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Pakistan Market

MORNING BRIEFING


Cements: Exports shine in FY09! Future looks hazy KSE100 Index: Closing 7684.65 ↑ (+181.99)

Cement exports in the outgoing year FY09 grew by 47% compared to total dispatches growth of 2%. Regional capacity constraints drove exports upwards. Though regional capacity expansions by FY10 are likely to hurt exports, we believe tapping of new markets will help mitigate damage. Decline in export retention prices remain a downside risk to our valuation. We maintain our 'Market-Weight' stance on the sector with Lucky & DG Khan Cement amongst our preferred plays.

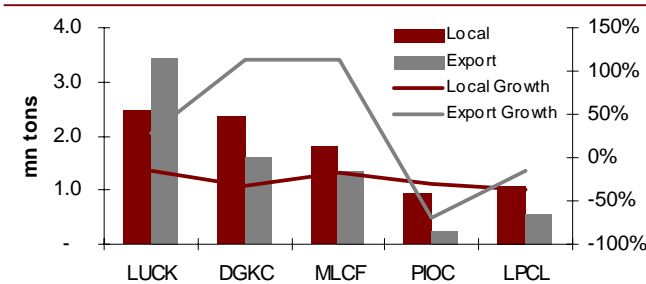
Exports grab limelight with growth of 47%YoY

Cement exports in FY09 depicted an astounding growth of 47% to 11.4mn tons compared to 7.7mn tons last year. Despite global recessionary woes, regional cement demand remained afloat largely driven by previously initiated projects in the Middle East and reconstruction activities in worn torn Iraq & Afghanistan. Local cement manufacturers capitalized on the regional cement shortfall as they looked to increase their export to local sales ratio with local sales (down 14%) dwindling last year. Moreover, rupee devaluation against US\$ (16%) and higher retention for export sales proved further incentives to expand export horizons for manufacturers. In FY09, export retention on average touched a high of Rs260 per bag (US\$65 per ton) compared to Rs235 per bag locally. Currently, export retention is hovering around Rs225 per bag (US\$55 per ton) while local retention is averaging at Rs210.

DGKC exports up 113% as Lucky consolidates

In company-wise analysis, we saw DG Khan (DGKC) and Maple Leaf Cement (MLCF) export sales post handsome growth of 113% and 114% respectively. DGKC and MLCF increased its market share in export sales to 14% and 12%. Lucky Cement, largest cement exporter in Pakistan, consolidated its position in the export market with growth of 29%, however market share trimmed down to 30% from 35% last year. Meanwhile, Pioneer and Lafarge Cement depicted negative growth of 70% and 15%.

Graph: Companywise dispatches in FY09



Source: APCMA, JS Research

Regional capacities to provide stiff challenges

GCC region is set to increase its capacity by 119% by the end of FY10 which will hurt Pakistan's cement exports to the region. GCC constitutes 39% of the total cement exports with Qatar, Oman & UAE leading the pack with 12%, 10% and 10% share. However, new markets are being explored with some success already achieved. This is evident from details made available by TDAP, which shows exports sales have increased to countries like Sri Lanka, Lebanon, Sudan & Mozambique since last year. Political tensions with India and law & order situation in Afghanistan border's adjoining areas remain key concerns as well. Last year cement exports to India fell by 24% with 15% rise in exports to Afghanistan amid rehabilitation post war. Hence, going forward we expect exports to depict a decline of 6%YoY in FY10.

Table: GCC cement capacity expansions by FY10 (mn tons/annum)

| Country | Capacity in 2007 | Proposed capacity expansions | % change |
|------------------|------------------|------------------------------|--------------|
| Bahrain | 0.6 | 0.4 | 66.7 |
| Kuwait | 2.9 | - | - |
| Oman | 3.6 | 1.8 | 50.8 |
| Qatar | 1.5 | 1.1 | 76.9 |
| Saudi Arabia | 26.6 | 33.2 | 124.9 |
| UAE | 14.7 | 22.7 | 154.6 |
| Total GCC | 49.8 | 59.2 | 118.9 |

Source: MEED

Table: Country-wise share in cement exports

| Countries | 8MFY09 | 8MFY08 | Countries | 8MFY09 | 8MFY08 |
|-----------------|--------|--------|----------------|--------|--------|
| Afghanistan | 28.0% | 36.7% | Kuwait | 4.7% | 2.2% |
| Qatar | 12.0% | 16.4% | Bahrain | 2.3% | 0.0% |
| Oman | 10.4% | 6.1% | Sri Lanka | 1.5% | 0.6% |
| U.A.E. | 10.0% | 9.0% | UR of tanzania | 1.4% | 0.7% |
| Djibouti | 8.1% | 9.8% | Mozambique | 1.1% | 0.0% |
| Other Countries | 7.0% | 1.3% | Yemen | 0.1% | 5.4% |
| India | 6.9% | 10.4% | Iran | 0.1% | 0.0% |
| Iraq | 6.4% | 1.1% | | | |

Source: TDAP

Outlook: 'Market-Weight' maintained

We remain optimistic on the sector's outlook with record PSDP allocation of Rs621bn and reduction in excise duty by Rs10 per bag. Furthermore, with a sharp decline in KIBOR (6-month KIBOR is down 368bps since Jan 1, 2009) interest cost of the cement companies is expected to fall. However, materialization of PSDP and dam building announcements remain key triggers for cement manufacturers with decline in export retention our downside risk to our valuation. While maintaining 'Market-Weight' stance on the cement sector, we flag Lucky and DG Khan Cement as preferred plays trading at FY10F PE's of 4.7x and 10.2x respectively.

atif.zafar@js.com

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

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) 32800165

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) 22800163

azhar.iqbal@js.com

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