

January 15, 2010  
Pakistan Market

## Cement Sector: Rising to the challenges

MORNING BRIEFING



KSE100 Index: Closing 9802.45 ↑ (+17.60)

We reaffirm our liking for the cement sector given its anticipated recovery based on 1) improving macro fundamentals 2) increased government focus on infrastructure development spending and 3) reconstruction activities post the successful military operations. Expected foreign inflows from the Friends of Democratic Pakistan (FoDP) and Kerry Lugar Bill are likely to stimulate fiscal spending on infrastructure development, boosting cement demand locally, while realization of the inland freight subsidy announced in the trade policy will enhance competitiveness of our exports. Additionally, an expected 100bps cut in the discount rate in Jan on the back of improved domestic liquidity will bode positive for the highly leveraged cement sector. Sharp rebound in energy prices and delays in foreign funding remain key downside risks to our valuation. On the contrary, any reprieve from the penalty imposed by the Competition Commission of Pakistan's (CCP) is likely to act as a major trigger for the cement companies.

We believe, the cement sector is attractive at current levels, as it has priced in most of the negatives. The sector is currently trading at a 29% discount to its historical earnings multiple and at a deep discount of 42% to the region's forward looking multiple. DG Khan Cement and Lucky Cement remain our preferred plays in the sector.

**Table: Cement Sector - Key numbers**

	FY09A	FY10E	FY11F	FY12F
PBV (x)	0.5	0.5	0.5	0.5
PE (x)	7.6	7.6	5.3	4.5
Div. Yield (%)	3.2%	3.6%	6.5%	7.9%
ROA (%)	3.3%	3.6%	5.1%	5.9%
ROE (%)	7.1%	7.0%	9.3%	10.2%

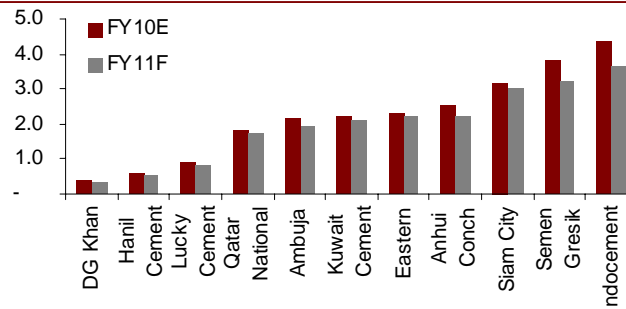
Source: JS Research

### DG Khan Cement: Containing Inefficiencies

We believe, the DGKC's share price has bottomed out and is expected to recover following a surge in local demand and

easing cost pressures. Declining interest rates and higher dividend payouts from Nishat Mills and Nishat Chunian are likely to further strengthen the company's bottom line. We reiterate our 'Buy' stance on DGKC as the scrip offers an upside potential of 28% to our SOTP based target price of Rs42. Interestingly, the scrip looks attractive even after incorporating the CCP fine of Rs933mn as it still offers a decent upside of 13%. DGKC trades at a massive discount of 85% and 40% to the region and local peers, respectively on FY10E PBV.

**Graph: Regional PBV (x) comparison**

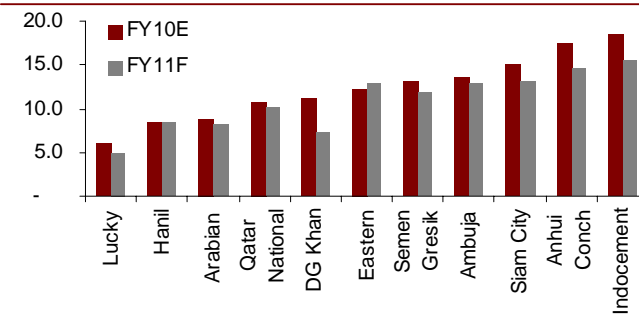


Source: Reuters & JS Research

### Lucky Cement: Rising Above the Rest

Lucky Cement's ability to accommodate the anticipated rise in local demand and its geo-strategic edge in catering to foreign markets has placed itself in a superior position relative to other cement plants. Initiatives taken for acquiring local coal as an input and sale of excess power is likely to augment its bottom-line. Moreover, reduced debt levels will lower the financial cost burden on the company. We reiterate our 'Buy' call for Lucky with a potential upside of 19.7% from our target price of Rs84. The scrip is presently trading at a 54% and 64% discount to the regions' FY10 PE and PBV, respectively and is at a discount of 21% to the local competition on one year forward looking earnings multiple.

**Graph: Regional PE (x) comparison**



Source: Reuters, JS Research

For more details please refer to our detailed report titled 'Cement Sector: Rising to the challenges'.

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