

May 27, 2009

**Pakistan Market****Cement: FY10 Budget Expectations & Outlook****MORNING BRIEFING**

KSE100 Index: Closing 7176.89 ↑ (+3.32)

Cement sector has made a decent recovery in FY09 after witnessing difficult times in FY08. Reduced cost pressures on account of a steep fall in coal prices coupled with high retention prices (up 64%YoY) have led turnaround in profitability with profits up 833% in 9M FY09. That said, the performance is skewed towards large players with export potential as a large number of companies still remain in the red.

Given the risk of export demand slowdown, the Cement Manufacturer's Association has put forward a host of proposals aimed at stimulating growth in the sector. In today's report, we present our expected budgetary measures for the cement sector in Budget FY10.

**Higher development expenditure**

IMF's approval to accommodate recent external flows commitment will stimulate PSDP allocation next year. As a result, we expect PSDP outlay of Rs550-650bn as against Rs550bn last year.

**Proposal to reduce federal excise duty**

In Budget FY09, excise duty was increased from Rs37.5 to Rs45 per bag. All Pakistan Cement Manufacturers Association (APCMA) have now proposed that this duty be reduced to Rs20 per bag. We do not expect the revenue starved government to reduce the excise duty to Rs20 per bag. However, we expect excise duty to be reduced to around Rs33-35 per bag.

**Export grants and incentives**

Cement manufacturers have suggested Rs200 per ton subsidy on exports by sea. In light of the country's challenging fiscal deficit, we do not expect government to accept the proposal.

**Impact: Neutral to positive**

Higher PSDP allocation for infrastructure development programs including construction of dams is likely to boost cement sales. Moreover, cement sales would get further support from any potential reduction in excise duty.

**Outlook: 'Market-Weight' maintained**

High retention prices have boosted cement sectors profitability in the outgoing fiscal year when compared to low profits last year. However, we believe current local demand supply dynamics do not suggest such high prices would continue in the local market. Going forward, economic revival and higher PSDP allocation bodes well for domestic demand. However, outlook for exports seems vulnerable on account of global recession and new capacity addition in the Middle East.

Currently, we have a 'Market-weight' stance on the cement sector. The sector is trading at FY09E and FY10F PE of 6.3x & 5.3x, respectively. On the back of robust export growth, we expect Lucky to post 72% and 2% earning growth in FY09E and FY10F respectively, while, DG Khan's profits are expected to grow by 14% and 13% respectively. We recommend 'Buy' on both Lucky and DG Khan Cement, as both stocks are trading at an attractive FY10F PE of 3.9x and 8.3x, respectively.

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**Also in focus****SC verdict on Sharifs to reduce political risk**

Yesterday, Supreme Court (SC) has given a decision in favour of Sharif brothers and allowed them to participate in elections. This should pave the way for Mr. Nawaz Sharif to return to Parliament. Accordingly, PPP has also decided not to field its candidates against the Sharifs. SC decision, we believe, is positive development and would help to reduce the political risk premia.

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