Day Break

Wednesday, 24 April 2019

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COMPANY UPDATE

Cherat Cement Company Limited
Cement

Recommendation		NEUTRAL
Target Price:	31-Dec-19	101.0
Last Closing:	22-Apr-19	43.0
Upside:		135%
Valuation Methodology:		Discounted Cash Flow (DCF)
Time Horizon:		8M

Market Data

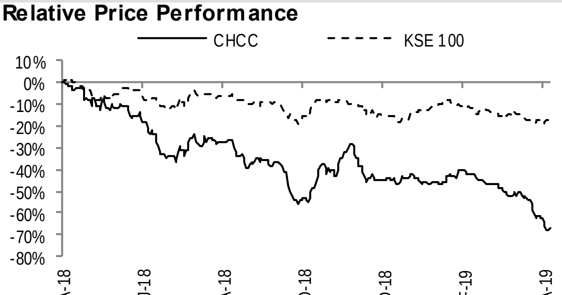
Bloomberg Tkr.			CHCC PA
Shares (mn)			176.6
Free Float Shares (mn)			97.1
Free Float Shares (%)			55.0%
Market Cap (PKRbn | USDmn)		7.6	53.6
Exchange			KSE ALL
Price Info.	90D	06M	12M
Abs. Return	(37.9)	(28.4)	(66.8)
Lo	41.6	41.6	41.6
Hi	76.7	91.2	128.0

Key Company Financials

Period End: Jun

PKRbn	**FY18A**	**FY19E**	**FY20F**	**FY21F**
Total Revenue	14.4	16.8	23.1	22.9
Net Income	2.1	2.7	2.5	2.7
EPS (PKR)	12.1	15.2	14.0	17.5
DPS (PKR)	5.0	3.3	3.0	3.3
Total Assets	19	31	34	34
Total Equity	11	13	15	17
Key Financial Ratios				
ROE (%)	19.1	20.2	16.2	15.4
P/E (x)	3.6	2.8	3.1	2.5
P/B (x)	2.2	0.7	0.6	0.5
DY (%)	11.6	7.6	7.0	7.6

Relative Price Performance



About the Company

Cherat Cement Company Limited was incorporated in Pakistan as a public limited company by shares in the year 1981. Its main business activity is manufacturing, selling and marketing of cement. Company's current rated capacity is 1.1mn ton per annum, with a current market share of ~3%.

Source: Bloomberg, PSX & IGI Research

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Cements

CHCC 3QFY19E Results Preview: Positive taxation to conceal pretax losses; EPS 3.59 (+42%YoY)

- Cherat Cement Company Limited's (CHCC) board meeting is scheduled on 25th Apr-19 to announce financial result for 3QFY19, wherein we expect the company to post earnings of PKR 634mn (EPS: PKR 3.59), up by +42%YoY
- The results are subject to a substantial one off tax gain and are rather quite depressing on a pretax level, where the Company is reporting a loss of PKR 1.56/share.
- Despite enhanced revenues, the Company is expected to register a substantial downfall of 31%YoY in gross profits due to a) impact of incremental depreciation post commencement of production line III, b) 25%YoY PKR depreciation, c) 20% YoY increase in FED; and d) 23%YoY rise in gas tariff.
- The Company is expected to witness a substantial ~7 fold rise in its finance costs, enabling it to present a loss before taxation of PKR 276mn (PKR 1.56/share).
- A positive tax charge of PKR 910mn, on account of 10% investment tax credit on investment made in plant and machinery of production line III is expected to transform loss before taxation worth PKR 276mn to profit after tax of PKR 634mn (EPS: PKR 3.59).

CHCC: 3QFY19E earnings to jump by +42%YoY to PKR 3.59/share; favorable one off tax impact to conceal pretax losses.

Cherat Cement Company Limited's (CHCC) board meeting is scheduled on 25th Apr-19 to announce financial result for 3QFY19, wherein we expect the company to post earnings of PKR 634mn (EPS: PKR 3.59), up by +42%YoY, compared to PKR 446mn (EPS: PKR 2.52) in the same period last year. However, though the performance appears quite remarkable, given the tough sector dynamics, the results are subject to a substantial one off tax gain and are rather quite depressing on a pretax level, where the Company is reporting a loss of PKR 1.56/share.

Exhibit:

CHCC Result Highlights

Period end (JUN) - PKRmn	3QFY19	3QFY18	YoY	9MFY19	9MFY18	YoY
Net Sales	3,949	3,562	11%	10,982	11,148	-1%
Gross Profit	486	708	-31%	1,753	2,569	-32%
Sell. / Dist. & Admin	211	145	46%	550	430	28%
Non-Operating Income	25	18	38%	96	55	73%
EBIT	289	556	-48%	1,245	2,088	-40%
Financial Charges	565	84	6.7x	793	267	3.0x
Pre-tax Profits	(276)	472	n/m	452	1,821	-75%
Taxation	(910)	26	n/m	(1,210)	26	n/m
Post-tax Profits	634	446	42%	1,661	1,795	-7%
EPS	3.59	2.52		9.41	10.16	
Key Ratios						
Gross Margin (%)	12.3	19.9		16.0	23.0	
Net Margin (%)	16.1	12.5		15.1	16.1	
Effective Tax Rate (%)	n/m	5.5		n/m	1.4	

Source: Company Accounts, IGI Research — *No. of Shares : 177mn*

Sluggish demand hampers utilization levels post commencement of production line III.

To recall, CHCC announced commencement of its production line III in the beginning of the quarter under review (Jan-19) taking its total annual capacity to 4.50mn tons as against 2.37mn tons previously. However, owing to sluggish local demand, courtesy suspension of development projects owing to fragile macro-economic fundamentals, the Company was only able to foster a +7%YoY dispatches growth, keeping more than 45% of its plant capacity unutilized. This coupled with improved retention prices during the period are expected to increase net sales by +11%YoY to PKR 3.95bn.

Depreciation costs and PKR devaluation to trim gross margins

Despite enhanced revenues, the Company is expected to register a substantial downfall of 31%YoY in gross profits. The decline in GP is primarily driven by deteriorated margins led by a) impact of incremental depreciation post commencement of production line III, b) 25%YoY PKR depreciation, c) 20% YoY increase in FED; and d) 23%YoY rise in gas tariff.

Finance costs to rise ~7 folds leading to Losses before taxation of PKR 1.56/share

In addition to feeble Gross Profits, the Company is expected to witness a substantial ~7 fold rise in its finance costs, enabling it to present a loss before taxation of PKR 276mn (PKR 1.56/share). The notable rise in finance cost is attributed to a) unwinding of finance costs to the income statement post capitalization of production line III, b) sharp increase in benchmark interest rates of +66%YoY (SBP Discount Rate); and c) enhanced short term borrowings to finance coal procurement under a weakened PKR scenario.

Investment tax credits on line III to boost net earnings to PKR 3.59/share

However, a positive tax charge of PKR 910mn, largely driven by 10% investment tax credit on the amount of investment made in plant and machinery of expansion plant (production line III) is expected to transform loss before taxation of PKR 276mn to profit after tax of PKR 634mn (EPS: PKR 3.59).

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Recommendation	Rating System
Buy	If target price on aforementioned security(ies) is more than 10%, from its last closing price(s)
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Sell	If target price on aforementioned security(ies) is less than -10%, from its last closing price(s)

Time Horizon: Dec – 2019

Valuation Methodology: The analyst(s) has used following valuation methodology to arrive at the target price of the said security (ies):
(Discounted Cash Flow)

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