Day Break

Wednesday, 15 August 2018

IGI Securities

Sector Update

Exhibit: IGI Cement Coverage Companies Estimated Earnings and Dividend Payout

Scrip	FY18	FY17	YoY	DPS
DGKC	21.1	18.2	16%	4.5
FCCL	2.1	1.9	11%	1.8
CHCC	12.1	11.1	9%	2.5
ACPL	28.6	26.5	8%	8.5
LUCK	37.7	42.3	-11%	8.0
MLCF	7.1	8.0	-11%	2.5
KOHC	18.6	22.9	-19%	4.0
PIOC	6.8	12.8	-47%	1.5

Exhibit: Peaked coal prices coupled with PKR devaluation have damaged the cost structure.

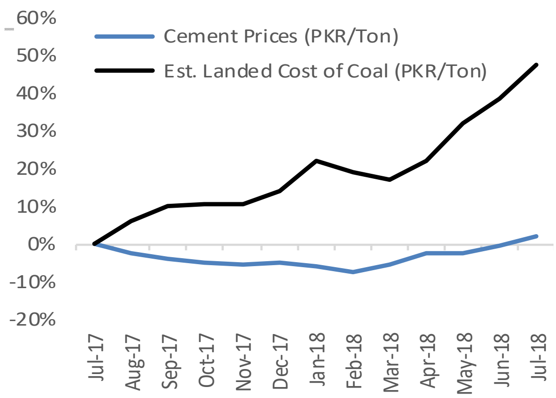
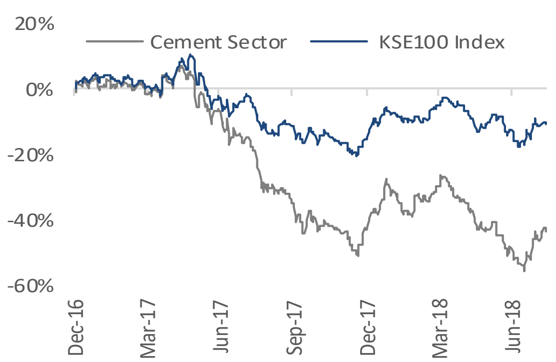


Exhibit: IGI Sector performance relative to Benchmark KSE 100 Index



Source: PSX, Bloomberg, PBS & IGI Research

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Cements

Lower retentions and elevated input costs pull FY18E earnings down by 5%YoY; DGKC and FCCL to lead earnings growth

- We preview annual financial results for IGI cement coverage companies for FY18 wherein we expect profitability to decline by 5%YoY. On a company wise basis, we expect DGKC, FCCL, CHCC and ACPL to present earnings growth of +16%/+11%/+9%/+8% respectively.
- On dispatches front, the recently completed financial year turned out to be the most promising one in the country's history with total offtakes recorded at 45.89mn tons as against 40.32mn tons reported in the preceding year, marking a yearly growth of ~+14%YoY.
- Net Sales of our coverage companies grew by +7%YoY. This was largely due to the industry's failure to pass over the impact of enhanced FED (up by +25%YoY) in the financial year under review.
- In addition to lower retention prices, the sector was substantially marred by a heightened cost structure situation, with average cost of producing cement rising by +21%YoY during the year.
- We expect a low dividend payout from the sector provided that the industry is engaged in an expansionary phase and given distribution requirements have been relaxed. We expect FCCL to provide higher dividends than prior year.
- Cement sales are expected to continue the remarkable trend of growth in the local front with CPEC activities and household sectors being the primary contributors, albeit possibilities of cuts in PSDP expenditures owing to rising pressures over fiscal curtailment do exist.

FY18 earnings preview: Lower retention prices and higher coal prices continue to overshadow higher dispatches growth

We preview annual financial results for IGI cement coverage companies for FY18 wherein we expect profitability to decline by 5%YoY. Albeit on a quarterly basis, we expect 4QFY18 profitability to increase by +32%YoY largely due to incorporation of significant tax benefits ancillary to expansion plants. Although, cement dispatches remained upbeat during the year, lower retention prices and heightened cost structure pulled earnings downwards. On an individual basis, DGKC and FCCL are expected to lead the earnings growth chart by +16%/+11% YoY respectively.

Exhibit:

IGI Cement Companies' financial highlights (PKR mn)

	FY18E	FY17A	YoY	4QFY18E	4QFY17A	YoY
Net Sales	179,852	168,684	7%	44,496	40,160	11%
Gross Profits	56,732	66,317	-14%	13,809	13,903	-1%
Taxation	7,646	16,684	54%	(393)	3,988	-110%
Net Profits	38,391	40,510	-5%	11,061	8,382	32%
Gross Margins (%)	31.5	39.3		31.0	34.6	
Effective Tax Rate (%)	13.5	25.2		(2.8)	28.7	
Net Margins (%)	21.3	24.0		24.9	20.9	

Source: IGI Research and Company Accounts

A wholesome year with respect to dispatches; offtakes up by +14%YoY

On dispatches front, the recently completed financial year turned out to be the most promising one in the country's history with total offtakes recorded at 45.89mn tons as against 40.32mn tons reported in the preceding year, marking a growth of ~+14%YoY.

Albeit low retention prices arrest net sales growth to +7%YoY…

Despite posting a commendable dispatches growth, the cement industry will fail to reflect similar growth in their top line, which is expected to only grow by +7%YoY (almost half of dispatches growth). This is largely due to the industry's failure to pass over the impact of enhanced FED (up by +25%YoY) in the financial year under review. Alternatively, average cement sales prices for the year also dropped marginally by ~1%YoY to PKR 549/bag as against PKR 553/bag in the corresponding year following heated competition by regional players in an effort to dominate dispatches growth.

Elevated coal/FO prices and PKR devaluation will keep sector margins subdued

In addition to lower retention prices, the sector was substantially marred by a heightened cost structure situation, with average cost of producing cement rising by +21%YoY during the year. This was largely driven by a +20% /+9%YoY increase in coal/FO prices globally and an average +5%YoY devaluation of PKR against the USD in addition to growing inflationary pressures.

Company wise outperformers

On an annual basis, we expect DGKC and FCCL to lead the earnings growth chart with an earnings growth figure of +16%/+11%YoY respectively. For DGKC, this is due to incorporation of one-time tax credit as per section 65B of the Income Tax Ordinance worth PKR 7.08/share in 4QFY18 taking quarter earnings up by a substantial 2.8x from its corresponding period. Whereas for FCCL, this is driven primarily by commencement of operations of production line II in Oct-17, thereby improving margins. To recall, FCCL's production line II was damaged due to an accident in May-16, resulting in management procuring expensive clinker from regional players to sustain market share at the cost of modest margins.

CHCC and ACPL bag the third and fourth position with an earnings growth of +9%/+8% YoY. For CHCC, this is due to full year effect of expansion plant operations commenced in mid of last year, thereby enhancing its volumetric sales and providing a lower effective tax rate while ACPL incorporates similar one-time tax credit (as for DGKC) worth PKR 8.07/share stemming from its expansion plant coming online in early Jan-18.

All other players are expected to display negative earnings growth.

Exhibit:

FY18 Earnings Estimate (PKR/share)

	4QFY18E	4QFY17A	YoY	FY18E	FY17A	YoY
DGKC	9.75	3.47	181%	21.09	18.20	16%
FCCL	0.57	0.46	22%	2.10	1.89	11%
CHCC	1.90	2.21	-14%	12.07	11.08	9%
ACPL	12.63	6.95	82%	28.58	26.49	8%
LUCK*	7.41	10.11	-27%	37.72	42.34	-11%
MLCF**	1.47	1.39	6%	7.14	8.04	-11%
KOHC	3.69	2.74	35%	18.55	22.94	-19%
PIOC	1.72	2.28	-25%	6.77	12.84	-47%

Source: IGI Research and Company Accounts

** Actual Result, ** Consolidated Result (Fully Diluted)*

Dividend outlook

Provided that approximately all the players (coverage companies) have entered or just completed their expansion phase (except for FCCL) and given that the profit distribution clause (5A) of the Income Tax Ordinance has been recently relaxed to 20% cash payout as against 40% previously, we expect a low dividend payout in the current year.

Exhibit:

FY18 Dividend Per Share (DPS) Estimate (PKR/share)

	DGKC	FCCL	CHCC	ACPL	LUCK*	MLCF**	KOHC	PIOC
9MFY18A	-	1.00	1.00	-	-	1.50	-	-
4QFY18E	4.50	0.75	1.50	8.50	8.00	1.00	4.00	1.50
FY18E Total	4.50	1.75	2.50	8.50	8.00	2.50	4.00	1.50
FY17A Total	7.50	0.90	4.50	13.50	17.00	3.75	14.00	5.50

Source: IGI Research and Company Accounts

** Actual Result*

Sector Outlook

Cement sales are expected to continue the remarkable trend of growth in the local front with CPEC activities and household sectors being the primary contributors, albeit possibilities of cuts in PSDP expenditures owing to rising pressures over fiscal curtailment do exist. A sort of pricing discipline is also anticipated to be maintained by the industry players in an effort to sustain margins amid rising input costs and a dynamic business environment. However, fluctuating FX, high coal prices and upward trending inflation will counter the positive impacts.

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Time Horizon: Dec – 2018

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