Cements – Headwinds Could Keep Valuation in Check

ABBASI SECURITIES

REP-091

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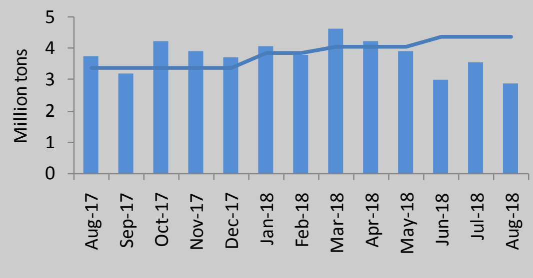
- Overall decline of 8.3% YoY in **cement dispatches** during the month of August 2018 has increased investors' concerns regarding the sustainability of cement demand while the concerns regarding supply glut due to capacity expansion are also dampening investors' sentiment.
- The declining trend in dispatches started from April 2018. Volumetric sales recorded a decline of 7.78% between March 2018 and August 2018 (See Fig. 1)
- Average **retention prices** (See Fig. 3) have decreased by about 7.57% since 2016. Our channel check suggest that this decline in retention prices is largely due to bulk sales discounts and higher freight cost. These two costs have increased by approximately 12.66% between FY16 and FY18. Most recently, retail prices of cement have also decreased by Rs10 - Rs15 per bag in north region, which would further exacerbate the decline in retention prices. We note this price decline with particular concern at a time when additional capacities are coming online
- Current **cement capacity** is 52.34mn tons per annum which would increase to 72.52mn tons per annum by FY21. However, the utilization level of the industry has declined from 92.82% in FY18 to 80% in FYTD, and could decline further as additional capacities are coming online.
- **Cost of goods sold** per bag has increased by ~14.06% since 2016 (See Fig. 4). Key cost drivers are increase in cost of coal and electricity as a result of currency devaluation and increase in base price (i.e. coal price per ton and electricity per KWH)
- The continued impact of lower retention prices and higher cost has resulted in a decline in operating profit margin. We expect gross profit margin to remain under pressure in the near term
- There are some supporting factors for the industry as well which can be key demand drivers. Construction of 5mn small houses and dams including Diamir Bhasha dam could drive cement demand going forward. Materialization and timing of these projects are still unclear
- Cement industry is currently trading at FY19E PE of 7.57x. In view of all of the above mentioned factors, we have **underweight** stance on cements until any further significant development on sector dynamics

Key Risks

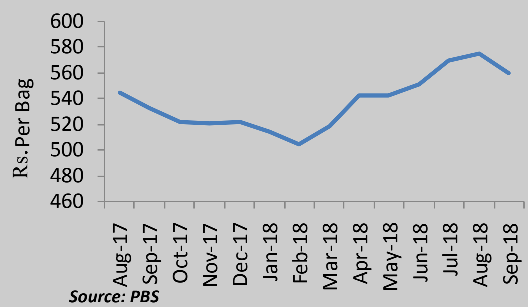
- Higher than expected demand
- PKR appreciation
- Higher than expected change in coal prices

Fig 1. Industry Capacity & Dispatches



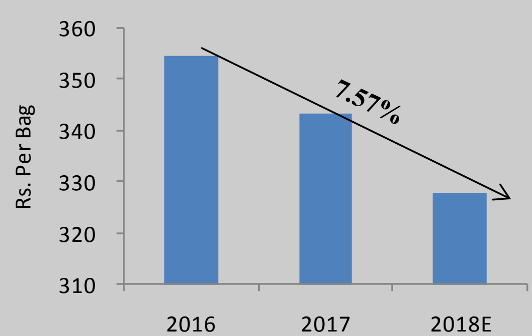
Source: APCMA

Fig. 2 Price Chart



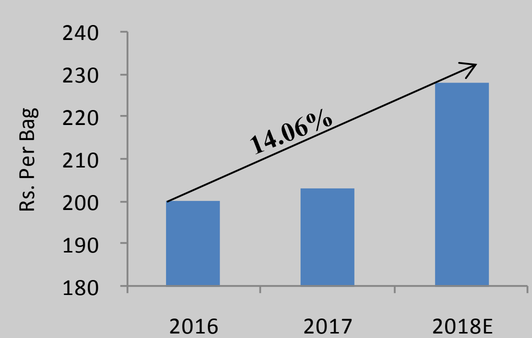
Source: PBS

Fig. 3 Average Retention Price



Source: ASL

Fig. 4 Cost of Goods Sold



Source: ASL

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Valuation Methodology

To arrive at period end target price, Abbasi Securities uses different valuation methodologies:

- Comparable Method (P/E, P/B, Justified P/B & P/E etc.)
- Discounted Cash flow Method
- Equity and Asset based valuation

Stock Ratings

BUY	Total return more than 20% from last closing of market price
HOLD	Total return is in between 10% and 20% from last closing of market price
REDUCE	Total return is less than 10% from last closing market price

Sector Ratings

Over Weight	> Weight in KSE 100 Index
Market Weight	= Weight in KSE 100 Index
Under Weight	< Weight in KSE 100 Index

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