



Pakistan Cements

Let the games begin?

February 15, 2023

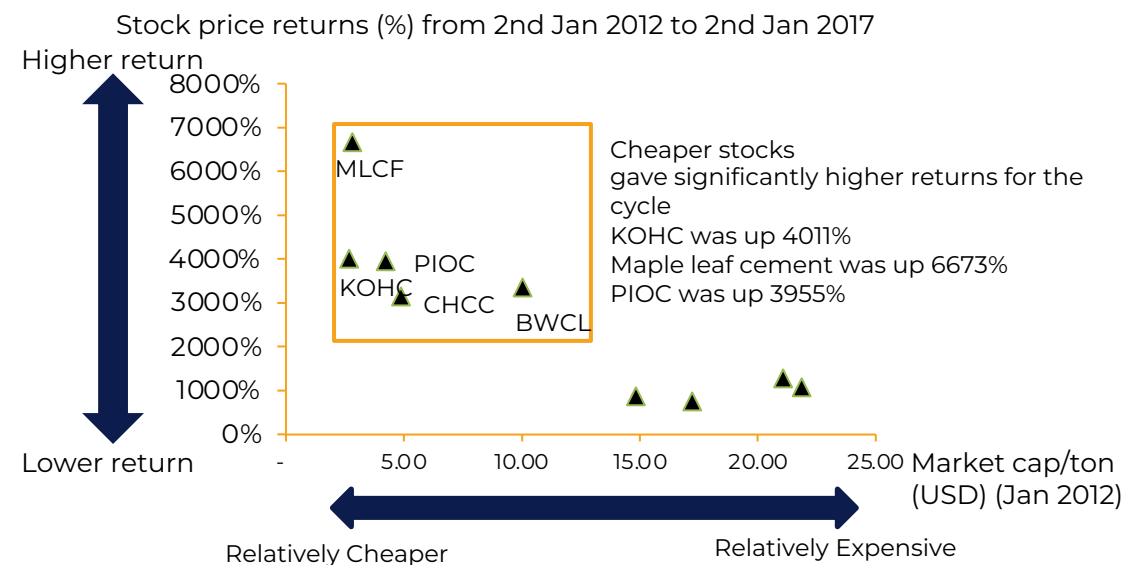
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The Cement Cycle - Historical Returns

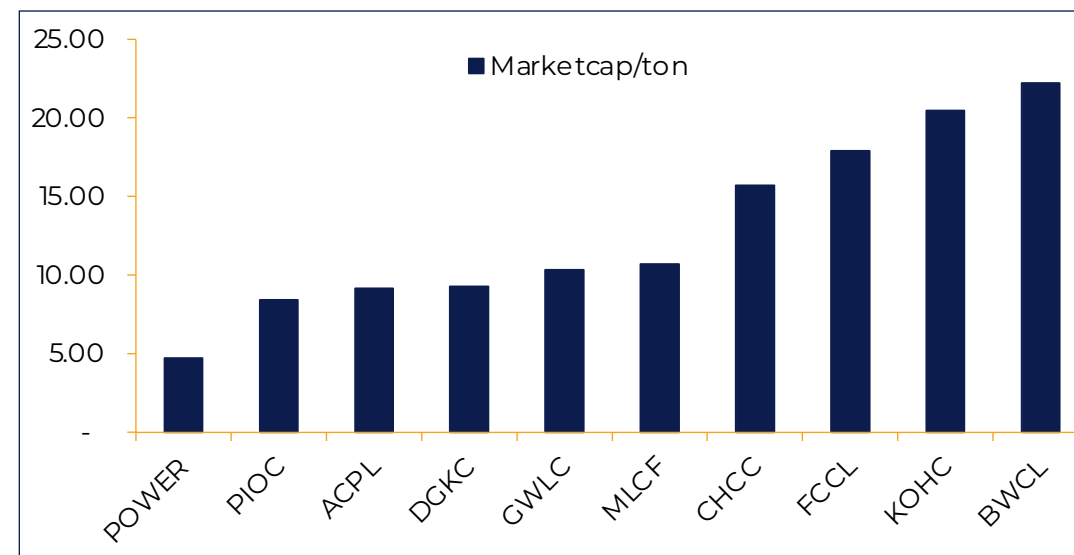
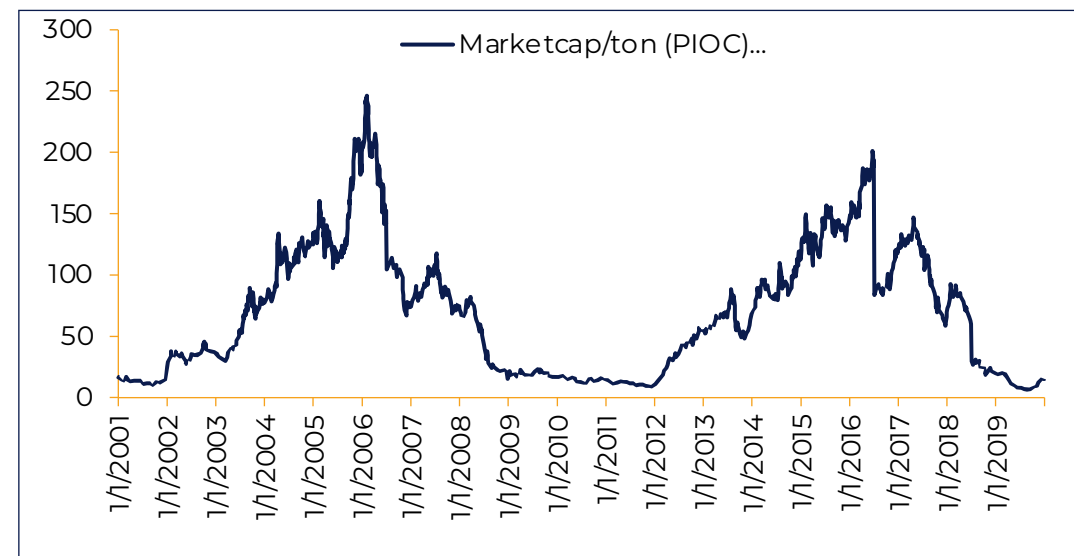
- Pakistani cement stocks have given abnormally high returns in the past if purchased at the bottom of the cycle.
- **Stock price returns for the cement sector ranged from 761% for Attock Cement to 6673% for Maple Leaf Cement during the last cycle from 2012 - 2017.**
- **Maple Leaf Cement started the cycle with a large debt burden and a low market capitalization, while ACPL started at a relatively higher valuation and a better balance sheet.**
- The returns of cement stocks trading at lower valuations at the start of a cycle were higher than those of more expensive stocks.
- In the past, cement company margins have adjusted for currency devaluations.

Cement Sector	Market cap/ ton 2012	Stock Price Return 2012-2017
Kohat Cement	2.68	4011%
Maple Leaf Cement	2.80	6673%
Pioneer Cement	4.24	3955%
Cherat Cement	4.88	3147%
Bestway Cement	10.01	3349%
Gharibwal Cement	14.83	870%
Attock Cement	17.22	761%
Fauji Cement	21.06	1288%
DG Khan Cement	21.85	1078%



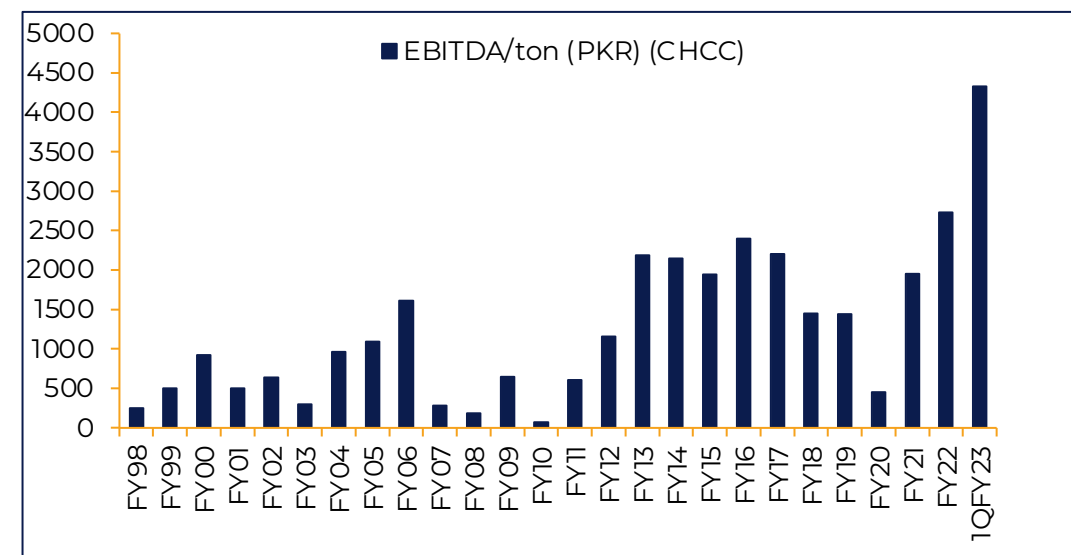
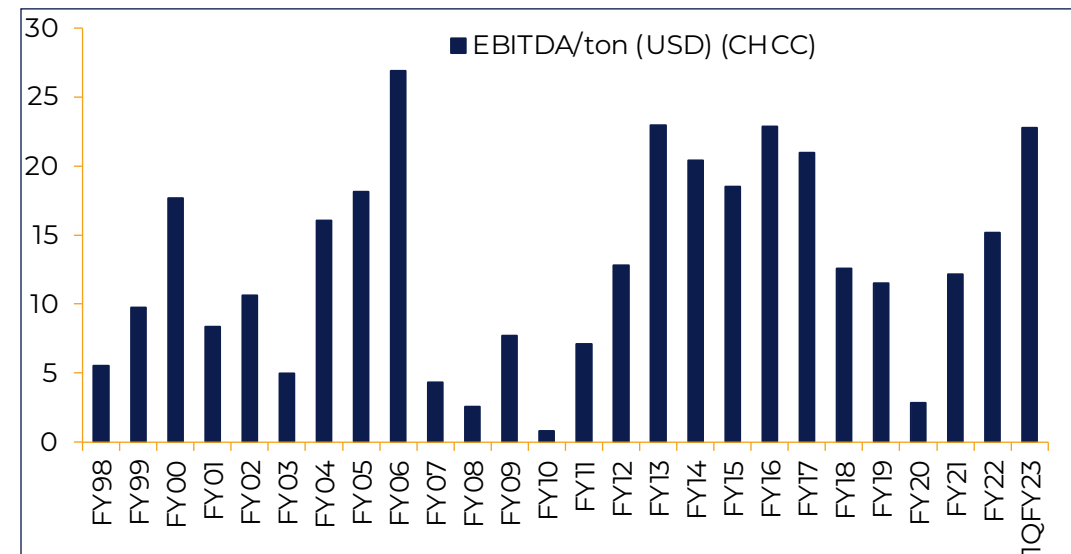
The Cement Cycle - Historical Valuations

- **The current market capitalization of cement companies ranges from USD 5/ton to USD 38/ton.**
- **At the end of the cement cycle, cement companies have historically traded at a high of USD 200/ton.**
- When making a decision, investors should also consider the total debt burden, current and future margins as well as the location of the cement companies.
- As a result of capacity enhancements over the past five years, margins have shrunk in the south zone, since companies rely heavily on exports where margins are lower.
- Cement Valuations are back to the levels last seen in 2002 and 2012-2013. These are somewhat similar times when GDP growth was low and economic situation was weak.
- As the economy gradually recovers, cement stocks could post a multi year rally.
- **Over the next 4-5 years, we believe cheaper stocks in the north zone will perform better (PIOC, GWLC, MLCF, CHCC, FCCL, KOHC, BWCL are based in the north zone).**

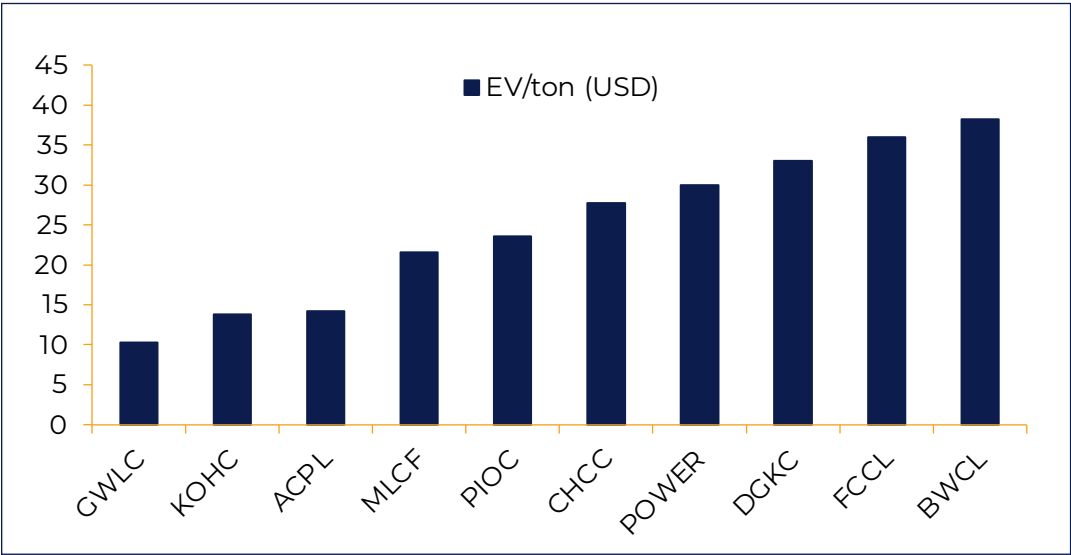
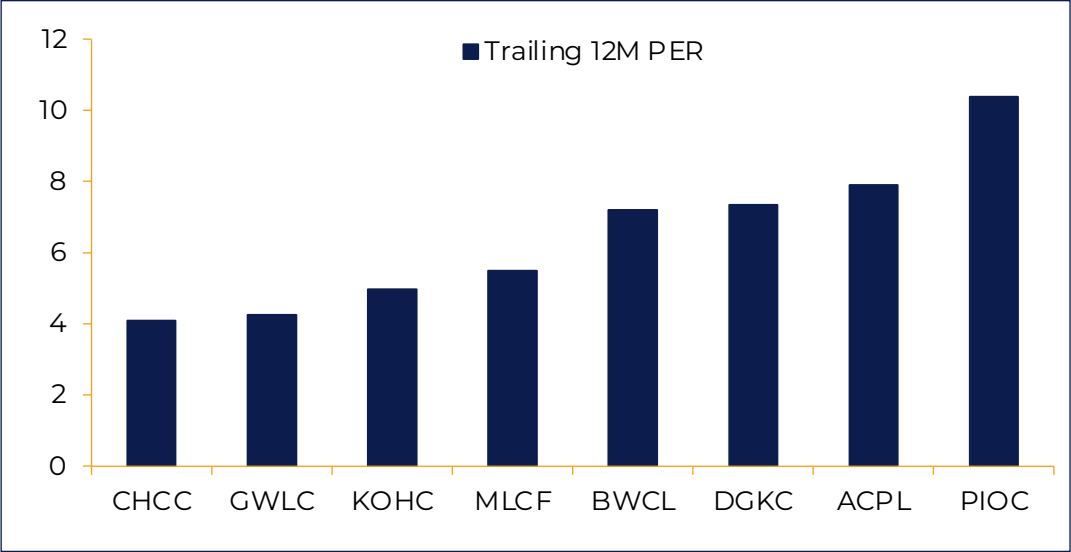
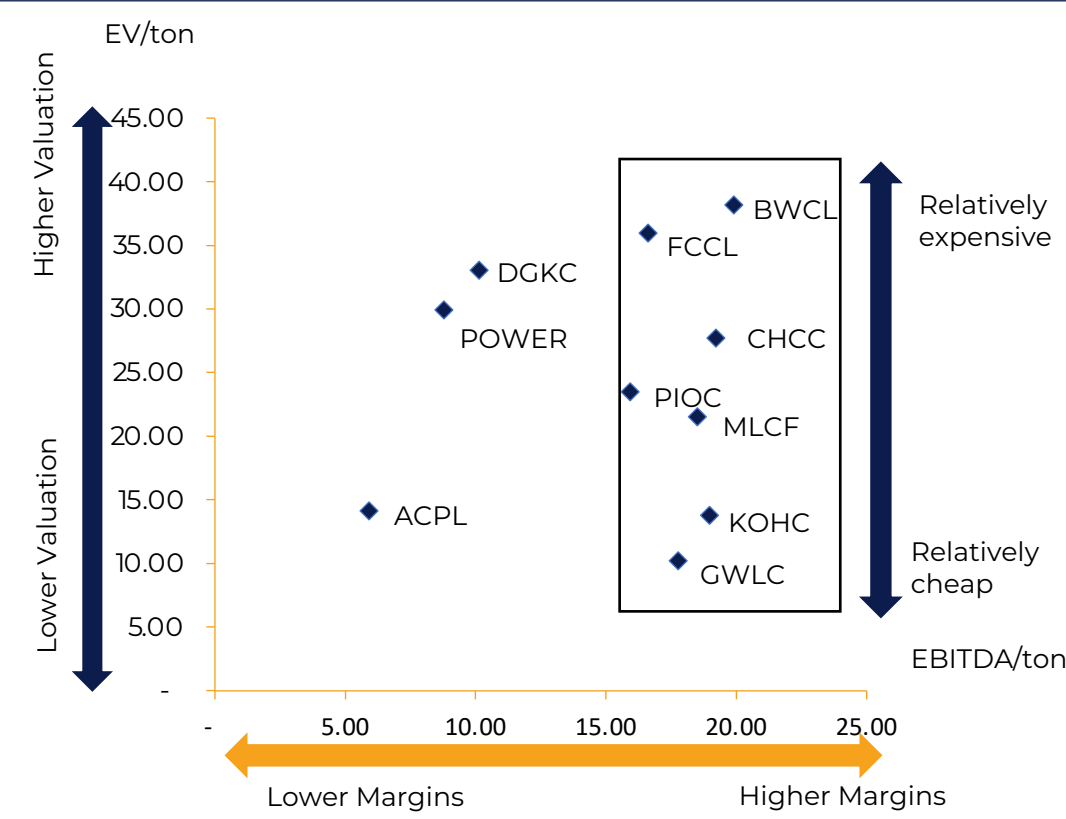


The Cement Cycle - Historical Margins

- In the north zone, EBITDA margins have historically ranged from USD 1/ton to USD 30/ton
- CHCC's average EBITDA margin was USD 13/ton from 2002 to 2022, while PIOC's was USD 15/ton from 2005 to 2022.
- Margins have been similar for other companies in the North Zone with efficient cement plants.
- Despite the challenging economic situation, cement companies' EBITDA margins are similar to what we saw during the last upcycle.
- Due to a large part of capacity being exported at lower margins, we expect EBITDA margins in the south zone to remain relatively low.
- **We expect that EBITDA margins/ton will continue to adjust for devaluation in the future.**
- While margins have adjusted for devaluation, stock prices have not.
- We believe that once sovereign default fears subside, stock prices could rerate upwards.

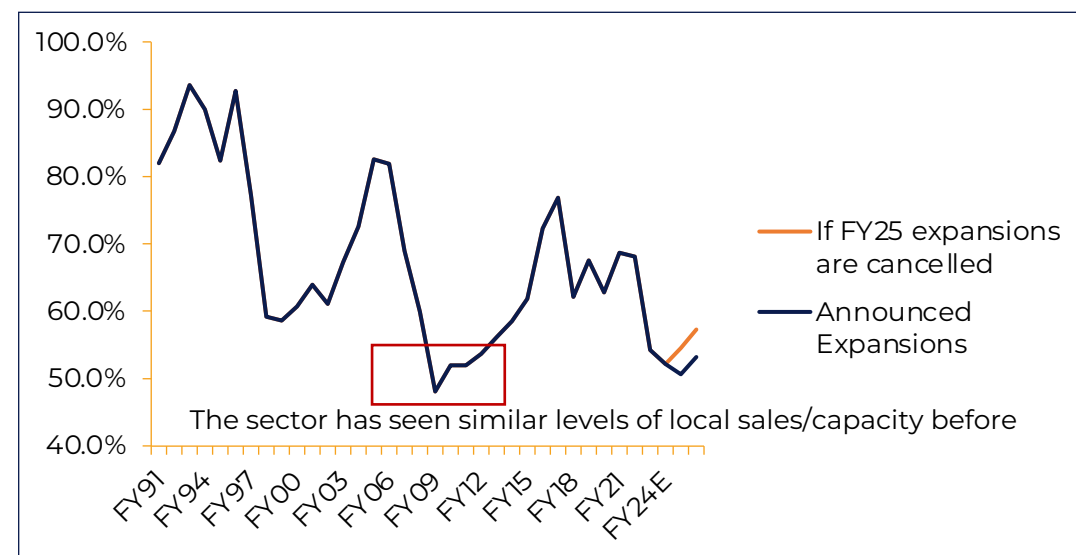
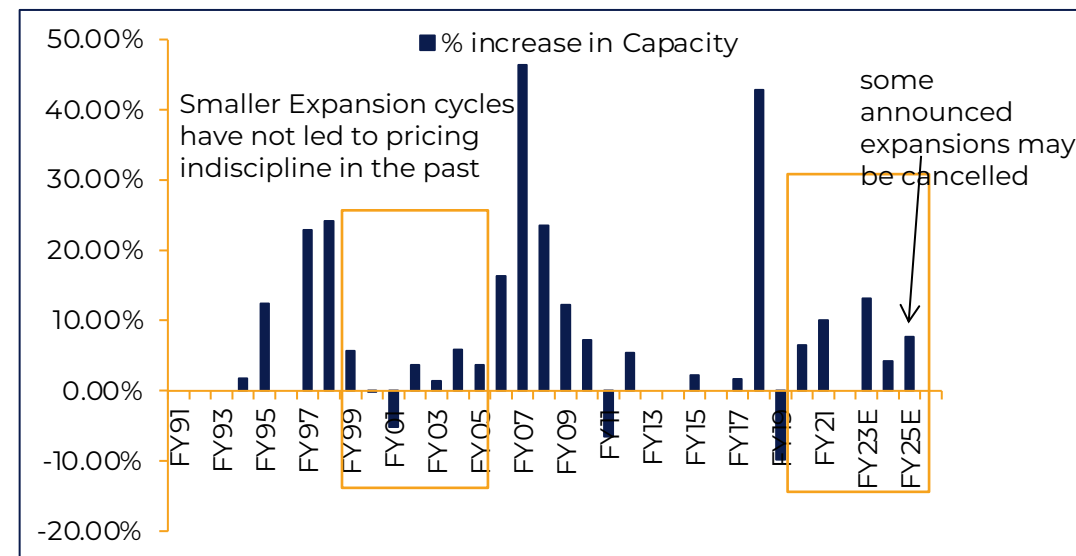


Current EV/ton and EBITDA/ton



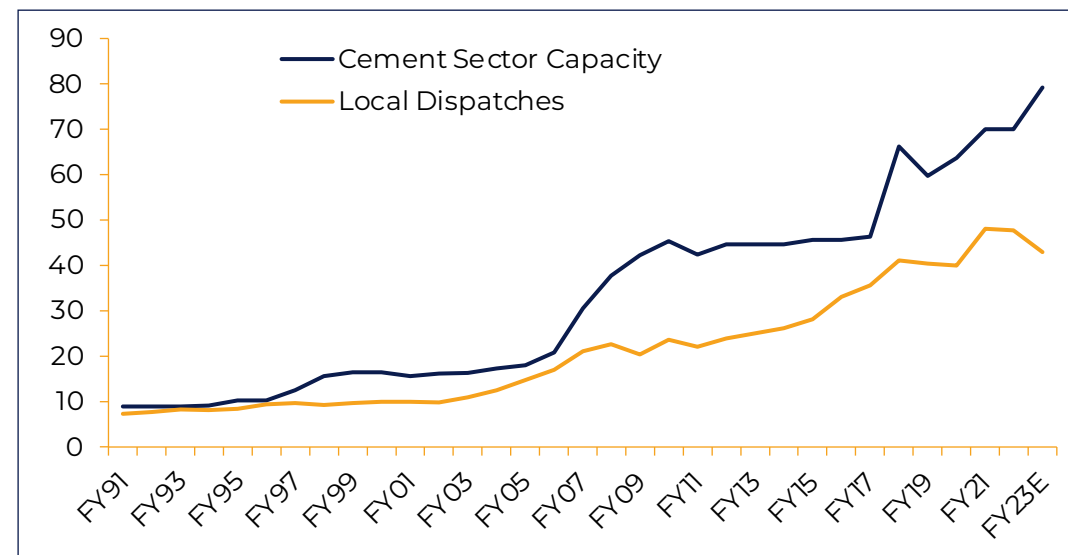
Capacity Utilization & Expansions

- As significant capacity has been added, local sales have fallen significantly as a percentage of total capacity.
- Cement demand has not kept up with capacity in the local market.
- **In the past, the sector has seen similar local sales/capacity from FY09-FY14.**
- We believe pricing discipline can be maintained over the coming years.
- **An uncertain demand outlook and machinery import restrictions could lead to some expansions being cancelled.**



Fewer Expansions & Higher Payouts/Buybacks Likely

- Local dispatches increased from approximately 10mn tons in FY02 to 41mn tons in FY18.
- With back-to-back IMF programs and low fiscal stimulus, dispatch growth is expected to significantly slow down going forward.
- In light of a muted demand outlook, we believe companies in the sector will either increase payouts and buybacks or invest in other projects.
- **We believe that cement sector payouts and buybacks will increase going forward** as cash will not be invested in increasing sector capacity.
- **Payouts/buybacks are more likely to be increased by companies with lower debt.**

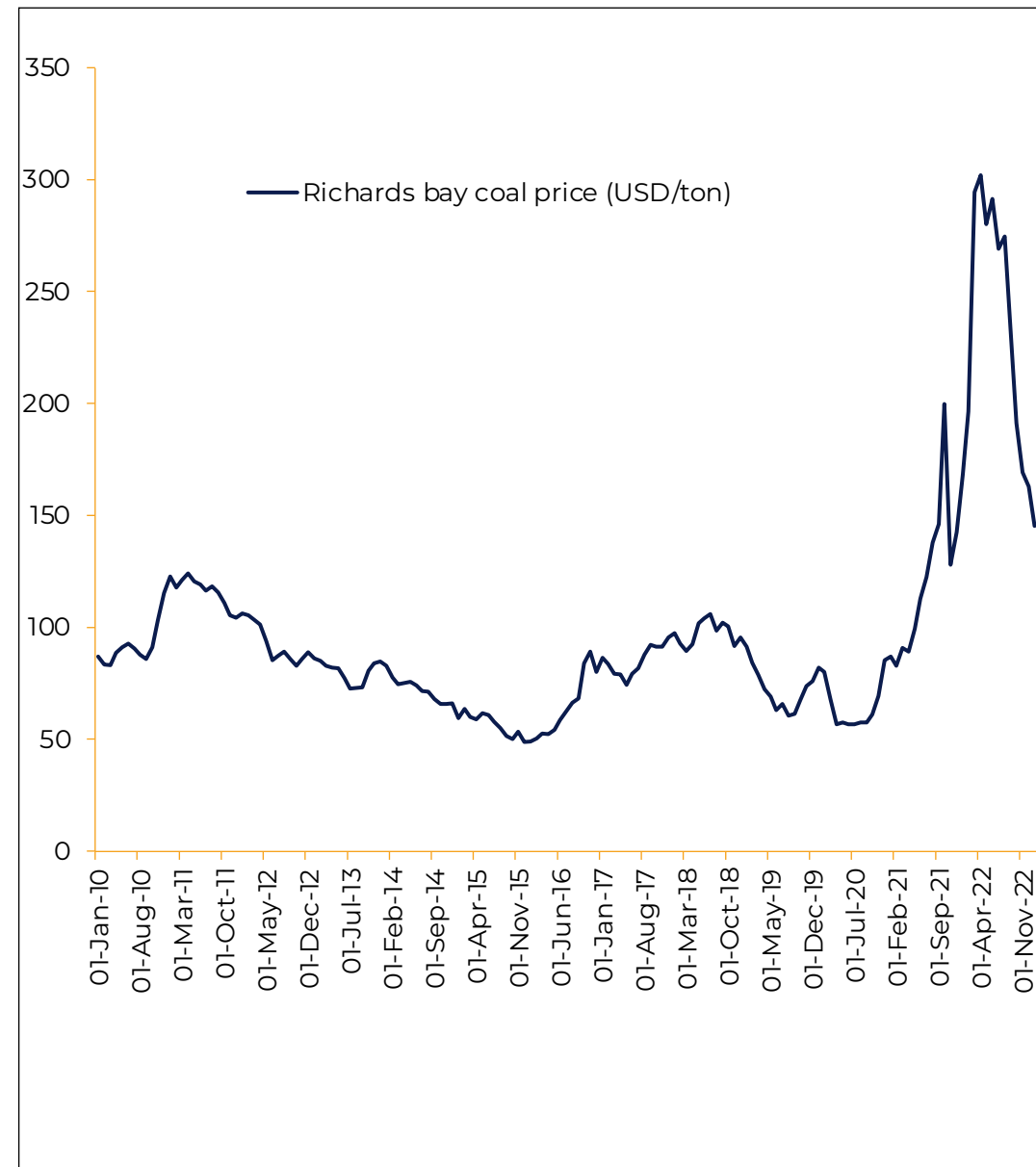


Company	Ticker	Net Debt (PKR 'mn)	Net Debt/ton (USD)
Kohat Cement	KOHC	(8,740)	(6.77)
Gharibwal Cement	GWLC	(51)	(0.09)
Attock Cement	ACPL	4,181	5.12
Maple Leaf Cement	MLCF	23,235	11.03
Cherat Cement	CHCC	14,945	12.30
Pioneer Cement	PIOC	21,601	15.40
Bestway Cement	BWCL	54,652	16.28
Fauji Cement	FCCL	28,197	18.45
DG Khan Cement	DGKC	46,127	24.21
Power Cement	POWER	25,656	25.68

*Some firms like DGKC have investments on their balance sheets that have not been considered when calculating net debt.

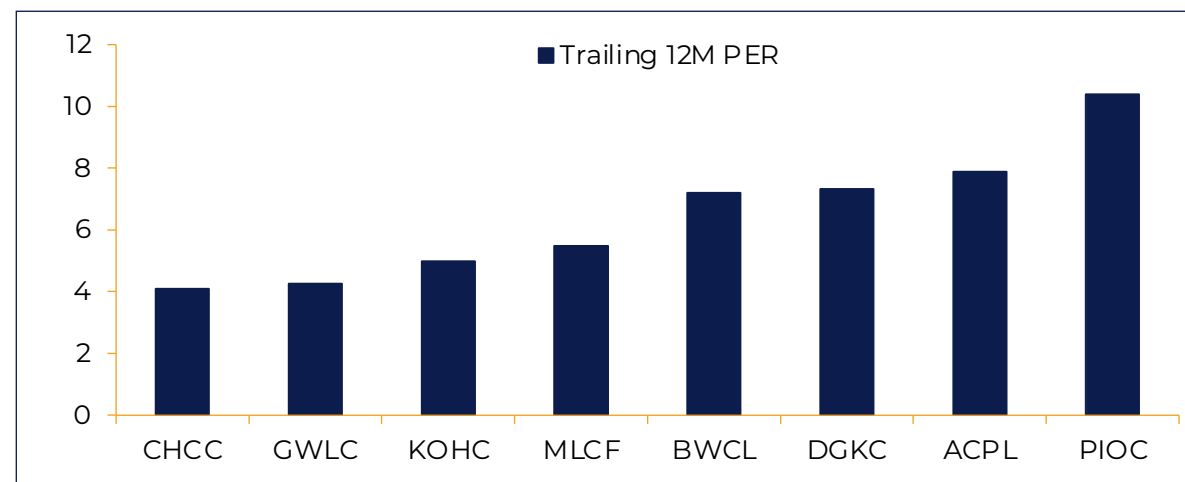
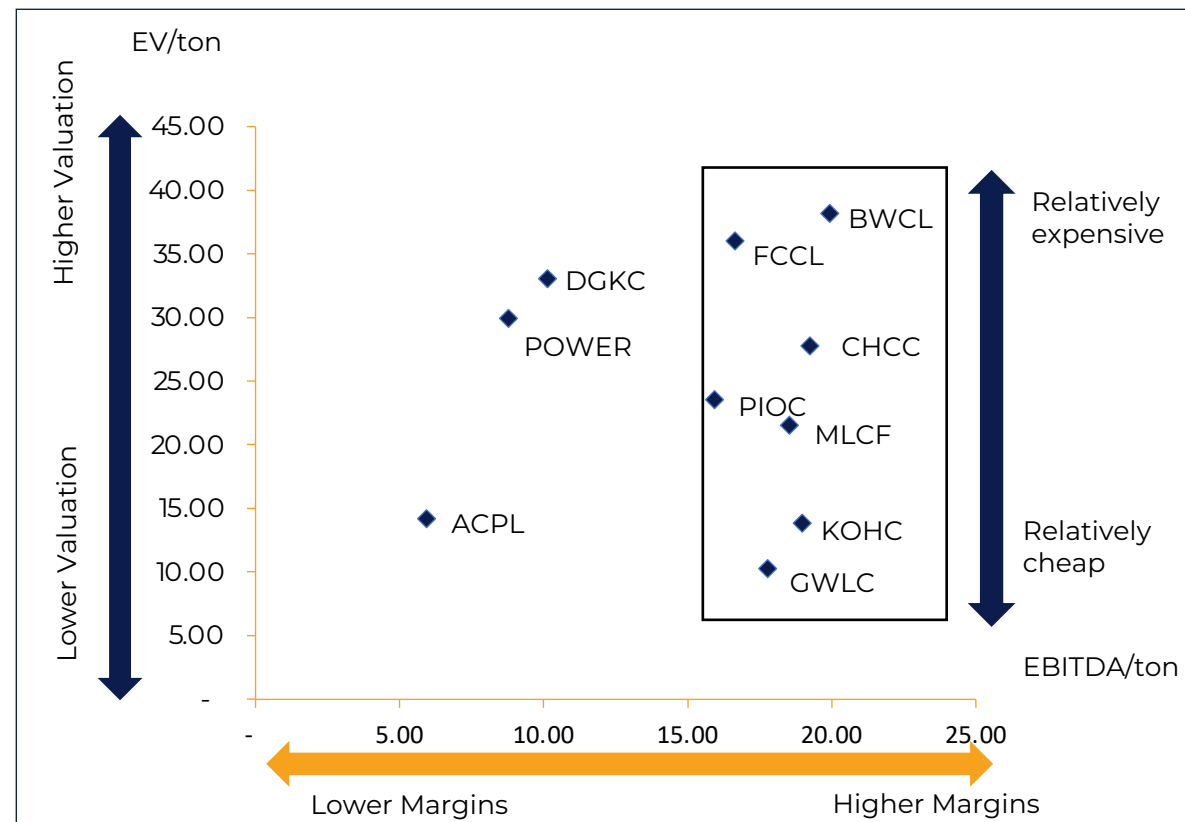
Lower Coal Prices Will Neutralize The Blow of Higher Electricity prices

- Coal prices have declined from PKR 66,000 per ton to PKR 48,000 per ton in the last few months.
- **In the next few months, electricity prices are expected to increase by PKR 13/Kwh. However, a decline in coal prices of PKR 10,000/ton will neutralize the cost increase.**
- The decline in Richards bay coal prices should put further pressure on local and Afghan coal prices.
- Richards bay coal has declined from USD 300/ton to USD 145/ton.
- Coal prices remain at historically higher levels and slower global demand could soften prices going forward.



Summary

- We understand that the current economic situation will take a toll on local dispatches, yet we are confident that pricing discipline will remain constant and consequently protect profitability.
- Additionally, we would like to draw attention to the fact that cement sector is trading close to bottom valuations.
- History has taught us that once IMF program has been established, these stocks have recovered from their lows.
- Even with these trying times, we hope for similar results this time around.
- We believe that the sector deserves a place in a long term portfolio with allocation in stocks that are trading at lower valuations. We prefer MLCF, PIOC, CHCC, KOHC and GWLC.



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Valuation Methodology:

- Period end target prices, Chase Securities Pakistan Private Limited uses different valuation methodologies including but not limited to:
- Discounted cash flow (DCF, DDM)
- Relative Valuation (P/E, P/B, P/S etc.)
- Equity & Asset return o arrive at our based methodologies (EVA, Residual Income etc.)

Rating Definition	
BUY	Total stock return > 15%
NEUTRAL	Total stock return between 0% -15%
SELL	Total Stock return < 0%

* Total stock return = capital gains + dividend yield