Cement 2QFY22 earnings preview

NEXT CAPITAL

Cements — Overweight

January 28, 2022

Pakistan Equities
Cement

Key Points

- For 2QFY22, we expect the cement manufacturers to post combined net profit of PKR9.54bn, as compared to PKR7.87bn in the same period last year, registering a growth of 21%YoY.
- The YoY growth is mainly attributable to better retention prices and improved operational efficiencies with expected local cement dispatches growth of 2%YoY. However, on sequential basis massive surge in coal prices, PKR depreciation and higher transportation cost are the key reasons behind this marginal growth of 1%QoQ, despite 13%QoQ growth in local cement dispatches and 10%QoQ growth in cement prices.
- We expect gross profit in absolute terms to increase to PKR18.4bn compared to PKR14.6bn of 2QFY21 and PKR16.5bn in 1QFY22. However, gross margin of our coverage companies is expected to decline of 2ppts on QoQ basis due to higher coal prices, PKR depreciation and elevated transportation cost.
- We maintain our overweight stance on the sector with LUCK and MLCF as our top picks from the sector.

The sector to witness a massive increase in earnings on YoY basis

Leading cement manufacturers are all slated to announce their 2QFY22 result where, we anticipate our cement sector coverage universe to post PAT of PKR9.54bn as compared to PKR7.87bn in the same period last year, up 21%YoY. The YoY growth is mainly attributable to better retention prices and improved operational efficiencies with expected local cement dispatches growth of 2%YoY. However, on sequential basis massive surge in coal prices, PKR depreciation and higher transportation cost are the key reasons behind this marginal growth of 1%QoQ, despite 13%QoQ growth in local cement dispatches and 10%QoQ growth in cement prices. On an individual basis MLCF, DGKC, KOHC and PIOC will mark an increase of 38%/10%/1%/46% sequentially due to higher dispatches and generation of electricity on coal based CPP in case of PIOC. Whereas, earnings of FCCL, CHCC and LUCK are expected to decline due to lower dispatches and inefficient operations of FO in case of LUCK.

On yearly basis, KOHC's earnings are expected to outshine the industry by posting an earnings growth of 47%YoY, courtesy higher dispatches and better retention prices. Whereas, earnings of DGKC are expected to decline by 10%YoY due to higher export sales on lower margins resultantly higher selling and distribution expenses. Topline of the companies are estimated to grow by 22%QoQ and 33%YoY.

Gross margins to remain intact despite higher energy cost

We expect gross profit in absolute terms to increase to PKR18.40bn compared to PKR14.86bn of 2QFY21 and PKR16.83bn in 1QFY22. However, gross margins of our coverage companies is expected to portray a decline of 3% on QoQ basis due to higher coal prices, PKR depreciation and elevated transportation cost. On the other hand, margins are estimated to remain relatively stable on yearly basis. To recall coal prices have risen sharply during the quarter under review. At the start of the quarter, coal touched history high of USD240/ton due to power shortages amid global reopening of economies. Lately, the price dropped significantly to ~USD130/ton due to China's decision to ramp up its own coal production by around 100mn tons.

Outlook

We have a long-term positive outlook for the sector with local demand growth estimates of 5%/8% in FY22/23. Higher remittances, liquidity in the agriculture sector, renewed interest in CPEC related construction projects, and increased limits for construction related financings by banks, are all likely to keep cement demand higher. Apart from demand, pricing discipline is also anticipated to be maintained by industry in an effort to sustain margins amid rising input costs. We have an Overweight stance on the sector at current levels and advise investors to gradually build positions in the sector. We flag LUCK and MLCF as our top picks given strong balance sheet in rising interest rate environment, first mover advantage in the upcoming expansion, low cost structure, attractive valuations, and diversified investments for LUCK.

Key Data

Mkt. Cap. (USDmn)	3,186
Mkt. Cap. (PKRbn)	564
Index Weightage (KSE-100)	8.7%
Number of Listed Companies	17

Source: PSX, Next Research

Dec'21 Estimates

	2QFY22	QoQ	YoY
CHCC	5.76	-6%	36%
LUCK	9.1	-10%	27%
MLCF*	1.05	38%	8%
PIOC	3.09	46%	9%
FCCL	0.88	-10%	33%
DGKC	2.28	10%	-13%
KOHC	7.05	1%	47%

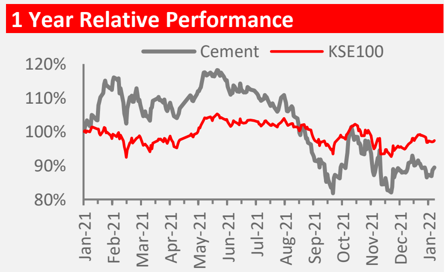
* Consolidated
Source: Company Accounts, Next Research

Cumulative Cement Estimates

	1HFY22	1HFY21	YoY
CHCC	11.89	5.81	105%
LUCK	19.25	14.04	37%
MLCF*	1.81	1.48	22%
PIOC	5.21	2.67	95%
FCCL	1.87	1.16	61%
DGKC	4.36	1.83	138%
KOHC	14.01	7.33	91%
LUCK*	41.39	32.05	29%

* Consolidated
Source: Company Accounts, Next Research

1 Year Relative Performance



Source: PSX, Next Research

M Shumail Rauf
+92-21-35222204
shumail.rauf@nextcapital.com.pk

Analyst Certification, Disclosures & Contacts

Analyst Certification

All of the views expressed in this report accurately reflect the personal views of the responsible analyst(s) about any and all of the subject securities or issuers. No part of the compensation of the responsible analyst(s) named herein is, or will be, directly or indirectly, related to the specific recommendations or views expressed by the responsible analyst(s) in this report.

Disclaimer

This information and opinion contained in this report have been compiled by our research department from sources believed by it to be reliable and in good faith, but no representation or warranty, express or implied, is made as to their accuracy, completeness or correctness. All opinions and estimates contained in the document constitute the department's judgment as of the date of this document and are subject to change without notice and are provided in good faith but without legal responsibility.

This report is not, and should not be construed as, an offer to sell or a solicitation of an offer to buy any securities. Next Capital Limited (the company) or persons connected with it may from time to time have an investment banking or other relationship, including but not limited to, the participation or investment in commercial banking transactions (including loans) with some or all of the issuers mentioned therein, either for their own account or the ac- count of their customers. Persons connected with the company may provide or have provided corporate finance and other services to the issuer of the securities mentioned herein, including the issuance of options on securities mentioned herein or any related investment and may make a purchase and/or sale, or offer to make a purchase and/or sale of the securities or any related investment from time to time in the open market or otherwise, in each case either as principal or agent.

This report may contain forward looking statements which are often but not always identified by the use of words such as "anticipate", "believe", "estimate", "intend", "plan", "expect", "forecast", "predict" and "project" and statements that an event or result "may", "will", "can", "should", "could" or "might" occur or be achieved and other similar expressions. Such forward looking statements are based on assumptions made and information currently available to us and are subject to certain risks and uncertainties that could cause the actual results to differ materially from those expressed in any forward looking statements. Readers are cautioned not to place undue relevance on these forward looking statements. NCEL expressly disclaims any obligation to update or revise any such forward looking statements to reflect new information, events or circumstances after the date of this publication or to reflect the occurrence of unanticipated events.

Next Capital Limited, its respective affiliate companies, associates, directors and/or employees may have investments in securities or derivatives of securities of companies mentioned in this report, and may make investment decisions that are inconsistent with the views expressed in this report.

Rating System

Next Capital Limited employs a three tier rating system depending upon sector's proposed weight in the portfolio as compared to sectors weight in KSE-100 index, as follows:

Rating	Sector's proposed weight in the portfolio
Over Weight	> Weight in KSE 100 index
Market Weight	= Weight in KSE 100 Index
Under Weight	< Weight in KSE 100 Index

Next Capital Limited also employs a three tier rating system, depending upon expected total return (R) of the stock, as follows:

Rating	Expected Total Return
Buy	R ≥ 15%
Neutral	0% ≥ R < 15%
Sell	R < 0%

Where;
R = Expected Dividend Yield + Expected Capital Gain
R' is before tax
Investment horizon is between six months to twelve months

Ratings are updated regularly based on the latest developments in the economy/sector/company, changes in stock prices, and changes in analyst's assumptions.

Karachi Head Office
2nd Floor Imperial Court Building,
Dr. Ziauddin Ahmed Road,
Karachi75530 , Pakistan

☏: +92-21-111-639-825
🖷: +92-21-35632321

Lahore Office
63-A, Agora Eden City
DHA Phase VIII,
Lahore, Pakistan

☏: +92-42-37135843-8
🖷: +92-42-37135840

Research
☏: 92-21-111-639-825 (Ext:109, 129)
✉: research@nextcapital.com.pk

Sales and Trading
☏: 92-21-111-639-825 (Ext: 106)
✉: equitysales@nextcapital.com.pk

Corporate Finance & Advisory
☏: 92-21-111-639-825 (Ext: 131)
✉: cf@nextcapital.com.pk

www.nextcapital.com.pk