# Day Break

Wednesday, 26 September 2018

## COMPANY UPDATE

**Lucky Cement Limited**
Cement

| **Recommendation** | | **BUY** |
|---|---|---|
| Target Price: | | 629.3 |
| Last Closing: | 25-Sep-18 | 502.4 |
| Upside: | | 25.3 |
| Valuation Methodology: | | Discounted Cash Flow (DCF) |
| Time Horizon: | | Dec-18 |

**Market Data**

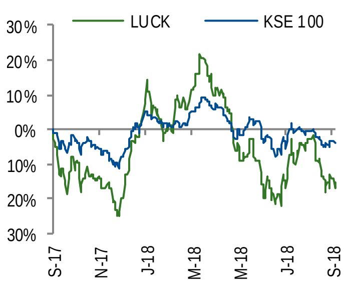
| | | |
|---|---|---|
| Bloomberg Tkr. | | LUCK PA |
| Shares (mn) | | 323.4 |
| Free Float Shares (mn) | | 129.4 |
| Free Float Shares (%) | | 40.0% |
| Market Cap (PKRbn \| USDmn) | 162.5 | 1,318.9 |
| Exchange | | KSE 100 |

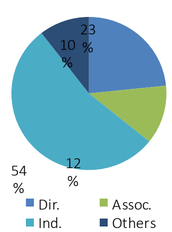
| **Price Info.** | 90D | 06M | 12M |
|---|---|---|---|
| Abs. Return | 5.4 | (24.1) | (15.4) |
| Lo | 462.7 | 462.7 | 445.8 |
| Hi | 583.7 | 723.2 | 723.2 |

**Key Company Financials**
Period End: Jun

| **PKRbn** | **FY18A** | **FY19E** | **FY20F** | **FY21F** |
|---|---|---|---|---|
| Total Revenue | 47.5 | 49.1 | 54.2 | 60.8 |
| Net Income | 12.2 | 11.2 | 12.0 | 13.2 |
| EPS (PKR) | 37.7 | 34.5 | 37.2 | 40.8 |
| DPS (PKR) | 8.0 | 7.0 | 7.5 | 8.5 |
| Total Assets | 97.3 | 109.0 | 114.9 | 125.7 |
| Total Equity | 86.4 | 95.3 | 104.9 | 115.3 |
| **Key Financial Ratios** | | | | |
| ROE (%) | 14.1 | 11.7 | 11.5 | 11.4 |
| P/E (x) | 13.3 | 14.5 | 13.5 | 12.3 |
| P/B (x) | 3.3 | 1.9 | 1.7 | 1.5 |
| DY (%) | 1.6 | 1.4 | 1.5 | 1.7 |

**Relative Price Performance**




**About the Company**

Lucky Cement Company Limited was incorporated in Pakistan on September 18, 1993. The Company manufactures and markets Cement. The Company has also issued GDRs which are listed and traded on the Professional Securities Market of the LSE.

Source: Bloomberg, PSX & IGI Research

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

## Cement

# LUCK: Macro Headwinds validate cement sector performance; Earnings downgraded - Buy Intact

- We revisit our investment case on the scrip after incorporating FY18 accounts and changes in assumption post gas price hike and the supplementary budget presented by the incumbent government.
- The company reported decline in its earnings by 11%YoY to PKR 37.72/share during FY18 despite displaying strong growth in dispatches. Depressed gross margins on the back of lower retention prices and elevated input costs dragged profitability.
- The Economic Coordination Committee (ECC) in its recent meeting concluded last week put into effect a gas price hike for both domestic and industrial consumers. Players residing in South and Khyber Pakhtunkhwa (KPK) having substantial reliance over gas for captive power generation such as LUCK are expected to be heavily affected.
- We have revised our earnings estimates downwards by 5% to PKR (34.5/37.2/40.8)/share for FY19E/FY19F/FY20F. As a result, our valuation is downgraded by to PKR 629.3/share (Previous 756.7)

We revisit our investment case on Lucky Cement Limited (LUCK) after incorporating FY18 accounts and changes in assumption post gas price hike and the supplementary budget presented by the incumbent government. The company reported decline in its earnings by 11%YoY to PKR 37.72/share during FY18 despite displaying strong growth in dispatches. Depressed gross margins on the back of lower retention prices and elevated input costs dragged profitability. Overall, the stock underperformed by 29% against the benchmark index during FY18TD whereby, negative sentiments encircling the entire cement sector (anticipation of massive fiscal curtailment in order to streamline the ailing economy followed with apprehensions of pricing indiscipline) have dragged down valuations. Moreover, the Economic Coordination Committee (ECC) of the Parliament recently approved surge in gas sales prices across all levels. The move comes at a time when commodity prices are already on the rise thus dampening earning prospects further. We have revised our earnings estimates downwards by 5% to PKR (34.5/37.2/40.8)/share for FY19E/FY19F/FY20F. As a result, our valuation is downgraded to PKR 629.3/share (Previous 756.7).

### FY18 earnings review: Lower retentions and rising prices dampen margins. Tax benefit from expansion plant arrests partial damage

Lucky Cement Limited (LUCK) reported unconsolidated earnings of PKR 12.20bn (EPS: PKR 37.72) for FY18 down by 11%YoY as against PKR 13.69bn (EPS: PKR 42.34) reported in the same period last year. Despite achieving a dispatches growth of +9%YoY, the Company failed to reflect similar increase in net sales which only grew by +4%YoY, largely due to the industry's failure to pass over the impact of enhanced FED (up by +25%YoY) promulgated via Finance Act 2017-18 amid heightened competition among industry players.

On the other hand, surge in coal and FO prices (up by 20%YoY and 29%YoY) internationally coupled with PKR devaluation against the greenback (average annual +5%YoY rise) pushed the Company's cost structure up by +15%YoY, from PKR 171/bag in FY17 to PKR 196/bag in the period under review, thereby diminishing FY18 gross margins of the Company to 36% as against 47% reported in the similar period of the preceding year.



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http://www.jamapunji.pk

Though all these factors decreased profit before taxation (PBT) of the Company by 19%YoY, a reduced effective tax rate of 19% (FY17 effective tax rate: 27%), courtesy tax credit available on expansion plant commissioned during the year (Khi Plant) arrested the overall decline in earnings to just 11%YoY.

Exhibit:

LUCK Result Highlights

| Period end (JUN) - PKRmn | 4QFY18 | 4QFY17 | YoY | FY18 | FY17 | YoY |
|---|---|---|---|---|---|---|
| Net Sales | 11,871 | 10,446 | 14% | 47,542 | 45,687 | 4% |
| Gross Profit | 3,860 | 4,347 | -11% | 16,952 | 21,298 | -20% |
| Sell. / Dist. & Admin | 919 | 560 | 64% | 3,082 | 2,725 | 13% |
| Non-Operating Income | 560 | 533 | 5% | 2,595 | 1,993 | 30% |
| EBIT | 3,139 | 4,107 | -24% | 15,119 | 18,778 | -19% |
| Financial Charges | - | - | n/a | - | - | n/a |
| Pre-tax Profits | 3,139 | 4,107 | -24% | 15,119 | 18,778 | -19% |
| Taxation | 744 | 839 | -11% | 2,922 | 5,086 | -43% |
| Post-tax Profits | 2,395 | 3,268 | -27% | 12,197 | 13,692 | -11% |
| | | | | | | |
| EPS | 7.41 | 10.11 | | 37.72 | 42.34 | |
| DPS | 8.00 | 17.00 | | 8.00 | 17.00 | |
| | | | | | | |
| **Key Ratios** | | | | | | |
| Gross Margin (%) | 32.5 | 41.6 | | 35.7 | 46.6 | |
| Net Margin (%) | 20.2 | 31.3 | | 25.7 | 30.0 | |
| Effective Tax Rate (%) | 23.7 | 20.4 | | 19.3 | 27.1 | |

*Source: Company Accounts, IGI Research* *No. of Shares : 323mn*

## ECC approves hike in gas prices… LUCK to remain in the most disadvantageous position…

The Economic Coordination Committee (ECC) in its recent meeting concluded last week recommended a gas price hike for both domestic and industrial consumers. Ranging from +30% to +57% rise for industrial while +10% to +143% for the domestic lot, the revision is expected to have wider impacts on the economy as a whole. Though the final approval from the Parliament remains to be sought in the coming days,

The specific impact over the cement sector comes from two sources:

a) **Gas sales price for cement sector has been increased by 30% to PKR 975/MMBtu:** We expect a marginal impact on cost structure due to this since all cement manufacturers use coal fired kilns for their routine operations.

b) **Gas sales price for captive power plants has been increased by 30% to PKR 780/MMBtu:** Substantial impact subject to Company’s use of gas in captive power mix.

Since Punjab based cement manufacturers are provided with a substantial mix of RLNG (RLNG: Local mix = 72:28), marginal impact is expected to occur on that side. However, players residing in South and Khyber Pakhtunkhwa (KPK) having substantial reliance over gas for captive power generation such as LUCK will remain most affected. Based on our estimates, the above hike in gas prices is expected to increase LUCK's cost of production by PKR 5/bag (PKR 100/ton) which translates to a loss in earnings of PKR 429/666/797mn for FY18/19/20 respectively.

## Industry to hit back with an increase in sales price, albeit this may be short lived

As per our industry sources and information circulated in the market, cement companies in the North have increased their sales prices by an average PKR 20/bag (up to PKR 40/bag in KPK) covering both the hike in gas prices and rising landed cost of coal. Though, the move appears to attract investor attention, however, we believe this to be a short term phenomena and prices may soon fall back amid rising competition among players to dominate dispatches growth. Hence, we stick to our FY19E average sales price assumption of PKR 565/bag for North and PKR 563/bag for South.

## Supplementary budget keeps FY19 development budget over and above last years' development outlay… Macro headwinds still on watch list however.

With proceeding towards another IMF funded debt program quite certain initially and a significant cut in development budget anticipated, the incumbent government finally presented its supplementary budget on 18th September 2018 annulling certain popular measures brought forward in the Annual Budget 2018-19. Contrary to street debates, the government has earmarked PKR 725bn for development expenditures via the PSDP in contrast to PKR 661mn outlaid in the preceding year, marking an increase of ~10%YoY. It is pertinent to mention that this is in excess of CPEC projects which have been reaffirmed top priority and low cost housing schemes for which the government has setup a parliamentary committee.

Whether the government eventually bows out for an IMF bailout package prompting fiscal tightening and whether it would be able to deliver according to its plan remain the questions for only time to answer, however it has shunned the anticipations of a growth stuck economy, at least for now.

## Downward revision in earnings

Accordingly, our earnings estimates are marginally revised downwards by 5% to PKR (34.5/37.2/40.8)/share for FY19E/FY19F/FY20F. Though the cost of manufacturing cement is rising, we believe a stable price discipline shall be maintained in order to support sector margins.

Exhibit:

LUCK's Earnings Revised

| | FY16A | FY17A | FY18A | FY19E | FY20F | FY21F | FY22F |
|---|---|---|---|---|---|---|---|
| EPS | 40.0 | 42.3 | 37.7 | 34.5 | 37.2 | 40.8 | 43.9 |
| DPS | 10.0 | 12.0 | 8.0 | 7.0 | 7.5 | 8.5 | 9.0 |

*Source: IGI Research, Company Financials*

## Recommendation

We maintain a **'BUY'** call on the scrip with a Dec-18 based target price of PKR 629.3/share, offering a +25% upside from its last close.

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|---|---|
| Buy | If target price on aforementioned security(ies) is more than 10%, from its last closing price(s) |
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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):
(Discounted Cash Flow)

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IGI Finex Securities Limited
**Research Analyst(s)**
Research Identity Number: BRP009
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http://www.jammapunji.pk

IGI Securities

# 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 |
| 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 |
| 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 |
| Irfan Ali | Regional Manager (Faisalabad) | Tel: (+92-41) 2540843-45 | irfan.ali@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
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
Tel: (+92-51) 2604861-2, 2604864, 2273439
Fax: (+92-51) 2273861

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

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

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

**Abbottabad Office**
Ground Floor, Al Fatah Shopping Center,
Opp. Radio Station, Mansehra Road
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
Tel: (+92-52) 3258437, 3258762

IGI Finex Securities Limited
Research Identity Number: BRP009
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http://www.jamapunji.pk