

## PAKISTAN CEMENTS

### Dark clouds emerging

- Commissioning of expansion by CHCC spells an oversupply situation for the local market with a bleak demand outlook in backdrop, pointing towards significant pressure on prices (we expect prices to drop by PkR30-40/bag in 2HFY19).
- Though our base case assumes a conservative FY19 average price of PkR585/bag (vs. 7MFY19 average of PkR595/bag) for North, should pricing stand its ground even after commencement of CHCC's expansion, this would result in upward revision in our estimates with CHCC itself being the biggest beneficiary.
- We maintain our underweight stance on the sector with FCCL as our top sell and advise caution to investors as historically, stock prices have been very expressive towards variation (particularly downwards) in local cement prices.

**Price decline on the horizon?** The alarm bells of decline in prices have been set off as 2.2mn tons of CHCC's capacity has been commissioned on Jan 25'19. This capacity forms 5% of the region's capacity and marks the start of the year in which 9.4mn tons of capacity is expected to be commissioned in the region. Historically, divergent trends were witnessed where commissioning of CHCC's line-2 in Jan'17 led to a decline of PkR27/bag in region's prices as local manufacturers tried to push their product. Au contraire, exports released the pressure off prices in South after local manufacturers banked on clinker demand in Sri Lanka and Bangladesh to utilize 5.4mn tons of capacity commissioned in CY18. However, with north posting 6%YoY decline in local demand for the region and Pakistani cement losing its market share in Afghanistan (exports to Afghanistan down by 23%YoY in 6MFY19), we opine of scenario where prices are expected to decline PkR30-40/bag in 2HFY19 as lack of demand will compel local manufacturers to push towards price cuts in order to increase utilization especially in the wake of expected significant capacity additions of 9.4mn tons (incorporated in our base case). To highlight, a PkR5/bag change in cement prices impacts the bottomline of LUCK/DGKC/MLCF/CHCC/PIOC/FCCL by PkR1.0/0.6/0.3/1.01/0.3/0.1/sh.

**Robust prices will pose upside risk:** After witnessing a significant increase in costs courtesy rise in coal prices (increasing by 12% between Mar-Oct'18), revision in gas prices (revised upwards by 30% for captive power generation) and oil prices (WTI) increasing by 22%YoY in Oct'18, local manufacturers increased prices by PkR49/23/bag in North/South. Prices have since sustained their ground and average around PkR595/614bag in North/South for 7MFY19. Though our base case assumes a conservative FY19 average price of PkR585/bag for North, prices standing their ground even after commencement of CHCC's expansion will result in upward revision in our estimate where CHCC will be the biggest beneficiary due to the company being most sensitive to a price change. While for South, we reiterate our expectation of not foreseeing any significant pressure from commissioning of 2.4mn tons of capacity, however a decline in prices in North will have spillover effects to the region. As such, our base case incorporates average prices of PkR615/bag against current prices of PkR627/bag.

**Soft local demand increases the likelihood of price decline:** Moving forward, demand for local cement is expected to remain lackluster given the ongoing fiscal consolidation and economic uncertainty weighing over private sector demand. Our market intelligence suggests that sales numbers for Jan'18 are going to be disappointing as heavy rain and snowfall coupled with very low temperatures in North take toll on demand. In our view, this raises the likelihood of pressure on prices as declining demand will make absorption of depreciation and finance cost of new lines harder.

**Investment Perspective:** With a prospect of price decline lingering on the horizon, we advise caution to investors as historically stock prices have been very expressive towards change in local cement prices. We retain an underweight stance on the sector with FCCL as our top sell.

Shahrukh Saleem  
shahrukh.saleem@akdsecurities.net  
111-253-111 Ext:685

#### Exports

000 tons	6MFY19	6MFY18	YoY
Afghanistan	928	1204	-23%
India	531	565	-6%
Other (Sea)	1881	638	195%
<b>Total</b>	<b>3340</b>	<b>2407</b>	<b>39%</b>

Source: APCMA & AKD Research

#### Local Cement Prices (PkR/bag)



Source: PBS & AKD Research



AKD Securities Limited

## Disclosure Section

Neither the information nor any opinion expressed herein constitutes an offer or a solicitation of an offer to transact in any securities or other financial instrument and is for the personal information of the recipient containing general information only. AKD Securities Limited (hereinafter referred as AKDS) is not soliciting any action based upon it. This report is not intended to provide personal investment advice nor does it provide individually tailored investment advice. This report does not take into account the specific investment objectives, financial situation/financial circumstances and the particular needs of any specific person. Investors should seek financial advice regarding the appropriateness of investing in financial instruments and implementing investment strategies discussed or recommended in this report and should understand that statements regarding future prospects may not be realized. AKDS recommends that investors independently evaluate particular investments and strategies and it encourages investors to seek the advice of a financial advisor.

The appropriateness of a particular investment or strategy will depend on an investor's individual circumstances and objectives. The securities or strategies discussed in this report may not be suitable for all investors, and certain investors may not be eligible to purchase or participate in some or all of them.

Reports prepared by AKDS research personnel are based on public information. AKDS makes every effort to use reliable, comprehensive information, but we make no representation that it is accurate or complete. Facts and views presented in this report have not been reviewed by and may not reflect information known to professionals in other business areas of AKDS including investment banking personnel. AKDS has established information barriers between certain business groups maintaining complete independence of this research report.

This report has been prepared independently of any issuer of securities mentioned herein and not in connection with any proposed offering of securities or as agent of any issuer of any securities. Neither AKDS, nor any of its affiliates or their research analysts have any authority whatsoever to make any representation or warranty on behalf of the issuer(s). AKDS Research Policy prohibits research personnel from disclosing a recommendation, investment rating, or investment thesis for review by an issuer prior to the publication of a research report containing such rating, recommendation or investment thesis.

We have taken all reasonable care to ensure that the information contained herein is accurate, up to date, and complies with all prevailing Pakistani legislations. However, no liability can be accepted for any errors or omissions, or for any loss resulting from the use of the information provided as any data and research material provided ahead of an investment decision are for information purposes only. We shall not be liable for any errors in the provision of this information, or for any actions taken in reliance thereon. We reserve the right to amend, alter, or withdraw any of the information contained in these pages at any time and without notice. No liability is accepted for such changes.

## Stock Ratings

Investors should carefully read the definitions of all ratings used in each research report. In addition, research reports contain information carrying the analyst's view and investors should carefully read the entire research report and not infer its contents from the rating ascribed by the analyst. In any case, ratings or research should not be used or relied upon as investment advice. An investor's decision to buy, sell or hold a stock should depend on individual circumstances and other considerations. AKDS uses a three tier rating system: i) Buy, ii) Neutral and iii) Sell (new rating system effective Sep 10'18) with total returns (capital upside + dividend yield) benchmarked against the expected one year forward floating (variable) risk free rate (10yr PIB) plus risk premium.

### 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.)

## Analyst Certification of Independence

The analysts hereby certify that their views about the companies and their securities discussed in this report are accurately expressed and that they have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

The research analysts, strategists or research associates principally having received compensation responsible for the preparation of this AKDS research report based upon various factors including quality of research, investor client feedback, stock picking, competitive factors and firm revenues.

## Disclosure of Interest Area

AKDS and the authoring analyst do not have any interest in any companies recommended in this research report irrespective of the fact that AKD Securities Limited may have, within the last three years, served as manager or co-manager of a public offering of securities for, or currently may make a primary market in issues of, any or all of the entities mentioned in this report or may be providing, or have provided within the previous 12 months, significant advice or investment services in relation to the investment concerned or a related investment.

## Regional Disclosures (Outside Pakistan)

The information provided in this report and the report itself is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation or which would subject AKDS or its affiliates to any registration or licensing requirements within such jurisdiction or country.

Furthermore, all copyrights, patents, intellectual and other property in the information contained in this report are held by AKDS. No rights of any kind are licensed or assigned or shall otherwise pass to persons accessing this information. You may print copies of the report or information contained within herein for your own private non-commercial use only, provided that you do not change any copyright, trade mark or other proprietary notices. All other copying, reproducing, transmitting, distributing or displaying of material in this report (by any means and in whole or in part) is prohibited.

For the United States

## Compliance Notice.

This research report prepared by AKD Securities Limited is distributed in the United States to Major US Institutional Investors (as defined in Rule 15a-6 under the Securities Exchange Act of 1934, as amended) only by Decker & Co, LLC, a broker-dealer registered in the US (registered under Section 15 of Securities Exchange Act of 1934, as amended). All responsibility for the distribution of this report by Decker & Co, LLC in the US shall be borne by Decker & Co, LLC. All resulting transactions by a US person or entity should be effected through a registered broker-dealer in the US. This report is not directed at you if AKD Securities Limited or Decker & Co, LLC is prohibited or restricted by any legislation or regulation in any jurisdiction from making it available to you. You should satisfy yourself before reading it that Decker & Co, LLC and AKD Securities Limited are permitted to provide research material concerning investment to you under relevant applicable legislations and regulations.