

Company Report

Monday, 08 February 2016



Initiation Report

Cherat Cement Company Limited

Cement

Recommendation	BUY
Target Price	138.7
Last Closing	97.6
Upside	42%

Market Data

Bloomberg Tkr.	CHCC PA		
Shares (mn)	176.6		
Market Cap (PKRbn USDmn)	17.2	164.2	

Price Info.	90D	180D	365D	
Abs. Return	11.4	6.1	10.9	
Low	80.9	80.9	65.4	
High	99.6	99.6	99.6	

Key Company Financials

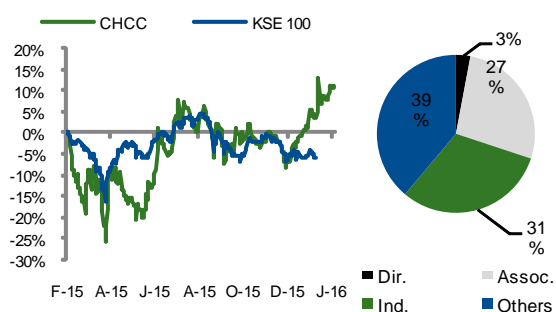
Period End: Jun

PKRbn	FY15A	FY16E	FY17F	FY18F
Total Revenue	6.6	6.8	11.1	16.3
Net Income	1.3	1.5	2.8	3.8
EPS (PKR)	7.3	8.5	15.9	21.5
DPS (PKR)	3.0	3.5	6.6	9.7
Total Assets	9.5	15.1	19.5	22.1
Total Equity	8.0	8.9	10.6	12.7

Key Financial Ratios

ROE (%)	16%	17%	27%	30%
P/E (x)	13.4	11.5	6.1	4.5
P/B (x)	2.1	1.9	1.6	1.4
DY (%)	3.1	3.6	6.8	9.9

Relative Price Performance & Shareholding



About the Company

Cherat Cement Company Limited was incorporated in Pakistan as a public limited company by shares in the year 1981. Its main business activity is manufacturing, selling and marketing of cement. Company's current rated capacity is 1.1mn ton per annum, with a current market share of ~3%.

Source: Bloomberg, KSE 100 & IGI Research

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Cherat Cement Company Limited

Expansion and Cost-Efficiency Firm-Up Investment Case

Initiating Coverage, with a Buy call, offering +42% upside

We extend our coverage on cement sector with the inclusion of Cherat Cement Company Limited (CHCC) with a BUY rating and a Dec-16 Target Price of PKR 139/share, providing an upside of +42% from its last closing price of PKR 98/share. The scrip is currently trading at FY16E P/E of 11.5x and provides a healthy dividend yield of 3.6%.

Investment Case

Our investment case is based on a) +27% 5-yr earnings CAGR, b) 1.3mn ton green field cement plant to become operational in 3QFY17 along with 7MW WHR plant, c) +20%YoY growth in EBITDA/ton to PKR 2,443 in FY16 (Industry average:PKR 2,627/ton expected in FY16) and d) 5-year tax holiday on new plant.

Premier beneficiary of Rising Local Demand

CHCC is expected to be the premier beneficiary of gush in local cement demand, as company is in the process of installing green field cement plant (first one to add a new line in the industry) with capacity of 1.3mn tons at an estimated cost of PKR 12bn (USD 115mn), effectively increasing total capacity to 2.5mn tons. The plant is expected to come online by the end of Dec-16 (there is high probability that plant may come online as soon as Sep-16), with production starting from Jan-17. We expect company to run new plant at 100% capacity to benefit from 5-yr tax holiday, offered to new units set up in KP before FY18 and fulfill the rest of the demand by old plant.

Efficiency to Enhance Margins

Company requires ~15MW of energy to run old cement mill at 100% utilisation, for which company depends on 7MW WHR, 27.89MW FO/Diesel based power plant and national grid. However, the addition to capacity is expected to increase power requirement to ~35 MW, for which a 7MW WHR plant is already in pipeline, expected to come online in 2QFY17. Owing to sizeable decline in furnace oil prices, cost of energy has dropped down significantly to PKR 6-7/Kwh on FO for the company, which is roughly at 40-45% discount to power provided by National Grid. As a result, CHCC has been running its FO plant from Sept-15 onwards, largely for off-peak hours. Going forward, we anticipate company to rely heavily on its captive power plant for energy requirements. Along with self-generated cheap energy, decline in coal and power cost by national grid, are expected to expand company's gross margins to +38% in FY16 from +30% in FY15.

Profitability expected to rise by +6%YoY in 2QFY16

Earning in 2QFY16 is expected to grow by +6%YoY to PKR 412mn (EPS PKR 2.33) on the back of a) +5%YoY growth in dispatches, whereas local sales are expected to go up by +10%YoY and exports to decline by 10%YoY, b) +635bps augment in gross margins on the back of decline in fuel and power cost as company has also running its captive power plant on FO, c) enhanced net retention rate due to increased local sales. Profitability is forecasted to rise by +6%YoY in 1HFY16 to PKR 681mn (EPS PKR 3.85) from PKR 640mn (EPS PKR 3.62) last year.

Exhibit: Financial Highlights

PKR mn	2QFY16	2QFY15	YoY	1HFY16	1HFY15	YoY
Revenue	1,890	1,758	8%	3,450	3,311	4%
Gross Profit	715	553	29%	1,179	966	22%
Selling and Admin	94	90	4%	192	140	37%
EBT	589	483	22%	933	790	18%
Tax	177	95	87%	252	150	69%
Net profit	412	389	6%	681	640	6%
EPS	2.33	2.20		3.85	3.62	
Key Ratios						
Gross Margin	38%	31%		34%	29%	
Net Margin	22%	22%		20%	19%	
Effective Tax Rate	30%	20%		27%	19%	

Source: IGI Research, Company Financials

Exhibit: Profitability to increase with rising plant utilization

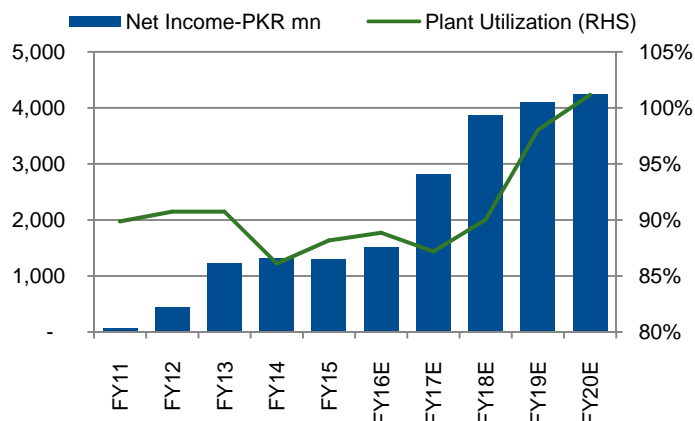


Exhibit: Exports continue to decline, supported by growth in local sales (mn tons)

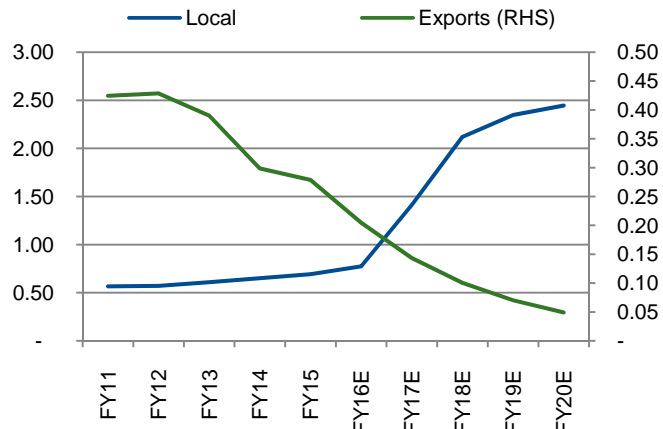


Exhibit: Increase in debt and finance cost due to expansion in capacity (PKR mn)

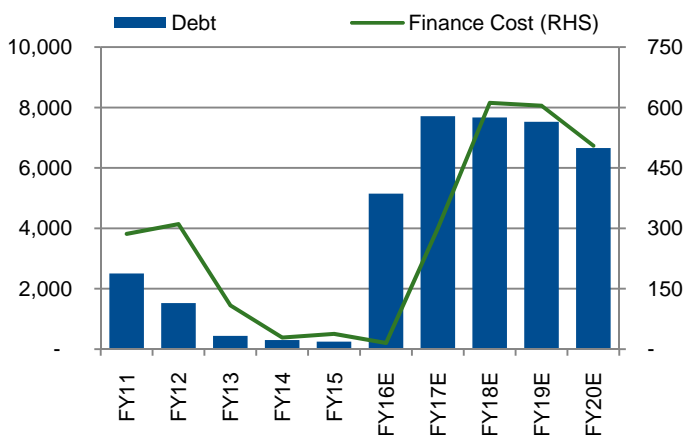
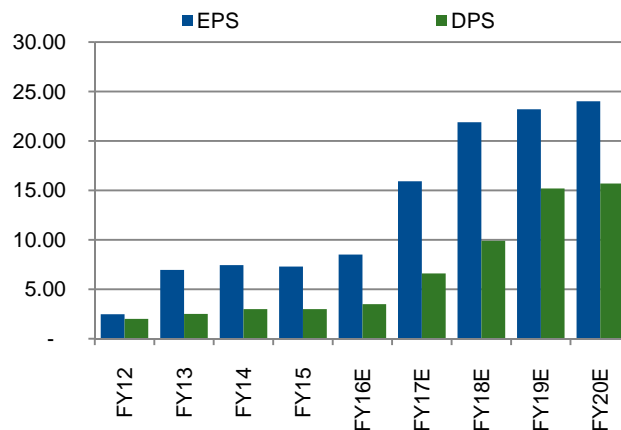


Exhibit: Dividend expected to grow amid increasing Profitability (PKR/share)



Source: IGI Research, Company's Financials

Valuation and Recommendation

We have used discounted cash flow method for our valuation, with a cost of equity of 13.7% (risk-free rate=6.5%, beta 1.2 and risk premium 6%). Based on this, our Dec-16 target price for CHCC comes at PKR 139/share, offering a sizeable +42% return from its last closing price of PKR 98/share. In addition, for FY16 we estimate CHCC to pay a cash dividend of PKR 3.5/share, (+3.6% dividend yield), bringing total investor return to +45.6%.

Valuation Parameters

Risk Free Rate	6.5%
Beta	1.2
Risk Premium	6.0%
Cost of Equity	13.7%
Cost of Debt	8.0%
Cost of Debt (after Tax)	5.4%
WACC	10.7%
Sustainable Growth Rate	2.0%

Discounted Cash Flows	Jun-16	Jun-17	Jun-18	Jun-19	Jun-20
PKRmn					
EBIT	2,115	3,842	5,116	5,318	5,340
EBIT (1-t)	1,438	2,651	3,581	3,723	3,738
+ Depreciation	258	736	927	927	923
- CAPEX	(5,687)	(3,919)	(927)	(850)	(769)
- WC	(291)	(958)	(931)	(367)	(174)
FCFF	(4,282)	(1,489)	2,651	3,433	3,717

Terminal Value	28,011
Sum of PV FCFF	1,558
Net Debt	(5,066)
Enterprise Value	24,503
No. of Shares (mn)	176.6
Target Price (PKR/share) - Dec-16	138.7

Sensitivity to Discount Rate and Terminal growth

		Risk Free Rate				
		4.5%	5.5%	6.5%	7.5%	8.5%
Terminal Growth Rate	1.0%	153.1	136.4	121.9	109.3	98.3
	1.5%	164.2	145.7	129.9	116.2	104.2
	2.0%	176.7	156.2	138.7	123.7	110.7
	2.5%	190.9	167.9	148.6	132.1	117.9
	3.0%	207.2	181.2	159.6	141.3	125.7

Financials

Cherat Cement Company (CHCC)

Current Price (PKR): 97.6 Target Price (PKR): 138.7

Upside **42%** Recommendation **BUY**

Jun-end	FY14A	FY15A	FY16E	FY17F	FY18F
Income Statement Items (PKRmn)					
Gross Sales	7,649	7,857	6,823	11,138	16,340
Net Sales	6,451	6,565	6,823	11,138	16,340
Gross Profit	2,103	1,983	2,617	4,641	6,276
Admin.	141	164	196	320	470
Selling&Dist.	188	206	158	220	341
EBIT	1,716	1,709	2,160	3,849	5,160
Finance	29	38	15	300	612
Pre-tax Profits	1,688	1,671	2,145	3,549	4,548
Taxation	372	383	640	736	682
Post-tax Profits	1,316	1,288	1,505	2,813	3,866
Balance Sheet Items (PKRbn)					
Net PPE	3,362	6,845	12,273	15,456	15,456
LT Assets	3,526	7,197	12,627	15,810	15,811
Stores and Spares	1,181	983	1,160	1,782	2,696
Current Assets	2,905	2,267	2,516	3,642	6,275
Total Assets	6,431	9,464	15,143	19,452	22,086
LT Loans	163	122	4,722	7,582	7,441
Total LT Liab.	686	611	5,211	8,070	7,929
Payables	677	654	547	650	1,208
Current Liab.	881	827	1,020	823	1,481
Total Liabilities	1,567	1,438	6,231	8,893	9,410
Share Capital	1,051	1,766	1,766	1,766	1,766
Retained	3,813	6,260	7,146	8,793	10,910
Total Equity	4,864	8,026	8,912	10,559	12,676

Jun-end	FY14A	FY15A	FY16E	FY17F	FY18F
Valuation Ratios					
EPS	7.5	7.3	8.5	15.9	21.9
DPS	3.0	3.0	3.5	6.6	9.9
BVPS	27.5	45.4	50.5	59.8	71.8
P/E	13.4	13.7	11.7	6.3	4.6
Cash/share	0.1	0.1	0.5	0.9	7.3
DY	3%	3%	4%	7%	10%
P/B	3.6	2.2	2.0	1.7	1.4
Earnings Growth	7%	-2%	17%	87%	37%
ROE	27%	16%	17%	27%	30%
ROA	20%	14%	10%	14%	18%
EBITDA/ton	2,084	2,035	2,443	2,901	2,700
Financial Gearing					
Debt/Equity	6%	3%	58%	73%	60%
Interest Coverage	59.7	45.1	140.6	12.8	8.4
Margins					
Gross Margins (%)	33%	30%	38%	42%	38%
EBITDA Margins (%)	31%	30%	35%	41%	37%
Net Profit Margins (%)	20%	20%	22%	25%	24%
Macro- Assumption					
Coal (FOB)	77.3	65.7	51.6	48.8	51.8
Sales Volume (MnTon)					
- Local	0.7	0.7	0.8	1.4	2.1
- Export	0.3	0.3	0.2	0.1	0.1
Total	0.9	1.0	1.0	1.6	2.2

Source: IGI Research, Company's Financials

About the Company

Incorporated in 1981, Cherat Cement is a premier name in the field of cement manufacturing, producing high quality grey Portland cement using modern and sophisticated production facilities. The company has a production capacity of 1.1mn Ton and enjoys strong brand loyalty amongst its customers both in Pakistan and abroad. The company is a recipient of Forbes “Asia Under a Billion Dollar” company award.

Analyst Certification

The analyst[^] hereby certify that the views about the company/companies and the security/securities discussed in this report are accurately expressed 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 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.

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

Valuation Methodology

The analyst[^] has used following valuation methodology to arrive at the target price of the said security (ies):

- DCF(Discounted Cash Flow)

Time Horizon

- Dec - 2016

Risk

- Changes in State Bank of Pakistan Policy Rate
- Changes in country (Pakistan) macro-economic environment
- Changes in Company(ies) operating structure
- Delay in Expansion
- Lesser demand in local growth than expected
- Drop in local cement prices

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