

September 29, 2009

Pakistan Market

Cement profits up 16 times in FY09

MORNING BRIEFING



KSE100 Index: Closing 9409.58 ↓ (-254.67)

After witnessing substantial growth in all three quarters of FY09, cement sector concluded FY09 with a handsome growth of 1492%YoY. Higher retention prices (up 59%YoY) and high rupee based export sales amid rupee depreciation (20%YoY) drove profits up north. However, this growth is magnified as FY08 was an abnormally low profit period for the sector.

Moreover, the performance is skewed towards large players with export potential as profitable companies in both years posted increase of just 109%. Our sample includes 12 out of the total 21 listed companies representing approximately 80% of the market capitalization of the cement sector. Moreover, we have removed one time gain (Rs815mn) recorded by Lafarge Cement for extinguishment of deferred liabilities for custom duties and sales tax in FY08.

Key numbers based on sample companies

	FY09	FY08	%Δ
Cement Sector Sales (mn tons)			
Total dispatches	21.4	22.0	-2%
Capacity Utilization	86%	88%	
Sector Profitability			
Net sales	101,371	65,514	55%
Cost of Goods Sold	71,231	55,095	29%
Gross profit	30,139	10,419	189%
Gross Profit Margins	30%	16%	
Financial Charges	10,649	413	2477%
Profit before tax (PBT)	8,274	(1,329)	NM
Profit after tax (PAT)	6,151	386	1492%
Net Profit Margins	6%	1%	
Per Ton Analysis (Rs)			
Net Retention Price	4,731	2,983	59%
Cost of Goods Sold	3,324	2,508	33%
Gross Profit	1,406	474	197%
Financial Cost	497	19	2542%
Net Profit	287	18	1532%

Source: Company accounts, JS Research

Better margins drive earnings upwards

Cumulative profitability of our sample companies in FY09 stood at Rs6.2bn (US\$78.2mn), compared to Rs386mn (US\$6.2mn) depicting a massive growth of 1492%. Companies with profits in both the years posted 109% earnings improvement.

Though total dispatches were down 2%, net sales grew by 55% to Rs101.4bn (US\$1.3bn) on the back of higher net retention prices (up 59%YoY) and improved export based revenues. Cost of sales/ton also rose by 33%YoY amid higher realized coal prices and inflationary pressures. Resultantly, gross profits were up 189% with gross margins improving by 1,383bps to 30%. Financial charges rose to Rs10.6bn (up 2477%YoY), were a massive burden for the cement companies during the year due to monetary tightening. Average 6M KIBOR for FY09 was recorded at 14.14%, up 364bps from year earlier. Consequently net margins only improved by 548bps to 6% as net profits of our sample companies jumped north 16 times.

Company (diluted EPS)	FY09	FY08	%Δ
Al-Abbas Cement	0.7	(0.6)	NM
Attock Cement	20.7	6.0	243%
Cherat Cement	1.7	0.1	1438%
DG Khan Cement	1.7	(0.2)	NM
Fauji Cement	1.4	0.6	144%
Fecto Cement	6.9	(1.8)	NM
Javedan Cement	(14.7)	(14.2)	NM
Lucky Cement	14.2	8.3	72%
Maple Leaf Cement	(2.3)	(1.6)	NM
Lafarge Cement*	(0.7)	(1.3)	NM
Pioneer Cement	0.2	(0.9)	NM
Thatta Cement	2.6	0.5	416%

NM = Not Meaningful

*Adjusted for one time gain for extinguishment of deferred liabilities

Source: Company announcements, JS Research

Investment perspective:

The massive earnings growth has been largely due to price arrangement between companies during the period. However, with the arrangement coming to end in August, margins for the cement companies are likely to remain tight during 1QFY10. Moreover, dispatches have also been disappointing in the said period due to low public sector development projects and private sector's subdued activity amid holy month of Ramadan. However, lower financial charges due to declining interest rate scenario may give some room for breather. With rumors of APCMA gaining some strength to increase prices (local cement prices trading at Rs265-270 per bag), we believe post 1QFY10 results would be a good time to take exposure in cement stocks. With Lucky and DG Khan Cement trading at FY10E P/E of 6.9x and 17.3x, we currently have a 'Hold' stance on the scrip.

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Also in focus

Monetary Policy Statement due today

State Bank of Pakistan (SBP) is due to announce the Monetary Policy State (MPS) today. We do not expect any interest rate cuts today due to higher inflationary expectation led by electricity pass down to the end customer. However, our view on monetary easing by another 200bps remains intact but that will be in November and January MPSs. Moreover, we expect SBP may opt to reduce CRR by 1ppt to 4% to ease liquidity concerns.

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