

March 01, 2010

Pakistan Market

Cement profits down 90%YoY in 1HFY10

MORNING BRIEFING



KSE100 Index: Closing 9657.79 ↓ (-9.38)

Cement sector's profitability plunged 90%YoY during first half (Jul-Dec) FY10 primarily on account of lower retention prices, despite an estimated rise of 13%YoY in volumetric sales. Our sample includes 14 out of the listed 21 cement companies, representing 80% of the market capitalization. Amongst them, companies with profits in both the periods (1HFY10 & 1HFY09) posted a decline of only 5.2%YoY – suggesting a harder period for smaller players.

However, with anticipated rise in local demand and gradual improvement in prices, we remain bullish on the sector's future performance. Lucky and DG Khan remain our preferred plays, trading at FY11F PE's of 5.0x & 6.3x, respectively.

Key numbers based on sample companies

(Rs mn)	1HFY10	1HFY09	%Δ
Capacity (mn tons)	31.8	29.2	9%
Dispatches (mn tons)*	11.8	10.4	13%
Capacity Utilization	74.2%	71.5%	
Net sales	43,905	48,669	-10%
Cost of Goods Sold	33,958	33,711	1%
Gross profit	9,947	14,958	-33%
Gross Margins	23%	31%	
Financial Charges	3,980	5,943	-33%
Profit / (Loss) before tax	345	(150)	NM
Profit after tax	257	2,650	-90%
Net Margins	0.6%	5.4%	

Source: Company accounts, APCMA & *JS Estimates

Lower retention drags down margins

With price consensus amongst cement manufacturers having ended during Aug 2009, retention price during 1HFY10 witnessed a substantial decline of 20%YoY. However, volumetric sales which are estimated to be 13%YoY higher and COGS/bag 11%YoY lower due to fall in coal prices (50%YoY), managed to slightly mitigate the impact of decline in prices on the gross margins. Hence, margins stood at 23%, down 808bps from the corresponding period last year.

Per ton analysis

(Rs)	1HFY10	1HFY09	%Δ
Net sales (retention prices)	3,727	4,669	-20%
COGS	2,883	3,234	-11%
Gross profit	844	1,435	-41%
Financial cost	338	570	-41%
Net profit	22	254	-91%

Source: Company accounts, APCMA & JS Research

Financial costs continue to hurt bottom-line

Financial charges continue to hurt the profitability of the highly leveraged cement sector, despite a declivity of 33%YoY owing to reduced leverage by certain companies and lower interest rates. As per our analysis, financial cost still constitutes 9% of the total cost of a cement bag (13% earlier). Thus, cumulative profitability of our sample companies during 1HFY10 stood at Rs257mn (US\$3.1mn), compared to Rs2,650mn (US\$34.4mn) in the corresponding period last year, reflecting a decline of 90%.

Diluted EPS (Rs)	1HFY10	1HFY09	%Δ
Attock Cement	7.20	8.32	-13%
Cherat Cement	(0.65)	0.98	NM
DG Khan Cement	1.54	0.42	270%
Dewan Cement	(0.80)	(0.87)	NM
Fauji Cement	0.28	0.74	-62%
Fecto Cement	(1.92)	2.76	NM
Flying Cement	(0.42)	(0.87)	-51%
Javedan Cement	(10.54)	(5.97)	NM
Kohat Cement	(1.15)	(0.59)	NM
Lucky Cement	5.90	5.99	-2%
Maple Leaf Cement	(2.47)	(0.76)	NM
Gharibwal Cement	(3.55)	0.35	NM
Pioneer Cement	(1.20)	(0.29)	NM
Thatta Cement	0.20	1.11	-82%

Source: Company accounts

Outlook: 'Over-Weight'

Though cement sector's profitability suffered a decline of

90%YoY during 1HFY10, yet we remain bullish on the sector's fundamentals for the following reasons:

- Anticipated rise in local demand on the back of government's focus on infrastructure development to meet the rising energy crisis in the country
- Higher than expected growth in export sales during Jul-Jan FY10
- Gradual recovery in local cement prices due to improved demand outlook

We expect Lucky and DG Khan Cement to reap the benefits of improving fundamentals, as they constitute 27% of the total cement capacity. With the scrips trading at FY11 PE's of 5.0x and 6.3x, respectively, we maintain our 'Buy' stance on both. However following remain key risks to our valuations:

- Delays in foreign funding
- Higher than expected commodity prices

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Also in focus

Local oil prices revised down by 0.9-4.7%

Local petroleum product prices have been revised down by OGRA in the range of 0.9-4.7% for the month of March 2010, due to lower Arab Gulf petrol and diesel prices in the preceding month. Though it is likely to have a negative earnings impact of Rs0.13-0.17/share (including possible pre-tax inventory loss of Rs15-20mn) on PSO, the quantum is relatively small, compared to a likely positive impact of Rs1.3-1.4/share in February when prices were raised by 4.8%-9.4%. With PSO trading at a FY10E PE of 5.7x, we maintain our 'Buy' stance on the scrip.

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