Cements' 1QFY21 earnings preview

Cement — Marketweight

October 20, 2020

Pakistan Equities
Cement

Key Points

- We present earnings expectations for our Cement sector universe (LUCK, DGKC, CHCC, MLCF, KOHC and FCCL) for 1QFY21.
- The combined profit of the sector is likely to clock in at PKR2.7bn as compared to a loss of PKR1.4bn in 1QFY20.
- Local dispatches in 1QFY21 improved to 10.8mn tons a 19%YoY/15%QoQ growth whereas export remained robust at 2.7mn tons compared to 2mn tons of 1QFY20.
- Lucky Cement is likely to remain the most profitable company in our universe whereas Cherat Cement owed to high leverage is expected to post an insignificant profit during the quarter under review.
- Going forward, we remain upbeat on the sector's prospects as we believe construction activities both public and private to pick up pace in the coming months. We have however a marketweight stance on the sector at current levels.

After a dull period earnings to shine in 1QFY21

Earnings of Next Cement Universe are likely to recover from losses in comparison to both Sep'19 and Jun'20. The combined earnings of the companies under our coverage are expected at PKR2,715mn compared to losses of PKR1,412mn and PKR1,930mn of Sep'19 and Jun'20, respectively. The marked improvement in earnings is based on strong dispatches growth as last year pre buying was witnessed in 4QFY20 with anticipated implementation of budgetary measures, kept sales low in 1QFY20. Moreover, selling prices improved during the quarter as price war subsided between manufacturers. Lastly, the decrease in input costs, mainly Energy (Coal) is likely to give a boost to earnings. 625bps reduction in policy rate during Mar-Jun'20 would also be significantly positive for the earnings of the companies this quarter.

Sector sales remained robust

Local sales during the quarter remained upbeat improving 19%YoY where a 20%YoY increase was seen in the Northern region and in South sales were up by 9%YoY. We attribute significant increase in local sales to improved business environment and resumption of full scale construction activity post lifting of lockdown. Moreover, the last quarter of FY19 saw an uptick in sales as cement dealers increased their buying before the implementation of budgetary/taxation measures, which resulted in subdued sales in 1QFY20. Export sales (Cement & Clinker) during the quarter under review were up 35%YoY.

Selling prices gradually improving

The price war that broke out post expansionary phase has subsided, which is evident from selling prices that are gradually improving, however, still lower on YoY basis (average North prices are ~PKR531/bag compared to ~PKR559/bag a year ago) but higher in comparison to ~PKR511/bag of 4QFY20. We see selling prices to continue rising gradually tracking improvement in demand.

Higher prices and lower cost to improve margins

Gross margins of companies under our coverage are likely to improve to 16.6% in 1QFY21 compared to 5.3% of 1QFY20 and 4.4% of 4QFY20, a significant increase of 11.3pps. The increase in margins can be attributed to higher selling prices coupled with lower energy costs (Cost). Coal prices have come down from USD66/ton (2 months lag) in 1QFY20 to USD55/ton during the current quarter.

Outlook

Local cement demand is expected to remain upbeat and we have a long term positive outlook on the sector. Local demand is expected to register a growth of 10% in FY21 after declining in FY19 and FY20. Higher remittances, liquidity in the agriculture sector, renewed interest in CPEC and construction package are all likely to keep cement demand higher. Apart from demand, selling prices that were depressed as a result of severe price war have started recovering and we see them rise gradually. We have a market-weight stance on the sector at current levels, where we are of the opinion that the market has largely incorporated improving fundamentals of the sector and there is little upside left with few exceptions. LUCK is our top pick from the sector with its diversified business exposure.

Key Data

Mkt. Cap. (USDmn)	3,404
Mkt. Cap. (PKRbn)	553
Index Weightage (KSE-100)	9.8%
Number of Listed Companies	21

Source: PSX, Next Research

1QFY21 Estimates

	1QFY21	1QFY20	YoY	4QFY20	QoQ
LUCK	5.57	2.96	88%	1.26	341%
DGKC	0.24	(3.26)	n/a	(0.70)	n/a
MLCF*	0.26	(0.89)	n/a	(0.76)	n/a
CHCC	0.10	(1.74)	n/a	(3.63)	n/a
FCCL	0.22	0.21	4%	(0.24)	n/a
KOHC	0.99	0.44	125%	(0.80)	n/a

*Consolidated
Source: Company Accounts, Next Research

1 Year Relative Performance

Source: PSX, Next Research

Taimoor Asif
+92-21-35222204
taimoor.asif@nextcapital.com.pk

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,
Karachi 75530 , 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