Pakistan Cements

MLCF PA: Standing strong in challenging times

Domestic cement industry has remained under pressure since last 12-18 months as local dispatches witnessed a decline of 13% in 8MFY23 to clock in at 27.2mn tons vs. 31.42mn tons in SPLY. This was mainly attributed to multiple headwinds on macro front such as inflationary pressures, low private & public sector spending and high commodity prices, which were further exacerbated by flood, political uncertainty and PKR devaluation against greenback, all of which kept the local cement demand suppressed. Additionally, export sales showed no signs of recovery due to political and economic instability in Afghanistan. Furthermore, exports to other countries remained unviable due to high production cost and increase in freight charges.

Despite the slowdown in volumetric sales MLCF's topline witnessed the highest ever revenue during 1HFY23. This is mainly attributable to higher retention prices and a healthy market share maintained by the company through expanding capacity over the years to match the growing size of the market. Along with the growing market share, company has also relied on its own power generation, which provides a cushion against abrupt increase in electricity charges. Thus, we recommend a 'BUY' stance on MLCF with a DCF-based target price of PKR39 for Dec'23, offering 58% upside potential. At current valuations, MLCF's is trading at an EV/ton of ~US$20.4 compared to 5-year average of ~US$83.72. On an EV/EBIDTA basis, the stock is trading at 2.8x as compared to 5-year average of 7.68x. Our liking for the stock emanates from the following facts i) Capacity enhancement to enhance market share, ii) TERF/LTFF facility to keep finance cost in check and iii) Higher margins on the back of operational efficiency.

Key risks to our investment thesis include: i) Increase in interest rates, ii) Slowdown in construction activity, iii) Price competition amongst players, iv) Increase in energy and input prices and v) Change in regulatory environment.

Maple leaf cement factory Ltd

BUY | HOLD | SELL

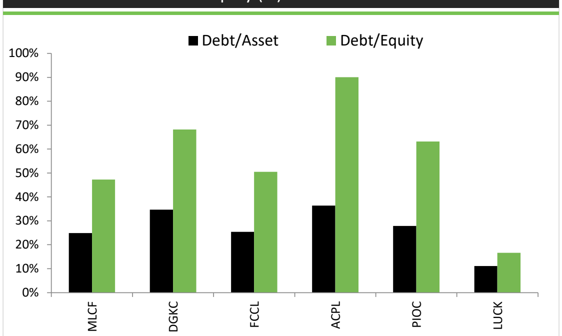
We recommend BUY with Dec'23 DCF based target price of PKR39/sh, providing 58% Capital Upside

Current Price		24.9
Market cap	PKR b	26.7
Market cap	US$ m	95
Free Float Market cap	US$ m	43
30-day Avg. turnover	m Shares	8.4
30-day Avg. turnover	PKR m	213.9
52 week range	PKR/sh	19.00-39.02
Shares Outstanding	m	1,073
Free float	%	45%
Major Sponsors		Saigol Group
Bloomberg Ticker		MLCF PA

Financials* (PKR mn)	FY22	FY23E	FY24E
Sales	48,520	62,699	64,921
Cost of sales	35,280	43,559	46,780
Gross Profit	13,240	19,140	18,140
Finance Cost	1,658	2,014	1,574
Profit Before Tax	8,140	13,114	12,245
Profit after Tax	4,554	9,311	8,576
Key Ratios*	**FY22**	**FY23E**	**FY24E**
EPS	4.2	8.7	8.0
DPS	-	-	-
Gross Margins	27.3%	30.5%	27.9%
P/E	6.3	2.9	3.1
EV/ton ($)	59.0	21.1	12.2
EV/EBITDA	4.4	2.2	2.0

Source: Company Accounts, Insight Research
*Consolidated

Debt to assets & Debt to equity (%): MLCF vs. ISL universe



Source: Company accounts, Insight Research

Driving Growth with operational Efficiency

In line with the industry, MLCF has also increased its capacity which came online in Nov'22. The production line enhanced company's current clinker capacity by ~37% from 5.7mn tons to 7.8mn tons and capacity based market share to ~9.8%.

On efficiency front, a new 12MW WHR capacity is also being added, which increases the total capacity to 37MW from 25MW. Along with that, MLCF has also added 7.5MW solar capacity which took solar plant's total capacity to 12.5MW. To note, MLCF achieved highest gross margins during 1HFY23 compared to ISL universe cement companies. This is mainly attributable to company's reliance on own power generation sources,

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which consists of coal fired power plants of 40MW, followed by WHR (37MW) and solar (5MW), which remains company's cheapest energy source.

Optimal fuel mix to keep margins elevated

During 1HFY23, the company posted a gross profit of ~31%, compared to the average gross margins of ~23% of ISL universe. The higher gross margins are mainly attributable to an efficient coal mix. To note, similar to other industry players, MLCF is also using a mix of local/afghan coal and alternative fuel to optimize its fuel cost. However, the company's share of local coal in fuel mix remained higher compared to its peers, accounting for ~60%-70%. This is mainly due to the company's new production line, which allows them to use coal with high sulphur content. Additionally, company is also benefiting from using pet coke, which is cost-effective due to its higher energy content. Furthermore, management has also initiated different measures, which include the use of alternative fuels and optimized plant operations, with a focus on reducing fixed costs. This allows the company to enjoy higher gross margins in the foreseeable future compared to its peers.

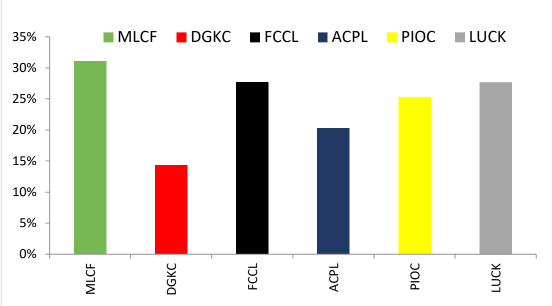
TERF/LTFF facility to keep finance cost in check

For expansion, company availed TERF & LTFF facility which will keep company insulated from rising interest rates and maintain finance cost at a comfortable level. Currently, company's debt-to-asset ratio stands at ~25% compared to average debt to asset ~27% of ISL universe. Whereas debt to equity stands at ~47% compared to ~58% of ISL universe. We believe that in current high interest rate environment MLCF is relatively better placed as compared to its peer, thanks to company's subsidized financing which allow them to shield against higher interest rate charges.

Outlook

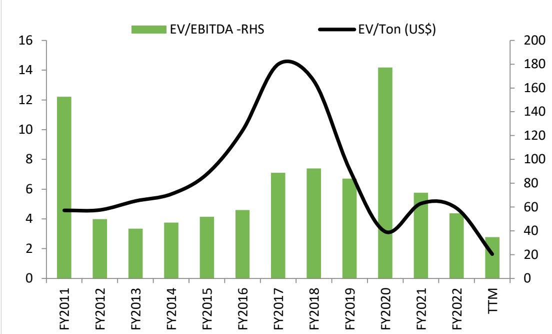
During FY23TD, ~11.9mn capacity has been added, taking industry total capacity to ~83.6mn. On the flipside, dispatches remained depressed to clocked in at 29.8mn, down by 17% during 8MFY23, keeping industry utilization at lower side. Thus, with almost ~9mn tons more capacity to come online by FY24 coupled with increase cost of construction, political uncertainty and low PSDP utilization, there is a fear among market participants that industry demand might take significant hit. This sentiment has also been witnessed in cement stock performances, which have brought cement companies to unprecedented discounts.

1HFY23 Gross margins (%): MLCF vs. ISL universe



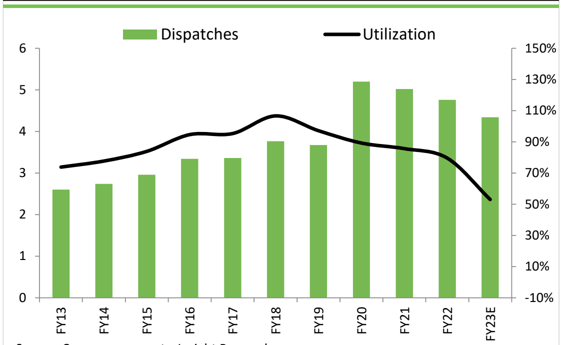
Source: Company accounts, Insight Research

MLCF: $EV/ton & EV/EBITDA



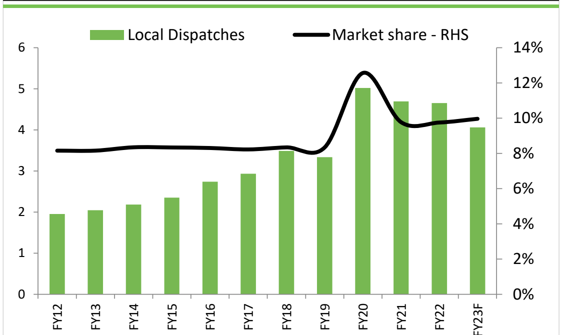
Source: Company accounts, Insight Research

MLCF: Dispatches (mn tons) vs. Capacity Utilization (%)



Source: Company accounts, Insight Research

MLCF: Dispatches (mn tons) vs. Market share (%)



Source: Company accounts, Insight Research

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Valuation Methodology: To arrive at our period end target prices, ISL uses different valuation methodologies including

- Discounted cash flow (DCF)
- Relative Valuation (P/E, P/Bv, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)

Frequently Used Acronyms

TP	Target Price	**DCF**	Discounted Cash Flows	**FCF**	Free Cash Flows
FCFE	Free Cash Flows to Equity	**FCFF**	Free Cash Flows to Firm	**DDM**	Dividend Discount Model
SOTP	Sum of the Parts	**P/E**	Price to Earnings ratio	**P/Bv**	Price to Book ratio
P/S	Price to Sales	**EVA**	Economic Valued Added	**BVPS**	Book Value per Share
EPS	Earnings per Share	**DPS**	Dividend per Share	**DY**	Dividend Yield
ROE	Return on Equity	**ROA**	Return on Assets	**CAGR**	Compounded Annual Growth Rate

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