July 08, 2009

CEMENT
PAKISTAN

PAKISTAN CEMENT SECTOR REVIEW

Industry Update

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Investment Consideration

LUCK and DGKC outperform industry capacity utilization

During FY10 LUCK and DGKC are expected to achieve capacity utilization levels of 70% and 90% respectively versus the industry capacity utilization level of 68%. Being larger manufacturers LUCK and DGKC have been able to leverage local and international ties resulting in above industry capacity utilization levels. In FY09 capacity utilization for LUCK and DGKC stood at 86% and 90% respectively versus the industry level of 70%. Local demand is expected to remain sluggish in FY10 registering a growth of 2% YoY with export contribution remaining key to capacity utilization. Exports are expected to remain flat in FY10 contributing to the tune of 35% to total industry sales volume.

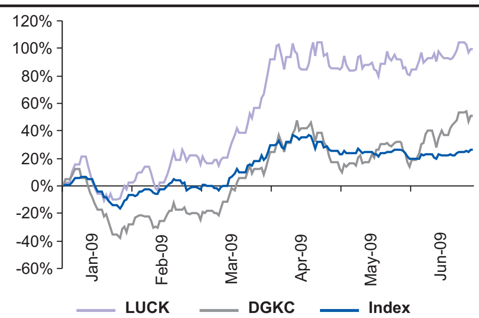
Declining input costs to compensate for low capacity utilization

With coal prices having remained low in 3Q and 4Q FY09 averaging USD 68.6 MT and USD 60 MT respectively, we expect margins to continue their improving trend over the next two quarters before stabilizing. While we maintain our coal price assumption of USD 60 (FOB) for FY10, the upward trend in energy prices may lead to us reviewing our coal price assumption. The volatility in input price is likely to delay the expected 15% YoY voluntary decline in cement prices. This in turn will result in gross margin expansion during FY10 versus our expectation of margin being maintained at current levels.

Sector outlook remains positive

LUCK and DGKC have outperformed the benchmark KSE 100 index by 2% and 12% respectively over the last month. Going forward we believe news flows on stable cement prices, resistant export volumes and healthy manufacturer margins will create further opportunities for stock re-rating. While we have made minor tweaks to our EPS estimates for LUCK and DGKC our overweight stance remains intact. Despite its recent outperformance LUCK remains our top pick due to its sound financials and attractive valuations. The scrip is trading on a FY10 and FY11 PER of 6.0x and 5.1x respectively.

Chart 1: LUCK and DGKC price performance vs KSE 100



Source: Bloomberg & IGI Research

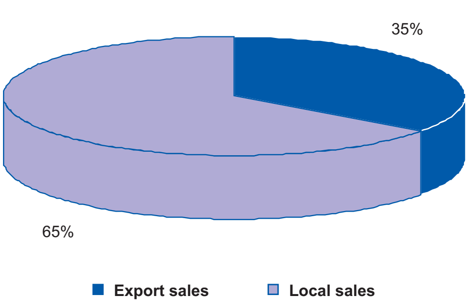
Key risks remain sharper-than-expected demand and cement price declines, regulatory pressure and/or a surge in commodity prices.

Cement Sector Update

Exports continue to beat market expectations

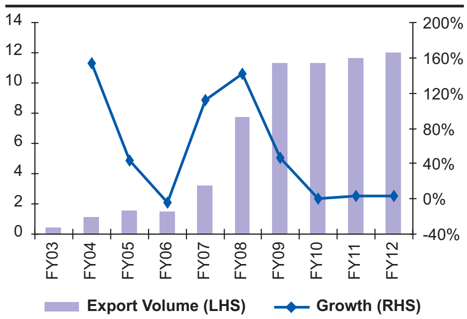
Despite the global slowdown, cement exports continue to remain strong during FY09 crossing 11.3mn MT, achieving a growth of 46.6% YoY. During Jun09 exports surprised market participants by crossing the 1mn MT mark for the fourth consecutive month. In our view the various infrastructure focused stimuli packages introduced by governments abroad to boost economic demand are keeping cement demand in the green. While export sales are unlikely to achieve the phenomenal growth achieved over FY07-09 we expect export contribution to total sales volumes to remain in the 30-35% range going forward. According to international reports, the decline in cement demand appears to be slowing across markets as a recovery in the global economy is imminent. Demand in neighboring India accounting for 6% of Pakistan's cement export market, is registering double digit growth.

Chart 2: FY09: Exports as a % of total sales



Source: APCMA

Chart 3: FY03-12 Export sales trend (mnMT)



Source: APCMA, IGI Research

No threat from lifting of Saudi export ban

GCC media has reported that the Saudi government has allowed partial lifting of an export ban introduced in CY08 to control cement prices as they touched a record high. However the ban removal comes with stringent conditions such as keeping cement prices between SAR 10-10.5/bag and maintaining inventories representing 10% of the local markets' needs. Some factories in Saudi Arabia are already selling locally as low as SAR 8/bag. Local demand is expected to remain strong in Saudi Arabia with the government in its 2009 budget having made an allocation of total new capital budget (new projects and increased appropriations for existing projects) amounting to more than SAR 225bn (USD 60bn), a 36% increase over last year's appropriation. With construction activities in full swing within the Kingdom we do not expect companies to focus on export markets.

Infrastructure spending expected to disappoint in FY10

While the government has made a hefty PSDP allocation of PKR 646bn for FY10 we expect fiscal constraints to prevent full spending from materializing. Due to fiscal constraints over the last two years the government has had to slash the initially projected PSDP target. According to industry participants infrastructure accounts for approximately 30% of total cement consumption.

Housing construction key driver for cement

There is a reported backlog of more than 6mn housing units in Pakistan, growing approximately by about 0.3mn units ever year. The mortgage to debt ratio is less than 1% compared to 5% in India, 18% in Malaysia and 15% in China. With the economy stabilizing, interest rates easing and the ongoing military offensive expected to be complete soon, we expect housing construction projects to commence in 2H FY10.

While total consumer financing in May09 was down 18% YoY, loans for house building as a percentage of total loans continued to show an upward trend growing to 17% from 15% in May08.

Chart 4: Housing loans as a % of total personal loans

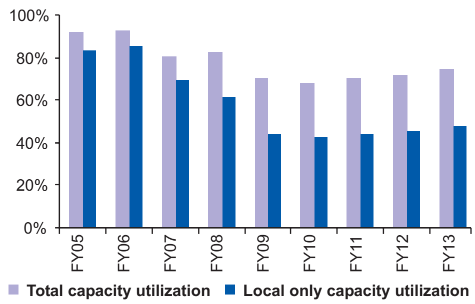
Source: SBP

FY10 budget contained specific measures to support housing development including construction of 9,469 housing units for industrial workers and allocation of residential plots to working journalists. Furthermore the tax credit limit on interest paid on loans for construction of a new house or acquisition has been increased to PKR 0.75mn from PKR 0.50mn previously which is also likely to bode well for cement demand. Going forward uplift in local cement demand is also expected from reconstruction activities in war affected areas upon completion of the military offensive. Although there are no numbers available on local cement consumption for housing, industry players believe that approximately 60-70% of total cement demand is comes from the housing sector.

Capacity Utilization key to thesis

Even while the industry's capacity utilization stands at 70% during FY09, LUCK and DGKC have outperformed the industry with capacity utilization levels of 87% and 90% respectively. However much of the capacity utilization is dependent on export sales and local sales industry capacity utilization stands significantly lower at 44%. With capacity expansion cycle drawing to close in CY10 our industry capacity utilization assumption stands at 68% and is dependent on flat export growth. A key risk to our industry capacity utilization assumption is a sharp decline in export volumes.

Chart 5: FY05-13 Capacity utilization outlook

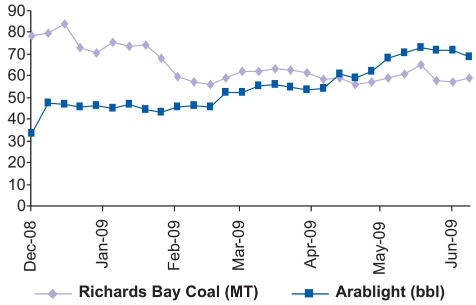


Source: APCMA, IGI Research

Cement prices holding strong in weak demand

Admittedly cement prices at the retail level are down by 2% to PKR 342/bag in Jul09 from May09 levels. However the decline is attributed to the PKR10/bag cut in FED charge announced in budget FY10. The after tax actual reduction in retail price worked out to be PKR11.6/bag but manufacturers pocketed PKR 1.6/bag as margin. Coal prices remained extremely volatile in Jun09 following the recent surge in crude oil price but settled under USD 60 MT. We maintain our coal price assumption of USD 60 MT (FOB) for FY10. Even while conservatively assuming a 15% YoY cement price decline in FY10, we expect manufacturers to defer the price cuts until some stability is reached in input costs. This is likely to result in gross margin expansion through FY10 versus our expectations of flat margin.

Chart 6: CY09 YTD Coal and crude oil price trends (USD)



Source: Bloomberg

Table 1: Pakistan cement sector attractively priced against the region

		EV/EBITDA (x)			P/E (x)		
Company	**Country**	**FY08**	**FY09**	**FY10**	**FY08**	**FY09**	**FY10**
Holcim	Switzerland	6.3	8.7	8.4	8.9	19.4	24.4
Italcementi	Italy	4.1	4.8	4.1	7.1	14.6	13.0
Lafarge	France	5.8	6.3	6.1	5.2	12.3	12.8
Titan Cement	Greece	6.9	7.5	7.3	7.7	10.7	11.0
PPC	South Africa	7.4	5.4	5.4	10.2	10.4	10.7
Adelaide Brighton	Australia	8.3	8.0	7.4	10.9	13.0	12.4
Anhui Conch Cement Co	China	16.4	10.6	8.3	28.6	16.9	13.0
Buzzi Unicem	Italy	3.5	5.6	5.6	5.3	11.1	12.3
Ambuja Cements Ltd	India	7.4	6.3	6.6	12.8	11.4	12.2
Cemex	Mexico	6.2	7.8	6.7	18.0	11.5	8.8
Union Cement	UAE	5.5	5.5	5.9	7.6	9.2	12.8
Yamama Cement	Saudi Arabia	6.2	6.0	5.6	8.4	9.6	10.2
Raysut Cement	Oman	8.2	8.2	7.9	10.0	10.7	10.7
Qatar National Cement	Qatar	12.3	8.4	8.4	9.0	10.8	11.3
IGI Cement Sector							
Lucky Cement	Pakistan	9.0	4.7	4.9	7.9	5.1	6.0
DG Khan Cement	Pakistan	15.2	8.5	8.0	NA	15.8	8.9

Source: Bloomberg, IGI Research

Key Risks

The key risks to our thesis include 1) a price war leading to a collapse in local cement prices and/or export prices 2) sudden surge in coal/commodity prices 3) local and export demand falling short of our expectations. The upside risks to our thesis include 1) a recovery in global and local economic conditions 2) Cement prices faring better than our FY10 local and export price assumption of PKR 271/bag and USD 49 MT.

Stock Summaries

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Recommendation **BUY**

Fair Value **PKR 81**

LUCKY CEMENT

Company Update

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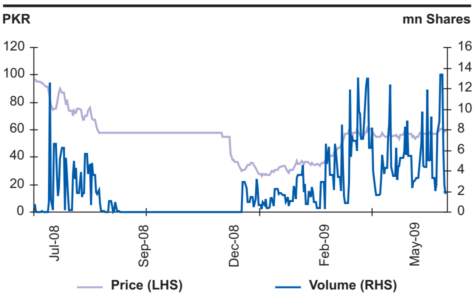
IGI Securities

LUCK: The darling of the cement sector

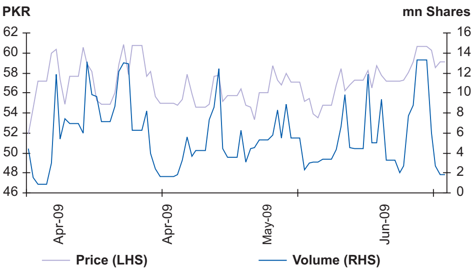
Bloomberg code	*LUCK PA*
Current Price PKR)	*65.02*
12mo Average Daily Volume (mn shares)	*2.54*
Market Capitalization (PKR bn)	*20.94*
Paidup Capital (PKR bn)	*3.2338*
Shares Outstanding (mn)	*323.38*
Weightage (%)	*1.05*
Average 12mo Price (PKR)	*54.72*
Free Float	*60%*

Chart 7: 12mo Price & Volume Graph



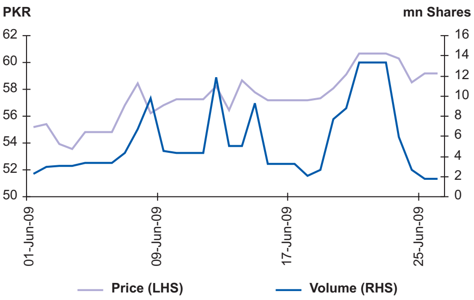
Source: Bloomberg & IGI Research

Chart 8: 3mo Price & Volume Graph



Source: Bloomberg & IGI Research

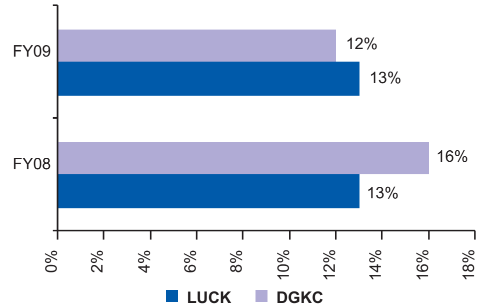
Chart 9: 1mo Price & Volume Graph



Source: Bloomberg & IGI Research

Despite a 14.1% decline in local cement demand during FY09 LUCK has not seen attrition and maintained its local market share of 12%. With export growth limited during FY10 in light of the sluggish global economic market we expect the company to focus on capturing local market share. However local demand is expected to remain slow and we forecast a 2% YoY growth during CY09 making growing local market share a key challenge for LUCK.

Chart 10: LUCK and DGKC local market share



Source: APCMA

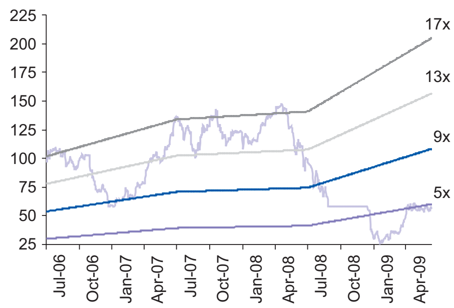
Growing local share to remain a challenge in current environment

In FY10 we expect PSDP spending to fall below the record allocation of PKR646bn. With the government already having reversed numerous revenue generating measures introduced in budget FY10 we expect a third consecutive year of weak PSDP spending on the back of fiscal resource constraints. According to industry participants the infrastructure element accounts for approximately 30% of total cement consumption and project delays will not bode well for local cement demand. Furthermore the security situation in the country is likely to lead to slow recovery in housing construction.

Weak sales volume in FY10 priced in

The aforementioned scenario has resulted in us revisiting our demand growth assumptions for LUCK. For FY10 we revise downwards our total dispatch growth assumption for LUCK to 6% taking overall capacity utilization to 70%. The downward revision results in an 11% reduction in our FY10 EPS to PKR10.90. With strong 9mo FY09 results, we revise upward our FY09 EPS forecast by 4% for LUCK to PKR 12.75 from PKR 12.29 previously. Tweaks to our FY09 and FY10 earning estimates leads to a 2% reduction in target price to PKR 81. The decline in YoY earnings during FY10 is more than priced in the current scrip price. The scrip is currently trading at the lower end of its P/E band and we reiterate our BUY call on the scrip offering a 25% upside at current levels.

Chart 11: LUCK - PE Band



Source: Bloomberg

Reiterate BUY with a target price of PKR 81

We derive our target price of PKR 81 for LUCK using a DCF based valuation. We use a WACC of 17.6% and terminal growth rate of 4%. Our cost of equity of 20.2% is calculated using a beta of 1.3, risk free rate of 12.4% and risk free premium of 6%. Despite the recent surge in price, trading on a FY10 PER of 5.9x the scrip is cheap on valuations and we reiterate our BUY call on the scrip.

Table 2: LUCK

Income Statement (PKR mn)	FY07	FY08	FY09E	FY10E
Net sales	12,522	16,958	22,793	21,424
Cost of sales	8,847	12,595	14,274	13,512
Gross profit	3,675	4,363	8,519	7,912
Operating profit	3,066	3,076	6,353	5,679
EBITDA	3,949	4,055	7,764	7,382
Financial charges	863	127	1,457	1,361
Profit before tax	2,690	2,307	4,739	4,207
Taxation	206	(286)	616	715
Net Profit	2,547	2,678	4,123	3,491
Shares outstanding (mn)	323.38	323.38	323.38	323.38
EPS (PKR)	7.88	8.28	12.75	10.80

Cashflow Statement (PKR mn)	FY07	FY08	FY09E	FY10E
Cashflow from Operating Activites	1,850	1,225	6,827	5,453
Cashflow from Investing Activities	(2,037)	(6,488)	(5,609)	(4,025)
Cashflow from Financing Activites	(887)	2,841	(814)	(1,235)
Net change in cash	(1,074)	(2,422)	405	193
Beginning cash balance	2,063	733	270	675
Ending cash balance	733	270	675	867

Balance Sheet (PKR mn)	FY07	FY08	FY09E	FY10E
Current assets	5,409	8,407	7,049	6,859
Operating assets	20,319	25,830	30,027	32,350
Total assets	25,730	34,239	37,078	39,211
Current liabilities	6,352	7,687	7,604	6,793
Long term liabilities	10,024	7,897	6,895	6,548
Shareholders equity	9,354	18,655	22,579	25,870
Total equity and liabilities	25,730	34,239	37,078	39,211

Key Ratios	FY07	FY08	FY09E	FY10E
Gross Margins	29%	26%	37%	37%
Operating Margins	24%	18%	28%	27%
Net Margins	20%	16%	18%	16%
Sales Growth	57%	35%	34%	-6%
EPS Growth	32%	5%	54%	-15%
ROE	27%	14%	18%	13%
ROA	10%	8%	11%	9%

Valuation	FY07	FY08	FY09E	FY10E
PER (x)	8.25	7.85	5.10	6.02
P/BV (x)	2.25	1.13	0.93	0.80
Dividend Yield	2%	0%	0%	2%

Source: Company Reports & IGI Research

July 2009

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PAKISTAN

Recommendation **BUY**

Fair Value **PKR 46**

D. G. KHAN CEMENT

Company Update

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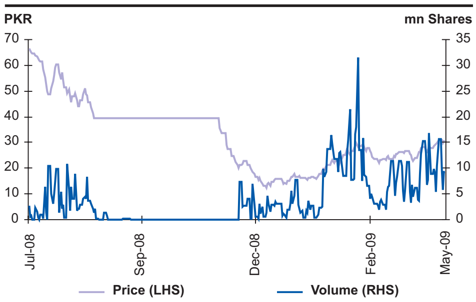
DGKC: Earning turnaround intact

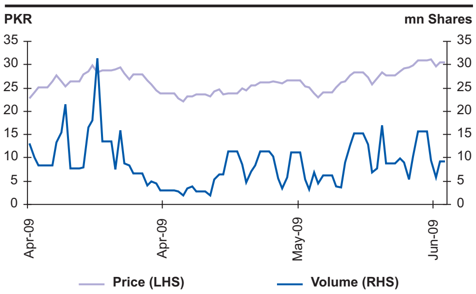
Bloomberg code	*DGKC PA*
Current Price PKR)	*30.94*
12mo Average Daily Volume (mn shares)	*4.15*
Market Capitalization (PKR bn)	*9.41*
Paidup Capital (PKR bn)	*3.0425*
Shares Outstanding (mn)	*304.25*
Weightage (%)	*0.47*
Average 12mo Price (PKR)	*32.4*
Free Float	*61%*

Chart 12: 12mo Price & Volume Graph



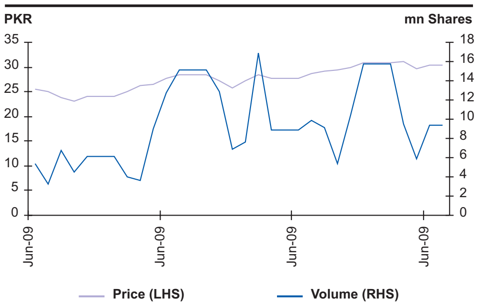
Source: Bloomberg & IGI Research

Chart 13: 3mo Price & Volume Graph



Source: Bloomberg & IGI Research

Chart 14: 1mo Price & Volume Graph



Source: Bloomberg & IGI Research

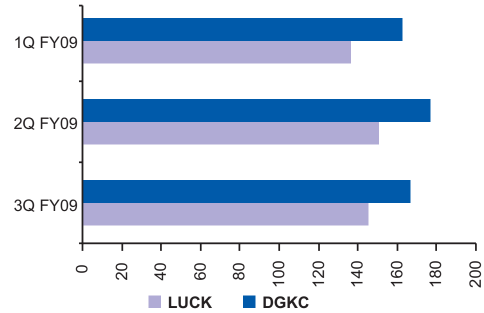
Downward revision in FY09 earnings outlook; Maintain BUY

We have cut our EPS forecast for FY09 from PKR 2.54 to PKR 1.96 and FY10 from PKR 4.09 to PKR 3.45 respectively. The downward revision in earnings has resulted in a 8% downward revision in our DCF based valuation for the core operations to PKR 24. Additionally we have re-priced DGKC's investment portfolio as of Jul7'09 taking our total SOTP based target price to PKR 46 from PKR 55 previously. That said we remain optimistic on DGKC given the earnings turnaround expected in FY09 with a PAT of PKR 595.5mn (EPS PKR 1.96) compared to a LAT of PKR 53mn (LPS PKR 0.17) in FY08.

Turnaround is slower than expected

The underlying factor behind the downward revision of FY09 EPS was slower than expected turnaround. With South African coal prices showing a downward trend through 2Q and 3Q FY09, we had expected a lower input cost to materialize from 3Q FY09. High levels of expensive inventory had prevented the full benefits from flowing through margins during 3Q FY09. Even while COGS/bag were lower by 5.5% to PKR167/bag on a QoQ basis during 3Q FY09, they remained 15% higher than LUCK. On a QoQ basis in 3Q FY09 gross margin slipped to 25% from 30% in the preceding quarter but going forward we expect that the proper reduction in input costs will be reflected in 4Q FY09 and FY10 as cheaper coal is used to replenish inventory.

Chart 15: QoQ comparison of COGS/bag (PKR)



source: company accounts, IGI research

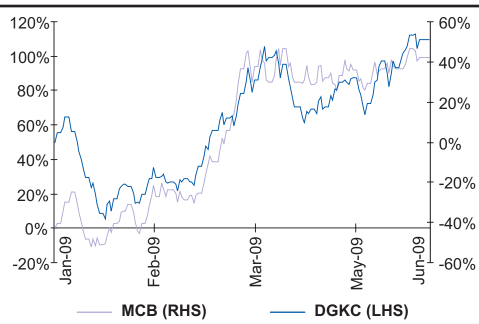
Impairment to be amortized over 4Q FY09 and 1H FY10

With total impairment expected to be amortized over CY09 standing at PKR 434mn our EPS forecast for FY09 includes an impairment charge of PKR 247mn. This translates into a PKR 0.81/share impact. PKR 154.7mn has already been expensed in 3Q FY09 while the balance of PKR 279mn is expected to be amortized quarterly over 4Q FY09 and 1H FY10.

Portfolio value to act as key trigger

With core operations priced in at current levels, we believe upside offered from the portfolio is yet to reflect in DGKC's stock value. Approximately 86% of DGKC's portfolio value consists of MCB. DGKC's stock price performance shows a 0.85 correlation with MCB's performance.

Chart 16: CY09 DGKC and MCB price performance



source: Bloomberg

BUY rating intact

DGKC still offers investors with an upside of 49% at current levels and we maintain our buy stance on DGKC. Full impact of lower coal costs, currency stability and lower financial charges are likely to show in 4Q FY09 and full year FY10. While the core business is fully priced in at current levels, we believe the company's portfolio value is still to be priced in. The scrip trades on a FY10 and FY11 PER of 8.9x and 5.3x respectively.

Table 3: DGKC

Income Statement (PKR mn)	FY07	FY08	FY09E	FY10E
Net sales	6,420	12,446	18,044	15,804
Cost of sales	4,388	10,531	13,010	11,344
Gross profit	2,032	1,915	5,035	4,460
Operating profit	1,863	1,242	3,178	2,806
EBITDA	2,342	2,544	4,548	4,229
Financial charges	607	2,332	3,447	1,778
Profit before tax	1,720	(251)	94	1,236
Taxation	98	(198)	(502)	185
Net Profit	1,622	(53)	596	1,051
Shares outstanding (mn)	304.25	304.25	304.25	304.25
EPS (PKR)	5.33	(0.17)	1.96	3.45

Cashflow Statement (PKR mn)	FY07	FY08	FY09E	FY10E
Cashflow from Operating Activites	475	(610)	849	2,992
Cashflow from Investing Activities	(4,789)	(2,357)	655	(1,415)
Cashflow from Financing Activites	3,023	(577)	(1,234)	(1,680)
Net change in cash	(1,291)	(3,544)	270	(104)
Beginning cash balance	(2,546)	(3,827)	226	497
Ending cash balance	(3,837)	(7,371)	497	393

Balance Sheet (PKR mn)	FY07	FY08	FY09E	FY10E
Current assets	19,215	19,203	21,299	20,753
Operating assets	32,529	32,790	30,486	30,291
Total assets	51,744	51,993	51,785	51,044
Current liabilities	7,390	12,055	12,846	13,693
Long term liabilities	10,431	9,858	7,553	5,220
Shareholders equity	33,923	30,080	31,386	32,132
Total equity and liabilities	51,744	51,993	51,785	51,044

Key Ratios	FY07	FY08	FY09E	FY10E
Gross Margins	32%	15%	28%	28%
Operating Margins	29%	10%	18%	18%
Net Margins	25%	NA	3%	7%
Sales Growth	-19%	94%	45%	-12%
EPS Growth	-33%	NA	NA	76%
ROE	5%	NA	2%	3%
ROA	3%	NA	1%	2%

Valuation	FY07	FY08	FY09E	FY10E
PER	5.81	NA	15.84	8.98
P/BV	0.28	0.31	0.30	0.29
Dividend Yield	5%	0%	0%	2%

Source: Company Reports & IGI Research

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Analyst Certification

I, Aisha Kirmani hereby certify that the views expressed in this research report accurately reflect our personal views about the subject, securities and issuers. I also certify that no part of our compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report.

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