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Pakistan Cement Conference – Key takeaways

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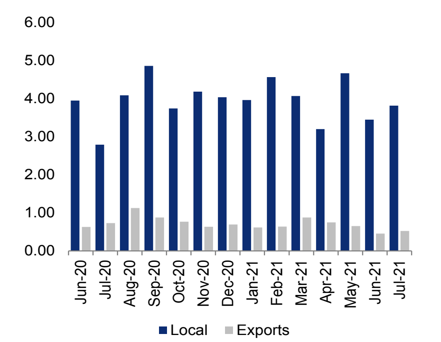
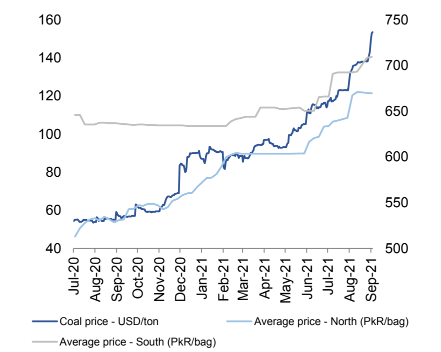
- **AKD Securities Ltd. organized Pakistan Cement Conference where some of leading local cement manufacturers, namely LUCK, DGKC, ACPL and GWLC participated and shed light on industry's and their company's outlook over short to medium term.**
- **On the demand side, optimism was noted across the board with different companies placing their estimate for FY22 demand growth at 8-10%YoY as private sector is expected to continue providing the support in the aftermath of the recently concluded amnesty scheme.**
- **On the exports side, dispatches to Afghanistan are expected to remain uncertain in the short term as things settle down in the country while in medium term, rebuilding post war can result in increased exports. On the other hand, sea based clinker exports will become infeasible with the increasing coal costs.**
- **Current coal inventory with the industry is at average cost USD100-110/ton however the recent shipments have been arriving at much higher rates of USD140-150/ton and if the cement prices are not increased further, margins are expected to take hit from 2QFY22 onwards.**
- **Even though sector is expected to remain under pressure in near term on the back of increasing coal prices, we maintain our positive stance on the sector with the current lull as an opportunity to build positions at attractive prices. LUCK (TP: PkR1289/sh) and MLCF (TP: PkR80/sh) remain our top pick from the sector.**

Cement Dispatches (mn tons)



Source: APCMA and AKD Research

Coal prices vs local cement prices



Source: Bloomberg, PBS and AKD Research

Local demand to remain strong: AKD Securities Ltd. organized Pakistan Cement Conference where some of leading local cement manufacturers, namely LUCK, DGKC, ACPL and GWLC participated and shed light on industry's and their company's outlook over short to medium term. On the demands side, optimism was noted across the board with different companies placing their estimate for FY22 demand growth at 8-10%YoY as private sector is expected to continue providing the support in the aftermath of the recently concluded amnesty scheme. The 20%YoY increase in local demand for FY21 was a mix of pent-up demand and initiation of work on private sector projects while moving forward, more private sector projects are expected to be initiated in shape of housing schemes and high rises while commencement of construction of dams can further propel the demand. On the exports side, dispatches to Afghanistan are expected to remain uncertain in the short term as things settle down in the country while in medium term, rebuilding post war can result in increased exports. However, competition from Iran based players will be tough to beat in the region. On the other hand, sea based clinker exports will become infeasible with the increasing coal costs while the margins on cement exports is expected to reduce due to the same reason. It remains unclear currently whether international prices will increase in the aftermath of increase in coal prices.

Coal prices to remain elevated in near term: Current coal inventory with the industry is at average cost USD100-110/ton however the recent shipments have been arriving at much higher rates of USD140-150/ton. With coal prices increasing by 77% since Dec'20, even though some portion of the increase in cost has been passed on, as per our estimates, PkR60-70/bag still remains to be passed on. Government has increased efforts to control increase in price of commodities and the same can restrict the ability of local players to pass-on additional cost which can result in decline in margins from 2QFY22. On the future of coal prices, industry does not expect them to retreat before CY21-end at least. Usage of thar coal as an alternative has number of limitations including high freight costs and high sulfur content hence a purifier will have to be installed before using it. However, no work has been done in this regard and it will only become a possibility if the coal prices remain at current level in longer run. Not only fuel but power cost has been on an uptrend as well with prices of furnace oil increasing (LUCK's Pezu plant current utilizes furnace oil for captive power generation) while prices of afghan/local coal are also

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linked with international prices.

LUCK: LUCK apprised on its ongoing projects where in the automobile segment, new models of KIA and Peugeot are expected to be launched next month where news reports have already indicated launch of Kia Stonic and Peugeot 2008. Regarding the latest expansion, it is expected to come online in Dec'22 and the total CAPEX will be around PkR23bn, of which ~50% will be financed through debt in the shape of TERF and LTFF. Company's coal inventory currently has an average cost of ~USD100/ton while cash flows can decrease if prices are not increased, moving forward.

DGKC: Company is working on its next expansion where delays were previously due to land marking issues while adverse law and order situation also played a part. The project will cost USD250mn and will be financed using a mix of debt and equity. Management remains optimistic on local cement demand while company is also pursuing cement export contacts which if materialized will significantly increase cement exports. DGKC's stake in Hyundai Nishat has also been revalued post strong FY21 to PkR38/sh.

ACPL: Company is also going for an expansion of 1.3mn tons which is expected to come online in Jan'24. ACPL availed concessionary financing for the CAPEX in the shape of PkR4.7bn under TERF and PkR5bn under LTFF. Work on solar power project is nearing completion and it is expected to come online by Oct'21. Management remains optimistic regarding local demand while the coal inventory of the company has an average cost of USD100-105/ton.

GWLC: Company did not expand during the last expansion cycle however currently it is contemplating an expansion and in case board gives a green light, it will take two years for the project to come online. The CAPEX of the project will be 20-25% lower than other projects of similar size as company already has some parts installed. Coal inventory with company is at average cost of USD100-110/ton while company expects cement demand to remain strong on the back of upcoming housing and infrastructure projects.

Investment perspective: We expect cement sector to remain under pressure in near term given the aforementioned reasons with margins expected to take a hit in 2QFY21 if prices do not increase. However once coal prices retreat, the sector will be back into limelight, in our opinion. Over a medium term horizon, we maintain our positive stance on the sector with the current lull as an opportunity to build up positions at attractive prices. Among local manufacturers, we continue our liking for LUCK (TP: PkR1289/sh) with company being one of the lowest cost producers while additional flavor is added to the mix by a diversified portfolio which includes exposure to booming automobile sector in the name of Lucky Motors Corporation while Lucky Electric Power Plant is also expected to commission in 1QFY22. Among pure cement plays, we like MLCF with company's third line being run on pet coke making it least sensitive to coal prices.

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