Day Break

Monday, 06 November 2017

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Sector Update

Exhibit: 1Q dispatches crossed nearly 10mn

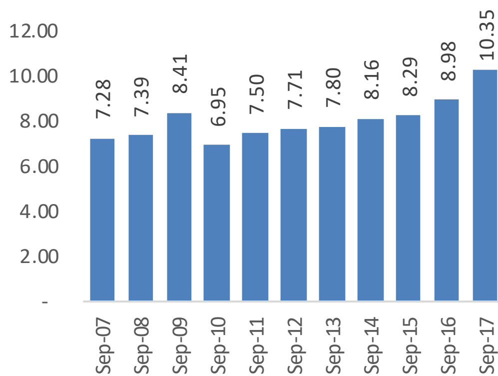


Exhibit: Rising coal prices depressed overall sector gross margins

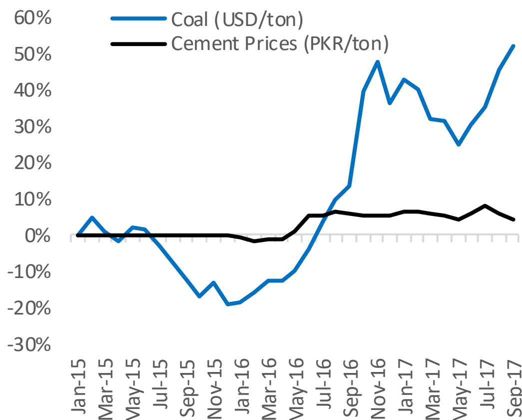
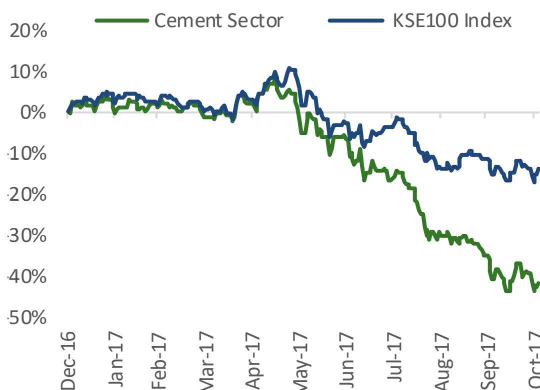


Exhibit: Relative Performance to KSE 100



Source: Bloomberg, PSX & IGI Research

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Cements

Lower retention prices overshadow higher dispatches growth in 1QFY18

- Cement sector achieved record breaking first quarter dispatches of 10.3mn tons, however, this remarkable performance was significantly marred by lower retention prices.
- As a result, margins were considerably subdued, with gross margins of IGI universe alone dropped to 33% as opposed to 43% in the similar period of the preceding year
- However, efficient tax planning helped curb the extent of erosion in net margins, restricting them to 23% as compared to 26% in 1QFY17.
- Going forward, the overall demand outlook appears quite encouraging, having said that possibility of further cuts in cement sales prices following rising competition is still on the cards, thereby posing further threats to margins

Lower retention prices overshadow higher dispatches growth

The cement industry in general portrayed mixed to negative sentiments during 1QFY18. Although record breaking first quarter dispatches of 10.3mn tons were achieved, manifesting a robust growth of +15%YoY as against 9.0mn tons in the same period last year, this remarkable performance was significantly marred by lower retention prices, courtesy a) imposition of higher FED through Finance Act 2017-18; b) trimmed cement sales prices in the northern region and; c) elevated coal prices globally.

Exhibit:
Financial highlights of coverage cement companies

	1QFY18	1QFY17	YoY	4QFY17	QoQ
Net Sales	42,655	37,942	12%	40,160	6%
Gross Profits	14,063	16,389	-14%	13,942	1%
Taxation	217	520	-58%	499	-56%
Net Profits	9,880	9,766	1%	8,276	19%
Gross Margins (%)	33.0	43.2		34.7	
Effective Tax Rate (%)	14.9	29.9		32.5	
Net Margins (%)	23.2	25.7		20.6	

Source: Company Accounts, IGI Research

Efficient tax planning lends support to the sector

As a result, margins were considerably subdued, with gross margins of IGI universe alone dropped to 33% as opposed to 43% in the similar period of the preceding year. However, efficient tax planning by major players carrying out BMR & expansion activities (IGI universe effective tax rate 1QFY18: 15%, 1QFY17: 30%) helped curb the extent of erosion in net margins, restricting them to 23% as compared to 26% in 1QFY17.

Demand to remain encouraging; pricing pressure to keep margins in check

Going forward, the overall demand outlook appears quite encouraging where we expect local demand in second half of FY18 to add further impetus, ascribed

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to a) increase in ground breaking of pipelined infrastructure projects in the wake of an election year; and b) higher demand post winter season. However, possibility of further cuts in cement sales prices following rising competition is still on the cards, thereby posing further threats to margins.

KOHC: Earnings dropped by 9%YoY in 1QFY18 to PKR 5.85/share

Despite registering 14% growth in dispatches, lower retention prices restricted Kohat Cement Company Limited (KOHC) to post profitability of PKR 903mn (EPS: PKR 5.85) as against PKR 992mn (EPS: PKR 6.42) in the same period last year, down by 9%YoY. However, a significant 113%QoQ upside in earnings was witnessed on a sequential basis, largely accredited to normalized effective tax rate of 28% in contrast to 55% (super tax included) in 4QFY17.

CHCC: Higher dispatches due to enhanced capacity drove 1QFY18 earnings up by +50%YoY to PKR 3.43/share

Cherat Cement Company Limited (CHCC) posted 1QFY18 earnings of PKR 606mn (EPS: PKR 3.43), up by +50%YoY (up +55%QoQ) as compared to PKR 404mn (EPS PKR 2.29) in the similar period last year. Taking full advantage of its recently commissioned production line II, CHCC registered a massive +156%YoY increase in volumetric sales. This not only enabled the Company to effortlessly outweigh the negative impact of industry wide lower retentions but in the process also made it the only company in our coverage to surpass its own gross profits of 1QFY17. Further, income tax exemption on profits reaped from line II has also lent additional support to earnings with effective tax rate of 1QFY18 reduced to 18% as against 27% in 1QFY17. However, all these measures could not sustain the net margins which dropped to 16% in contrast to 23% in the same period last year.

MLCF: Earnings down by 14%YoY in 1QFY18 to PKR 1.99/share

Maple Leaf Cement Factory Limited (MLCF) recorded 1QFY18 earnings of PKR 1.05bn (EPS: PKR 1.99) as opposed to PKR 1.22bn (EPS: PKR 2.32) in the corresponding period last year, marking a 14%YoY down turn. Whilst the Company managed to increase its volumetric sales by +4%YoY, major cause of earnings attrition stimulated from lower retention prices affecting the entire industry.

ACPL: 1QFY18 earnings reduced by 12% to PKR 5.28/share due to curtailed margins despite lower effective tax rate.

Despite registering 7% growth in dispatches and reducing effective tax rate to 23% in the quarter under review, lower retention prices withheld Attock Cement Pakistan Limited (ACPL) to post bottom line of PKR 605mn (EPS: PKR 5.28) as against PKR 691mn (EPS: PKR 6.03) in the same period last year, down by 12%YoY.

DGKC: Tax reversal lifts up 1QFY18 earnings to PKR 6.48/share, up by +49%YoY

The 1QFY18 financial results of D.G Khan Cement Company Limited (DGKC) recorded unconsolidated earnings of PKR 2.84bn (EPS: PKR 6.48), up by +49%YoY (+87%QoQ) as compared to PKR 1.91bn (EPS PKR 4.35) in the similar period of preceding year. Although lower retentions outmatched the value impact of 16% rise in dispatches, resulting in curtailed gross margins of 35% as against 44% in 1QFY17, the impact was equivalently outweighed by a 15% tax reversal

stemming from Greenfield expansion in HUB plant, thus lifting net margins to 38% as compared to 29% in the same period last year.

LUCK: 1QFY18 earnings fall by 7% to PKR 9.33/share due to declining margins despite lower effective tax rate

Lucky Cement Limited (LUCK) registered 1QFY18 unconsolidated earnings of PKR 3.02bn (EPS: PKR 9.33), down by 7%YoY as opposed to PKR 3.24bn (EPS PKR 10.01) in the corresponding period last year. Lower retentions severely injured gross margins, taking them to 37% as against 51% in 1QFY17. However this impact was arrested to supplement injury on net margins by controlled operating expenses and improved non-operating income, thereby taming net margins to 27% as against 31% in the same period last year.

FCCL: 1QFY18 earnings slashed by 27%YoY to PKR 0.32/share

Fauji Cement Company Limited (FCCL) posted earnings of PKR 444mn (EPS: PKR 0.32) as against PKR 609mn (EPS: PKR 0.44) in the same period last year, marking a 27%YoY dip. Already operating on slim net margins after the ill-fated accident which damaged its production line II, industry wide lower retentions further compressed net margins to unprecedented levels of 9% during 1QFY18, making it the only company in our coverage to have single digit net margins. However, it is pertinent to mention that post close 1QFY18; FCCL announced the successful restoration of its production line II, thus marking an end to its distress.

PIOC: Lower retentions and negative non-operating income team up to reduce 1QFY18 earnings by 41%YoY

The 1QFY18 earnings of Pioneer Cement Limited (PIOC) were slashed by a hefty 41%YoY margin to PKR 417mn (EPS: PKR 1.84) as against PKR 702mn (EPS: PKR 3.09) in 1QFY17. The fall in earnings mainly attributed to lower retentions which coupled with reduced dispatches (lower clinker sales to FCCL) curtailed gross margins to 34% as opposed to 43% in the same period last year. This impact was further magnified by negative non-operating income of PKR 105mn stimulating from mark-to-market losses incurred on short term investments held by the Company. Accordingly, net margins decreased to 17% as against 28% in 1QFY17.

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Time Horizon: Dec - 2017

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