

May 03, 2010

Pakistan Market

Cement's bottom-line turns red during 9MFY10

MORNING BRIEFING



KSE100 Index: Closing 10428.12 ↓ (-26.51)

The cement sector plunged into losses during the 9M (Jul-Mar) FY10 as low retention prices markedly dragged down margins for the manufacturers. Further, financial costs continued to be a major thorn for the bottom-line. Interestingly, the 4 companies which were profitable in both the periods (9MFY10 & 9MFY09) also saw their earnings decline by 21%YoY.

Our sample comprising 19 out of the 20 listed companies, (represents ~100% of the sector's capitalization) recorded cumulative losses of Rs3.3bn (US\$39.2mn) in 9MFY10, compared to profits of Rs3.7bn (US\$47.5mn) in the corresponding period last year. We have adjusted one time impairment loss on acquired goodwill of Rs3bn, booked by Javedan Cement during 9MFY09.

Key numbers based on sample companies

(Rs mn)	9MFY10	9MFY09	%Δ
Capacity (mn tons)	30.1	28.1	7%
Dispatches (mn tons)	24.8	22.1	12%
Capacity Utilization	82.5%	78.5%	
Net sales	82,244	93,983	-12%
Cost of Goods Sold	67,620	67,780	-0.2%
Gross profit	14,623	26,203	-44%
Gross Margins	18%	28%	
Financial Charges	8,640	11,294	-24%
Profit / (Loss) before tax	(3,369)	4,063	NM
Profit after tax	(3,282)	3,699	NM
Net Margins	-4.0%	3.9%	

Source: Company accounts, APCMA, Lucky Cement & JS Research

Price war → lower margins

Despite the industry witnessing an increase of 12% in its sales and an increase in capacity utilization to 83%, retention prices for the cement manufacturers fell by ~22% to Rs166/bag from Rs213 earlier. This is mainly due to price war amongst the cement manufacturers after break in their price consensus. Though COGS/bag declined by 11%, given lower

average coal prices during the period, it failed to significantly mitigate the impact of a lower selling price, leading to a fall in margins to 18% from 28% earlier.

Per ton analysis

(Rs)	9MFY10	9MFY09	%Δ
Net sales (retention prices)	3,313	4,256	-22%
COGS	2,724	3,069	-11%
Gross profit	589	1,187	-50%
Financial cost	348	511	-32%
Net profit	(132)	168	NM

Source: Company accounts, APCMA, Lucky Cement & JS Research

Finance cost still hurts

Financial charges continue to dent the bottom-line, given the highly leveraged nature of the cement companies' balance sheet. Though the cost was down 24%YoY, it still constitutes ~10% of the total cost of a cement bag. Hence, we saw net margins at a dismal -4.0%, down 793bps.

Outlook: Better things to come!

We believe, rising local demand on the back of infrastructure development should provide the required impetus to local prices. Moreover, with export sales holding up, despite regional capacities coming online and the government providing 35% inland freight subsidy on exports to manufacturers, sector fundamentals should improve, going forward. Hence, with Lucky Cement (LUCK) trading at an FY11F PE of 5.2x and DG Khan Cement (DGKC) available at an FY11F PBV of 0.3x, we maintain our 'Buy' stance on both the scrips.

atif.zafar@js.com

92 (21) 111-574-111 (ext. 3118)

Financial snapshot

Diluted EPS (Rs)	9MFY10	9MFY09	%Δ
Al-Abbas Cement	(2.12)	0.03	NM
Attock Cement	10.32	11.99	-14%
Bestway Cement	(1.90)	2.24	NM
Cherat Cement	(1.56)	1.23	NM
DG Khan Cement	1.06	0.88	21%
Dadabhoj Cement	0.80	(0.22)	NM
Dewan Cement	(1.25)	(1.42)	NM
Fauji Cement	0.30	1.01	-70%
Fecto Cement	(3.20)	4.19	NM
Flying Cement	(0.45)	(0.80)	NM
Gharibwal Cement	(5.21)	(0.73)	NM
Javedan Cement	(8.45)	(56.28)	NM
Kohat Cement	(1.88)	(0.43)	NM
Lafarge Pakistan*	(0.91)	(0.51)	NM
Lucky Cement	7.92	9.50	-17%
Maple Leaf Cement	(4.95)	(1.84)	NM
Mustehkam Cement	(3.89)	(1.89)	NM
Pioneer Cement	(2.06)	(0.27)	NM
Thatta Cement	(0.16)	2.21	NM

Source: Company accounts

* Lafarge Pakistan year end adjusted for analysis

JS Global Capital Limited

6th Floor, Faysal House, Main Shahrah-e-Faisal, Karachi

Research:

Tel: +92 (21) 32799005

Fax: +92 (21) 32800163

js.research@js.com

Fixed Income Sales:

Tel: +92 (21) 32799541-44

Fax: +92 (21) 32800163

tariq.usman@js.com

Equity Sales:

Tel: +92 (21) 32799513

Fax: +92 (21) 32800166

junaid.iqbal@js.com

Corporate Finance:

Tel: +92 (21) 32799005

Fax: +92 (21) 32800163

azhar.iqbal@js.com

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