capacity does not suggest that they will take the sea route for OPC export.

Located near Kalabagh Dam-stands to benefit the most if no quota allocation occurs On the other hand, MLCF's location makes it favorable for export to Afghanistan like other Northern manufacturers. MLCF is located near Kalabagh Dam. There are only two manufacturers located close to Kalabagh: one being MLCF and the other is PIOC. Askari and FCCL are the other factories in the vicinity but they are not as close as MLCF and PIOC, and have much smaller capacities. If the government does not allocate any quota to manufacturers, these two companies (MLCF and PIOC) would be the most obvious choice for cement supply that would ensure six to seven years of high demand for the two. Kalabagh Dam is one of the biggest of the five dams under consideration requiring 4.5-5mntn in total that will generate cement demand of 1mntpa.

Local Sales

Consistently maintained its market share at 8-9%

MLCF has never been a leader in terms of market share. However, it contributes significantly to local sales and its share has consistently been in the range of 8-9% in the past few years. After the recent expansions it is expected to enjoy the same share in the local market. In order to maintain their respective local market shares, many manufacturers have produced more than their capacities. MLCF has done the same in this regard. It has done so even though it meant producing through the costlier wet process plants. At one point in time in the current fiscal year, MLCF was selling below its break even level.

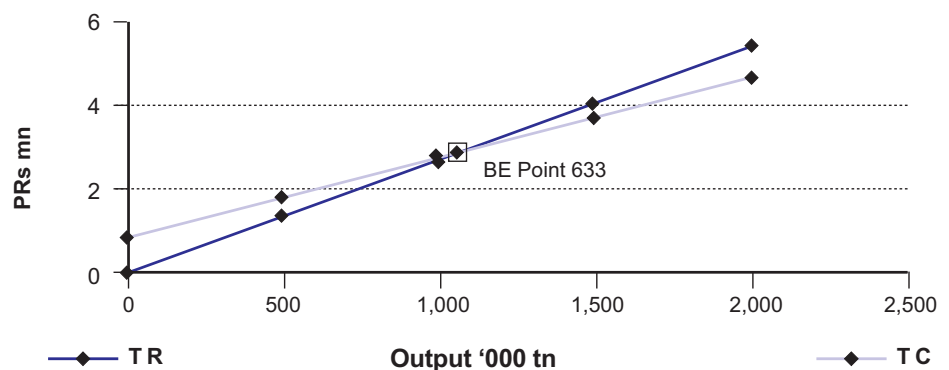
High capacity utilization expected to come down

In the past few years it operated on a capacity of more than 100%, and even achieved 122% capacity utilization in FY03. FY06 was an exception with just 66% utilization but at that time the company had dedicated a lot of its resources to plant expansion. This new plant will come online in June 2007. In future we expect MLCF to operate on 100% or more capacity, especially in the event of construction of Kalabagh Dam.

Breakeven Analysis

Our breakeven analysis suggests that with a constant sales price, the company breakeven point stands at 633,200tn level of sales. Our analysis is based on the assumption that the fixed costs are constant and that sales equal production. Nevertheless, it is a reasonable supply side measure that depicts the level of output that must be achieved in order to reach a no-loss-no-gain situation.

Chart 33: MLCF: Break-Even Analysis



Source: Company Reports and IGI Research

MLCF's level of break-even is slightly higher than our selected average of 606,376tn. This is due to its lowest contribution margin of 31% suggesting inefficient manufacturing capabilities. The average contribution margin for our selected companies is 37%.

Exports

Initiating export with White Cement

MLCF has not been involved in export of cement unlike other companies in the region. Its location only affords the Afghan market for potential exports. With recent enhancements in its capacity to make WC and declining local demand for WC in the presence of other substitutes, MLCF has started to export WC mainly to Middle Eastern countries.

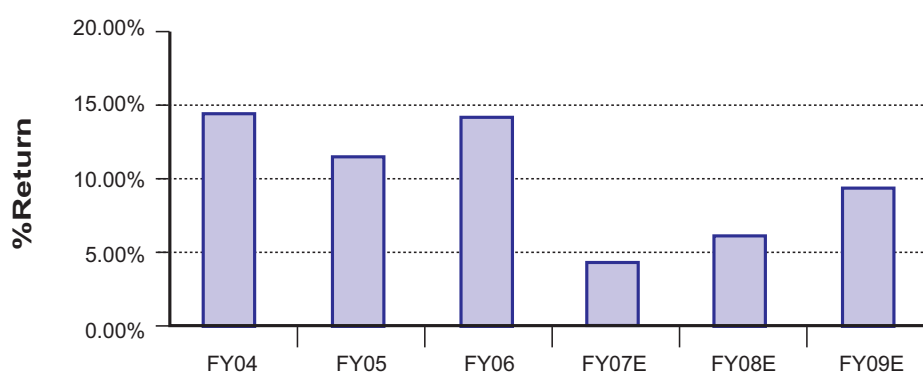
Profitability

Operating profits expected to decline in FY07 but later recover The company showed operating profit growth of 60% in 2006. MLCF is expected to show slightly negative operating profit growth in FY07. However, in FY08 it is expected to post close to 150% growth in operating profits but it is not expected to sustain that growth rate in the years to come after that.

As mentioned earlier, MLCF is not significantly active in exports. In order to maintain its local market share it even sold below its breakeven at one point in time and operated at more than 100% of the capacity. Therefore, it has been able to sustain a sales growth of above 20% for the last few years. Decline in sales is expected in FY07 on account of the cartel war. However, in FY08 it is expected to post a growth of more than 60% with its new expansion. In the years to come after that the growth rate is expected to be low.

Impressive returns in the past few years MLCF has been impressive with its high ROE in the previous few years. However, we expect close to 5% ROE in FY07 as a result of decline in operating profit, low prices and new equity raised through right issue. However, in FY08 and FY09 we expect ROE to rise consistently.

Chart 34: MLCF: Return on Equity



Source: Company Reports and IGI Research

Returns expected to dip in FY07 but recover later We only expect 1.75% return on assets in FY07 as the new plant with additional capacity of 2.1mntpa will come online in June 2007 and will operate only for one month before FY07 ends, therefore, not producing for the full year. In the years to follow i.e. in FY08 and FY09, MLCF is expected to post returns around 2.07% and 3.59% respectively.

Recent Results

Recent results have been dismal due to the cartel war The most recent result announcement was the half-yearly result of FY07 for December 2006. Sales declined by 27.6% to PRs2.029bn from PRs2.803bn. PBT declined to PRs836.4mn as compared to PRs9.935mn in the corresponding period last year, which is a staggering decline of 98.8%. PAT also registered a decline with PRs109.9mn (EPS PRs0.28) as compared to PRs539.7mn (EPS PRs1.72) in the 1HFY06, which is a decline of 79.6%.

Valuation and Recommendation

We suggest a 'BUY' recommendation on MLCF Currently MLCF is trading at a PE multiple of 11.7x on FY08E earnings. Our fair value for MLCF based on DCF valuation is PRs28. Currently the scrip is trading at 49.33% discount to our fair value. We suggest a 'BUY' recommendation on MLCF.

Table 39: MLCF: FCFF Valuation

	FY07E	FY08E	FY09E	FY10E	Terminal
Free Cash Flow					
EBITDA	1,094,154	2,561,999	3,012,192	3,520,172	
Less: Cash Tax Payable on EBIT	200,362	532,045	665,662	827,878	
Less: Change in Working Capital	(1,397,900)	124,047	(216,491)	597,321	
Less: Capital Expenditure	2,023,878	839,449	61,323	26,402	
Free Cash Flow	267,814	1,066,457	2,501,698	2,068,571	
WACC	14.53%	14.53%	14.53%	14.53%	
PV of Free Cash Flow	262,727	913,147	1,870,333	1,350,334	2,151,314
Terminal Value					
Terminal Growth Rate	4.00%				
Terminal WACC	14.53%				
Estimated Terminal Free Cash Flow	2,151,314				
Terminal Value	20,433,437				
PV of Terminal Value today	13,338,658				
DCF Valuation					
Sum of PV of forecasted FCFF	4,396,540	24.79%			
PV of Terminal Value	13,338,658	75.21%			
Enterprise Value	17,735,199	100.00%			
Less: Net Debt	9,386,203	52.92%			
Equity Value	8,348,996	47.08%			
No. Shares in '000	297,811				
Per Share Equity Value	28.03				

Table 40: Sensitivity Table

Discount Rate	NPV of FCF	PV of Term Val.	Enterprise Value	Equity Value	Equity Value Per Share (PRs)
9.5%	4,837,374	4,837,374	20,185,857	10,799,654	36.26
10.5%	4,743,602	4,743,602	19,659,701	10,273,498	34.50
11.5%	4,652,749	4,652,749	19,152,377	9,766,174	32.79
12.5%	4,564,696	4,564,696	18,663,044	9,276,841	31.15
13.5%	4,479,331	4,479,331	18,190,908	8,804,705	29.56
14.5%	4,396,544	4,396,544	17,735,215	8,349,012	28.03
15.5%	4,316,235	4,316,235	17,295,252	7,909,049	26.56
16.5%	4,238,305	4,238,305	16,870,342	7,484,139	25.13
17.5%	4,162,663	4,162,663	16,459,841	7,073,638	23.75
18.5%	4,089,219	4,089,219	16,063,142	6,676,939	22.42
19.5%	4,017,889	4,017,889	15,679,664	6,293,461	21.13

Table 41: Sensitivity Analysis

Discount Rate	Terminal growth rate				
	3.0%	3.5%	4.0%	4.5%	5.0%
13.0%	24.57	26.42	28.45	30.69	33.16
13.5%	24.43	26.28	28.31	30.55	33.01
14.0%	24.29	26.14	28.17	30.41	32.87
14.5%	24.15	26.00	28.03	30.27	32.74
15.0%	24.01	25.87	27.90	30.13	32.60
15.5%	23.88	25.73	27.77	30.00	32.47
16.0%	23.75	25.60	27.63	29.87	32.33

Table 42: MLCF: Sensitivity Analysis-Coal Prices

CAGR of Coal Prices upto FY10	Percentage Change in Coal Prices						
	(8)	(4)	-	4	8	12	16
Fair Value (PRs)	44	39	34	28	22	16	9
FY08-EPS (PRs)	2.29	2.06	1.83	1.60	1.37	1.14	0.91

Table 43: Valuation Summary

Maple Leaf Cement Company Ltd.	FY04	FY05	FY06	FY07E	FY08E	FY09E
Income Statement						
						PRs'000
Net Sales	3,375,799	4,290,734	5,709,792	4,447,414	8,060,880	9,169,926
Cost of Goods Sold	2,227,571	2,962,802	3,561,212	3,768,318	6,266,183	6,927,398
Operating Profit	1,090,766	1,214,958	1,949,121	598,927	1,634,893	2,052,029
EBITDA	1,438,390	1,584,389	2,347,201	1,094,154	2,561,999	3,012,192
Net Income	487,472	727,450	1,059,240	303,282	477,242	798,752
Balance Sheet						
						PRs'000
Current Assets	1,499,266	1,940,059	2,664,462	3,753,031	4,523,166	4,526,887
Operating Assets	5,356,082	5,099,297	6,885,915	6,807,876	16,717,533	16,627,084
Long Term Loans	2,061,737	2,157,706	7,868,948	7,797,690	8,039,910	6,003,748
Total Equity	3,426,807	6,290,462	7,299,737	7,603,019	7,782,450	8,283,391
Per Share						
Number of Share ('000)	180,491	297,811	297,811	297,811	297,811	297,811
Book Value (PRs)	19	21	25	26	26	28
Earning Per Share (EPS) (PRs)	3	2	4	1	2	3
DPS (PRs)	2	-	2	-	1	1
Sales Per Share (PRs)	19	14	19	15	27	31
Price per Sales per Share (PSR) (x)	1	2	2	1	1	1
Price Earning Ratio (PER) (x)	8	10	10	18	12	7
Price Per Cash Flow (PCF) (x)	3	(3)	(2)	21	5	2
Price to Book Value (PBR) (x)	1	1	1	1	1	1
Profitability						
						%
Gross Profit Margin	34.01	30.95	37.63	15.27	22.26	24.46
Operating Profit Margins	32.31	28.32	34.14	13.47	20.28	22.38
EBITDA Margins	42.61	36.93	41.11	24.60	31.78	32.85
EBIT Margins	32.64	28.74	34.60	14.08	20.63	22.68
Pre- Tax Margins	22.26	23.94	28.63	5.08	6.97	11.61
Net Profit Margins	14.44	16.95	18.55	6.82	5.92	8.71
Return On Equity (ROE)	14.23	11.56	14.51	3.99	6.13	9.64
Return On Assets (ROA)	6.88	6.98	5.64	1.41	2.15	3.75
Return On Common Stockholders Equity (ROCE)	14.23	11.56	14.51	3.99	6.13	9.64
Dividend Payout	55.54	0.00	66.09	0.00	62.40	37.28
Retention Rate	44.46	100.00	33.91	100.00	37.60	62.72
Asset Turnover	47.63	41.14	30.38	20.75	36.39	43.08
Liquidity						
Current Ratio	1.03	1.22	1.01	0.91	0.85	0.76
Acid Test Ratio	0.21	0.29	0.10	0.30	0.15	0.06
Quick Ratio	0.96	1.10	0.93	0.86	0.79	0.70
Days' R/B	15.92	16.46	22.45	21.90	25.55	25.55
Days' Inventories	16.41	22.57	20.60	18.17	19.46	20.19
Days' Payables	35.75	40.04	65.93	107.77	70.99	68.93
Operating Cycle	-3.43	-1.01	-22.88	-67.70	-25.97	-23.19
Solvency						
						%
Debt to Total Assets	51.65	39.68	61.16	64.53	64.86	61.08
Total Debt to Equity	106.83	65.79	157.45	181.91	184.61	156.96
Long Term Debt to Equity	60.16	34.30	107.80	102.56	103.31	72.48
Net Debt to Equity	76.76	46.02	128.58	138.37	156.57	134.02
Interest Coverage Ratio (x)	354.49	599.51	579.45	161.05	154.97	216.35
Asset to Equity	206.83	165.79	257.45	281.91	284.61	256.96
Others						
Net Debt (PRs '000)	2,630,407	2,895,077	9,386,203	10,520,222	12,185,091	11,101,714
Market Value of Equity (PRs '000)	3,922,076	7,606,085	10,113,651	6,700,740	6,700,740	6,700,740
Enterprise Value (EV) (PRs '000)	6,552,483	10,501,162	19,499,854	17,220,963	18,885,832	17,802,455
EV/ EBITDA (x)	5	7	8	16	7	6
EV/ Ton of Sales (PRs)	5,632	7,715	12,959	10,934	7,321	6,441
EV/Ton in US\$	92	126	212	179	120	106
EV/ Share (PRs)	36	35	65	58	63	60
EV/ Ton of Capacity (PRs)	4,368	7,001	12,714	10,934	5,235	4,935
EV/Ton in US\$	72	115	208	179	86	81
Gross Price per Ton (Ex-Fact) (PRs)	4,269	4,550	5,286	4,180	4,578	4,805
Gross Price per Bag (Ex-Fact) (PRs)	213	228	264	209	229	240
Net price per ton (PRs)	2,901	3,152	3,794	2,824	3,125	3,317
Net price per bag (PRs)	145	158	190	141	156	166
CGS per ton (PRs)	2,200	2,425	2,606	2,684	2,771	2,837
CGM per ton (PRs)	2,192	2,433	2,608	2,673	2,772	2,837
CGS per Bag (PRs)	110	121	130	134	139	142
CGM per Bag (PRs)	110	122	130	134	139	142
Working Capital (PRs '000)	40,094	344,560	14,943	(376,417)	(767,926)	(1,432,779)
Change in Working Capital (PRs '000)	(354,620)	304,466	(329,617)	(391,360)	(391,510)	(664,853)
Capital Expenditure (PRs '000)	508,320	83,564	2,149,906	389,984	10,809,014	841,550

Pioneer Cement Limited

Initiating Coverage

Recommendation: BUY

Fair Value: PRs39

Investment Consideration

- One of the first cement manufacturers to come up with additional capacities (1.5mntpa) whereas existing capacity is 2.1mntpa.
- Highly leveraged and sensitive to change in cement prices. Likely to be severely hit by price wars.
- Factory is located near Kalabagh dam. If quota allocation does not occur it would benefit the most along with MLCF.
- Location is not favorable to export to Afghanistan yet it has a share of 5.4% in total exports, PIOC is relying on BOT terminal issue to be solved so that it could explore the sea route for exports.
- Unlike others in the industry it did not operate on more than 100% capacity in the recent past as its new plant was already underway when others were busy in expansions.

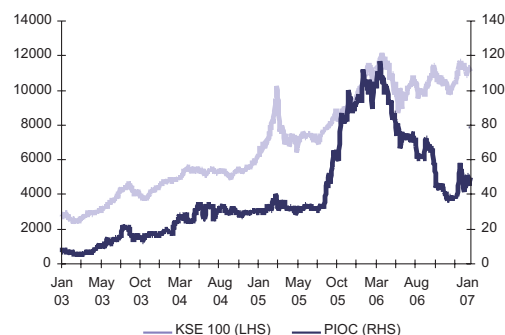
KATS Code	PIOC
Bloomberg Code	PIOC PA
Reuters Code	PION.KA
Current Price (PRs per share)	29.05
Average Daily Volume (shares) ('000)	644.93
Market Capitalization (PRs mn)	4,933.04
Paid-up Capital (PRs bn)	1.69
Shares Outstanding (mn)	169.8148
Free Float (%)	38.27
Weightage in KSE-100 (%)	0.16
Average Price (PRs per share)	40.16

Table 44: Estimates

	FY04	FY05	FY06	FY07E	FY08E	FY09E
Net Income (PRs '000)	424,265	332,089	675,982	108,927	382,607	510,207
Dividend per Share (PRs)	-	-	-	-	0.5	0.7
Earning per Share (PRs)	4.4	2.1	4.2	0.6	2.3	3.0
Book Value per Share (PRs)	5.7	10.5	14.3	14.3	16.1	18.4
Price/Book (x)	2.0	1.7	3.0	2.0	1.8	1.6
Price/Earning (x)	2.6	8.3	10.4	45.3	12.9	9.7
Dividend Yield (%)	0.0	0.0	0.0	0.0	1.6	2.4

Source : Company Reports and IGI Research

Chart 35: PIOC: Price Performance



Source : Company Reports and IGI Research

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Securities

Introduction

Sales concentrated in Lahore and adjoining areas Noon family has the major share holding in PIOC with 47% stake. Pioneer Cement is located near Sargodha, Punjab. About two-thirds of the company's local sales are to the Lahore area (Lahore, Sheikhpura Gujranwala) with the remainder sold to Faisalabad. The company is not well placed to target the Afghanistan market. PIOC has a free float of 38%.

Expansions

One of the first ones to come up with capacity expansions PIOC was one of the first ones to come up with additional capacities in the recent phase of industry wide plant expansions. In FY06 PIOC came up with additional capacity of 1.5mntpa and their overall capacity became 2.1mntpa. The first plant was setup by FL Smidth while the new one uses KHT, a German technology. PIOC has no further plans to extend their capacities in the recent future. However, they may eye a new location in the South for setting up a Greenfield plant.

Location

Located close to Kalabagh Dam PIOC plant is located in Khushab. It is close to MLCF's plant but unlike MLCF, PIOC is involved in exports. It also enjoys the privilege of being near Kalabagh Dam, and in case supply to Kalabagh starts PIOC and MLCF will benefit the most because they will bear minimum transportation costs.

Product

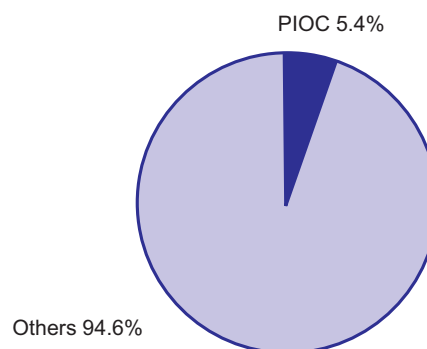
Two product lines, OPC and SRC PIOC does not offer significant product differentiation. It mainly produces OPC but it is expected that as the construction of Kalabagh dam starts it may increase production of SRC as it is needed in dam construction. SRC currently comprises 10% of PIOC's total production.

Export

Share of exports increasing Like other northern counterparts, PIOC is also in search of good avenues to export. The sea route proves to be expensive for them due to transportation costs.

PIOC had less than 1% market share of export sales until FY05 but since then it has increased market share significantly. The absence of BOT is a great hurdle and government decision on BOT terminal will be crucial in deciding the industry's future exports.

Chart 36: PIOC: Exports Share (1HFY07)



Source: Company Reports, APCMA and IGI Research

Local Sales

Fairly stable share of local sales

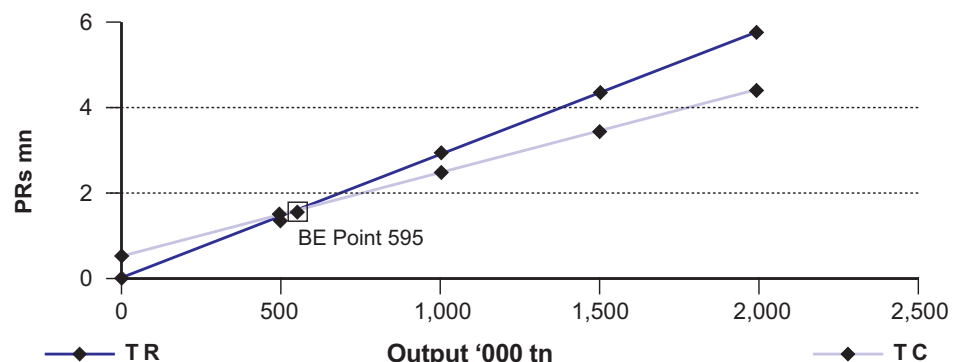
Unlike exports its market share is fairly stable when it comes to local sales. This share has remained around 4% in the past years. Due to PIOC's recent plant expansion, its market share of local sales is expected to remain the same in the coming 3 or 4 years. PIOC's local sales are mainly concentrated in the North Zone. In the event of construction of Kalabagh Dam, PIOC along with MLCF will be the major beneficiaries as their factories are closest to the dam.

Recently many cement manufacturers have chosen to operate on low margins with massive production, however, PIOC is an exception. The reason for that is that unlike PIOC others have not yet completed their capacities. The company has around 75% capacity utilization now and in future it intends to operate in the range of 85-90%. Bearing in mind the plant quality and previous history of PIOC, it is expected that it will be able to sustain this rate.

Breakeven Analysis

Our breakeven analysis suggests that with a constant sales price figure of PRs210 per bag, the company quantity breakeven point stands at 595,393tn level of sales. Our analysis is based on the assumption that the fixed costs are constant and that sales equal production. Nevertheless, it is a reasonable supply side measure that depicts the level of output that must be achieved in order to reach a no-loss-no-gain situation.

Chart 37: PIOC: Break-Even Analysis



Source: Company Reports and IGI Research

Cost efficient technology

PIOC's level of break-even is lower than our selected average of 606,376tn despite having lower than average contribution margin. PIOC's contribution margin is 32% whereas the average contribution margin for our selected companies of 37%. This apparent contrast can be explained by its lower fixed costs because it undertook expansions earlier than the others. Its main cost reduction comes from the efficiency of its plant, especially the new one.

Profitability

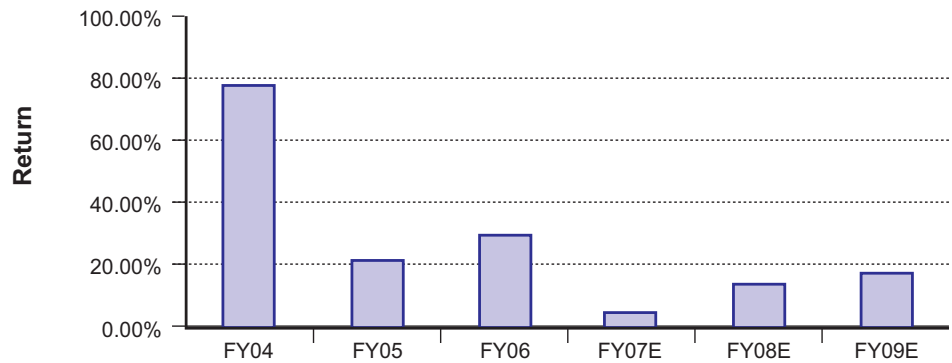
Profits expected to decline in FY07 but later recover

The company has shown operating profit growth of 107% in 2006. 1HFY07 has been dismal for PIOC and we expect PIOC's operating profit growth to be negative as a result of the price war. The situation is expected to improve in FY08 and FY09.

Returns expected to dip in FY07 but later recover

We expect PIOC to post Return on Equity of 6.61% in FY07. Returns are likely to improve in the subsequent years. In the FY07 we expect a low Return on Assets at 1.87%. However, ROA is also expected to improve in the subsequent years.

Chart 38: PIOC: Return on Equity



Source: Company Reports and IGI Research

Recent Results

Recent result was dismal due to cartel war The most recent result announcement was the half-yearly result of FY07 for December 2006. Sales remained stable and only grew by 0.6%. PBT declined to PRs(166.2)mn as compared to PRs502.1mn in the corresponding period last year. PAT also registered a decline with PRs(121.6)mn (EPS PRs(0.72)) as compared to PRs388mn (EPS PRs2.29) in the 1HFY06.

Valuation and Recommendation

We suggest a 'BUY' recommendation on PIOC Currently PIOC is trading at a PE multiple of 12.9x on FY08E earnings. Our fair value for PIOC based on DCF valuation is PRs39. Currently the scrip is trading at 34.25% discount to our fair value. We suggest a 'BUY' recommendation on PIOC.

Table 45: PIOC: FCF Valuation

	FY07E	FY08E	FY09E	FY10E	Terminal
Free Cash Flow					
EBITDA	786,809	1,232,014	1,410,672	1,618,223	
Less: Cash Tax Payable on EBIT	125,761	261,640	313,513	376,000	
Less: Change in Working Capital	(113,035)	(154,704)	35,203	165,282	
Less: Capital Expenditure	470,953	311,931	284,883	289,949	
Free Cash Flow	303,130	813,148	777,073	786,992	
WACC	11.65%	11.65%	11.65%	11.65%	
PV of Free Cash Flow	298,446	716,831	613,551	556,545	818,472
Terminal Value					
Terminal Growth Rate	4.00%				
Terminal WACC	11.65%				
Estimated Terminal Free Cash Flow	818,472				
Terminal Value	10,699,003				
PV of Terminal Value today	7,566,123				
DCF Valuation					
Sum of PV of forecasted FCFF	2,185,374	22.41%			
PV of Terminal Value	7,566,123	77.59%			
Enterprise Value	<u>9,751,497</u>	100.00%			
Less: Net Debt	<u>3,115,186</u>	31.95%			
Equity Value	<u>6,636,311</u>	68.05%			
No. Shares in '000	169,814				
Per Share Equity Value	39.08				

Table 46: Sensitivity Table

Discount Rate	NPV of FCF	PV of Term Val.	Enterprise Value	Equity Value	Equity Value Per Share (PRs)
6.6%	2,375,450	8,738,424	11,113,874	7,998,688	47.10
7.6%	2,335,035	8,485,740	10,820,775	7,705,589	45.38
8.6%	2,295,870	8,242,599	10,538,469	7,423,283	43.71
9.6%	2,257,904	8,008,557	10,266,461	7,151,275	42.11
10.6%	2,221,087	7,783,196	10,004,283	6,889,097	40.57
11.6%	2,185,373	7,566,119	9,751,492	6,636,306	39.08
12.6%	2,150,718	7,356,952	9,507,670	6,392,484	37.64
13.6%	2,117,079	7,155,341	9,272,419	6,157,233	36.26
14.6%	2,084,416	6,960,948	9,045,364	5,930,178	34.92
15.6%	2,052,692	6,773,456	8,826,149	5,710,963	33.63
16.6%	2,021,870	6,592,565	8,614,435	5,499,249	32.38

Table 47: Sensitivity Analysis

Discount Rate	Terminal growth rate				
	3.0%	3.5%	4.0%	4.5%	5.0%
10.1%	34.25	36.66	39.40	42.51	46.10
10.6%	34.14	36.56	39.29	42.41	45.99
11.1%	34.03	36.45	39.18	42.30	45.88
11.6%	33.93	36.35	39.08	42.20	45.78
12.1%	33.83	36.24	38.98	42.09	45.68
12.6%	33.72	36.14	38.88	41.99	45.58
13.1%	33.63	36.04	38.78	41.89	45.48

Table 48: PIOC: Sensitivity Analysis-Coal Prices

CAGR of Coal Prices upto FY10	Percentage Change in Coal Prices						
	(8)	(4)	-	4	8	12	16
Fair Value (PRs)	59	53	46	39	31	23	15
FY08-EPS (PRs)	2.81	2.63	2.44	2.25	2.07	1.88	1.69

Table 49: Valuation Summary						
Pioneer Cement Company Ltd.	FY04	FY05	FY06	FY07E	FY08E	FY09E
Income Statement						PRs'000
Net Sales	1,322,728	2,009,430	3,075,922	3,456,624	4,628,394	5,047,416
Cost of Goods Sold	936,066	1,372,012	1,845,284	2,913,500	3,613,454	3,848,745
Operating Profit	300,431	539,423	1,117,419	393,003	817,624	979,727
EBITDA	541,972	790,668	1,521,032	786,809	1,232,014	1,410,672
Net Income	424,265	332,089	675,982	108,927	382,607	510,207
Balance Sheet						PRs'000
Current Assets	395,013	462,683	617,732	791,459	1,031,557	1,145,132
Operating Assets	3,572,688	4,398,164	7,075,726	7,460,087	7,512,925	7,446,203
Long Term Loans	1,911,662	2,023,151	2,162,063	1,877,066	1,452,196	1,007,828
Total Equity	545,243	1,621,109	2,322,063	2,430,990	2,734,485	3,126,024
Per Share						
Number of Share ('000)	95,437	154,746	162,483	169,814	169,814	169,814
Book Value (PRs)	6	10	14	14	16	18
Earning Per Share (EPS) (PRs)	4	2	4	1	2	3
DPS (PRs)	-	-	-	-	0	1
Sales Per Share (PRs)	14	13	19	20	27	30
Price per Sales per Share (PSR) (x)	1	1	2	1	1	1
Price Earning Ratio (PER) (x)	3	8	10	45	13	10
Price Per Cash Flow (PCF) (x)	6	(1)	(11)	16	6	6
Price to Book Value (PBR) (x)	2	2	3	2	2	2
Profitability						%
Gross Profit Margin	29.23	31.72	40.01	15.71	21.93	23.75
Operating Profit Margins	22.71	26.84	36.33	11.37	17.67	19.41
EBITDA Margins	40.97	39.35	49.45	22.76	26.62	27.95
EBIT Margins	26.89	25.61	36.74	11.37	17.67	19.41
Pre- Tax Margins	18.01	19.60	30.33	4.63	12.16	14.87
Net Profit Margins	32.07	16.53	21.98	3.15	8.27	10.11
Return On Equity (ROE)	77.81	20.49	29.11	4.48	13.99	16.32
Return On Assets (ROA)	9.93	4.82	8.04	1.25	4.30	5.75
Return On Common Stockholders Equity (ROCE)	77.81	20.49	29.11	4.48	13.99	16.32
Dividend Payout	0.00	0.00	0.00	0.00	20.68	23.26
Retention Rate	100.00	100.00	100.00	100.00	79.32	76.74
Asset Turnover	30.94	29.17	36.60	39.66	52.03	56.85
Liquidity						
Current Ratio	1.03	0.47	0.44	0.40	0.38	0.41
Acid Test Ratio	0.10	0.02	0.05	0.08	0.03	0.04
Quick Ratio	0.97	0.41	0.43	0.38	0.36	0.40
Days' R/B		2.22	1.29	1.10	1.28	1.47
Days' Inventories	9.34	16.40	2.70	3.65	4.38	3.65
Days' Payables	51.32	148.61	98.18	107.81	119.65	111.35
Operating Cycle		-129.98	-94.18	-103.06	-113.99	-106.22
Solvency						%
Debt to Total Assets	87.24	67.33	65.18	65.17	62.46	57.99
Total Debt to Equity	683.99	286.07	235.94	233.67	203.19	164.70
Long Term Debt to Equity	350.61	124.80	93.11	77.21	53.11	32.24
Net Debt to Equity	381.34	151.23	134.16	128.91	111.20	82.86
Interest Coverage Ratio (x)	3.03	4.26	5.74	1.75	3.61	5.11
Asset to Equity	783.99	424.89	361.96	358.53	325.29	284.04
Others						
Net Debt (PRs '000)	2,079,246	2,451,668	3,115,186	3,133,730	3,040,826	2,590,186
Market Value of Equity (PRs '000)	1,083,211	2,759,124	7,063,137	5,388,202	5,388,202	5,388,202
Enterprise Value (EV) (PRs '000)	3,162,457	5,210,792	10,178,323	8,521,932	8,429,028	7,978,388
EV/ EBITDA (x)	6	7	7	11	7	6
EV/ Ton of Sales (PRs)	6,562	7,238	12,193	6,997	5,734	5,277
EV/Ton in US\$	108	119	200	115	94	87
EV/ Share (PRs)	33	34	63	50	50	47
EV/ Ton of Capacity (PRs)	5,271	8,685	10,714	4,261	4,215	3,989
EV/Ton in US\$	86	142	176	70	69	65
Gross Price per Ton (Ex-Fact) (PRs)	4,064	3,889	4,976	4,172	4,538	4,759
Gross Price per Bag (Ex-Fact) (PRs)	203	194	249	209	227	238
Net price per ton (PRs)	2,745	2,791	3,685	2,838	3,149	3,338
Net price per bag (PRs)	137	140	184	142	157	167
CGS per ton (PRs)	2,315	2,280	2,669	2,706	2,732	2,823
CGM per ton (PRs)	2,325	2,280	2,626	2,709	2,731	2,823
CGS per Bag (PRs)	116	114	133	135	137	141
CGM per Bag (PRs)	116	114	131	135	137	141
Working Capital (PRs '000)	11,892	(526,856)	(780,572)	(1,197,148)	(1,683,819)	(1,642,344)
Change in Working Capital (PRs '000)	69,535	(538,748)	(253,716)	(416,576)	(486,671)	41,475
Capital Expenditure (PRs '000)	117,657	1,099,194	3,065,354	774,785	463,847	360,841

Fauji Cement Company Limited

Initiating Coverage

Recommendation: BUY

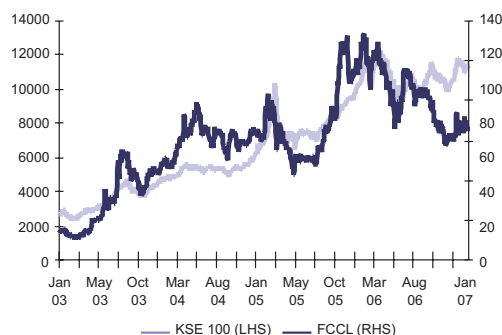
Fair Value: PRs24

Investment Consideration

- The only major player in the industry that did not undertake capacity expansions. Currently operating with 1.1mntpa capacity, it is expected to have 3.1% share of total industry capacity at the end of FY07.
- Market share is declining in the absence of additional capacity although FCCL is trying to make up for it with more than 100% capacity utilization.
- Strong group backing with Fauji Foundation (FF) having 52% share holding. FF also helps in getting loans at low markup.
- In FY02 FCCL was exports leader with 14% of exports share. Currently it has 6.5% exports share and that too is on a decline.
- Low sales growth is expected in the next 3 years.
- ROE may improve in the years to come as a result of low equity.

KATS Code	FCCK
Bloomberg Code	FCCL PA
Reuters Code	FAUC.KA
Current Price (PRs per share)	19.00
Average Daily Volume (shares) ('000)	7,714.60
Market Capitalization (PRs mn)	7,044.12
Paid-up Capital (PRs bn)	3.7
Shares Outstanding (mn)	370.743
Free Float (%)	45.21
Weightage in KSE-100 (%)	0.23
Average Price (PRs per share)	20.51

Chart 39: FCCL: Price Performance



Source : Company Reports and IGI Research

Table 50: Estimates

	FY04	FY05	FY06	FY07E	FY08E	FY09E
Net Income (PRs '000)	314,148	510,490	1,203,735	899,385	969,365	1,137,259
Dividend per Share (PRs)	-	-	1.0	1.0	1.0	1.0
Earning per Share (PRs)	0.8	1.4	3.2	2.4	2.6	3.1
Book Value per Share (PRs)	5.2	6.6	8.9	10.3	11.9	14.0
Price/Book (x)	2.4	2.3	2.3	1.8	1.6	1.4
Price/Earning (x)	14.6	11.1	6.4	7.8	7.3	6.2
Dividend Yield (%)	0.0	0.0	4.8	5.3	5.3	5.3

Source : Company Reports and IGI Research

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Introduction

Majority share holding is with Fauji Foundation-52% Fauji Foundation has major shareholding in FCCL with a stake of 52%. Fauji Cement Company, headquartered in Islamabad, operates a cement plant at Jhang Bahtar, Tehsil Fateh Jang, District Attock in the province of Punjab. Free float of FCCL is 45%.

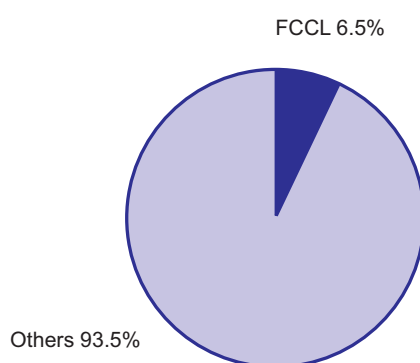
Market Share

Decided not to expect in the current wave of expansions When it comes to expansions, FCCL seems to have missed the train. In the recent years when most players were going through an expansion phase, FCCL was looking for an acquirer. Later on the sponsors decided not to sell the company. Currently the problem is that FCCL did not enhance capacity along with others and it is too late now. Its existing capacity is 1.1mntpa and it has no plans of expansion for the near future. FCCL produces only one variety of cement i.e. OPC and with such a low capacity, declining market share and increasing industry capacity FCCL is not favorably positioned.

Exports

Once a market leader in exports-now has only 6.5% share In FY02 FCCL was the market leader in export sales with share of 14% and the second largest shareholder had less than 7% share. With the passage of time FCCL's share of exports has reduced to 6.5% as of 1HFY07. In future the share is likely to decline further as other competitors with additional capacities will be in pursuit of this segment of the market to utilize their additional capacities.

Chart 40: FCCL: Exports Share (1HFY07)



Source: Company Reports, APCMA and IGI Research

Local Sales

Local sales share is fairly stable but expected to decline going forward Unlike exports share, FCCL's local sales share seems to be fairly stable. For the last six years it has remained in the range of 5% to 6%. This is due to the fact that FCCL has raised its capacity utilization to 95% from 65% in the previous 3 years in order to defend its market share. However, eventually, its capacity will exhaust and it will not be able to defend its share in the next couple of years.

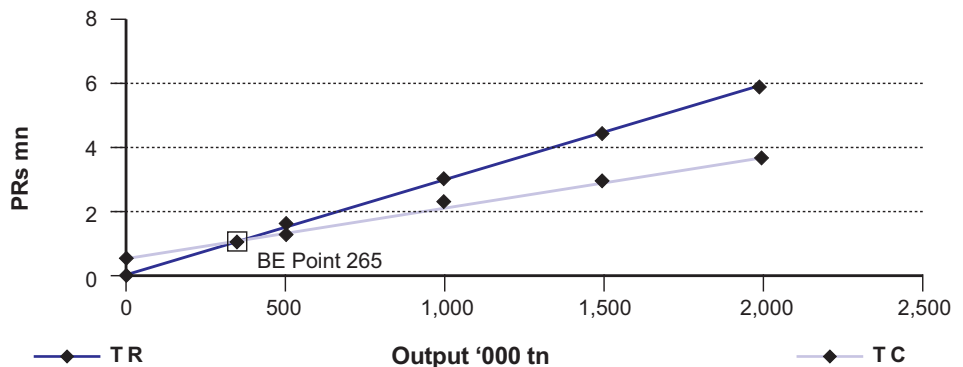
Expected to utilize 100% capacity in future In FY02 and FY03, FCCL operated with capacity utilization of around 60%. However, in FY04 it increased utilization to 90% and has kept on increasing since then. In the years to come we expect FCCL to operate on full capacity as it has made no expansions recently and has no plans to do so in the near future. However, with old plant and without any up gradation, it may not be sustainable.

Breakeven Analysis

Lowest breakeven point in our selection due to low fixed cost

Our breakeven analysis suggests that with a constant sales price figure of PRs230 per bag, the company quantity breakeven point stands at 265,760tn level of sales. Our analysis is based on the assumption that the fixed costs are constant and that sales equal production. Nevertheless, it is a reasonable supply side measure that depicts the level of output that must be achieved in order to reach a no-loss-no-gain situation.

Chart 41: FCCL: Break-Even Analysis



Source: Company Reports, APCMA and IGI Research

FCCL's level of break-even is the lowest in our selection. The average for our selection is 606,376tn. FCCL's contribution margin is 44%, which is in line with the average contribution margin for our selected companies of 37%. The lowest level of break-even is due to lower fixed costs because the company has not incurred any significant costs in recent years unlike others because FCCL chose not to expand.

In FY02 and FY03, FCCL operated with capacity utilization of around 60%. However, in FY04 it increased utilization to 90% and has kept on increasing since then. In the years to come we expect FCCL to operate on full capacity as it has made no expansions recently and has no plans to do so in the near future. However, with old plant and without any up gradation, it may not be sustainable.

Profitability

Operating profit growth expected to be negative in FY07

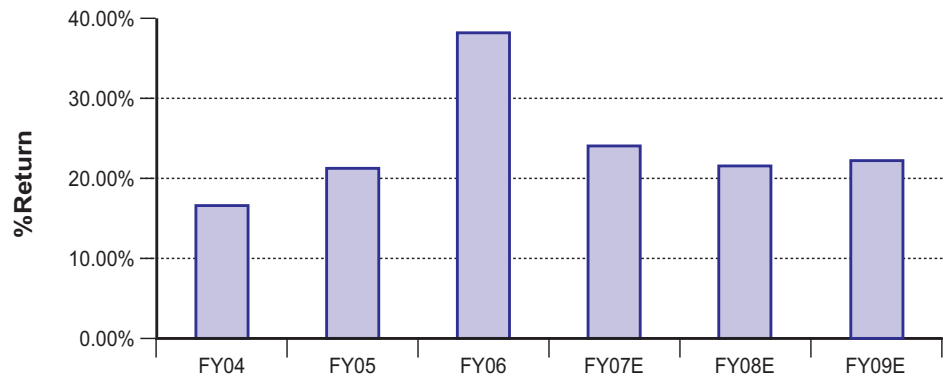
The company showed operating profit growth of 105% in 2006. We do not expect any growth in the operating profitability of FCCL in the years to come. In fact we expect a slight decline as FCCL is not going to come up with expansions in the near future. Currently produces at 100% capacity and further increase in production is not possible.

Returns are high due to equity erosion

FCCL posted an impressive ROE of 37% in FY06 but we expect it to come down in FY07 and the years to follow on the back of declining market share and low operating profits.

FCCL's ROA will show slight improvement in the future as it has not come up with any expansions so as to increase asset base. Depreciation expense will also be low.

Chart 42: FCCL: Return on Equity



Source: Company Reports and IGI Research

Recent Results

Recent result was dismal due to cartel war

The most recent result announcement was the half-yearly result of FY07 for December 2006. Sales declined by 9% to PRs2.5bn. PBT declined to PRs541.5mn as compared to PRs830.5mn in the corresponding period last year which is a decline of 34.7%. PAT also registered a decline of 34.6% with PRs366mn (EPS PRs0.987) as compared to PRs560.4mn (EPS PRs1.512) in the 1HFY06.

Valuation and Recommendation

We suggest a 'BUY' recommendation on FCCL

Currently FCCL is trading at a PE multiple of 7.8x on FY07E earnings. Our fair value for FCCL based on DCF valuation is PRs24. Currently the scrip is trading at 26.3% discount to our fair value. We suggest a 'BUY' recommendation on FCCL.

Table 51: FCCL: FCF Valuation

	FY07E	FY08E	FY09E	FY10E	Terminal
Free Cash Flow					
EBITDA	1,674,014	1,730,963	1,883,207	2,053,769	
Less: Cash Tax Payable on EBIT	448,545	466,402	514,761	569,034	
Less: Change in Working Capital	263,796	106,983	65,301	315,034	
Less: Capital Expenditure	14,303	36,085	34,435	30,848	
Free Cash Flow	947,370	1,121,494	1,268,710	1,138,853	
WACC	15.11%	15.11%	15.11%	15.11%	
PV of Free Cash Flow	928,725	954,715	938,245	731,642	1,184,408
Terminal Value					
Terminal Growth Rate	4.00%				
Terminal WACC	15.11%				
Estimated Terminal Free Cash Flow	1,184,408				
Terminal Value	10,658,178				
PV of Terminal Value today	6,847,210				
DCF Valuation					
Sum of PV of forecasted FCF	3,553,327	34.16%			
PV of Terminal Value	6,847,210	65.84%			
Enterprise Value	<u>10,400,538</u>	100.00%			
Less: Net Debt	<u>1,363,763</u>	13.11%			
Equity Value	<u>9,036,774</u>	86.89%			
No. Shares in '000	370,743				
Per Share Equity Value	24.37				

Table 52: Sensitivity Table

Discount Rate	NPV of FCF	PV of Term Val.	Enterprise Value	Equity Value	Equity Value Per Share (PRs)
10.1%	3,812,273	7,873,153	11,685,426	10,321,663	27.84
11.1%	3,757,361	7,652,523	11,409,884	10,046,121	27.10
12.1%	3,704,075	7,439,970	11,144,045	9,780,282	26.38
13.1%	3,652,350	7,235,130	10,887,480	9,523,717	25.69
14.1%	3,602,124	7,037,659	10,639,783	9,276,020	25.02
15.1%	3,553,338	6,847,231	10,400,569	9,036,806	24.37
16.1%	3,505,937	6,663,537	10,169,474	8,805,711	23.75
17.1%	3,459,868	6,486,283	9,946,151	8,582,387	23.15
18.1%	3,415,080	6,315,191	9,730,271	8,366,508	22.57
19.1%	3,371,525	6,149,999	9,521,524	8,157,761	22.00
20.1%	3,329,157	5,990,454	9,319,612	7,955,849	21.46

Table 53: Sensitivity Analysis

Discount Rate	Terminal growth rate				
	3.0%	3.5%	4.0%	4.5%	5.0%
13.6%	23.05	23.78	24.57	25.44	26.40
14.1%	22.98	23.71	24.51	25.38	26.33
14.6%	22.92	23.64	24.44	25.31	26.27
15.1%	22.85	23.58	24.37	25.24	26.20
15.6%	22.79	23.52	24.31	25.18	26.14
16.1%	22.72	23.45	24.25	25.12	26.07
16.6%	22.66	23.39	24.18	25.05	26.01

Table 54: FCCL: Sensitivity Analysis-Coal Prices

CAGR of Coal Prices upto FY10	Percentage Change in Coal Prices						
	(8)	(4)	-	4	8	12	16
Fair Value (PRs)	29	27	26	24	23	21	19
FY08-EPS (PRs)	2.85	2.77	2.69	2.61	2.54	2.46	2.38

Table 55: Valuation Summary

Fauji Cement Company Ltd.	FY04	FY05	FY06	FY07E	FY08E	FY09E
Income Statement						
						PRs'000
Net Sales	2,296,231	2,845,143	4,286,138	3,951,837	4,185,513	4,427,730
Cost of Goods Sold	1,555,407	1,763,567	2,095,027	2,486,027	2,669,633	2,756,038
Operating Profit	(81,812)	1,017,949	2,092,787	1,357,514	1,412,431	1,562,880
EBITDA	968,891	1,244,955	2,308,515	1,674,014	1,730,963	1,883,207
Net Income	314,148	510,490	1,203,735	899,385	969,365	1,137,259
Balance Sheet						
						PRs'000
Current Assets	574,461	1,172,766	1,579,381	1,982,753	2,396,808	2,787,877
Operating Assets	4,386,946	4,491,353	4,423,042	4,254,859	4,017,485	3,777,342
Long Term Loans	3,558,839	2,522,005	1,425,000	1,102,856	583,750	-
Total Equity	1,939,134	2,449,624	3,282,617	3,811,258	4,409,880	5,176,395
Per Share						
Number of Share ('000)	370,743	370,743	370,743	370,743	370,743	370,743
Book Value (PRs)	5	7	9	10	12	14
Earning Per Share (EPS) (PRs)	1	1	3	2	3	3
DPS (PRs)	-	-	1	1	1	1
Sales Per Share (PRs)	6	8	12	11	11	12
Price per Sales per Share (PSR) (x)	2	2	2	2	2	2
Price Earning Ratio (PER) (x)	15	11	6	8	7	6
Price Per Cash Flow (PCF) (x)	6	4	6	7	6	6
Price to Book Value (PBR) (x)	2	2	2	2	2	1
Profitability						
						%
Gross Profit Margin	32.26	38.01	51.12	37.09	36.22	37.76
Operating Profit Margins	-3.56	35.78	48.83	34.35	33.75	35.30
EBITDA Margins	42.19	43.76	53.86	42.36	41.36	42.53
EBIT Margins	-1.70	34.75	47.64	35.47	34.82	36.33
Pre- Tax Margins	-10.60	26.68	41.48	28.45	28.95	32.11
Net Profit Margins	13.68	17.94	28.08	22.76	23.16	25.68
Return On Equity (ROE)	16.20	20.84	36.67	23.60	21.98	21.97
Return On Assets (ROA)	5.32	8.20	19.42	14.17	14.85	17.02
Return On Common Stockholders Equity (ROCE)	16.20	20.84	36.67	23.60	21.98	21.97
Dividend Payout	0.00	0.00	30.80	41.22	38.25	32.60
Retention Rate	100.00	100.00	69.20	58.78	61.75	67.40
Asset Turnover	38.85	45.71	69.15	62.25	64.10	66.26
Liquidity						
Current Ratio	1.54	0.97	1.25	1.63	1.82	2.16
Acid Test Ratio	0.65	0.59	0.69	0.93	1.02	1.32
Quick Ratio	1.38	0.93	1.13	1.50	1.69	2.03
Days' R/B	11.70	5.91	5.99	7.30	7.72	7.30
Days' Inventories	14.46	11.58	25.28	22.05	21.93	21.89
Days' Payables	45.40	44.27	40.95	39.31	39.64	38.60
Operating Cycle	-19.25	-26.79	-9.68	-9.96	-9.98	-9.41
Solvency						
						%
Debt to Total Assets	67.19	60.64	47.04	39.96	32.46	22.53
Total Debt to Equity	204.79	154.07	88.82	66.57	48.06	29.08
Long Term Debt to Equity	183.53	102.95	43.41	28.94	13.24	0.00
Net Debt to Equity	177.82	113.52	41.54	22.57	4.73	-14.97
Interest Coverage Ratio (x)	-19.13	430.54	772.61	642.09	800.72	1433.25
Asset to Equity	304.79	254.07	188.82	166.57	148.06	129.08
Others						
Net Debt (PRs '000)	3,448,259	2,780,767	1,363,763	860,339	208,457	(775,114)
Market Value of Equity (PRs '000)	4,589,802	5,650,128	7,681,802	6,951,437	6,951,437	6,951,437
Enterprise Value (EV) (PRs '000)	8,038,062	8,430,895	9,045,565	7,811,776	7,159,894	6,176,323
EV/ EBITDA (x)	8	7	4	5	4	3
EV/ Ton of Sales (PRs)	9,656	9,278	8,484	6,383	6,143	5,299
EV/Ton in US\$	158	152	139	105	101	87
EV/ Share (PRs)	22	23	24	21	19	17
EV/ Ton of Capacity (PRs)	8,931	9,368	9,080	7,094	6,450	5,564
EV/Ton in US\$	146	154	149	116	106	91
Gross Price per Ton (Ex-Fact) (PRs)	3,901	4,315	5,331	4,576	5,002	5,247
Gross Price per Bag (Ex-Fact) (PRs)	195	216	267	229	250	262
Net price per ton (PRs)	2,758	3,131	4,020	3,229	3,591	3,799
Net price per bag (PRs)	138	157	201	161	180	190
CGS per ton (PRs)	2,160	2,218	2,210	2,250	2,520	2,596
CGM per ton (PRs)	2,144	2,226	2,208	2,264	2,524	2,594
CGS per Bag (PRs)	108	111	111	112	126	130
CGM per Bag (PRs)	107	111	110	113	126	130
Working Capital (PRs '000)	202,345	(34,180)	312,183	764,023	1,076,479	1,497,705
Change in Working Capital (PRs '000)	(46,661)	(236,525)	346,363	451,841	312,456	421,225
Capital Expenditure (PRs '000)	51,698	360,691	198,220	104,126	36,085	34,435

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Analyst Certification

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