PAKISTAN INSIGHT

JUNE 08, 2023

Insight Securities

Pakistan Cements

DGKC PA: Revival in export volumes to lift margins

Profitability of cement sector has recorded an increase of ~12% YoY in 9MFY23, thanks to higher retention prices and efficient fuel mix. Despite uptick in profitability, performance of cement stock remained muted in 1HFY23 due to weak demand outlook coupled with high coal prices and rising borrowing rate. However, cement stock started to show recovery from their respective lows in 2HFY23 amid use of efficient fuel mix and dirt cheap valuation. In current rally, performance of DGKC remained muted as compared to its peers primarily due to high leverage and loss in market share as peers have expanded/announced new capacities. With revival of export sales amid steep devaluation and advantage of close proximity to sea, we reiterate our BUY stance on DGKC with Jun'24 TP of PKR94/sh, providing capital upside of 77%.

In FY22, DGKC posted unconsolidated revenue of PKR58bn vs. 45bn in SPLY, up by 29%. Whereas, in 9MFY23, company has posted unconsolidated revenue of PKR48bn vs. PKR43bn, up by 11%. However, despite higher revenue company's PAT plunged by ~42% primarily due to financial charges which increased by twofold amid higher interest rate.

In 11MFY23, local dispatches remained weak amid economic slowdown, rising cost of construction, low PSDP utilization and higher interest rate environment. However, in last couple of months, there is a noticeable recovery in cement exports as global demand is gradually improving. Where, we believe DGKC will capitalize on export opportunities. To highlight, company's export volume has recovered in 3QFY23 to clock at ~0.34mn tons vs. 0.16mn tons in 1HFY23.

At current valuations, DGKC is trading at an EV/ton of ~US$27 compared to 5-year average of ~US$86. On EV/EBIDTA basis, the stock is trading at 4.5x as compared to 5-year average of 11x. Our liking for the stock emanates from i) DGKC's strong footprint in both regions to cater exports, ii) Decline in oil and coal prices to enhance margins, iii) Higher other income to support bottom line and iv) Trading at attractive valuation.

Key risks to our valuation includes i) Price competition amid supply glut, ii) Rise in energy prices, iii) Increase in interest rates and iv) Change in regulatory environment.

Exports to rescue in challenging domestic environment

The cement industry has experienced negative tailwinds in recent times amid subdued construction activity led by rising cost of construction, economic slowdown, political uncertainty and higher interest rate. To note, local cement dispatches have plunged by 14% in FY23. Whereas, export sales plunged by 15% YoY. However, in last couple of months export sales have witnessed a tremendous recovery on the back of PKR devaluation

DGKC Cement Ltd.

BUY | HOLD | SELL

We recommend Buy with Jun'24 SOTP & DCF based target price of PKR94/sh, providing 77% capital upside

Current Price		53.1
Market cap	PKR b	23.3
Market cap	US$ m	80
Free Float Market cap	US$ m	40
30-day Avg. turnover	m Shares	3.1
30-day Avg. turnover	PKR m	151.6
52 week range	PKR/sh	39-65.70
Shares Outstanding	m	438
Free float	%	50%
Major Sponsors		Nishat Group
Bloomberg Ticker		DGKC PA

Financials (PKR mn)	FY22	FY23E	FY24E
Sales	58,044	63,509	63,689
Cost of sales	47,616	52,679	49,971
Gross Profit	10,428	10,831	13,719
Finance Cost	3,571	6,435	5,718
Profit Before Tax	6,020	4,807	8,064
Profit after Tax	2,972	3,243	5,821

Key Ratios	FY22	FY23E	FY24E
EPS	6.8	7.4	13.3
Gross Margins	18%	17%	22%
P/E	11.9	7.2	4.0
P/Bv	0.51	0.32	0.29
EV/ton ($)	57.3	29.3	22.3
EV/EBITDA	6.1	4.2	3.2

Source: Company Accounts, Insight Research

Cement stock performance from its 52 week low

Ticker	LDCP	52 week Low	Δ 52-week low
PIOC	87.5	43.6	100.7%
ACPL	83.0	50.5	64.3%
CHCC	123.3	74.6	65.3%
MLCF	29.1	19.0	53.1%
KOHC	168.3	113.0	48.9%
LUCK	514.6	375.6	37.0%
DGKC	53.1	39.0	36.2%
BWCL	150.0	118.1	27.0%
FCCL	12.7	10.2	23.5%

Source: PSX, Insight Research

Ali Asif AC

Ali.asif@insightsec.com.pk

+92-21-32462541 Ext:114

coupled with industry's timely shift towards alternative fuels and decline in freight charges. In current scenario, DGKC can capitalize this opportunity, thanks to company's presence in both southern & northern market. Furthermore, given the import restrictions, industry was not able to enjoy the full benefit of declining coal prices as afghan coal is still trading at slight premium. With reasonable export proceed, company can avail the benefit of declining international coal prices. To note, company has recently exported cement to USA with the price of US$60/ton. Moreover, company is also planning to tap new export markets which will provide better export pricing.

Margins to improve amid lower commodity prices

Richard bay coal prices have plunged to US$105/ton (↓69% FYTD). DGKC would reap benefit from this development as lower coal prices would reduce company's fuel & power cost, resulting in higher margins. To note, DGKC has a total power capacity of ~181MW with ~60MW coal based power plants, which accounts for 33% of company's total power capacity. Moreover, company has also installed 7MW solar power plant at KHP which will reduce their reliance on fossil fuel. Company is also planning to add another 12MW solar project which will result in further margin accretion.

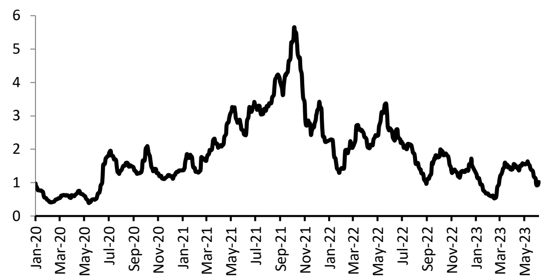
Dividend income to support bottom-line

DGKC's has diversified portfolio across range of industries, including banks, insurance, textiles, oil, dairy, paper, and hospitality. This provides a buffer to company's bottom-line in the form of dividend income. To highlight, company's dividend income stood at PKR2.3bn in FY22. We value DGKC portfolio at PKR36/share, assuming 25% holding company discount.

Deleveraging of balance sheet to ease burden

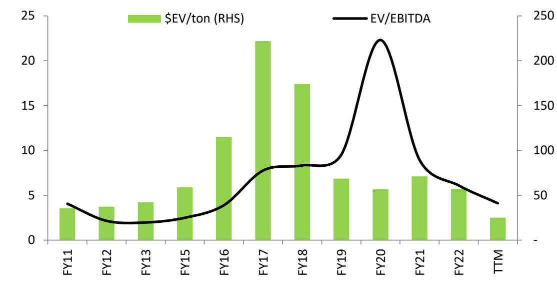
DGKC has highest debt to asset ratio of 31% as compared to ISL cement universe which continues to hurt company's bottom line. As per latest accounts, DGKC total debts stands at PKR41.5bn. Whereas, in 9MFY23, company's total finance cost stood at PKR4.9bn. However, recovery in export sales and decent cashflow generation will help DGKC in de-leverage its balance sheet, which will ease off its debt burden.

Baltic Dry index ('000)



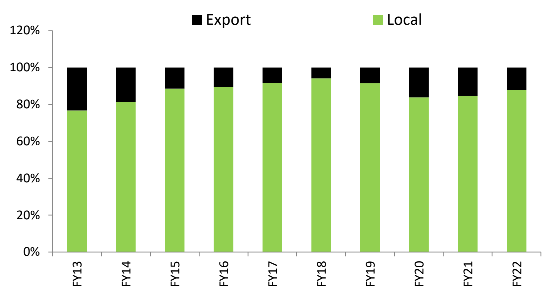
Source: Bloomberg, Insight Research

DGKC: $EV/ton & EV/EBITDA



Source: Company accounts, Zakheera, Insight Research

DGKC sales mix: Local vs. Export



Source: Company accounts, Insight Research

DGKC Portfolio	Value PKR(mn)
Hyundai Nishat Motor	2,386
NCL	157
Nishat Paper	251
NML	1,882
MCB	11,742
AICL	645
Nishat Dairy	2,169
Nishat Hotel	1,920
UBL	25
PPL	50
Total	**21,229**
DGKC (No. of shares)	**438**
Portfolio Value/Share	**48**
With Discount (25%)	**36**

Source: Company accounts, PSX, Insight Research

Important Disclaimer and Disclosures

Disclaimer: This report has been prepared by **Insight Securities (Private) Ltd**, hereinafter referred as 'ISL') and is provided for information purposes only. Under no circumstances is to be used or considered as an offer to sell or solicitation of any offer to buy. While all reasonable care has been taken to ensure that the information contained therein is not untrue or misleading at the time of publication, we make no representation as to its accuracy or completeness and it should not be relied upon as such. This report is provided solely for the information of professional advisers who are expected to make their own investment decisions without undue reliance on this report. Statements regarding future prospects may not be realized while all such information and opinions are subject to change without notice. ISL recommends investors to independently evaluate particular investments and strategies and it encourages investors to seek the advice of a financial advisor.

Investments in capital markets are subject to market risk and ISL accepts no responsibility whatsoever for any direct or indirect consequential loss arising from any use of this report or its contents. In particular, the report takes no account of the investment objectives, financial situation and particular need of individuals, who should seek further advice before making any investment or rely upon their own judgment and acumen before making any investment. The views expressed in this document are those of the ISL Research Department and do not necessarily reflect those of ISL or its directors.

ISL may, to the extent permissible by applicable law or regulation, use the above material, conclusions, research or analysis in which they are based before the material is disseminated to their clients. ISL, as a full-service firm, has/intends to have business relationships, including investment-banking relationships, with the companies in this report. Investors should be aware of that the ISL may have a conflict of interest that could affect the objectivity of the report. Investors should consider this report as only a single factor in making their investment decision. This report may not be reproduced, distributed or published by any recipient for any purpose whatsoever without prior written approval by ISL. Action may be taken for unauthorized reproduction, distribution or publication.

ISL Stock Rating System: ISL employs a 3-tier rating mechanism i.e 'BUY', 'HOLD' and 'SELL', which is based upon the level of expected annualized return for a specific stock. When total annualized return (capital gain + dividends) exceeds 22%, a 'BUY' rating is assigned. A 'SELL' rating is issued whenever total annualized return is less than negative 5% and for return in between the 2 ranges, 'HOLD' rating is meted out. An 'Under Review' stance is given if ISL research stance depends upon the outcome of an uncertain event having significant impact on the valuations. Different securities firms use a variety of rating terms/systems to describe their recommendations. Similar rating terms used by other securities companies may not be equivalent to ISL rating system.

Time horizon is usually the annual financial reporting period of the company (unless otherwise mentioned in the report). Ratings are updated daily and can therefore change daily. They can change because of a move in the stock's price, a change in the analyst's estimate of the stock's fair value, a change in the analyst's assessment of a company's business risk, or a combination of any of these factors. In addition, research reports contain information carrying the analyst's views and investors should carefully read the entire research report and not infer its contents from the rating ascribed by the analyst. In any case, ratings or research should not be used or relied upon as investment advice. An investor's decision to buy, sell or hold a stock should depend on individual circumstances (such as the investors existing holdings or investment objectives) and other considerations.

Target price risk disclosures: Any inability to compete successfully in the markets may harm the business. This could be a result of many factors which may include (but not limited to) geographic mix and introduction of improved products or service offerings by competitors. The results of operations may be materially affected by global economic conditions generally, including conditions in financial markets. The company is exposed to market risks, such as changes in interest rates, foreign exchange rates and input prices. From time to time, the company may enter into transactions, including transactions in derivative instruments, to manage/offset certain of these exposures.

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

Analyst Certification and important disclosures

Analyst Certification: The research analyst(s), if any, denoted by AC on the cover of this report, who exclusively reports to the research department head, primarily involved in the preparation, writing and publication of this report, certifies that (1) the views expressed in this report are unbiased and independent opinions of the Research Analyst(s) which accurately reflect his/her personal views about all of the subject companies/securities and (2) no part of his/her compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

The research analyst or any of its close relatives do not have a financial interest in the securities of the subject company aggregating more than 1% of the value of the company and the research analyst or its close relative have neither served as a director/officer in the past 3 years nor received any compensation from the subject company in the past 12 months. The Research analyst or its close relatives have not traded in the subject security in the past 7 days and will not trade in next 5 days.

Disclosure of Financial Interest: ISL or any of its officers and directors does not have a significant financial interest (above 1% of the value of the securities of the subject company) in the securities of the subject company. Under normal course of business, ISL, their respective directors, officers, representatives, employees and/or related persons may have a long or short position in any of the securities or other financial instruments mentioned or issues described herein at any time and may make a purchase and/or sale, or offer to make a purchase and/or sale of any such securities or other financial instruments from time to time in the open market or otherwise. ISL or its employees may trade contrary to the recommendation given by ISL Research through this report or any other. ISL may be providing, or have provided within the previous twelve months, significant advice or brokerage services to the subject company. ISL may have, within the past twelve months, served as manager or co-manager of a public offering of securities for, or currently may make a primary market in issues of, any or all, the entities mentioned in this report or received compensation for corporate advisory services, brokerage services or underwriting services from the subject company. Close relative of one of the Research Analysts in ISL is currently under employment in the middle management of HBL (a stock covered by ISL), as branch manager. Apart from this, ISL or any other of its officers and directors have neither served as a director/officer in any company under ISL research coverage in the past 3 years nor received any compensation from the subject company in the past 12 months.

ISL Research Dissemination Policy: ISL endeavors to make all reasonable efforts to disseminate research to all eligible clients in a timely manner through either physical or electronic distribution such as mail, fax and/or email. Nevertheless, not all clients may receive the material at the same time.

Insight Securities (Pvt.) Limited

Suite 509, Business and Finance Centre,

I. I. Chundrigar Road , Karachi, Pakistan

+92-21-32462541-44