REP-057

Pakistan Equity | Cement | Sector Research

September 16, 2022

Prices as of September 13, 2022

Floods & Cement Sector Outlook

Demand to pickup in 3-6 months

Market Weight Maintained

CFA Society Pakistan
Best Local Brokerage House 2015-16, FY2020

ASIAMONEY
Best Local Brokerage House Brokers Poll 2011-14, 2016-21

Country Awards for Achievement 2018 FinanceAsia
Best Brokerage House 2018,19-20

2019 International Finance Brokerage Awards
Best Research House 2019-20

Asset Asian Awards 2019 The Asset Triple A
Best Brokerage House 2019-21

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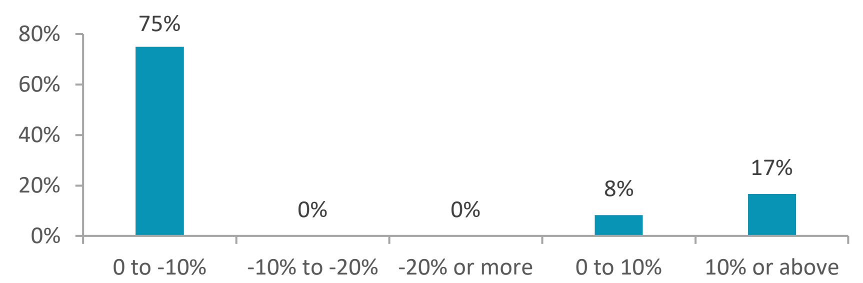
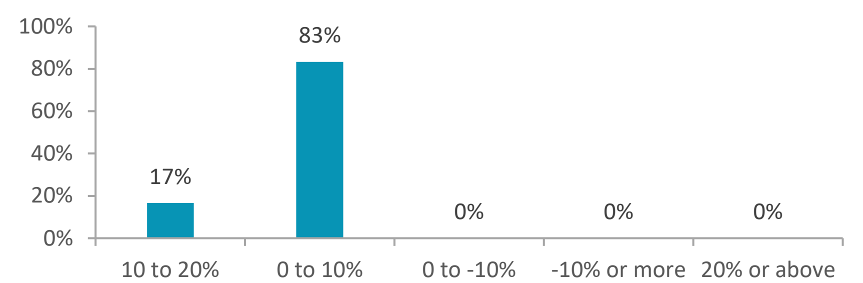
Local Sales to decline by 0-10% in FY23, will rebound in FY24 - Poll

Cement sector dispatches (local) growth post floods in FY23



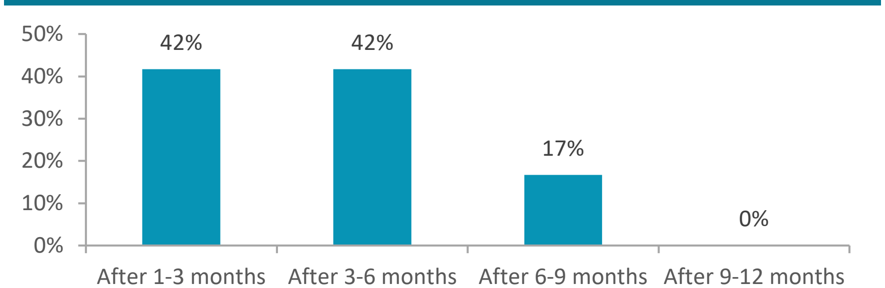
Source: Survey Results, Topline Research

Cement sector dispatches (local) growth in FY24



Source: Survey Results, Topline Research

Reconstruction activity to start after 3-6 months



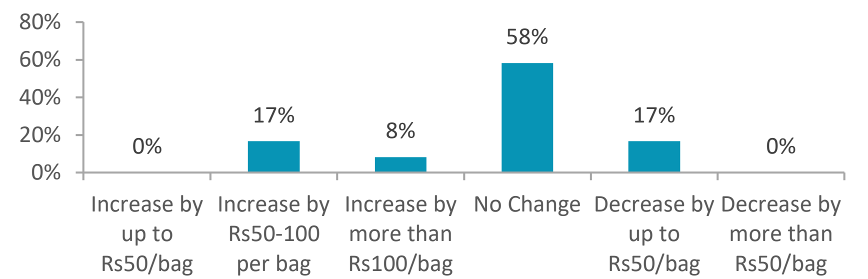
Source: Survey Results, Topline Research

- Pakistan has been severely impacted by the recent floods as it has led to massive damage to country's physical infrastructure including damage to homes, roads, bridges etc.
- As per National Disaster Management Authority (NDMA) a cumulative loss of 1.76mn houses (Partially and Fully Damaged), 390 Bridges and Roads (distance of 12,718km) has already taken place till Sep 14, 2022.
- Given the severity of the situation, we received numerous queries on the cement sector outlook specially after floods. In order to get a better understanding of the situation and sector's outlook, we conducted survey of Pakistan's leading cement manufacturers. These manufacturers cumulatively represent 76% of the total industry size in terms of plant capacity.
- **Demand outlook for FY23 & FY24:** Our survey results show that 75% of the participants expects domestic cement dispatches to fall in the range of 0 to -10% YoY in FY23 vs 2MFY22 fall of 35%. On other hand, around 17% of the participants anticipates growth of 10% or above and 8% expect it to increase by 0-10%.
- This 0-10% likely fall in local sales is better than initial expectation of a larger fall due to floods and economic slowdown.
- Cement manufacturers anticipate cement demand to pickup next year as 83% of the participants expect demand to remain in the range of 0 to +10% in FY24 whereas 17% of the manufacturers believe it will increase by 10-20% as construction activity will pick up once relief measures complete and the water starts receding.
- **Timeline for reconstruction activity:** The survey results showed that rebuilding or reconstruction activity could at least take 3-6 months. 42% of the participants expect it to start after 1-3 months whereas 42% of the participants believe it will start after 3-6 months. On other hand, 17% of the participants anticipates that it will start after 6-9 months.

Cement price to remain flat, coal prices may ease in FY24 as per survey

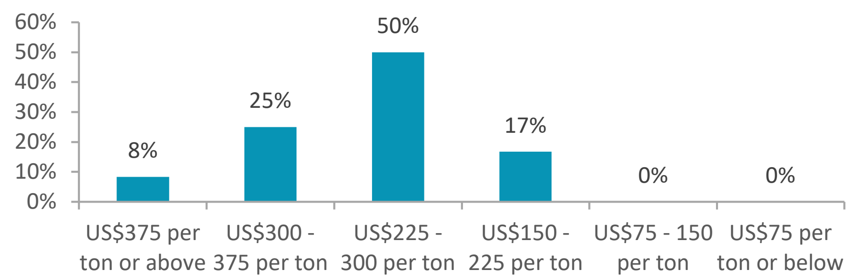
TOPLINE

Local Cement bag price for FY23



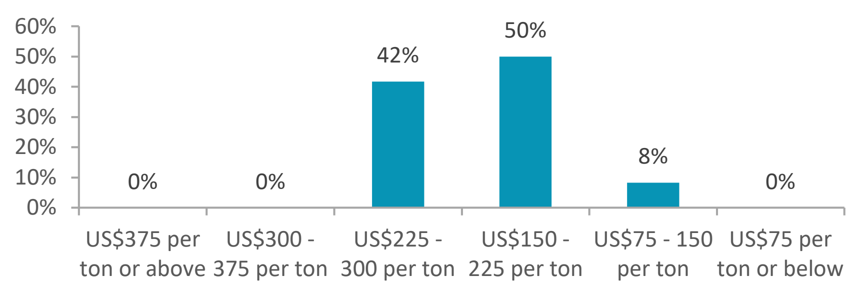
Source: Survey Results, Topline Research

Richard Bay Coal Price forecast for FY23



Source: Survey Results, Topline Research

Richard Bay Coal Price forecast for FY24



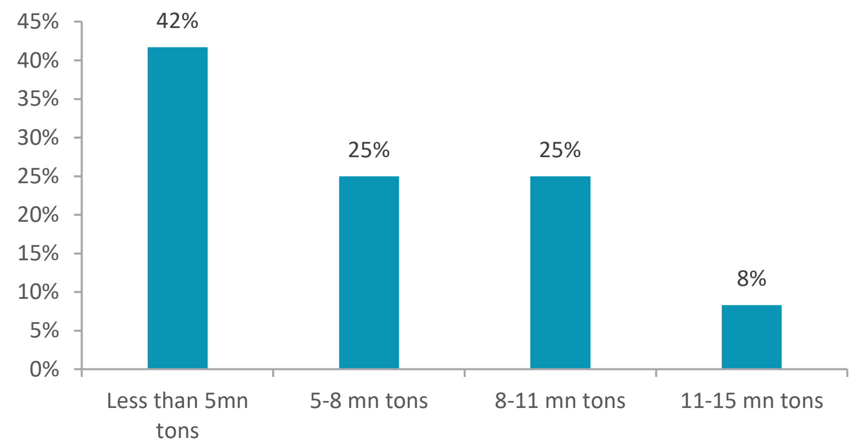
Source: Survey Results, Topline Research

- **Cement Prices Outlook:** Given slowdown in cement dispatches, majority of the participants or around 58% believe that there will be no change in cement prices in FY23. 17% of the participants expect cement prices to increase by Rs50-100 per bag, while 8% of the participants anticipates cement bag prices to increase by more than Rs100/bag. In contrast, 17% of the participants expects decrease in cement prices by up to Rs50/bag.
- **Coal Price forecast for FY23 & FY24:** Our survey results show that 50% of the participants expect Richard Bay coal prices to average US$225-300 per ton in FY23. 25% of the participants expect it to remain in the range of US$300-375 per ton in FY23 whereas 17% of the participant anticipate prices to remain in range of US$150-225 per ton and 8% of the participants expect it to be US$375 per ton or above.
- From FY24 onwards, participants expect coal prices to start coming down as 50% of the participants expect it to average around US$150-225 per ton whereas 42% of the participant believe it will be in the range of US$225-300 per ton. The remainder of 8% anticipate it to be between US$75-150 per ton.
- Industry, specially the Northern players are currently using alternative coal sources like Afghan coal which is around 30% cheaper than Richard Bay (South African) coal but moves in tandem with Richard Bay coal prices. Local sources of coal are also being used but they have lower GCV (Gross Calorific Value) with higher Sulphur content compared to Richard Bay.
- Coal prices has already come down by 35% from its peak to US$304 per ton currently and it remains key determinant towards gross margins of the companies.

42% expect less than 5mn tons of capacity to be added in FY23

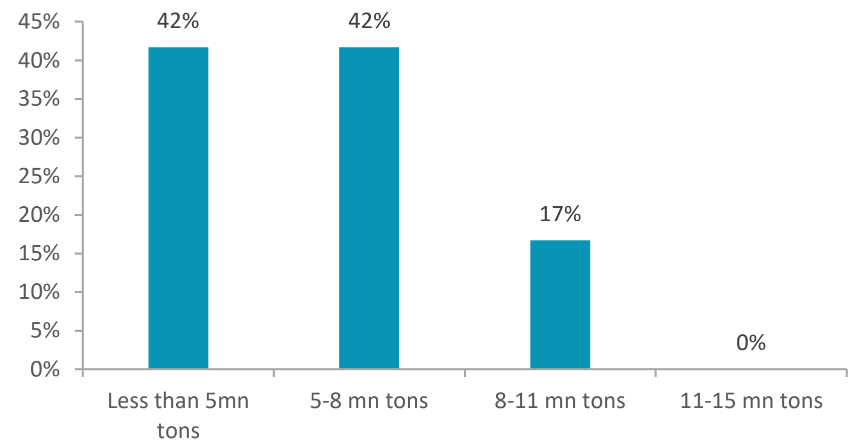
- **Cement Expansion Cycle:** As several cement manufacturers had announced various green field and brownfield expansion projects and there are fears of increased competition in the industry, survey result show interesting results.
- 42% of the participants expect less than 5mn tons of capacities coming online in FY23, whereas the remainder of them anticipate additional capacities in the range of 5-15mn tons.
- The survey results show that the actual capacities coming online could be much lower than initially anticipated or planned capacities of 15mn tons in FY23.
- For FY24, 42% of the participants expect less than 5mn tons of capacities coming online whereas 42% of them expect it in the range of 5-8mn tons. The remaining 17% expect it to remain in between 8-11mn tons.

Industry Capacity expected to come online in FY23



Source: Survey Results, Topline Research

Industry Capacity expected to come online in FY24



Source: Survey Results, Topline Research

Sector Outlook: Market Weight Maintained

Cement Assumptions

mn tons	FY22	FY23E	FY24F
Total Despatches (mn tons)	**52.89**	**46.48**	**51.72**
Local (mn tons)	47.63	41.99	46.72
Export (mn tons)	5.26	4.50	5.00
Despatches Growth YoY			
Total	**-7%**	**-12%**	**11%**
Local	-2%	-12%	11%
Export	-38%	-15%	11%
Richard Bay Coal Price (US$/ton)	**213**	**325**	**225**

Source: APCMA, Topline Research

Prices of Richard Bay, Afghan and Local coal

(Rs/ton)	Quetta	Darra Adam Khel	Afghan	Richard Bay
Jan-22	17,000	25,000	28,000	37,392
Feb-22	17,500	24,000	26,000	44,117
Mar-22	18,000	28,000	35,000	75,638
Apr-22	20,000	33,000	38,000	66,460
May-22	22,000	35,000	40,000	75,860
Jun-22	23,000	37,000	42,000	81,442
Jul-22	27,000	42,000	47,000	91,021
Aug-22	28,000	45,000	58,000	86,431

Source: Industry Traders, Dealers & Topline Research

***Quetta Coal Mine is closed from last 2 months due to Monsoon rains and Flood.**

- Our outlook on the sector is also consistent with survey results as we expect fall in cement dispatches in FY23. We anticipate cement dispatches to decline by 12% in FY23 followed by an increase of 11% in FY24, as reconstruction of infrastructure will result in increased demand for the sector specially when Federal and Provincial government will increase spending in election year.
- For FY23, we expect cement prices to remain flat from the current levels as it would be tough for manufacturers to further increase prices given the existing economic environment.
- There are concerns that whether increased capacities could again cause pressures on cement pricing but we believe that the planned capacities could face delays specially greenfield projects where SBP had imposed restrictions on import of machinery. Some of the planned capacities that were expected in FY23 and FY24 could be delayed to FY24 and FY25.
- We have assumed cement bag price of (North Rs1,025/bag and South Rs1,050/bag) for FY23 and (North Rs950/bag and South Rs975/bag) for FY24. Our price assumption for FY23 is inline with the survey results. On the other hand, the decline in cement price in FY24 is incorporated given expected decline in coal price as the industry could pass on the benefit to the consumers.
- Our Richard bay coal price assumption for FY23 and FY24 is US$325 per ton and US$225 per ton, respectively as against US$213 per ton in FY22.
- Correspondingly, our Afghan coal price (Factory price) assumption for FY23 and FY24 is Rs60k/ton (US$270/ton) and Rs48k/ton (US$208/ton), respectively.
- Given high coal prices and other inflationary pressures in FY23, gross margins of Topline Cement Universe are likely to fall to 17% in FY23 from 24% in FY22 as per our estimates. From FY24, it is anticipated to improve to 21% due to expected drop in coal prices.

Market Weight Maintained: LUCK & MLCF our preferred picks

Cement Expansion Cycle & Timelines			
(mn tons)	**Expansion Type**	**FY23E**	**FY24E**
LUCK	Brownfield	3.15	
MLCF	Brownfield	2.10	
BWCL	Greenfield	2.16	
BWCL	Brownfield	2.16	
ACPL	Brownfield	1.28	
FLYNG	Greenfield	2.31	
FCCL (ASKARI)	Brownfield	1.95	
CHCC	Greenfield		3.30
FCCL	Greenfield		1.95
GWLC	Greenfield		3.00
KOHC	Greenfield		3.00
Total Planned Capacities		**15.11**	**11.25**

Source: PSX, Topline Research

- We believe that the actual capacities coming online in FY23 and FY24 could be much lower than the initially planned 15mn tons in FY23 and 11mn tons in FY24. Greenfield project could face delays as mentioned by CHCC in their latest analyst briefings where SBP import restrictions are causing delays in machinery imports. Hence, we do not expect any major threat to pricing.
- It is worth mentioning that brownfield expansion project specially that of Lucky Cement (LUCK) with 3.15mn tons and Maple Leaf Cement (MLCF) of 2.1mn tons is very much likely to be added in FY23 out of total planned capacities of 15mn tons in FY23.
- Other players like Attock Cement (ACPL), Askari Cement, Bestway Cement (BWCL) and Flying Cement (FLYNG) also had announced expansions in FY23. It would be interesting to see how many of them actually come online in FY23.
- Profitability of our universe (core cement earnings) is expected to decline by 13% in FY23 but it is anticipated to rebound by 20% in FY24 with expected up tick in margins and dispatches post floods.
- Though, profitability of the Topline Universe is expected to come down in FY23 but we believe that the negatives associated with sector are already priced in as the sector trades at a FY23 PE of 5x, EV/ton of US$25 & EV/EBIDTA of 3.2x. We maintain our 'Market Weight' stance on the sector with LUCK and MLCF as our preferred picks.

Cements: Key Numbers					
	FY20A	**FY21A**	**FY22A/E**	**FY23F**	**FY24F**
PE	NM	7.7	5.8	5.0	4.2
Earnings Growth	NM	NM	34%	15%	20%
PBV	1.1	0.9	0.7	0.7	0.6
Dividend Yield	0%	0%	0%	0%	0%
ROE	NM	13%	14%	14%	16%

Source: Company Accounts, Topline Research

Lucky Cement: Strong portfolio to drive value

'Buy' Rated	
KATS Code	LUCK
Bloomberg Code	LUCK PA
Reuters Code	LUKC.KA
Market Price	Rs517.11
Market Cap	Rs166bn/US$715.1mn
Free float Market Cap	Rs58.1bn/US$250.3mn
1-Yr Avg. Daily Vol. (mn)	0.5
1-Yr Avg. Daily Val. (mn)	Rs318.4/US$1.7
1-Yr High/ Low	Rs790.3/411.9
Estimated free float	35%
Share outstanding (mn)	323.38
Index weight	3.57%

LUCK: Key Numbers

	FY20A	FY21A	FY22A	FY23F	FY24F
EPS (Rs)	19.0	70.7	91.2	119.5	131.9
Earnings Growth	-46%	273%	29%	31%	10%
PE @ Rs513.4	27.1	7.3	5.6	4.3	3.9
Dividend Yield	0%	0%	0%	0%	0%
ROE	5%	15%	15%	19%	20%
PBV (x)	1.3	1.1	0.8	0.8	0.8

Source: Company Accounts, Topline Research

- We maintain our 'Buy' rating for LUCK with SOTP based target price of Rs817/share. Our liking for the stock stems from 1) cement capacity enhancement of 3mn tons, 2) installation of solar plants, 3) ICI Pakistan (ICI) expansion in Soda Ash along with acquisitions and joint ventures, and 4) full year earnings contribution from LECPL & gradual reduction in circular debt.
- **Expansion in Cement business**: Brownfield expansion of 3.1mn tons is expected to come online in Jan-2023 at its Pezu plant located in the North region. LUCK will be amongst the first two players along with MLCF who will be increasing its capacity as LUCK's capacity based market share is expected to increase from 10% in FY22 to 14% in FY23.
- **Setup of Solar plant:** The company is also planning to install 34MW captive solar plant at its North Pezu plant and 25MW of plant at South plant which also bodes well for company profitability outlook.
- **ICI's expansion to further add value:** ICI is in expansionary phase where it is adding capacity into its existing segments (Soda Ash). Post expansion, the capacity would be enhanced to 560k tons by Dec 2022 from 500k tons currently. ICI has also successfully added the recycled chip PET plant with production capacity of 16k tons.
- ICI is further diversifying into new businesses with Tariq Glass (TGL) by setting up the Greenfield Float Glass Manufacturing Facility with production capacity of up to 1,000 tons/day. ICI has also shown intention to acquire 75% shareholding of Lotte Chemical (LOTCHEM) which is under process. Given these aggressive plans and business development strategies, LUCK is likely to benefit from these developments. ICI is expected to contribute Rs23.6/share in FY23 & Rs29.3/share in FY24.
- **LECPL to contribute significantly to bottom-line, cashflow concerns to subside:** 660MW coal based power plant of LECPL has achieved COD on March 21, 2022. In FY23, it is expected to have full year operations which will result in earnings contribution of around 17-18% in FY23 & FY24. So far, LECPL is relying on imported coal but with completion of SECMC Phase 3 in 1HFY24, it could start using local coal which could have lower working capital requirements and cash flow concerns could subside going forward.

Lucky Cement: Strong portfolio to drive value

LUCK: SOTP Valuation

Businesses	Rs/Share	Basis of Valuation
Cement operations	351	DCF
Foreign Operations	120	Implied BV
KIA Motors	117	DCF
Coal Power	115	DDM
ICI Pakistan	109	Market Price
Wind Farm	34	DCF
Net Cash/(Debt)	3	As of Jun 2022
SOTP Valuation	**850**	
LUCK Market Price	513	
Market Price Discount	**-40%**	

Source: Company Accounts, Topline Research

- Given the circular debt situation and risk of increased receivables, we have assumed low load factor in FY23 & FY24 for LECPL and have incorporated any additional borrowing needs. Also, with government measures to increase power tariffs, accumulation of circular debt could reduce going ahead.
- **Lucky Motor Corporation Limited (LMCL)**: KIA, Peugeot, and Samsung falls under the umbrella of LMCL. KIA which has performed well and have a material contribution in LUCK's profitability. Due to economic slowdown and inflationary pressures auto sector is facing pressures on sales in the short term but from FY24 it is anticipated to pickup as economic activity picks up. KIA contribution in LUCK profitability is likely to be (FY23E: Rs18/share & FY24F: Rs22/share).
- **Foreign Operations** – The company has three manufacturing plants in 3 locations (2 in Iraq and 1 in DRC Congo) with a joint venture. A full year operations of fully integrated plant in Iraq (COD in March 2021) has posted phenomenal sales of 1.4mn tons with EBITDA generation of US$33mn. Globally, the cement prices have improved which reflect that the manufacturers have passed the cost impact (higher coal prices) despite economic slowdown.
- **Buyback of shares:** LUCK's board recently approved buy back of 10mn shares which is worth of around Rs5.2bn (9% of free float). Buy back indicates sponsor confidence in the business given it trades at attractive valuations. It will also help unlock stock valuations. The company intends to purchase the shares from Sep 29, 2022 to Mar 27, 2023 as per the notice sent on the PSX and it intends cancellation of shares.
- **Valuations:** LUCK is currently trading at 40% discount to its SOTP valuation with major value contributions coming from Core Operations, LECPL and ICI. LUCK trades at a FY23 PE of 4.3x, PBV of 0.8x and EV/ton of US$23.
- **Risks**: 1) delay in cement and Soda Ash expansion, 2) elevated energy cost including coal, 2) rise in ocean freight, 3) lower than expected demand, 4) prolong global recession, 5) higher than expected pileup of power sector receivables.

Maple Leaf Cement: Major beneficiary of cement expansion

'Buy' Rated	
KATS Code	MLCF
Bloomberg Code	MLCF PA
Reuters Code	MPLF.KA
Market Price	Rs27.89
Market Cap	Rs30.6bn/US$131.8mn
Free float Market Cap	Rs13.8bn/US$59.3mn
1-Yr Avg. Daily Vol. (mn)	4.3
1-Yr Avg. Daily Val. (mn)	Rs141.8/US$0.7
1-Yr High/ Low	Rs40.3/23.2
Estimated free float	45%
Share outstanding (mn)	1,073.35
Index weight	0.82%

MLCF: Key Numbers

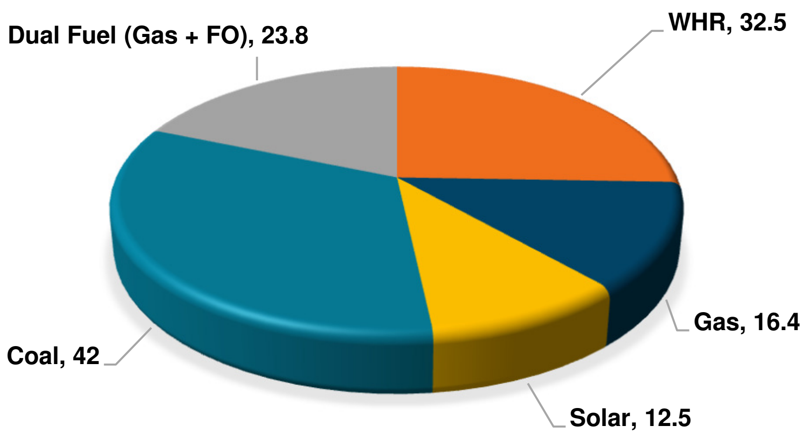
	FY20A	FY21A	FY22E	FY23F	FY24F
EPS (Rs)	(3.2)	3.5	4.8	4.0	6.5
Earnings Growth	NM	NM	37%	-15%	61%
PE @ Rs25.84	NM	8.2	6.0	7.0	4.4
Dividend Yield	0%	0%	0%	0%	0%
ROE	NM	10%	12%	9%	13%
PBV (x)	0.9	0.8	0.7	0.7	0.6

Source: Company Accounts, Topline Research

- We maintain our 'Buy' stance on MLCF with June 2023 Target Price of Rs38/share. Our investment thesis is based on 1) first player to enter into expansion cycle, 2) Major use of Afghan coal, 3) leading player of White Cement in Pakistan, and 4) efficient power mix. **Cement expansion to drive earnings:** MLCF brownfield expansion of 2.1mnton (7,000 tpd) is expected to come online 4Q2022. This capacity would be the first in the current cement expansion cycle which in our view could result in improved dispatches outlook for the company in FY23 and FY24. With this increase, MLCF capacity based market share would increase to 10.5% in FY23 from 8.0% in FY22.
- Dominant position in North will help MLCF capture increased market share specially in the election year. Furthermore, increased demand which is expected to pick up from 2HFY23 is also anticipated to bode well for the company.
- **Major use of Afghan coal to shield margins:** Thanks to Afghan coal which is a blessing for the cement industry where the delta between Richard bay and Afghan coal price (factory cost) hovers at $100/ton.
- MLCF is using more than 85% of Afghan and local coal which keeps the cost under control in such times where Richard bay coal prices are very high.
- It is important to note that Afghan coal is currently trading at around 30% discount to Richard bay prices which has allowed MLCF to address any margins concerns. It's gross margins in FY22 clocked in at 27% vs. 23% last year. We see a similar trend going forward unless Richard bay prices come down substantially.
- **Leading player of White Cement:** MLCF is the largest manufacturer of White Cement in the country with capacity of 170k tons annually and market share of 80-90%. This is a high margin product as it provides company an edge over other companies.

Maple Leaf Cement: Diverse fuel mix to bode well for company

Fuel Power Capacities in MW



Source: Company Accounts, PSX, Topline Research

- **Expansion in Waste Heat Recovery plant:** Along with the cement expansion, the company is also commissioning a 7.5MW Waste Heat Recovery (WHR) plant. With this addition the overall WHR plant capacity would increase to 32.5MW. The company also has 12.5MW solar power plant which provides efficiency gains in overall power cost.
- **Maple Leaf Power Limited (MLPL) is partially meeting the power requirement of MLCF:** MLCF is also fulfilling its energy requirement from Maple Leaf Power Limited (MLPL), a wholly owned subsidiary of MLCF with 42MW coal power plant. Any reduction in coal prices would benefit MLCF in a multifaceted way (fuel & power) savings in FY24. MLCF is using Afghan coal for its power plant which has also resulted in cost savings for the company.
- **Buyback of shares also giving positive signal to investor:** MLCF recently completed buy back of 25mn shares (5% of free float) with intention to cancel the shares. The purchase period was from May 26, 2022 to August 15, 2022 and the stock had rallied by 11%.
- Buy back of shares by sponsor shows sponsor interest in the company at current valuations and also depict future potential of the company.
- **Valuations:** MLCF currently trades at FY23 PE of 4x, PBV of 0.7x, EV/ton of US$30, EV/EBIDTA of 3.5x. Our TP of Rs38/share offers an upside of 35% from current levels.
- **Risks:** 1) higher than expected coal prices, 2) higher Sea freight cost, 3) local currency devaluation, 4) weak demand, and 5) delay in expansion.

Listed Cement Comp Sheet

Listed Cement Comp Sheet

Companies	Price (Rs/share) (Sep 13, 2022)	Market Cap (US$mn)	Sales CAGR		Profit CAGR		P/E (x)		P/S(x)		P/B(x)		EV/Ton (US$) (Inv Adjusted)	EV/EBITDA (x) (Inv. Adjusted)		Cement Sales Market Share	
			5-Year (FY17-21)	10-Year (FY12-21)	5-Year (FY17-21)	10-Year (FY12-21)	FY21A	FY22E	FY21A	FY22E	FY21A	FY22E		FY21A	FY22E	FY21A	FY22E
Lucky Cement Limited (LUCK)	513	716	20%	23%	9%	19%	7.3	5.6	0.8	0.5	1.1	0.8	28.9	4.7	3.9	17.5%	17.0%
Bestway Cement Limited (BWCL)	132	340	4%	13%	-1%	33%	6.8	7.7	1.4	1.1	1.3	1.3	38.8	5.0	3.8	15.2%	14.5%
Fauji Cement Company Limited (FCCL)	16	146	4%	18%	-8%	23%	9.7	7.0	1.4	1.0	1.5	1.2	37.3	4.3	3.0	6.1%	6.1%
Kohat Cement Company Limited (KOHC)	166	144	11%	15%	-5%	49%	9.6	5.6	1.4	1.0	1.5	1.2	20.1	3.6	2.4	6.6%	6.6%
Maple Leaf Cement Factory Limited (MLCF)	29	132	9%	11%	-5%	NM	8.0	6.7	0.9	0.6	0.8	0.7	40.7	5.3	3.7	8.8%	8.5%
DG Khan Cement Company Limited (DGKC) *	61	115	9%	9%	-16%	36%	7.2	9.0	0.6	0.5	0.4	0.4	26.3	4.8	3.7	12.8%	12.2%
Cherat Cement Company Limited (CHCC)	117	98	29%	20%	18%	47%	7.1	5.1	0.9	0.7	1.7	1.3	35.6	4.9	4.1	6.9%	6.6%
Pioneer Cement Limited (PIOC)	70	69	18%	15%	-5%	32%	8.1	7.4	0.7	0.5	1.1	0.9	37.3	8.1	5.3	5.9%	6.3%
Attock Cement Pakistan Limited (ACPL)*	84	50	9%	10%	-17%	5%	10.4	10.3	0.5	0.6	0.7	0.6	27.0	7.0	6.8	5.9%	4.2%
Gharibwal Cement Limited (GWLC)	22	38	3%	14%	-10%	NM	5.6	3.9	0.7	0.6	0.6	0.5	20.5	2.5	2.1	3.1%	3.1%
Power Cement Limited (POWER)	5	23	28%	20%	-6%	NM	15.0	NM	0.4	0.3	0.5	0.5	41.0	12.1	11.3	4.2%	3.7%
Flying Cement Company Limited (FLYNG)	8	23	5%	16%	0%	NM	36.8	5.2	1.7	1.0	0.6	0.6	37.2	27.3	8.4	0.7%	0.7%
Dewan Cement Limited (DCL)	5	11	-13%	2%	-185%	6%	NM	NM	0.4	0.2	0.1	0.1	11.8	19.2	5.8	1.6%	3.2%
Thatta Cement Company Limited (THCCL)	15	6	0%	4%	NM	NM	NM	12.5	0.5	0.4	0.3	0.3	9.5	2.0	5.3	0.7%	0.9%
Fecto Cement Limited (FECTC)	23	5	0%	4%	NM	NM	NM	4.7	0.2	0.2	0.3	0.3	12.4	21.5	3.8	1.3%	1.3%
Sector Total		**1,917**	**12%**	**15%**	**-2%**	**39%**	**7.9**	**6.4**	**0.9**	**0.6**	**0.9**	**0.8**	**31.2**	**5.3**	**4.0**	**97.4%**	**95.2%**

Source: Company Accounts, Topline Research, *Unconsolidated, Coverage companies (LUCK, DGKC, MLCF, FCCL & KOHC) numbers are estimated, rest extrapolated, Safe Mix excluded

Analyst Certification and Disclosures

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Rating	Sector's Proposed Weight in 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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