PAKISTAN
CEMENT

February 27, 2019

REP-019
MARKET
VISTA

# LUCK: Wrapped up in cotton wool

- **Post release of detailed accounts for 2QFY19, we update our estimates for LUCK, i) tweaking our FY19 estimate of export sales, ii) incorporating finance cost due to emergence of short term borrowing, and iii) decreasing our tax rate for FY19 to 18.3% from previously assumed 21%.**
- **LUCK posted an EPS of PkR9.3 for 2QFY19, taking the EPS for 1HFY19 to PkR16.1, down 16%YoY. Gross margins of the company remained flat at 30% for 2QFY19 vs. 1QFY19 as clinker's share in sales mix increased.**
- **LUCK's expansion of 2.6mn tons, costing ~PkR19bn, will take its market share in North to 12% vs. current 10% however the pressure on local prices will keep average ROE for FY19-22 at 11%.**
- **Highest EBITDA margins (30% vs. 25% of our universe Ex. LUCK), exposure to both the regions (North and South) and diversified portfolio investments form the basis of our liking where our TP of PkR603/sh provides an upside of 29.2%.**

**Slight change in estimates:** We update our estimates for LUCK post release of detailed accounts for 1HFY19, tweaking our estimates for sales volumes (increased by ~1.5% for FY19 due to higher exports), ii) incorporating finance cost after the emergence of short term borrowing, and iii) toning down our effective tax rate for FY19 to 18% vs. 21% previously. Consequently our EPS estimate for FY19 has been revised by 2.3% to PkR31.1 from PkR30.4. The increase in dispatches comes on the back of more than expected clinker exports to Sri Lanka and Bangladesh as clinker demand in the countries remains strong due to low clinker capacity. On the flip side, higher weightage of clinker drags the gross margins; clinker export prices of USD35-40/tons vs. cement export price of USD45-55/ton. Having said that, a higher share of exports results in a lower effective tax rate with turnover tax of 1% on cement exports vs. 29% corporate tax rate on local sales. Interestingly, after 4 years, LUCK saw finance cost reemerge on its income statement as the company drew down short term borrowing of PkR1bn in 2QFY19 to fulfill the working capital requirement.

**Capacity expansion not translating into earnings growth for medium term:** In the wake of significant capacity expansion by competitors in the region, LUCK is in process of expanding the capacity in North by 2.6mn tons, expected to come online by Dec'19. CAPEX in this regard has started to appear on balance sheet as company incurred a CAPEX of PkR3.8bn during the quarter against the total cost of ~PkR19bn. The expansion will take LUCK's share to 12% in North vs. current 10% and will also provide LUCK the opportunity to capitalize on any demand emanating from construction of big-ticket projects like Diamer Bhasha Dam in medium term, while prospects of exports to Afghanistan post withdrawal of US troops also brighten up. However, the same will not translate into profitability improvement as average ROE for FY19-22 remains at 11% vs. 18% for FY15-18 on the back of pressure on prices due to capacity expansions by local players (we have incorporated a decline in prices in North of PkR20/5/bag for FY20/21).

**Strong balance sheet and portfolio investments further increase our liking:** Despite the emergence of debt (short term borrowing of PkR1bn as at Dec'19) on the balance sheet of LUCK after 4 years, a cash balance of PkR22bn (as at 2QFY19) against expected investments of ~PkR23bn provides us comfort. Also, average CFO generation of PkR14bn during next three years leads to expected investment to CFO ratio of 1.6x, further averting the risk of LUCK opting for long term debt to finance the upcoming CAPEX—shielding it against the increasing interest rates where D/E of AKD Universe (Ex. LUCK) stands at 60%. On the other hand, LUCK's diversified investments further increase our liking where Lucky Kia Motors, expected to commence operations from 1QFY20, ventures into automobile space while dollar based returns on Lucky Electric Power Ltd. (LEPL) and a ROE of 29.5% will add PkR22-24/sh to consolidated earnings from FY22—adding PkR85/sh to the portfolio value. Company's joint venture in Congo incurred a loss of PkR584mn (LUCK's share: PkR292mn - PkR0.9/sh) political instability and seasonal factors took a toll on bottomline while profitability in Iraq increased by 77%QoQ on the back lower cost of clinker. Moving forward, profitability in Iraq is expected to continue on upward trajectory, however, seasonality and political turmoil will continue dragging the profitability in Congo for 3QFY19.

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**BUY**

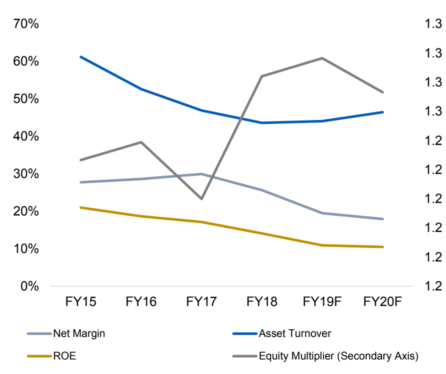
| TARGET PRICE (PkR) | SHARE PRICE (PkR) |
|---|---|
| 603.4 | 467.2 |
| UPSIDE/DOWNSIDE | DIV. YIELD |
| 29.2% | 2.0% |

*Company Financials*

| LUCK - Unconsolidated | FY18 | FY19F | FY20F |
|---|---|---|---|
| EPS (PkR) | 37.7 | 31.1 | 32.3 |
| EPS Growth | -10.9% | -17.5% | 3.7% |
| PER (x) | 12.4 | 15.0 | 14.5 |
| ROE (%) | 14.1% | 10.9% | 10.5% |
| P/BVS(x) | 1.7 | 1.6 | 1.5 |
| Dividend yield | 2.8% | 2.0% | 2.1% |
| Gross Margin | 35.7% | 28.6% | 26.7% |
| EBITDA Margins | 38.1% | 30.1% | 27.9% |

Source: Company Report & AKD Research

*DuPont Analysis*




Source: Company Report & AKD Research

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| ***New Rating Definitions*** | |
|---|---|
| Buy | > 19% expected total return (Rf: 13% + Rp: 6%) |
| Neutral | > 13% to < 19% expected total return |
| Sell | < 13% expected total return (Rf: 13%) |

| ***Old Rating Definitions (Discontinued)*** | |
|---|---|
| Buy | > 20% upside potential |
| Accumulate | > 5% to < 20% upside potential |
| Neutral | < 5% to > -5% potential |
| Reduce | < -5% to > -20% downside potential |
| Sell | < -20% downside potential |
| Not Rated | No investment opinion or recommendation |

### Valuation Methodology

To arrive at our period end target prices, AKDS uses different valuation techniques including:

- Discounted Cash Flow (DCF, DDM)
- Relative Valuation (P/E, P/B, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)

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