Day Break

Thursday, 25 January 2018

Sector Update

Exhibit: Coverage companies 2Q dispatches

000' tons	2QFY18E	2QFY17	YoY%
LUCK	1,939	2,027	-4%
MLCF	931	900	3%
KOHC	565	599	-6%
ACPL	556	542	3%
CHCC	650	352	85%
DGKC	1,333	1,245	7%
FCCL	886	827	7%
PIOC	385	399	-3%
INDUSTRY	11,894	10,830	10%

Exhibit: Rising coal prices depressed overall sector gross margins

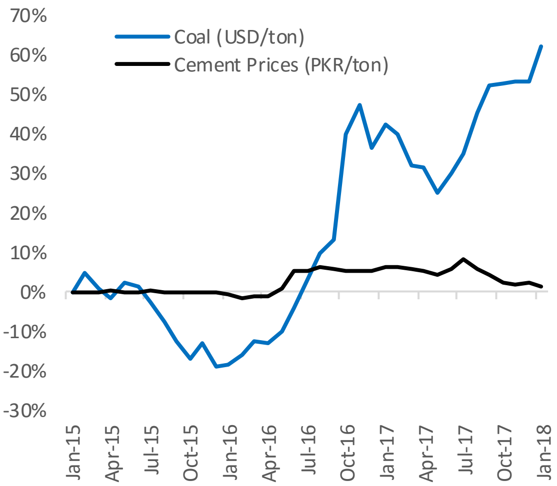
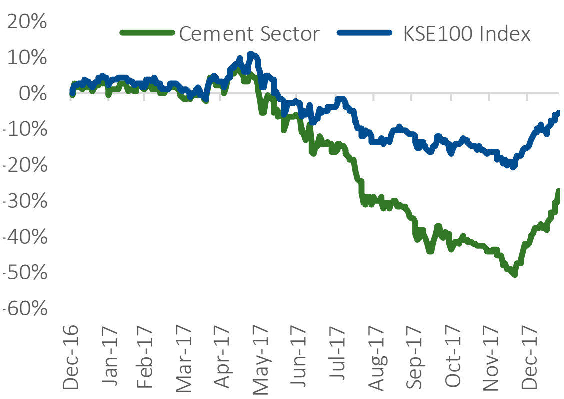


Exhibit: Relative Performance to KSE 100



Source: Bloomberg, PSX & IGI Research

Analyst
Muhammad Saad, ACCA
muhammad.saad@igi.com.pk
Tel: (+92-21) 111-234-234 Ext.: 816

Cements

Lower retentions to drag quarter earnings down by 13%YoY; DGKC and FCCL to surpass prior year earnings

- Despite posting a commendable growth of around +10%YoY, the cement industry fails to translate this growth in their top line.
- Lower retention prices, courtesy a) imposition of higher FED through Finance Act 2017-18; b) consistently falling cement sales prices in the northern region and; c) elevated coal prices globally; kept profit margins subdued
- DGKC is all set to consolidate the incidental tax benefits of its expansions, providing it a +13%YoY earnings growth
- The recommencement of FCCL's line II in the current quarter is expected to provide an earnings growth of around +107%.
- Dividend payout appears unlikely provided expansion activities are underway. However, PIOC, KOHC, CHCC, MLCF and FCCL might surprise investors.

2QFY18 earnings preview: Lower retention prices and higher coal prices continue to overshadow higher dispatches growth

Cement offtakes continued to display robust growth, whereby unprecedented dispatches level of 11.9mn tons were achieved as against 10.8mn tons in the same quarter last year. However, despite posting a commendable growth of around +10%YoY, the cement industry fails to reflect this growth in their top line, largely on account of trimmed sales prices in the north region and impact of enhanced FED in the current period. Accordingly we expect net sales of IGI Cement Universe to clock in at PKR 45.9bn, almost similar to PKR 46.0bn posted in the same quarter last year. Further injury to retention comes from increase in direct costs of cement manufacturing. With international prices of furnace oil and coal escalated by 13%/8% YoY coupled with impact of inflationary pressures, we expect our coverage companies to post gross profits of PKR 15.3bn in 2QFY18 as against PKR 19.1bn in 2QFY17, marking a significant 20%YoY decline. Consequently we expect our coverage companies to post earnings after tax of PKR 10.3bn as against PKR 11.8bn in the same quarter last year.

Exhibit:
Key cement companies financial highlights

	2QFY18E	2QFY17	YoY	1QFY18	QoQ
Net Sales	45,872	46,011	0%	42,655	8%
Gross Profits	15,291	19,124	-20%	14,063	9%
Taxation	2,225	4,441	-50%	1,735	28%
Net Profits	10,311	11,873	-13%	9,880	4%
Gross Margins (%)	33.3	41.6		33.0	
Effective Tax Rate (%)	17.7	27.2		14.9	
Net Margins (%)	22.5	25.8		23.2	

Source: IGI Research and Company Accounts

Company wise outperformers

Company wise, we expect DGKC and FCCL to surpass their prior year earning numbers. Along with a +7%YoY rise in dispatches, DGKC is all set to consolidate the incidental tax benefits of its expansions, providing it a +13%YoY earnings growth. Similarly the recommencement of FCCL's line II in the current quarter is expected to generate considerable savings in cost of sales of the Company. This along with related tax saving is expected to provide an earnings growth of around +107%.

Exhibit:

2QFY18 Earnings Estimate (PKR/share)

	2QFY18E	2QFY17	YoY	1QFY18	QoQ
LUCK	9.44	11.76	-20%	9.33	1%
MLCF	1.69	2.48	-32%	1.77	-4%
KOHC	4.96	7.76	-36%	5.85	-15%
ACPL*	4.78	6.00	-20%	5.28	-9%
CHCC	2.97	3.51	-16%	3.43	-14%
DGKC	6.73	5.93	13%	6.48	4%
FCCL	0.67	0.50	33%	0.32	107%
PIOC	2.42	3.52	-31%	1.84	32%

Source: IGI Research and Company Accounts

** Actual Result*

Dividend outlook

Given the situation that approximately all the players (coverage companies) have either entered or are about to enter the expansion phase (FCCL), we do not expect our coverage companies to offer any dividends during the period. Although based on historic trend, PIOC, KOHC, CHCC, MLCF and FCCL might surprise investors with a dividend of PKR 1.75/4.25/1.25/0.75/1.5 per share respectively, however we consider this situation less probable.

Demand to remain encouraging; pricing pressure to keep margins in check

Going forward, the overall demand outlook appears quite encouraging where we expect local demand in second half of FY18 to add further impetus, ascribed to a) increase in ground breaking of pipelined infrastructure projects in the wake of an election year; and b) higher demand post winter season. However, possibility of further cuts in cement sales prices following rising competition is still on the cards, thereby posing further threats to margins.

Recommendation

Given the recent rally in cement sector, the upside on some of our cement scrips have subsided. Nevertheless we still have a strong liking for ACPL, KOHC, DGKC and PIOC based on their Dec-18 target prices of PKR 359/270/190/134 per share, providing capital upside of around 85%/56%/14%/69% respectively.

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Time Horizon: Dec – 2018

Valuation Methodology: The analyst(s) has used following valuation methodology to arrive at the target price of the said security (ies):
DCF (Discounted Cash Flow)

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IGI Finex Securities Limited
Research Analyst(s)
Research Identity Number: BRP009

Contact Details

Research Team

Saad Khan	Head of Research	Tel: (+92-21) 111-234-234 Ext: 810	saad.khan@igi.com.pk
Abdullah Farhan	Senior Analyst	Tel: (+92-21) 111-234-234 Ext: 912	abdullah.farhan@igi.com.pk
Syed Daniyal Adil	Research Analyst	Tel: (+92-21) 111-234-234 Ext: 973	daniyal.adil@igi.com.pk
Suleman Ashraf	Research Analyst	Tel: (+92-21) 111-234-234 Ext: 957	suleman.ashraf@igi.com.pk
Muhammad Saad	Research Analyst	Tel: (+92-21) 111-234-234 Ext: 816	muhammad.saad@igi.com.pk
Tanweer Kabeer	Research/Fund Select	Tel: (+92-21) 111-234-234 Ext: 966	tanweer.kabeer@igi.com.pk
Umesh Solanki	Database Manager	Tel: (+92-21) 111-234-234 Ext: 974	umesh.solanki@igi.com.pk

Equity Sales

Faisal Jawed Khan	Head of Equities	Tel: (+92-21) 35301779	faisal.jawed@igi.com.pk
Zaeem Haider Khan	Regional Head (North)	Tel: (+92-42) 35777863-70	zaeem.haider@igi.com.pk
Muhammad Naveed	Regional Manager (Islamabad & Upper North)	Tel: (+92-51) 2604861-62	muhammad.naveed@igi.com.pk
Ejaz Rana	Regional Manager (Faisalabad)	Tel: (+92-41) 2540843-45	ejaz.rana@igi.com.pk
Asif Saleem	Branch Manager (RY Khan)	Tel: (+92-68) 5871652-56	asif.saleem@igi.com.pk
Mehtab Ali	Branch Manager (Multan)	Tel: (+92-61) 4512003	mahtab.ali@igi.com.pk
Zeeshan Kayani	Branch Manager (Abbottabad)	Tel: (+92-992) 408243-44	zeeshan.kayani@igi.com.pk
Ihsan Mohammad	Branch Manager (Peshawar)	Tel: (92-91) 5253035	ihsan.mohammad@igi.com.pk

IGI Finex Securities Limited
Trading Rights Entitlement Certificate (TREC) Holder of
Pakistan Stock Exchange Limited |
Corporate member of Pakistan Mercantile Exchange Limited

Head Office
Suite No 701-713, 7th Floor, The Forum, G-20,
Khayaban-e-Jami Block-09, Clifton, Karachi-75600
UAN: (+92-21) 111-444-001 | (+92-21) 111-234-234
Fax: (+92-21) 35309169, 35301780
Website: www.igisecurities.com.pk

Stock Exchange Office
Room # 719, 7th Floor, PSX Building, Stock Exchange Road, Karachi.
Tel: (+92-21) 32429613-4, 32462651-2 , Fax: (+92-21) 32429607

Lahore Office
5-F.C.C. Ground Floor, Syed Maratib Ali Road,
Gulberg II, Lahore
Tel: (+92-42) 35777863-70, 35876075-76
Fax: (+92-42) 35763542

Islamabad Office
Mezzanine Floor, Office 5, 6 & 7, Kashmir Plaza,
Block- B, Jinnah Avenue, Blue Area, Islamabad
Tel: (+92-51) 2604861-2, 2604864, 2273439
Fax: (+92-51) 2273861

Faisalabad Office
Room #: 515-516, 5th Floor, State Life
Building, 2- Liaqat Road, Faisalabad
Tel: (+92-41) 2540843-45
Fax: (+92-41) 2540815

Rahim Yar Khan Office
Plot # 12, Basement of Khalid Market,
Model Town, Town Hall Road, Rahim Yar Khan
Tel: (+92-68) 5871653-6, 5871652
Fax: (+92-68) 5871651

Multan Office
Mezzanine Floor, Abdali Tower,
Abdali Road, Multan
Tel: (92-992) 408243 - 44

Abbottabad Office
Ground Floor, Al Fatah Shoppinig Center , Opp. Rad
Station, Mansehra Road, Abbottabad
Tel: (+92-99) 2408243 - 44

Peshawar Office
2nd Floor, The Mall Tower,
35 The Mall Peshawar Cantt.
Tel: (92-91) 5253035, 5278448

Sialkot Office
Suite No. 10 & 11, 1st Floor, Soni Square,
Mubarik Pura, Sialkot.
Tel: (+92-52) 3258437, 3258762