Day Break

Thursday, 10 May 2018

COMPANY UPDATE

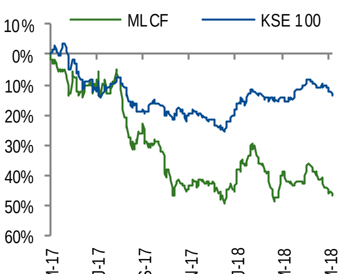
Maple Leaf Cement Factory Limited
Cement

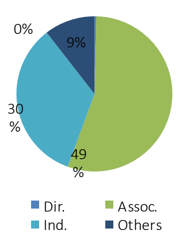
Recommendation			**BUY**
Target Price:			77.2
Last Closing:	9-May-18		63.2
Upside:			22.2
Valuation Methodology:			Discounted Cash Flow (DCF)
Time Horizon:			Dec-18
Market Data			
Bloomberg Tkr.			MLCF PA
Shares (mn)			593.7
Free Float Shares (mn)			237.5
Free Float Shares (%)			40.0%
Market Cap (PKRbn | USDmn)		37.5	323.8
Exchange			KSE 100
Price Info.	90D	06M	12M
Abs. Return	(14.0)	(5.6)	(46.9)
Lo	63.4	63.1	63.1
Hi	79.1	87.4	124.4

Key Company Financials
Period End: Jun

PKRbn	FY17A	FY18E	FY19F	FY20F
Total Revenue	23.9	25.6	26.1	33.7
Net Income	4.8	4.6	6.1	4.5
EPS (PKR)	9.1	7.7	10.3	7.5
DPS (PKR)	3.8	3.3	4.3	3.3
Total Assets	39.1	55.0	63.3	63.6
Total Equity	23.7	30.6	34.2	36.7
Key Financial Ratios				
ROE (%)	20.2	14.9	17.9	12.2
P/E (x)	7.0	8.2	6.1	8.4
P/B (x)	1.6	1.6	1.2	1.1
DY (%)	5.9	5.1	6.7	5.1

Relative Price Performance





About the Company

The Company was incorporated in Pakistan on April 13, 1960 as a public company limited by shares. The shares of the Company are quoted on Pakistan Stock Exchang Limited. It is engaged in production and sale of cement. The Company is a subsidiary of Kohinoor Textile Mills Limited

Source: Bloomberg, PSX & IGI Research

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

Cements

MLCF: Turning things around cost effectively

- We revise our earnings forecast for Maple Leaf Cement Factory Limited (MLCF) based on the recently presented Finance Bill 2018-19 and availability of 9MFY18 financial results of the Company wherein we expect the Company to post FY18 consolidated earnings of PKR 7.69/share
- During 9MFY18, MLCF posted consolidated earnings of PKR 3.37bn (Full share EPS: PKR 5.68) as against PKR 3.95bn (Fully diluted EPS: PKR 6.66) reported in the same period last year, marking a 15%YoY downturn
- Laid before the parliament on April 27, 2018, the Budget 2018-19 portrays rather mix sentiments for the cement sector. We strongly believe that the industry will smoothly pass over the impact of enhanced FED to the final consumers in the shape of a minimum price increase of PKR ~15/bag. Extension of tax credits and gradual reduction of corporate tax rate fare well for the sector however, continuation of super tax for the next two years (including FY18) remains a negative.
- We estimate MLPL to contribute PKR ~1bn (PKR 1.70/share) towards the group's annual consolidated earnings on a recurring basis and reduce its effective tax rate to a 5Yr average of 21% in FY2020-24
- We maintain a 'Buy' call on the scrip with a Dec-18 target price of PKR 77/share, which at current price of PKR 63/share, offers a decent +22% upside

MLCF: Earnings revised post budget and 9MFY18 result; 'Buy' intact

We revise our earnings forecast for Maple Leaf Cement Factory Limited (MLCF) based on the recently presented Finance Bill 2018-19 and availability of 9MFY18 financial results of the Company. Our revised earnings forecast also incorporates changes made in our savings estimates from Maple Leaf Power Limited (MLPL), a 100% owned subsidiary of the Company, enabling a more accurate depiction of the operational and tax efficient structure of the group. Using discounted free cash flow approach, we maintain a 'Buy' call on the scrip with a Dec-18 target price of PKR 77/share, which at current price of PKR 63/share, offers a decent +22% upside.

Exhibit:

Key Financial Highlights – Consolidated Results

	2015A	2016A	2017A	2018E	2019F	2020F	2021F
Gross Margins	36.2%	42.8%	39.3%	36.6%	35.8%	30.0%	29.3%
EBIT	5,584	7,511	7,044	6,923	6,718	7,165	6,172
EPS	6.55	9.18	9.05	7.69	10.27	7.52	6.86
DPS	2.00	4.00	3.75	3.25	4.25	3.25	2.75

Source: IGI Research, Company Accounts

Business environment has changed; Tougher times ahead

Having enjoyed a blissful 3Yr period of high profitability margins, wherein strong construction demand, stable price levels, benign global commodity prices and flattish yield curve supported the sector to earn net margins of as high as >30%, the cement industry of Pakistan has currently come across a massive turn around phase wherein it is being braw beaten from every corner. Beginning with a disturbed price structure in North following commencement of Cherat Cement Company Limited's (CHCC) production line II in Jan-17, whereby to rapidly achieve 100% capacity utilization levels the Company offered extravagant discounts, forced other regional players to drop down its price levels. This simultaneously restricted the north players' ability to completely pass over the impact of +25%YoY rise in FED imposed by the government via Finance Act 2017-18 resulting in average 8%YoY (9MFY17 comparison) fall in per bag retention prices. A striking rise in global commodity prices, wherein coal increased by +17% and prices of oil index increased by +22% further aggravated the situation leading to enhanced fuel and power cost which consequently led to cost of producing cement being increased to average PKR 217/bag as against average PKR 193/bag in the comparative period of the preceding year. Additionally, devaluation of PKR against the greenback and increased cost of debt has also hindered the performance of companies. Although demand of cement for 9MFY18 remained upbeat wherein local cement dispatches grew by +18%YoY, double impact of lower retention prices and elevated cost of production led to achievement of average net margins of 20%.

9MFY18 performance review

During 9MFY18, MLCF posted consolidated earnings of PKR 3.37bn (Full share EPS: PKR 5.68) as against PKR 3.95bn (Fully diluted EPS: PKR 6.66) reported in the same period last year, marking a 15%YoY downturn. On the dispatches front, despite achieving a +20%YoY growth in domestic offtakes, a 39% fall in exports effectively restrained the overall dispatches growth to just 12%. However, despite adverse industry wide impacts of enhanced FED and falling cement prices in the North region, the Company managed to retain its top position of having the highest retention price in the region (North), depicting strong brand loyalty of its products.

Tax measures proposed by Budget FY18-19

Laid before the parliament on April 27, 2018, the Budget 2018-19 has proposed some very populous decisions with respect to taxing of the economy. These include massive curtailment of income tax on both salaried and business class individuals, gradual reduction of corporate tax rate for companies other than banking companies from 30% to 25% over a period of five years and considerable reduction in customs duties for promotion of exports. However, the government has continued super tax charge for FY18 and has recommended its gradual phase out by FY20.

For the cement sector, however, the proposed budget portrays rather mix sentiments. The key amendments affecting the sector, apart from infrastructure spending and promotion of mortgage house financing in the country, which are to instigate demand, include:

a) 25% 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%;
c) Extension of tax credits up to 30 June 2021.
d) Gradual reduction of corporate tax rate from existing 30% to 25% over a period of five years;
e) Continuation of super tax at 3% for FY18 and its gradual phase out by FY20;

Based on historic precedence, we strongly believe that the industry will smoothly pass over the impact of enhanced FED to the final consumers in the shape of a minimum price increase of PKR ~15/bag (inclusive of sales tax impact), however price passing over ability will likely be limited post FY19, once fresh capacities become online. Similarly, reduction of customs duty on import of coal will not significantly reduce the cost of producing cement, since we estimate it to generate cost savings of PKR ~1/bag. However, extension of tax credits and gradual reduction of corporate tax rate fare well for the sector while continuation of super tax for the next two years (including FY18) remains a negative.

MLPL to provide significant operational and tax efficiencies

MLCF in order to setup its recently commissioned 40MW coal based captive power plant, incorporated a separate entity by the name of Maple Leaf Power Limited (MLPL), a 100% owned subsidiary. This provides MLCF with the following two distinct and significant advantages:

- Coal being the cheapest power source (after Waste Heat Recovery Power Plants), is to bring in significant cost savings to the cement manufacturing process, providing estimated savings of PKR ~5/unit of electricity consumed; and
- The group structure will generate hefty tax savings, thereby reducing the group's effective tax rate to average ~21% post FY19.

Transfer pricing mechanism…

The tax benefits for the group emanates from the traditional accounting concept of transfer pricing, the price at which divisions of a company transact with each other. MLPL has determined to supply electricity to MLCF at a transfer price of NEPRA approved rates of 12.92/Kwh, which is substantially higher than the actual cost of generating electricity. Given that profits derived from MLPL are exempt from tax as per clause 132 of second schedule of the Income Tax Ordinance, the group management's decision to determine a significantly higher transfer price is effectively transferring profits from MLCF (on a standalone basis), which is subject to 30% corporate tax rate, to MLPL (on a standalone basis), which has a tax exempt status. However, from a group perspective (consolidated basis); this leads to equivalent profits being derived but ending up paying lesser taxes than the usual way. Accordingly, we estimate MLPL to contribute PKR ~1bn (PKR 1.70/share) towards the group's annual consolidated earnings on a recurring basis and reduce its effective tax rate to a 5Yr average of 21% in FY2020-24.

Expansion project to sustain market share and accrete onetime tax savings of PKR 1.6bn in FY19

Undergoing a capacity expansion plan of 2.3mntpa, MLCF's proposed manufacturing facility will not only resolve its current capacity constraints (3QFY18 Capacity Utilization Level: 120%) but will also aid it in maintaining its current market share of ~9% going forward. Due to come online by 4QFY19, the plant will become eligible to avail 10% tax credit on the amount of plant and machinery invested therein as per section 65B of the Income Tax Ordinance (ITO). Accordingly, we estimate a tax credit amount close to ~PKR 1.6bn (PKR 2.68/share) to be available in FY19.

Exhibit:

Expansion plant will resolve current capacity constraints whereas buoyant demand will keep capacity utilization at optimal levels

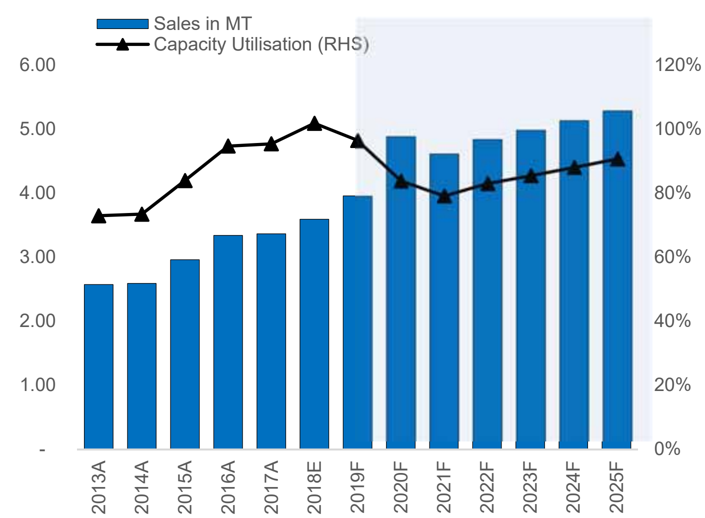
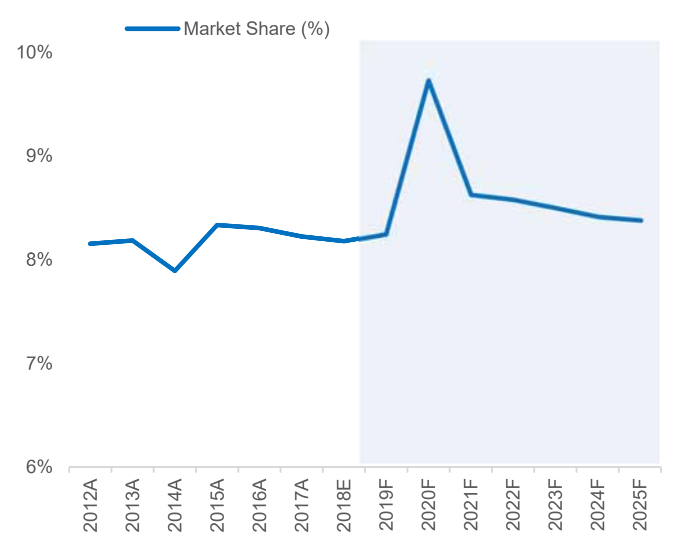


Exhibit:

Expansion plant will aid in maintenance of market share post industry wide expansion phase



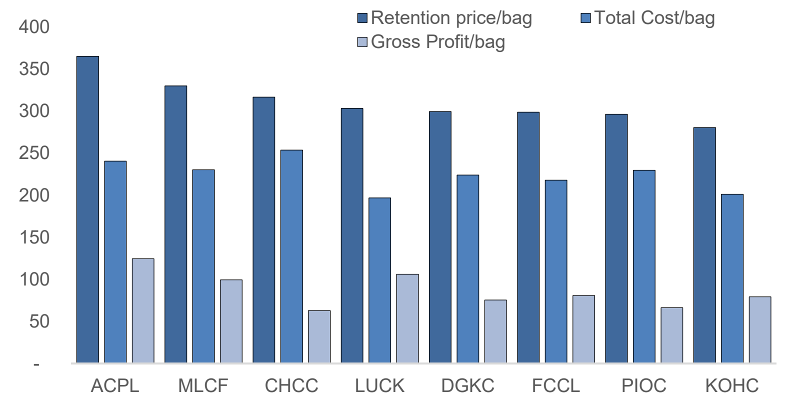
Source: IGI Research, Company financials

Higher retention prices in the region to act as buffer against falling prices

Currently marketed with an average retention price of PKR 330/bag, Maple Leaf Cement enjoys a handsome 10% premium retention price over its regional peers (North) and only stands behind ACPL at the national level. This portrays MLCF's better marketability, high brand loyalty and enhanced product reach towards its varied customer base. This unique advantage acts as a buffer for MLCF in an event of any price fall in contrary to other regional players.

Exhibit:

MLCF stands tall amongst our coverage companies in North with respect to retention prices; only behind ACPL at the national level



Source: IGI Research & Company financials

High Leveraging not a worry

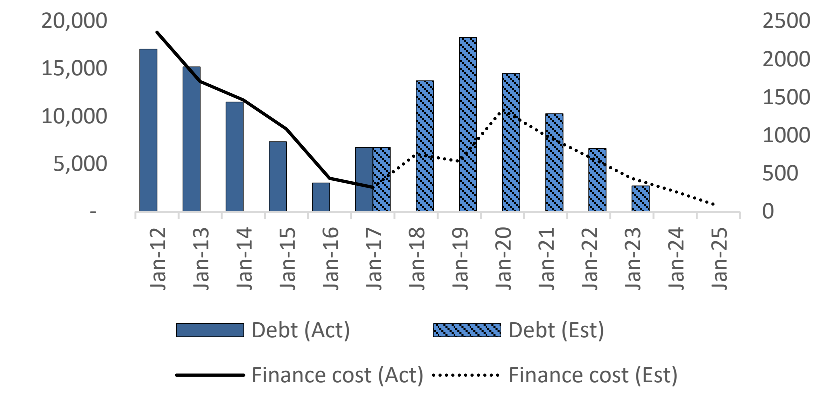
MLCF over the years has turned around its capital structure in a very aggressive manner in order to keep its cost of capital at optimal levels. Lowering its debt financing from PKR 17bn in FY12 to PKR ~7bn in FY17, the Company brought down its interest cost (Charged to P&L only) to PKR 318mn in FY17 as against PKR 2,351 recorded in FY12, registering a remarkable decline of 86%. As of Mar-18, the Company maintains a healthy Debt: Equity ratio of 0.53 (On a consolidated basis) as against risky levels of 4.45 back in FY12. As per management discussion, the Company aims to maintain a Debt: Equity ratio within a range of 0.45 - 0.55 going forward in order to achieve tax benefits available on interest cost as against cost of equity, which is a non-deductible tax expense.

As per information disclosed by the management, the Company envisages to borrow PKR ~12.75bn (51% of total cost of expansion) to finance its expansion plant which it expects to come online by 4QFY19. Accordingly, we believe debt financing of the Company to leap up to PKR 18bn by FY19 driving interest cost up to PKR 1.3bn for FY20 (post borrowing cost capitalization period).

However, we believe MLCF will continue its strategy of early retirement of debt post FY19 in order to keep itself competitive in a likely low cement-pricing situation. We base our belief on a) rising interest rate outlook of the country thereby pushing higher finance cost for the Company, b) heavy cash generation of the Company with less likelihood of business diversification and, c) lack of investment avenues yielding attractive returns. Disclosure in footnotes of the financial accounts with respect to availability of a cost free prepayment clause on outstanding debt of the Company also hints towards the same intention being shared by the management. Based on the afore-mentioned premises, we believe that although finance cost charged to income statement will rise up to PKR ~900mn by FY20; this will draw down to PKR ~350mn by FY22 due to its aggressive debt retirement strategy.

Exhibit:

Borrowing level of the Company is estimated to rise sharply by FY19 in the wake of expansion plant coming online, thereafter early retirement strategy will keep MLCF lightweight against the burden of rising interest costs



Source: IGI Research & Company financials

Outlook

Going forward, positive impacts will be coming from high cement demand and demand-based price gain in the ensuing quarters. However, fluctuating FX, high coal prices and upward trending inflation will counter the positive impacts simultaneously. We also believe that stable price levels will be a short-lived phenomenon and an intense competition among players will surface post FY19 when majority of fresh capacities are to enter the playing field leading to a serious price risk situation, especially in North.

However, players having tax and operational efficiencies with an ability to charge premium prices such as MLCF along with ACPL, LUCK, DGKC & KOHC will emerge as winners in these rough periods ahead.

Recommendation; 'Buy' call intact, with a potential upside of +22%

We have used a discounted free cashflow valuation approach to value the scrip with a cost of equity of 14.8%. Based on our assumptions, our Dec-18 target price comes at PKR 77/share, offering a decent +22% upside from its last close of PKR 63/share.

Important Disclaimer and Disclosures

Research Analyst(s) Certification: The Research Analyst(s) hereby certify that the views about the company/companies and the security/securities discussed in this report accurately reflect his or her or their personal views and that he/she has not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report. The analyst(s) is principally responsible for the preparation of this research report and that he/she or his/her close family/relative does not own 1% or more of a class of common equity securities of the following company/companies covered in this report.

Disclaimer: The information and opinions contained herein are prepared by IGI Finex Securities Limited and is for information purposes only. Whilst every effort has been made to ensure that all the information (including any recommendations or opinions expressed) contained in this document (the information) is not misleading or unreliable, IGI Finex Securities Limited makes no representation as to the accuracy or completeness of the information. Neither, IGI Finex Securities Limited nor any director, officer or employee of IGI Finex Securities Limited shall in any manner be liable or responsible for any loss that may be occasioned as consequence of a party relying on the information. This document takes no account of the investment objectives, financial situation and particular needs of investors, who shall seek further professional advice before making any investment decision. This document and the information may not be reproduced, distributed or published by any recipient for any purpose. This report is not directed or intended for distribution to, or use by any person or entity not a client of IGI Finex Securities Limited, else directed for distribution.

Rating system: IGI Finex Securities employs three tier ratings system, depending upon expected total return (return is defined as capital gain exclusive of tax) of the security in stated time period, as follows:

Recommendation	Rating System
Buy	If target price on aforementioned security(ies) is more than 10%, from its last closing price(s)
Hold	If target price on aforementioned security(ies) is in between -10% and 10%, from its last closing price(s)
Sell	If target price on aforementioned security(ies) is less than -10%, from its last closing price(s)

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)

Risk: Investment in securities are subject to economic risk, market risk, interest rate risks, currency risks, and credit risks, political and geopolitical risks. The performance of company (ies) covered herein might unfavorably be affected by multiple factors including, business, economic, and political conditions. Hence, there is no assurance or guarantee that estimates, recommendation, opinion, etc. given about the security (ies)/company (ies) in the report will be achieved.

Basic Definitions and Terminologies used: Target Price: A price target is the projected price level of a financial security stated by an investment analyst or advisor. It represents a security's price that, if achieved, results in a trader recognizing the best possible outcome for his investment, Last Closing: Latest closing price, Market Cap.: Market capitalization is calculated by multiplying a company's shares outstanding by current trading price. EPS: Earnings per Share. DPS: Dividend per Share. ROE: Return on equity is the amount of net income returned as a percentage of shareholders' equity. P/E: Price to Earnings ratio of a company's share price to its per-share earnings. P/B: Price to Book ratio used to compare a stock's market value to its book value. DY: The dividend yield is dividend per share, divided by the price per share. CY/FY: Calendar/Fiscal/Financial Year. YoY/ QoQ/ MoM: Year-on-Year, Quarter-on-Quarter, Month-on-Month. Th /Mn /Bn /Tn: Thousands/Million/Billion/Trillion.

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
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 Shoppinig 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 Analyst(s)
Research Identity Number: BRP009