

PAKISTAN CEMENT

Jan'19: Cement dispatches decline by 11%YoY

- Local dispatches for Jan'19 clocked in at 3.1mn tons, down 18.0%YoY, as economic slowdown looms large over the sector while seasonality took a toll as well, dragging down the local dispatches by 6.4%MoM.
- Exports have turned out to be the shining star of FY19 so far, averting the risk of price war for the Southern region while also taking the capacity utilization for South to a phenomenal 92%.
- The dismal run of local demand is expected to continue in the medium term (down 4% YoY in 7MFY19) as the slowdown intensifies, while sustained clinker demand in Sri Lanka and Bangladesh will keep the exports uplifted. (up 50.4%YoY in 7MFY19)
- We maintain our Underweight stance on the sector, trading at EV/EBITDA of 7.3x, as pressure on prices builds up in the backdrop of weak demand and rate FCCL (TP: 19.7, 11% downside) as our top sell.

Local dispatches decline by 4%YoY for 7MFY19: Local cement dispatches continued their disappointing run into CY19, falling by 18%YoY to 3.1mn tons in Jan'19. North led the decline, with a decrease in total dispatches of 22%YoY while South's local dispatches declined by 1.1%YoY. The overall economic slowdown has taken a toll on dispatches while the MoM decline of 6.4% is on the back of seasonality where heavy rain/snowfall and cold weather led to a slowdown in construction. Cumulatively, local dispatches for 7MFY19 stand at 22.6mn tons, down 4.0%YoY. Moving forward, we expect the local demand to remain dismal with no major demand catalyst on the horizon in medium term as Government persists with its policy of fiscal consolidation resulting in slowdown in infrastructure spending where ~43% of PSDP has been released so far whereas only 28% of the budgeted amount has been released under the head of 'Planning, Development & Reform Division.'

Exports to the rescue for South: Exports on the other hand have been the saving grace for the sector, increasing by 67.5%YoY in Jan'19, as south based players capitalize on the lack of clinker capacity in Bangladesh and Sri Lanka, though hurting their margins along the way with the clinker export price ranging between USD35-40/ton vs. cement export price of USD50-55/ton. Consequently, the region's utilization stands at 89% for 7MFY19, however, for Jan'19 alone, utilization was registered at a stellar ~92%. Moving forward, with no significant clinker capacity additions lined up in Bangladesh or Sri Lanka, exports will continue to avert the threat of price war in South despite significant excess capacity in the region.

Excess capacity has started to hurt: The double whammy of excess capacity and soft demand make the market dynamics ripe for a price cut where the initial signs have been unveiled in Peshawar with prices decreasing by Pkr10/bag in Jan'19, as per our channel checks. However, the prices in Punjab seem to be standing firm though the supply in the market has started to increase after commissioning of CHCC's expansion which will create pressure on prices, in our view. Commissioning of MLCF's expansion of 2.2mn tons, slated for Apr'19, can be a trigger in this regard with the company located in Mianwali (closer to the Punjab market). We reiterate our view of a decline in average prices of the region by Pkr30-40/bag in 2HFY19 and consequently highlight a threat to margins of local players. To highlight, PIOC is most sensitive to a Pkr5/bag change in average prices while LUCK lies on the other end of the spectrum. Having said that, declining coal prices may provide some respite (currently trading around USD86-87/ton, down 10.4% since Dec 31'19) where on unconsolidated basis, PIOC again is the most sensitive with a 7.30% average impact on EBITDA for FY19-20.

Investment perspective: We maintain our underweight stance on the sector with FCCL (TP: Pkr19.7/sh, 11% downside) as our top sell and advise caution with pressure on prices building up in North. Valuations look stretched with sector trading at EV/EBITDA of 7.3x against last four years average of 7.0x while fundamentals still don't paint a bright outlook and will keep the sector performance in check.

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Cement dispatches (mn tons)

	7MFY19	YoY	Jan'19	YoY	MoM
North					
Local	17.8	-8.4%	2.4	-22.0%	-9.4%
Exports	1.7	-16.8%	0.2	-7.8%	-4.7%
South					
Local	4.8	16.9%	0.7	-1.1%	5.4%
Exports	2.4	2.4x	0.4	2.24x	0.2%
Overall					
Local	22.6	-4.0%	3.1	-18.0%	-6.4%
Exports	4.1	50.4%	0.6	67.5%	-1.7%
Total	26.8	1.7%	3.6	-10.7%	-5.7%

Source: APCMA & AKD Research

Avg. impact on FY19-20 EBITDA for USD5/Pkr5 change in coal/cement prices

	Δ in coal prices	Δ in cement prices
CHCC	7.0%	4.6%
DGKC*	6.8%	4.0%
FCCL	6.7%	4.5%
LUCK*	5.0%	3.1%
MLCF*	5.8%	3.5%
PIOC	7.3%	4.8%

*Unconsolidated

Source: AKD Research



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Neutral	> 13% to < 19% expected total return	Accumulate	> 5% to < 20% upside potential
Sell	< 13% expected total return (Rf: 13%)	Neutral	< 5% to > -5% potential
		Reduce	< -5% to > -20% downside potential
		Sell	< -20% downside potential
		Not Rated	No investment opinion or recommendation

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