Company Report

Wednesday, 30 May 2018

COMPANY UPDATE

D.G. Khan Cement Company Limited
Cement

Recommendation		**BUY**
Target Price:		194
Last Closing:	29-May-18	127
Upside:		52
Valuation Methodology:		Discounted Cash Flow (DCF)
Time Horizon:		Dec-18

Market Data

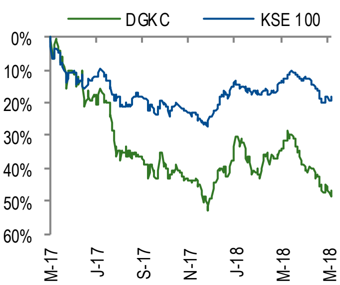
Bloomberg Tkr.		DGKC PA
Shares (mn)		438.1
Free Float Shares (mn)		241.0
Free Float Shares (%)		55.0%
Market Cap (PKRbn | USDmn)	55.8	481.9
Exchange		KSE 100

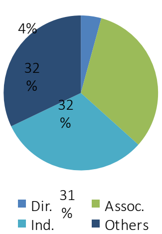
Price Info.	90D	06M	12M
Abs. Return	(11.4)	(3.9)	(46.8)
Lo	123.8	112.7	112.7
Hi	171.6	171.6	239.2

Key Company Financials
Period End: Jun

PKRbn	**FY17A**	**FY18E**	**FY19F**	**FY20F**
Total Revenue	30.1	31.2	44.6	39.6
Net Income	8.0	9.3	7.6	6.3
EPS (PKR)	18.2	21.3	17.3	14.3
DPS (PKR)	7.5	4.5	4.5	4.5
Total Assets	108.4	123.4	122.1	117.1
Total Equity	74.9	82.2	87.8	92.1
Key Financial Ratios				
ROE (%)	10.7	11.3	8.6	6.8
P/E (x)	7.0	6.0	7.3	8.9
P/B (x)	1.0	0.7	0.7	0.6
DY (%)	5.9	3.5	3.5	3.5

Relative Price Performance





About the Company

D. G. Khan Cement Company Limited is a public limited company incorporated in Pakistan. It is principally engaged in production and sale of Clinker, Ordinary Portland and Sulphate Resistant Cement.

Source: Bloomberg, PSX & IGI Research

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Cement

DGKC: South pricing discipline to sustain; Inexpensive multiples; Strong 'Buy' maintained

Underperformance overdone, 'Buy' call recommended at PKR 194/share

DGKC has lost nearly 40% since the beginning of FY18TD and compared to the benchmark KSE-100 index, the scrip has underperformed by nearly 32%. We think DGKC's strong share price underperformance is overdone. We reiterate our view on the scrip as we expect pricing discipline to continue in South despite recent commencement of DGKC's Hub Plant, which will be crucial in keeping company's gross margins stable. Recent budgetary tax measures such as sequential reduction in corporate tax from 30% in 2018, to 25% by 2023 is warmly welcomed. Albeit, continuation of Super tax and 20%YoY increase in FED have clearly negative implications for the sector as in whole, however, players have hit back yet again with a simultaneous cements price increase to compensate for the latter.

As such we have revised our earnings for DGKC incorporating budgetary measures and commencement of its Hub plant, with EBITDA now projected to show a +7% CAGR over the next 5yrs (FY19-FY23), making it one of the strongest growth companies in our cement coverage. However, higher depreciation charge and surged financed costs pertaining to Hub plant are estimated to overshadow net earnings growth during this period. The stock trades at an attractive FY19E EV/EBITDA multiple of 4.1x versus 6.9x of other IGI cement coverage companies, depicting a substantial discount. We value the company at PKR 194/share which offers +52% upside from its last closing of PKR 127/share.

Entry of DGKC not to harm Pricing discipline – Margins to display sustainability

As per the recent notice filed to the exchange, DGKC has completed the installation of Pakistan's largest cement plant at Hub , Baluchistan. Trial production has commenced whereas announcement of commercial production will be made in due course of time.

Entering the new territory, the south market, which pulls 20% of the total cement demand of the country and is considerably over supplied with respect to capacity from its existing predominant players (LUCK and ACPL), has led to much concern over break-up of pricing discipline in southern region.

However, we think the other wise. We believe that although DGKC's entry may tighter the pricing grip in south initially but that would be a very temporary phenomena. We base our assessment on the fact that DGKC has brought around a green field expansion plant with an estimated cost of PKR16bn/mnton as against existing south players who have undergone a brownfield expansion at a cost of PKR 4-10bn/mnton, thus resulting in higher depreciation charge in ensuing periods and effecitively a higher payback period. Further, high leverage of the Hub plant (external borrowing of PKR 18bn as of Mar-18) is also expected to deter operational performance as against competitors with low or nil financing (ACPL & LUCK: PKR 5bn and Nil financing as of Mar-18). All these measures are expected to enhance the breakeven cost of DGKC Hub Plant by roughly ~25%-35% from ACPL and LUCK and given the low cost structure of existing players and the brand loyalty of their products, disturbing the pricing discipline will add worries for DGKC only. This effectively incapacitates DGKC's position as a price determining force.

…5Yr tax holiday is not the weapon to fight a war with

Similarly, the 5Yr tax exemption on income and gains derived by the Hub plant is estimated to provide a tax benefit of PKR ~1bn over the five year period, however, since we expect the Hub plant to run in losses in the initial two years due to low utilization levels, high depreciation and elevated finance costs; we expect no such benefit to accrue in this period, further supporting our view of DGKC's inability to wage a price war and adherence of marketing arrangement during this period. However, better retention prices of South and low cost of production therein are to benefit DGKC in the upcoming periods. Similarly we also take that although DGKC might lose its market share in North in the next couple of years due to no expansion of it's in that market, we expect its overall market share to stay intact via its Hub expansion. We take this decision of DGKC as a wise step whereby not only does it keep its domestic market share intact by entering a high margin-low cost market and gets access to a wider export market, it also saves itself from the fierce price competition to arise in North in the next 3-4 years.

Tax measures incorporated in Finance Act 2018-19

To recall, the government in its FY18-19 budget announced various measures, which are to have substantial impact on the cement sector as a whole. These include a) 20% increase in Federal Excise Duty (FED) to PKR 1,500/ton as against existing levy of PKR 1,250/ton, b) reduction of customs duty on coal to 3% from existing 5% (negligible impact), c) extension of tax credits pertaining to section 65B, 65C and 65D till FY21, d) continuation of supertax with 1% decline thereof, e) gradual reduction in corporate tax rate by 1% each year to 25% by FY23; and f) relaxation of profit distribution limit to 20% as against existing 40%. As such, we have incorporated these measures in our model to determine their impact on our earnings estimates.

Exhibit:

Key Financial Highlights - Unconsolidated Results

	FY17A	FY18E	FY19F	FY20F	FY21F	FY22F	FY23F
Gross Margins	39%	30%	29%	26%	26%	26%	29%
EBITDA	13,603	11,485	17,464	14,334	13,807	14,396	16,233
EPS	18.20	21.27	17.33	14.34	15.47	17.95	22.26
DPS	7.50	4.50	4.50	4.50	6.00	7.00	9.00

Source: Company Accounts, IGI Research

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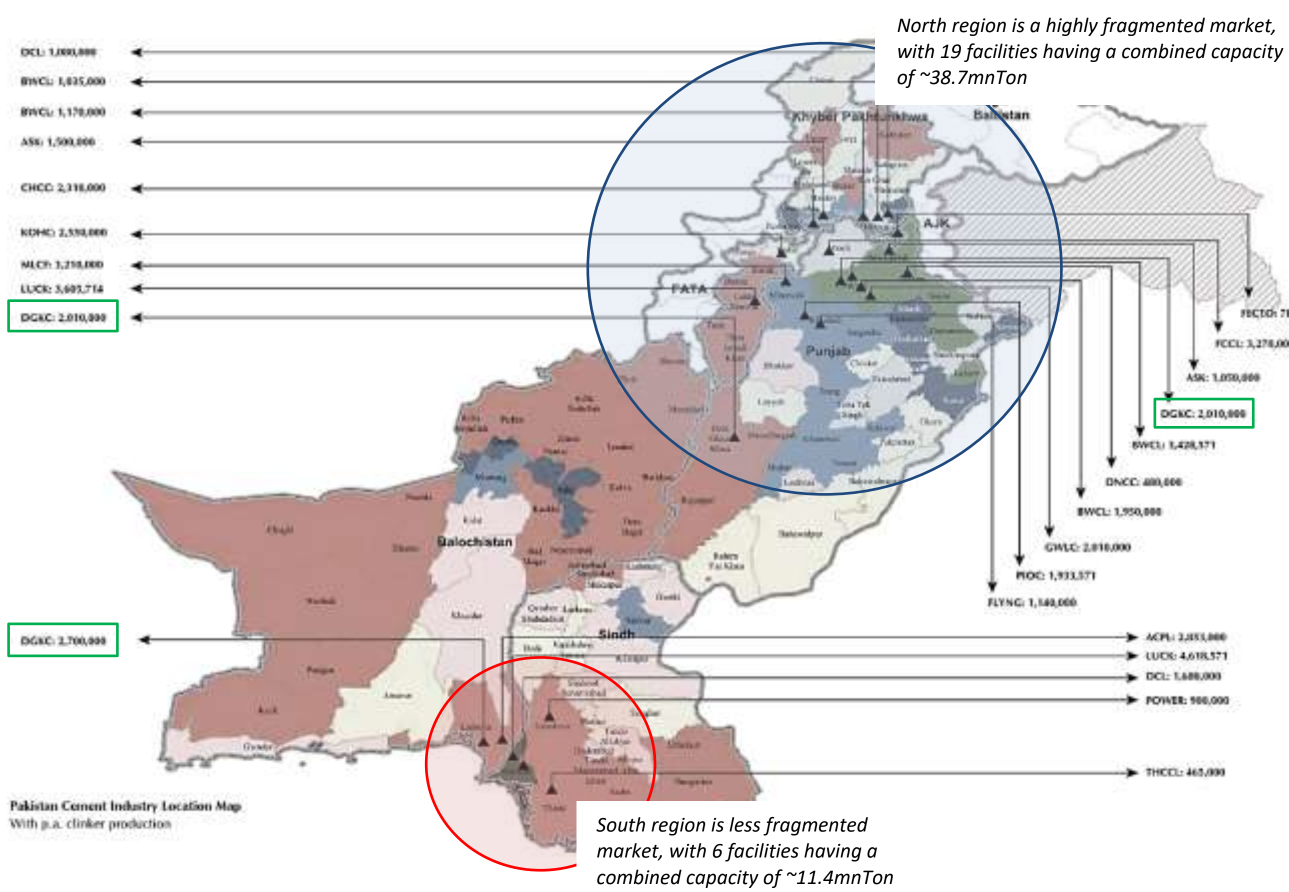
South pricing discipline to sustain despite DGKC's entry

South: A less framgmanted market

In contrary to the North market where we have 19 cement manufacturing facilities, the South market is less fragmented having only 6 such facilities. The subject market is also geographically well dispersed, with Thatta Cement Company Limited (THCCL) and Power Cement Limited (POWER) fairly distant from LUCK, ACPL & DCL. Due to these factors, South players have developed better marketing ties with each other, which have resulted in historically better retention prices than North region despite being cost effective.

However, concerns have emerged, whether similar strong marketing ties shall be maintained post entrance of DGKC Hub plant and will it lead to a fierce price competition thereby reducing their price levels, in an effort to maintain their market share?

Exhibit:
Cement manufacturing facilities in Pakistan



Source: DGKC FY17 Annual Report

Keeping up with the price discipline

A disparity of cement prices has historically been observed between the two major regions of the industry, North and South. Cement prices in the South region currently hover at an average of PKR 566/bag, roughly ~5% above comparative average of PKR 541/bag in the North region.

Exhibit:
Historic Cement Prices

Region	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18
South	548	547	545	545	544	543	539	537	565	570	574	575	568	569	568	566
North	513	507	504	505	505	505	501	506	544	534	539	527	546	517	506	541
Disparity	7%	8%	8%	8%	8%	8%	7%	6%	4%	7%	7%	9%	4%	10%	12%	5%

Source: Pakistan Bureau of Statistics & IGI Research

However lately, there has been a massive concern about the levels of cement prices to remain after the arrival of fresh capacities of ~19 mnTons (North: 14mnTons, South: 5mnTons) during the next 3 years. With expansions in south scheduled to come online earlier than those of North, much of the focus has been towards South's pricing structure given excess supply situation.

It is pertinent to mention here that almost ~5-6 months back, two dominant players of the industry, LUCK & ACPL had inaugurated their new capacities each of ~1.2mntons and interestingly no price war has been triggered yet suggesting that strong marketing ties still persist among the existing south players.

Does DGKC have the muscle enough to trigger a price war in south?

With DGKC entering the south market – DGKC Hub plant, we believe that DGKC might initially engage itself in a price war with existing south players by lowering its maximum retail price, in order to capture its market share. However, this in our view would not last longer and DGKC may eventually tailor itself (amicably) to the marketing arrangement determined thereon.

We base our belief on the fact that:

- **Greenfield plant:** DGKC has erected an expensive greenfield cement manufacturing facility, worth PKR ~45bn, thereby allocating the highest amount of depreciation/bag in the region (~PKR 106/bag), as against close competitor players, i.e.: ACPL & LUCK, having an average depreciation/bag of PKR~30/bag and PKR 21/bag respectively, thus making DGKC less competitive in terms of a high payback period.
- **Financing cost:** DGKC, estimated to obtain financing worth PKR ~21bn (PKR 18.6bn as of Mar-18 accounts) in order to setup this manufacturing facility is estimated to incur an average finance cost of PKR 50/bag in contrast to PKR 8/bag and Nil of ACPL & LUCK respectively due to their low borrowing requirements.

Exhibit:
Expansion ancillary costs of major South players

in PKRmn (FY19)	LUCK	ACPL	DGKC
Total capacity - mn tons	4.95	3.03	2.84
Expected utilization levels	67%	74%	55%
Dispatches - mn tons	3.31	2.24	1.56
Book value of plant	18,100	17,633	45,000
LT financing obtained for expansion	-	5,000	21,000
Expected depreciation charge	1,403	1,336	3,318
Expected finance charge	-	370	1,552
Total expected ancillary costs	1,403	1,705	4,870
Expansion ancillary (PKR/bag)	21	38	156

Source: Company Accounts, IGI Research

As tabulated above, we estimate DGKC to incur expansion ancillary costs of PKR 156/bag (for South plant only) as against ACPL and LUCK's cost of PKR 38/bag and PKR 21/bag, which is effectively 4x and 7x higher respectively. In an event that DGKC disturbs the prcing discipline in order to attain higher volumetric sales, this would be simultaneously followed by other players and given the fact that both ACPL and LUCK operate at a very cost effective structure and enjoy greater brand loyalty in South, this will only add further worries for DGKC.

If price is not to decide DGKC's market share in South, what will?

Based on the above, we strongly believe that DGKC cannot afford a price competition for long in order to achieve a reasonable market share. However, DGKC has also played wisely, in order to make its presence felt in the South market. The company for the past ~2yrs, has setforth dispatching cement bags to the south market from its DG Khan Plant, in order to familiarise its products to South customers and establish a dealer network therein. Additionally, although at a higher cost (transportation), it has helped the company to operate at higher capacity utilisation levels. As per our discussions with management, the company has been dispatching approximately ~1,000Tons per day in the south market on a regular basis. Accordingly, we believe DGKC has already partially penetrated in the market and as such will not require a prolonged tug of war to attain its share of pie.

Exhibit:

Projected market share of south market

Period end (JUN)	FY15A	FY16A	FY17A	FY18E	FY19F	FY20F	FY21F
LUCK	40%	42%	42%	42%	33%	30%	30%
ACPL	24%	24%	24%	25%	23%	24%	23%
DCL (south)	20%	18%	17%	18%	13%	12%	12%
POWER	11%	10%	10%	9%	8%	13%	14%
THCCL	6%	6%	6%	5%	5%	5%	4%
DGKC (Hub)	0%	0%	0%	0%	17%	17%	17%
Local dispatches (mt)	4.76	5.95	6.51	7.29	8.02	8.82	9.71
Dispatches growth	n/m	25%	9%	12%	10%	10%	10%

Source: APCMA, Company Financials & IGI Research

DGKC's entry may result in inability of south to pass over the impact of recently enacted FED

The recently enacted +20% rise in FED has already instigated a rise in cement prices across the country by at least PKR 15/bag. As such, both ACPL and LUCK have also issued notifications of their respective price increase. This will push average cement price in South up to PKR ~580/bag from existing levels of PKR ~566/bag. However, taking a conservative stance, we foresee that DGKC's entry will tighter this grip and thereby this pass over may not live long enough. Post entry of DGKC Hub plant, we anticipate prices of cement to fall gradually by as high as PKR 40-50/bag in specific areas of south. However based on DGKC's limited liability to sustain a price competetion for long, we believe prices will gradually revert back to normal levels in 2HFY19, taking FY19 average price levels to PKR ~>560/bag. This effectively means that South will not be able to pass over the impact of enhanced FED in FY19.

Tax savings

5Yrs Tax Holiday to provide savings of PKR~1bn

As per clause 126L of the Income Tax Ordinance (ITO), profits and gains derived by a taxpayer, from an industrial undertaking set up in the provinces of Khyber Pakhtunkhwa and Baluchistan between 1st day of Jul-15 and 30th day of Jun-18, shall be exempt from income tax.

The said clause has been a major influence for DGKC (apart from other business strategy) to setup a new manufacturing facility in Hub , Baluchistan. While the Finance Act FY18-19 has extended tax credits available on Section 65B, 65D and 65E until FY21, no such extension has been granted for clause 126L, thus leaving DGKC with no other option than to at least commence its trial production of Hub plant before 30-Jun-18 or else it would have lost the attractive 5Yrs tax holiday. With the Hub plant having commenced its trial production, the benefit can now be obtained. Since, the ITO requires maintenance of separate books of accounts for disbursement of this benefit; we have prepared similar projections for the Hub plant in order to estimate the same.

Income Tax Ordinance

Exemptions and tax concessions (126L)

Profits and gains derived by a tax payer, from an industrial undertaking set up in the Provinces of Khyber Pakhtunkhwa and Baluchistan between 1st day of July, 2015 and 30th day of June, 2018 for a period of five years beginning with the month in which the industrial undertaking is set up or commercial production is commenced, whichever is later: Provided that exemption under this clause shall be admissible where –
The industrial undertaking is set up between the first day of July, 2015 and 30th day of June, 2018, both days inclusive; and
The industrial undertaking is not established by the splitting up or reconstruction or reconstitution of an undertaking already inexistence or by transfer of machinery or plant from an undertaking established in Pakistan at any time before 1st July 2015.]

Exhibit:

DGKC HUB Plant - Financial Projections

Period end (JUN) – PKRmn	FY19F	FY20F	FY21F	FY22F	FY23F	FY24F	FY25F
Net Sales	10,766	11,634	12,713	13,795	14,970	16,245	17,194
Gross Profit	1,155	1,511	2,061	2,511	2,963	3,419	3,714
EBIT	422	662	1,112	1,475	1,850	2,235	2,468
Financial Charges	1,552	937	494	159	5	5	5
Pre-tax Profits	(1,130)	(275)	618	1,316	1,845	2,230	2,463
Taxation - Charge/(Refund)	(353)	(101)	(33)	1	2	514	567
Post-tax Profits	(777)	(175)	651	1,315	1,843	1,716	1,896
EPS	(1.77)	(0.40)	1.49	3.00	4.21	3.92	4.33
Effective Tax Rate (%)	n/m	n/m	n/m	0	0	23	23
Capacity Utilization (%)	55	60	66	71	76	82	85

Source: IGI Research

Had DGKC failed to bring about its Hub plant by the stipulated deadline, we estimate the company would have lost PKR ~1bn (PKR 2.25/share) worth of tax savings. As such, we also present financial projections for this scenario.

Exhibit:

DGKC HUB Plant - Financial Projections (Had 5Yrs Tax holiday been foregone)

Period end (JUN) - PKRmn	FY19	FY20	FY21	FY22	FY23	FY24	FY25
Taxation - Charge/(Refund)	(353)	(101)	133	342	461	514	567
PAT (w/o tax savings)	(777)	(175)	484	974	1,384	1,716	1,896
PAT (with tax savings)	(777)	(175)	651	1,315	1,843	1,716	1,896
Cumulative Savings	**-**	**-**	**166**	**507**	**967**	**-**	**-**
EPS (w/o tax savings) PKR	(1.77)	(0.40)	1.11	2.22	3.16	3.92	4.33
EPS (with tax savings) PKR	(1.77)	(0.40)	1.49	3.00	4.21	3.92	4.33
Chg. In EPS (with &w/o Tax saving)	0%	0%	34%	35%	33%	0%	0%

Source: IGI Research

…however it is not the weapon to fight a war with

As evident from the two exhibits, we estimate DGKC Hub plant to report losses in the initial two years of its operations i.e.: FY19 and FY20 due to low capacity utilization levels of the plant in these periods, high charge of depreciation and greater levels of finance cost charged in these periods. And since clause 126L provides exemption of income tax on “profits and gains only” (i.e.: no additional benefit is provided in case a loss is reported), the tax treatment for FY19 and FY20 shall be the same regardless of whether the benefit becomes available or not. This further supports are argument that DGKC is not in a position to wage a price war in south and as such disturb the marketing arrangement adhered by the existing players since this will only result in further losses for DGKC.

Moreover, one-time 10% tax credit as per 65B will also be earning catalyst

In addition to 5Yrs income tax exemption available as per clause 126L of the ITO, the Ordinance also provides a one-time 10% tax credit on the amount of plant and machinery invested for expansion plants as per section 65B for the tax year in which the plant begins commercial operations. As per management’s latest disclosure, the estimated amount available through this benefit accumulates to PKR 3.1bn (PKR 7.08/share), which will now form a part of its FY18 earnings.

Market share: The art of fighting without fighting

As mentioned earlier, the Pakistan cement manufacturing industry is currently undergoing an expansion phase where in fresh capacities of ~19mn tpa are expected to enter the industry in the next 3 years, ~14mn tpa in North and ~5mn tpa in South. Also discussed is that contrary to the South market, the North market is highly concentrated and presents a cluster like market structure. As such, we believe the North market appears more susceptible to a price risk situation than South, in the event of a supply glut situation. The recent commencement of CHCC's production line II, which resulted in severe price fall in the North whereas relatively no price movement in the South following commencement of two major expansions bears witness to our thesis.

No expansion in north will reduce DGKC's upcountry market share…

To recall, in addition to its Hub expansion plans, DGKC had also announced its intention to come up with a brownfield expansion plant of 2.2mn tpa at its existing Dera Ghazi Khan site but later dumped it off citing unviable economic conditions. With North players smoothly progressing towards the completion of their expansion plants, they are expected to retain their existing market share in their respective market; and since DGKC has still not decided whether to come up with a new manufacturing facility in the North, we expect its existing ~13% market share (in North) to gradually fall off to 9% by FY21 as and when new expansions enter the market. It is pertinent to mention that the Board of Directors of DGKC had recently disclosed its intention to continue to obtain applicable regulatory permissions from Government authorities for setting up of its brownfield cement production line at the Dera Ghazi Khan site, indicating its close vigilance with respect to changing market share dynamics of the industry.

…however, gaining share in south to be more fruitful

However, DGKC's entry in the South market is expected to keep its domestic market share intact at ~11%. Putting things in perspective, we feel that DGKC has acted rather wisely by entering South as against North, whereby not only does it keep its domestic market share intact but also saves itself from the fierce price competition to arise in North in the next 3-4 years. This way, it enters a high margin-low cost market (lesser input costs in South due to proximity to port) and gets access to a wider export market as well.

Exhibit:

DGKC domestic market share breakup

Region	FY15A	FY16A	FY17A	FY18E	FY19F	FY20F	FY21F	FY22F
North	14%	14%	13%	13%	12%	10%	9%	9%
south	0%	0%	0%	0%	17%	17%	17%	17%
Total	11%	11%	11%	11%	13%	11%	10%	11%

Source: APCMA, company Accounts & IGI Research

Budgetary Measures

Tax measures enacted in Finance Act 2018-19

To recall, the government in its FY18-19 budget announced various measures, which are to have substantial impact on the cement sector as a whole. These include;

- FED increase: 20% increase in Federal Excise Duty (FED) to PKR 1,500/ton as against existing levy of PKR 1,250/ton,
- CD on coal: Reduction of customs duty on coal to 3% from existing 5% (negligible impact),
- Tax Credits: Extension of tax credits pertaining to section 65B, 65C and 65D till FY21,
- Super tax: Continuation of supertax with 1% decline thereof,
- Corporate Tax: Gradual reduction in corporate tax rate by 1% each year to 25% by FY23; and
- Profit Distribution: Relaxation of profit distribution limit to 20% as against existing 40%.

As such, we have incorporated these measures in our model to determine their impact on our earnings estimates.

Enhancement of FED will lead to a price increase in North by a minimum of PKR ~15/bag

Over the years, the cement sector has come to terms with the rising trend in FED and has as such quite smoothly transferred its impact to the final consumer by an equal price increase. Though, the same couldn't be managed in the North region in FY18, wherein although the sector initially hit back with a compensating price increase, it couldn't sustain this for long due to severe competition following commencement of CHCC's production line II, resulting in North prices falling back to its original position.

Following the recently enacted +20% rise in FED via Finance Act 2018-19, cement manufacturing companies have already begun issuing notifications for a similar price increase, this time by a minimum of PKR ~15/bag (inclusive of sales tax). Given, that no new capacity is to come online at least in the major portion of FY19, we believe the North region would be able to sustain this increase, at least for FY19. However, post FY19 when major capacities are to come online, especially in the North, the sector's ability to pass over this levy to the final consumer may become quite weak. We have discussed the implication of FED on South prices in the above section.

Dividends to stay low amid relaxed profit distribution limits enacted in Finance Act 2018-19

Another noteworthy amendment promulgated by the Finance Act FY18-19 pertains to relaxation of distribution limits of profits earned by Companies. Presently under section 5A of the Income Tax Ordinance, 2001 public companies are obliged to distribute at least 40% of their after tax profits through cash or issuance of bonus shares within six months of the end of the financial year, failing which such companies are subjected to tax @ 7.5% of their accounting profit (before tax).

According to the new amendment, this distribution limit has now been reduced to 20% but is restricted to distribution of cash only (bonus issue has been eradicated as an eligible distribution option for the purposes of this section) and the applicable tax rate on accounting profit in case of failure to distribute such dividend has also been reduced to 5%. This comes after strong protests registered from large corporations undergoing heavy expansions such as LUCK with several companies even challenging its admissibility in the honorable courts in FY18.

Considering the fact that DGKC is rapidly depleting its cash resources (cash resources equal PKR 0.86/share as of Mar-18 as against PKR 16.00/share back in Jun-16) in order to come up with its Hub plant and has as such obtained external borrowings worth PKR 29bn as of Mar-18 (Debt: Equity ratio of 0.60) in contrast to external borrowings worth PKR 7bn in Jun-16 (Debt: Equity ratio of 0.19), the recent amendments are seen to relieve some pain for the company in the shape of lower payouts. As such we expect the company to maintain a payout ratio of 21%/26%/31% for FY18E/19F/20F with equal dividend payout of PKR 4.50/share for the respective years.

Super tax remains negative; gradual reduction of corporate tax rate to boost earnings going forward…

Introduced in FY15, super tax was levied @ 3% on Companies having profits above PKR 500mn for a period of 3yrs ending FY17. As such, the conclusion of FY17 brought some relief for the business community, which took it as the final year for the imposition of this tax measure. Defying expectation, the federal government in its Budget Briefing 2018-19 took the business fraternity with surprise by deciding to continue this levy for FY18 and gradually phase it out by FY20. However, as a compensatory measure, the government announced the gradual reduction of corporate tax rate by 1% each year to 25% over the next five years. Accordingly, our revised earnings estimates are reflective of these changes.

Exhibit:

DGKC: Impact on earnings of changes in Super Tax and Corporate Tax Rates

	FY18E	FY19F	FY20F	FY21F	FY22F	FY23F
Corporate tax rate (Pre Budget)	30%	30%	30%	30%	30%	30%
Corporate tax rate (Post Budget)	33%	31%	29%	27%	26%	25%
Super Tax Rate	3%	2%	1%	0%	0%	0%
Corporate Tax Rate	30%	29%	28%	27%	26%	25%
EPS (Pre Budget)	21.69	17.53	14.24	15.13	17.42	21.40
EPS (Post Budget)	21.27	17.33	14.34	15.47	17.95	22.26
Tax charge (EPS impact)	(0.42)	(0.20)	0.10	0.34	0.53	0.86

Source: Finance Act 2018-19, IGI Research

Valuation and Recommendation

Valuation

Using Free Cash Flow to Equity approach, we determine a Dec-18 based Target Price of PKR 194/share for the scrip, offering +52% return from its last closing price of PKR 127/share.

Valuation Parameters

Risk Free Rate	7.00%
Beta	1.28
Market Premium	6.50%
Cost Of Equity	15.32%
Sustainable Growth	3.00%
Valuation Period	Dec-18

Valuation Snapshot

PKRmn	Jun-18	Jun-19	Jun-20	Jun-21	Jun-22	Jun-23	Jun-24	Jun-25
EBIT	9,038	12,109	9,276	9,018	9,850	11,917	13,688	14,569
EBIT (1-t)	7,671	7,512	5,605	5,651	6,411	8,158	9,170	9,455
+ Depreciation & Amortisation	2,447	5,375	5,076	4,806	4,563	4,331	4,112	3,903
- Capex	(16,212)	(1,143)	(1,080)	(1,360)	(1,291)	(1,225)	(1,163)	(1,104)
- Working Capital Changes	903	1,322	(420)	(530)	(396)	(404)	(125)	(100)
FCFF	(5,191)	13,066	9,182	8,567	9,287	10,860	11,994	12,155
WACC	12.7%	13.7%	14.4%	14.9%	15.3%	15.3%	15.3%	15.3%

Sum of PV FCFF	22,937
Pv Of Terminal Value	40,201
Operating Assets Value	63,138
- Cash And Cash Equivalents	-
Firm Value	63,138
- Debt	-
Equity Value	63,138
Core Operations	**144.1**
Portfolio Value	21,904
Outstanding Shares	438.1
Target Price (PKR/share)	**194.1**

Target Price Sensitivity

		Discount rate				
		5.0%	6.0%	7.0%	8.0%	9.0%
	2.0%	167.5	150.6	136.4	124.2	113.8
Growth Rate %	3.0%	179.5	160.2	144.1	130.6	119.0
	4.0%	193.9	171.5	153.2	137.9	125.1

Sensitivty Analysis

%age Chg. In EPS	**Unit**	**2018(b)**	**2019F**	**2020F**	**2021F**
Change in Coal Prices (-/+5%)	USD/ton	90.9	-3.5%	-3.9%	-4.0%
Change in Interest Rates (-/+1%)	%	6.5%	-2.0%	-1.2%	-0.8%
Change in USD/PKR (-/+3%)	USD	108.8	0.4%	-1.3%	-3.5%
Change in Domestic Prices (-/+3%)	PKR/bag	547.7	12.5%	14.4%	15.1%

Investment Value (PKRmn)

Particulars of Investment	Valuation	Current Price (PKR/share)	Equity holding (mnShares)	Current Market Value	Investment Value	%age Share
MCB bank	at Market value	199	102.3	20,311	20,311	60.3%
Nishat Mills	at Market value	138	30.3	4,175	4,175	12.4%
Adamjee Isurance	at Market value	49	25.1	1,237	1,237	3.7%
Nishat Chunian	at Market value	49	7.3	356	356	1.1%
PPL	at Market value	213	0.6	127	127	0.4%
UBL	at Market value	169	0.2	36	36	0.1%
Nishat hotel & Property	at Cost	45	100.0	4,501	4,501	13.4%
Nishat dairy	at Cost	10	270.0	2,700	2,700	8.0%
Nishat paper	at Cost	10	25.6	256	256	0.8%
				Total undiscounted value	**33,699**	
				Haircut	*35%*	
				Total Portfolio Value	**21,904**	

Prices as of 28may2018

Financial Highlights

D.G. Khan Cement Company Limited (DGKC)

Current Price (PKR):	127		Target Price (PKR):	194			Upside	52%		Recommendation	BUY

Period end (JUN) - PKRbn	FY17A	FY18E	FY19F	FY20F	FY21F
Income Statement Items					
Net Sales	30.1	31.2	44.6	39.6	38.9
Gross Profit	11.8	9.4	13.1	10.3	10.1
Sell. / Dist. & Admin	1.5	1.5	2.2	2.3	2.4
Operating Profit	10.3	7.8	10.9	8.0	7.7
EBIT	11.5	9.0	12.1	9.3	9.0
Dep. & Amt.	2.1	2.4	5.4	5.1	4.8
EBITDA	13.6	11.5	17.5	14.3	13.8
Financial Charges	0.4	0.5	1.8	1.1	0.5
Pre-tax Profits	11.2	8.6	10.3	8.2	8.5
Taxation	3.2	(0.8)	2.7	1.9	1.7
Post-tax Profits	8.0	9.3	7.6	6.3	6.8
Balance Sheet Items					
PPE	62.4	76.2	72.0	68.0	64.5
LT Invst.	18.6	19.4	19.4	19.4	19.4
Inventory	1.2	1.4	2.0	1.9	1.8
Receivables	0.2	0.2	0.3	0.3	0.3
ST-invst.	-	-	-	-	2.3
Current Assets	27.3	27.7	30.6	29.6	31.8
Total Assets	108.4	123.4	122.1	117.1	115.8
ST-Borrowings & CP of LT Loans	9.1	7.5	7.4	4.8	4.1
Other Current Liab.	5.8	7.1	11.3	9.9	9.2
LT Loans	12.5	20.5	9.5	4.1	-
Other Non Current Liab.	6.1	6.1	6.1	6.1	6.1
Share Capital	4.4	4.4	4.4	4.4	4.4
Total Equity	74.9	82.2	87.8	92.1	96.3
Cashflow Items					
Operating	7.3	12.7	14.3	10.9	11.1
Investing	(30.5)	(17.1)	(1.1)	(1.1)	(3.6)
Financing	12.3	4.4	(13.1)	(9.9)	(7.4)
Cash	0.4	0.4	0.4	0.4	0.4

Period end (JUN)	FY17A	FY18E	FY19F	FY20F	FY21F
Per Share Data					
EPS	18.2	21.3	17.3	14.3	15.5
BV	171	188	200	210	220
DPS	7.5	4.5	4.5	4.5	6.0
Cash & Equivalents	1.0	1.0	1.0	1.0	6.2
Valuation					
P/E (X)	6.9	5.9	7.2	8.8	8.1
P/B (X)	0.7	0.7	0.6	0.6	0.6
Div. Yld (%)	6.0	3.6	3.6	3.6	4.8
Earnings growth (%)	(9.3)	16.8	(18.5)	(17.2)	7.9
EBITDA growth (%)	(6.1)	(15.6)	52.1	(17.9)	(3.7)
ROE (%)	10.7	11.3	8.6	6.8	7.0
Margins					
Gross Margins (%)	39.3	30.1	29.4	25.9	26.0
EBITDA Margin (%)	45.1	36.9	39.2	36.2	35.5
Net Profit Margins (%)	26.5	29.9	17.0	15.9	17.4
Financial Gearing					
Debt / Equity (%)	29	34	19	10	4
Interest Coverage	30	19	7	9	17
Efficiency Ratios					
Current Ratio	1.8	1.9	1.6	2.0	2.4
Quick Ratio	1.4	1.5	1.1	1.4	1.8
Volumes (mn tons)					
Local	3.9	4.4	6.0	5.4	5.3
Exports	0.6	0.5	0.7	0.7	0.7
Total Capacity	4.2	4.2	7.1	7.1	7.1
Capacity Utilization	106	115	95	87	85
Macro - Assumption					
Local cement Price/bag (avg.)	553	548	550	535	533
Coal	78	91	85	80	75
PKR/USD	105	109	116	120	124

Source: IGI Research, Company Accounts

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Sell	If target price on aforementioned security(ies) is less than -10%, from its last closing price(s)

Time Horizon: Dec – 2018

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