

Cements' 1QFY21 earnings preview

Cement

Marketweight

October 20, 2020

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.

Pakistan Equities
Cement

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

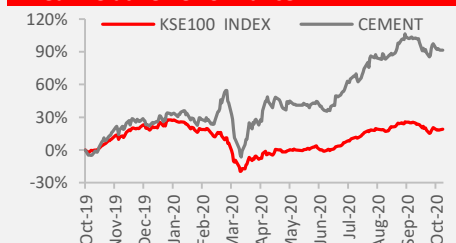
1QFY21 Estimates

	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

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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

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Rating	Expected Total Return
Buy	$R \geq 15\%$
Neutral	$0\% \geq R < 15\%$
Sell	$R < 0\%$

Where;

$R = \text{Expected Dividend Yield} + \text{Expected Capital Gain}$

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

