

Day Break

Friday, 17 July 2020

COMPANY UPDATE

Pioneer Cement Limited

Cement

Recommendation	BUY
Target Price: Dec/21	110.9
Last Closing: 16-Jul-20	72.7
Upside:	52.7
Valuation Methodology:	Discounted Cash Flow (DCF)

Time Horizon: 18M

Market Data

Bloomberg Tkr.	PIOC PA
Shares (mn)	227.1
Free Float Shares (mn)	124.9
Free Float Shares (%)	55.0%
Market Cap (PKRbn USDmn)	16.5 106.9
Exchange	KSE 100
Price Info.	90D 06M 12M
Abs. Return	84.5 138.0 243.7
Lo	39.4 22.8 17.4
Hi	74.4 74.4 74.4

Key Company Financials

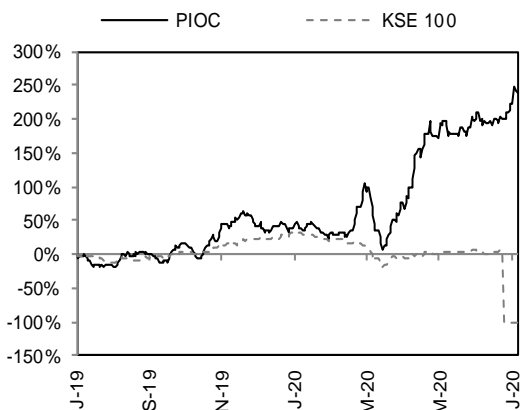
Period End: Jun

PKRbn	2020e	2021f	2022f	2023f
Total Revenue	7.4	19.4	23.8	27.6
Net Income	(0.7)	0.4	1.1	2.2
EPS (PKR)	(3.0)	1.8	5.0	9.7
DPS (PKR)	-	0.5	1.3	2.0
Total Assets	45.5	46.1	45.0	44.2
Total Equity	12.6	12.9	13.8	15.5

Key Financial Ratios

ROE (%)	5.9	(5.3)	3.3	8.5
P/E (x)	n/m	39.3	14.5	7.5
P/B (x)	1.2	1.3	1.3	1.2
DY (%)	-	0.7	1.7	2.8

Relative Price Performance



Source: Bloomberg, PSX & IGI Research

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Cements

PIOC: Strong fundamentals to drive earnings performance; TP: PKR 111, offers +53% upside

- ✓ We tweak our earnings and reiterate our 'Buy' call on Pioneer Cement Limited. Our revised earnings present a CAGR of 33% for the next five years.
- ✓ Our investment case, is premised on strong earnings accretion from FY21 backed on a) enhanced market share of PIOC post expansion, b) healthy margins driven by reduced FED, operational savings from power efficiencies and international subdued coal prices c) substantially reduced finance costs following recent reversal of the monetary cycle.
- ✓ We present a Buy call on PIOC with a Dec-21 target price of PKR 111/share, offering a substantial 53% upside from last close.

Pro construction sentiment drives stock performance; substantial upside still remains on the back of strong fundamentals

We tweak our earnings and reiterate our 'Buy' call on Pioneer Cement Limited (PIOC) after incorporating impacts of recent substantial decline in benchmark interest rates, reduction in Federal Excise Duty (FED) and softening of coal prices globally.

The stock has outperformed market, rallying a huge ~3.2x since 26, Mar-20 (KSE 100 index +36%). Based on our revised earnings, which present a CAGR of 33% for the next five years and a price target of PKR 111/share, the stock offers a substantial +53% above its last close of PKR 72.65/share.

Our investment case, is premised on strong earnings accretion from FY21 backed on a) enhanced market share of PIOC post settlement of industry wide expansion cycle, b) healthy margins driven by reduced FED, operational savings from coal power plant & WHR and international subdued coal prices c) substantially reduced finance costs following recent reversal of the monetary cycle.

Exhibit: Key financial projections of PIOC

PKRmn	FY20E	FY21F	FY22F	FY23F	FY24F	FY25F
Net Sales	7,434	19,372	23,754	27,641	30,183	32,940
Gross Profit	(180)	3,354	4,769	6,169	7,626	9,229
EBIT	(540)	2,738	4,033	5,275	6,582	8,027
Finance Cost	372	2,149	2,435	2,199	1,910	1,617
Profit before tax	(912)	589	1,599	3,076	4,671	6,410
EPS	(3.03)	1.85	5.02	9.66	14.67	20.13

Source: IGI Research

Investment case

1# Expansion to almost double PIOC's market share

PIOC recently inaugurated its new production line with an annual capacity of 3mn tons (greater than originally planned) taking its accumulated annual capacity to 5.09mn tons. While expansion capacities of majority of the players are aimed to maintain their respective market share that of PIOC is to increase its North market share from the recent 4.3% in FY19A to 9.0% by FY21E once all industry wide expansions have settled. This is quite evident from the capacity rated share, the pivotal factor of determining market share in the cement industry, wherein PIOC tops the list of manufacturers in the North region with respect to % increase in capacity share post expansion.

Exhibit: Pre and post expansion capacity rated share – North region (in mnTon)					
Company	Pre-Expansion Capacity	Old capacity share	Post Expansion Capacity	Revised capacity share	% Increase in share
PIOC	2.1	5.5%	5.1	9.5%	4.0%
CHCC	1.7	4.5%	4.5	8.4%	3.9%
KOHC	2.8	7.4%	5.2	9.6%	2.2%
MLCF	3.4	8.9%	5.7	10.6%	1.7%
LUCK	4.2	11.0%	6.8	12.7%	1.7%
FLYNG	0.6	1.7%	1.3	2.4%	0.7%
FECTC	0.9	2.3%	0.9	1.6%	-0.7%
DCL	1.1	3.0%	1.1	2.1%	-0.9%
GWLC	2.1	5.5%	2.1	3.9%	-1.6%
ASKARI	2.7	7.0%	2.7	5.0%	-2.0%
FCCL	3.6	9.4%	3.6	6.6%	-2.7%
BWCL	8.7	22.7%	10.5	19.7%	-3.1%
DGKC	4.2	11.1%	4.2	7.9%	-3.2%
TOTAL	38.0	100.0%	53.6	100.0%	

Source: IGI Research, Company Accounts

2# Healthy margins to accrete earnings going forward

Reduced Federal Excise Duty (FED) to add nearly 5-8% to company's bottom-line

With the objective of resisting the shocks of Covid-19 on the country's economy, the federal government has decided to incentivize the construction sector, which as per government records supports approximately 70 inter related industries and is the second largest provider of employment in the country. The Prime Minister of Pakistan introduced the Construction Package in Apr-20 and the incentives therein were subsequently incorporated in the Federal Budget 2020.

One of the principal incentives provided to the cement sector in the construction package include reduction of Federal Excise Duty (FED) to PKR 1,500/ton from previous PKR 2,000/ton, a reduction of PKR 500/ton (PKR 29.25/bag inclusive of sales tax adjustment). This is expected to materially improve the retention prices of local cement manufacturers. However, based on the recent interventions from the federal government on cement prices, we have reduced our cement

price/bag assumption for FY21 by PKR 15/bag, while keeping our forward price assumption intact.

Exhibit: Impact of revised FED and sales prices on retentions of PIOC					
PKR/bag	FY21F	FY22F	FY23F	FY24F	FY25F
Revised Sales Price	535	585	614	645	677
Earlier Sales Price	550	585	614	645	677
Change	-3%	0%	0%	0%	0%
Revised FED	75	75	75	75	75
Earlier FED	100	100	100	100	100
Change	-25%	-25%	-25%	-25%	-25%
Revised Retention (PKR/bag)	299	333	366	388	411
Earlier Retention (PKR/bag)	284	308	341	363	386
Change	5%	8%	7%	7%	6%
EPS Impact	2.89	5.47	5.80	5.97	6.15

Source: IGI Research

Operating margins to improve substantially amid operational efficiencies from Coal and Waste Heat Power Plant

In addition to a new production line, the expansion plan of PIOC includes a 12MW Waste Heat Power Plant and a 24MW Coal Power Plant, the two cheapest sources of energy available widely in the Pakistan cement space. With fuel and power cost representing a whopping 60% of the total cost of sales, substantial savings in them are expected to materially improve earnings from FY21. We expect investments in these power efficiencies to boost earnings sustainably by an estimated average EPS impact of PKR 6.7.

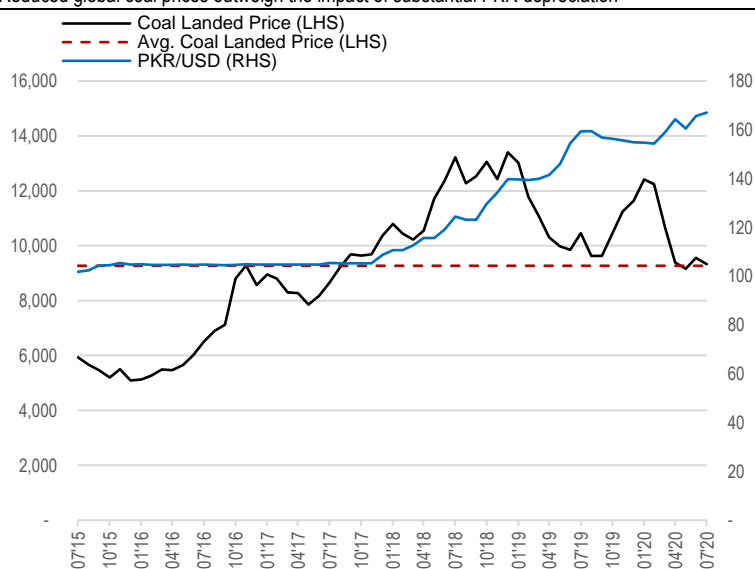
Softened Global Coal Prices to Mitigate the Impact of Depreciated Currency; To Provide Further Support to Margins of Cement Producers

Coal prices globally have been witnessing a declining trend ever since the beginning of CY19. This had much to do with slowing Chinese economy, the largest consumer of coal, US-China trade wars, gradual redundancy of thermal power producers worldwide and decline in global steel demand.

However, the situation has exacerbated further ever since the outbreak of Covid-19 due to economic shocks faced by major world economies and declining demand patterns thereof. Resultantly, coal prices (Richard Bay index) have gone down to as low as USD 49.5/ton globally from as high as USD 97.5/ton since CY19. As of now, coal prices are hovering around USD 55-58/ton. For our projections we expect coal prices to average around USD 55/65/70 onwards for FY21/22/23 onwards respectively.

Exhibit: International Coal prices

Reduced global coal prices outweigh the impact of substantial PKR depreciation



Source: IGI Research, Bloomberg

This material decline in global coal prices have in kind mitigated the adverse impact of currency fluctuations that has depreciated by a mammoth +59% since Nov-17.

3# SBP reduces benchmark interest rates substantially, borrowing costs no longer a threat for PIOC's profitability

With respect to debt leverage, PIOC currently ranks at the top in the IGI cement coverage with a Debt/Equity ratio of 2.1 which is largely ascribed to substantial financing required to fund its recent expansion plans. These huge debt levels posed grave concerns for investors up until a few months back, when benchmark interest rates stood at a double-digit figure of 13.25%, with regards to the Company's ability to present profitability since the combination of high debt levels and double digit interest rates were expected to eat away almost all the operational profits of the Company.

Exhibit: Key leverage data of IGI cement coverage

PKRbn	Debt	Equity	D/E	Reval. Res	Adj. Equity	Adj. D/E
PIOC	16.51	10.53	1.57	2.73	7.80	2.12
CHCC	15.96	10.42	1.53	-	10.42	1.53
MLCF	12.33	32.38	0.38	3.62	28.76	0.43
DGKC	17.11	64.67	0.26	-	64.67	0.26
KOHC	4.59	18.89	0.24	-	18.89	0.24
FCCL	0.32	20.14	0.02	-	20.14	0.02
LUCK	0.23	98.60	0.00	-	98.60	0.00
ACPL	-	16.67	-	-	16.67	-
Total	67.06	272.29	0.25	6.35	265.94	0.25

Source: 9MFY20 Interim Accounts, IGI Research

However, the recent sharp reversal of monetary cycle by the State Bank of Pakistan (SBP) in response to the potential threats of Covid-19 on the country's

economy, have turned the tables for PIOC. To recall, the SBP in a series of scheduled and non-scheduled meetings conducted during Mar20-Till Date, has slashed the benchmark interest rate by a substantial 625bps. Taking it to 7% as against 13.25% in the beginning of Mar-20. Provided PIOC's highest D/E position, the Company stands as the largest beneficiary of the monetary reversal in our cement space. With borrowing costs expected to be recede materially in comparison with earlier estimates, it no longer poses threat to the profitability of the Company, given retention prices have also improved after reduction in FED (mentioned earlier).

Exhibit: PIOC's key financial data post revision in FED and interest rates					
PKR mn	FY21F	FY22F	FY23F	FY24F	FY25F
Revised EBIT	2,738	4,033	5,275	6,582	8,027
Earlier EBIT	1,876	2,401	3,549	4,810	6,209
Change	46%	68%	49%	37%	29%
Revised Interest Cost	2,149	2,435	2,199	1,910	1,617
Earlier Interest Cost	3,058	2,776	2,417	2,123	1,824
Change	-30%	-12%	-9%	-10%	-11%
Revised EPS	1.85	5.02	9.66	14.67	20.13
Previous EPS	(3.50)	(1.22)	3.23	7.81	12.80

Source: IGI Research

Recommendation

We present a Buy call on PIOC with a Dec-21 target price of PKR 111/share, offering a substantial 53% upside from last close.

Key Risks

Risks to our price target include: 1) material decline in cement sales prices 2) administrative increase in energy prices; 3) significant rise in global coal prices 4) substantial rise in benchmark interest rates.

Exhibit: PIOC Financial Highlights							
Period end (JUN)	FY19A	FY20E	FY21F	FY22F	FY23F	FY24F	FY25F
Per Share Data							
EPS	3.5	(3.0)	1.8	5.0	9.7	14.7	20.1
BV	59	56	57	61	68	80	96
DPS	-	-	0.5	1.3	2.0	3.0	4.3
Cash & Equivalents	5.1	2.5	2.5	2.5	2.5	2.5	2.5
Valuation							
P/E (X)	20.9	(24.0)	39.3	14.5	7.5	5.0	3.6
P/B (X)	1.2	1.3	1.3	1.2	1.1	0.9	0.8
Div. Yld (%)	-	-	0.7	1.7	2.8	4.1	5.8
Earnings growth (%)	(52)	(187)	(161)	171	92	52	37
EBITDA growth (%)	(25)	(90)	2,038	29	28	17	16
ROE (%)	5.9	(5.5)	3.2	8.3	14.1	18.3	21.0
Margins							
Gross Margins (%)	21.9	(2.4)	17.3	20.1	22.3	25.3	28.0
EBITDA Margin (%)	21.6	2.8	22.6	23.7	26.2	28.1	30.0
Net Profit Margins (%)	8.1	(9.3)	2.2	4.8	7.9	11.0	13.9
Financial Gearing							
Debt / Equity (%)	112	113	76	41	13	-	-
Interest Coverage	6	(1)	1	2	2	3	5
Volumes (mn tons)							
Local	1.4	2.2	3.2	3.5	3.7	3.8	3.9
Exports	0.1	0.1	0.0	0.1	0.1	0.1	0.1
Total Capacity	2.1	3.4	4.6	4.6	4.6	4.6	4.6
Capacity Utilization	69	66	70	77	82	84	87
Key Assumptions							
Cement Price/bag	583	528	535	585	614	645	677
Coal	88	68	55	65	70	70	70
PKR/USD	136	153	172	180	186	192	198

Exhibit: Valuation snapshot (PKRmn)									
	Jun-20	Jun-21	Jun-22	Jun-23	Jun-24	Jun-25	Jun-26	Jun-27	
EBIT	(540)	2,738	4,033	5,275	6,582	8,027	9,762	10,577	
EBIT (1-t)	(408)	1,954	2,877	3,762	4,694	5,725	6,987	7,510	
+ Depreciation & Amortization	745	1,641	1,608	1,968	1,913	1,864	1,816	1,770	
- Capex	(5,259)	(812)	(796)	(780)	(945)	(921)	(897)	(874)	
- Working Capital Changes	2,458	(1,221)	(356)	(415)	(453)	(494)	(539)	(575)	
FCFF	(2,463)	1,561	3,332	4,537	5,210	6,175	7,367	7,830	
WACC	10.1%	10.9%	12.1%	13.7%	15.5%	16.6%	16.6%	16.6%	
Sum of PV FCFF	21,189								
Pv Of Terminal Value	25,457								
Operating Assets Value	46,646								
- Cash And Cash Equivalents	-								
Firm Value	46,646								
- Debt	21,452								
Equity Value	25,194								
Core Operations	111								
Portfolio Value	-								
Outstanding Shares	227								
Target Price (PKR/share)	110.9		Dec-21						

Source: IGI Research, Company Accounts

4QFY20 Results Preview

For 4QFY20E we expect PIOC to present a net loss of PKR 166mn (LPS: PKR 0.73), as compared to loss of PKR 35mn (LPS: PKR 0.15) recognized in 4QFY19. This will bring FY20 total loss to PKR 689mn (LPS: PKR 3.03) as against profitability of PKR 790mn (EPS: PKR 3.48) reported in FY19.

Net sales of the Company during the quarter are expected to decline by a substantial -35% YoY, largely due to lack of demand driven from lock downs in response to outbreak of Covid-19 during the quarter. The Company is expected to display a gross loss of PKR 122mn as against a gross profit of 376mn in the comparative period, largely due to substantial decline in cement retention prices during the period amid intense competition in the local market. Non-operating income of the Company is expected to rise by 4 folds, largely on the back of exceptional performance of KSE-100 index during the quarter under review wherein sizeable investments under equity mutual funds were in place of the Company. With expansion plant not expected to be capitalized in the current quarter, we do not expect substantial rise in depreciation and borrowing costs.

Exhibit: PIOC Result Highlights						
Period end (JUN) - PKRmn	4QFY20	4QFY19	YoY	FY20	FY19	YoY
Net Sales	1,461	2,245	-35%	7,434	9,734	-24%
Gross Profit	(122)	376	-0.3x	(180)	2,135	-0.1x
Sell. / Dist. & Admin	99	109	-9%	416	325	28%
Non-Operating Income	115	29	4.0x	198	73	2.7x
EBIT	(126)	168	-0.8x	(540)	1,594	-0.3x
Financial Charges	106	(17)	n/m	372	271	37%
Pre-tax Profits	(233)	185	-1.3x	(912)	1,323	-0.7x
Taxation	(67)	220	-0.3x	(223)	533	-0.4x
Post-tax Profits	(166)	(35)	4.8x	(689)	790	-0.9x
EPS	(0.73)	(0.15)		(3.03)	3.48	
DPS	-	-		-	-	
Key Ratios						
Gross Margin (%)	(8.3)	16.7		(2.4)	21.9	
Net Margin (%)	(11.3)	(1.5)		(9.3)	8.1	
Effective Tax Rate (%)	28.8	118.7		24.5	40.3	

Source: Company Accounts, IGI Research

No. of Shares : 227mn