

July 02, 2010

**Pakistan Market****Cement 4Q results; likely an upside surprise****MORNING BRIEFING**

KSE100 Index: Closing 9730.99 ↑ (+9.08)

Pakistan cement sector's market capitalization plunged by 15%YoY in FY10, which is reflective of the misfortunes endured by the industry during the year. Though the industry's total off-take is expected to increase by 14%YoY, investors remained concerned over the manufacturers being fined Rs6.4bn by the Competition Commission of Pakistan (CCP) for alleged price cartelization and retail prices hitting rock bottom alongside (declined by an average 25% following disintegration of the price consensus between the manufacturers). As a result, we have seen the sector underperform the KSE 100 Index by 51%, a statistic better only than the one in FY04 where the sector underperformed by 119% - another year in which rifts between manufacturers had threatened the existence of their cartel.

However, the situation for the manufacturers has slightly improved in 4QFY10 as both local and export prices increased in comparison to the previous quarter (3QFY10), counterbalancing the impact of rising coal prices. Total off-take of the industry is expected to be 11% higher QoQ as well. Moreover, recognition of the inland freight subsidy in the 4Q should further strengthen the margins of the companies.

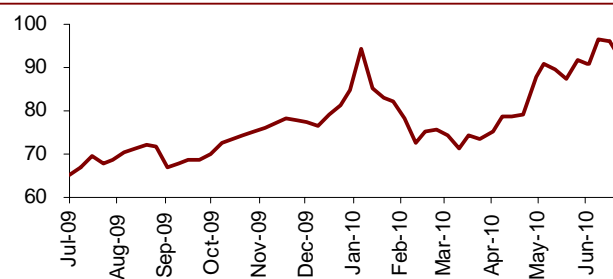
**Local sales ~24% higher YoY in FY10; exports flat**

As per our discussions with the industry experts, local sales are expected to arrive at ~24mn tons for FY10, an all time high and 24% higher YoY. On a QoQ basis, local off-take will be close to 6.4mn tons in 4Q, up 3%.

On the other hand, export sales are likely to remain flat and arrive at ~11mn tons. However, on an encouraging note, exports are expected to be higher 33%QoQ in the 4Q as manufacturers look to avail the inland freight subsidy, effective from Mar 26, 2010. Hence, total off-take for the industry is anticipated to be higher by 14%YoY in FY10 and 11%QoQ in 4Q.

**Coal prices down 28% in FY10; up 11%QoQ in 4Q**

We have used MCIS (McCloskey Coal Information Services) NEW Steam coal (C&F) marker price index for our analysis. The index shows that average coal prices were down 28%YoY in FY10, however, it is important to note that on a QoQ basis these have been registering a rising trend and are 11%QoQ higher in 4QFY10.

**Coal price trend in FY10 (US\$/ton)**

Source: Reuters

**Ex-factory prices up by 4%QoQ in 4Q**

Cement prices, particularly in the North have risen by ~33% from their trough of Rs230/bag in Nov-Dec 2009 to Rs305/bag now. However, the ex-factory price has increased by 23% since then, as retailers too have raised their margins. More importantly in the 4Q, prices are 4% higher QoQ and should sufficiently compensate for the 11%QoQ rise in coal prices which constitutes 45-50% of the cost.

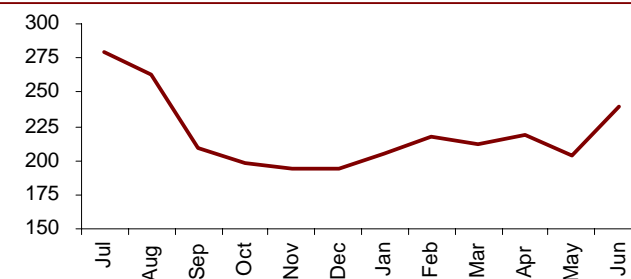
Prices have started to pick up in the export market as well. Currently, the export prices are hovering in the vicinity of US\$52-54/ton FOB, as opposed to the previous quarter when prices had fallen to US\$45-47/ton FOB.

**Outlook**

Higher off-take and rise in prices along with recognition of the inland freight subsidy should lead to a slight improvement in 4QFY10 results of the cement companies on a QoQ basis.

We maintain our Over-Weight stance on the sector as we believe the government's focus towards infrastructure development should boost local demand and in turn prices. Moreover, identification of new export avenues should sustain the current levels of export sales.

With LUCK trading at an FY11F PE of 4.5x and DGKC available at FY11F PBV of 0.3x, the two companies remain our preferred plays in the sector.

**Ex-factory price trend in North during FY10 (Rs/bag)**

Source: JS Research

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