JS Research

April 03, 2009

Pakistan Market

MORNING BRIEFING

DGKC: Earnings revised upwards/Upgraded to 'Buy'

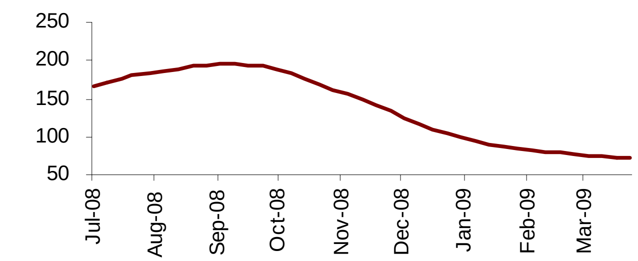
KSE100 Index Closing 7191.09 ↑ (+259.19)

Significant positive developments such as declining coal prices (63% from its peak) and KIBOR (touched an 11 month low of 12.43%) have made us revising our earnings estimate of DG Khan Cement (DGKC). We believe DGKC's earnings turnaround in FY09 and average growth of 9% beyond is yet to be fully reflected in its stock price. Hence, we upgrade our stance on the scrip from to 'Buy' from 'Hold'.

Declining coal prices to drive earnings upwards

Coal prices have seen a sharp fall from its peak and start of the year by 63% and 31% respectively falling to almost a 2 year low. We have used MCIS (McCloskey Coal Information Services) NEW Steam coal (C&F) marker price index for our analysis. In 1HFY09, coal prices had averaged US$166 per ton whereas coal prices in 2HF09 to date have so far averaged only US$80 per ton and yet to bottom out. We expect average coal prices in 2HFY09 to be around US$75 taking full year average to US$120. According to our analysis, a 10 dollar decline in coal prices will have a positive earnings impact of Rs0.8 per share on DGKC.

Graph: MCIS Coal Price Index (US$/ton)



Source: Reuters

Declining KIBOR providing further support

6-month KIBOR has seen a fall of 282bps since the start of the year amid improving liquidity in the interbank market. This decline is expected to provide further support to the bottomline of the company as it total debt to equity ratio of DGKC currently stands at 98%. According to our analysis, 100bps decline in average annualized KIBOR will have a positive impact of Rs0.20 per share.

Equity portfolio boosting DGKC's valuation

Another factor augmenting our target price is the increase in its portfolio value. DGKC has equity investment stakes in MCB Bank (9%), Nishat Mills (13%) and Adamjee Insurance (3%). All of these have seen a significant price increase over the last 2 weeks up 5%, 15% and 38% respectively. As of April 02, 2009, market value of DGKC's equity portfolio comes to Rs36 per share. Hence equity portfolio alone provides tremendous value to the investor.

Risk of fall in cement prices can spoil the party

Currently with a cartel type price arrangement in place, local cement prices are hovering at a price of Rs320-340 per bag. However, slowdown in construction activities amid challenges economic conditions and excess supply in the market, we can expect cement price to come down by Rs30-40 per bag. When coal prices were at similar levels previously, we saw cement price around Rs245 per bag. Keeping everything else constant, we believe fall of Rs10 per bag in average retail prices will pull down earnings by Rs0.75 per share. According to industry sources, decline in cement prices is expected in the beginning of FY10, making second half of FY09 highly profitable.

Recommendation: 'Buy'

After incorporating the above factors, we have increased our earnings estimates as below:

Table: Earnigs forecasts (Rs/share) - rights adjusted

	FY09	FY10
Old	(1.3)	0.7
New	2.8	3.2
Change	NM	374%

Source:JS Research

DGKC is currently trading at P/B value of 0.23x which is at a discount of 82%, 49% and 87% to our market, JS universe cement companies and regional cement companies. Moreover, DGKC's FY09 EV/ton of US$48 is at a 25% discount to the region. Hence we have upgraded our recommendation on the scrip to 'Buy'.

atif.zafar@js.com
92 (21) 111-574-111 (ext. 3118)

DG Khan Cement

Market Price: Rs23.95	**Kats Code:** DGKC
Market Cap: Rs7.3bn (US$90.5mn)	**Bloomberg Code:** DGKC PA
1-yrs Avg. Daily Volume: 5.4mn shares, Rs384.7mn (US$4.8mn)	**Reuters Code:** DGKH.KA
1-year High/Low: Rs118.85/13.01	

JS Global Capital Limited
6th Floor, Faysal House, Main Shahrah-e-Faisal, Karachi

Research:
Tel: +92 (21) 2799005
Fax: +92 (21) 2800163
js.research@js.com

Equity Sales:
Tel: +92 (21) 2799513
Fax: +92 (21) 2800166
junaid.iqbal@js.com

Fixed Income Sales:
Tel: +92 (21) 2799541-44
Fax: +92 (21) 2800165
tariq.usman@js.com

Corporate Finance:
Tel: +92 (21)2799005
Fax: +92 (21) 2800163
azhar.iqbal@js.com

JS RESEARCH IS AVAILABLE ON BLOOMBERG & THOMSON REUTERS