Pakistan Cement Sector Review

Industry Update

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IGI Securities

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Investment Consideration

Exports to support diminishing local demand

During the prevailing year, we expect local demand to subside by 10% to 20.1mn MT in FY09 against 22.4mn MT in FY08. This is largely on account of an expected cyclical slowdown in demand in lieu of the expected GDP growth stabilization around the 3.5% level. However, this decline in demand is likely to be cushioned by a 25% increase in exports to 9.6mn MT. Higher margins on exports are likely to benefit export-oriented manufacturers up until FY10 which is when regional capacities come online.

Interest rate hike will take its toll on debt obligations

With the industry debt-to-asset ratio averaging at 55% and LTD-to-assets averaging at 35%, manufacturers are likely to witness a manifold increase in their financial charges on account of the recent 200bps interest rate hike, causing net profit depletion. On the flipside, the obligation of meeting debt payments is likely to mitigate some risk of a price war as manufacturers strive to maintain a positive bottomline.

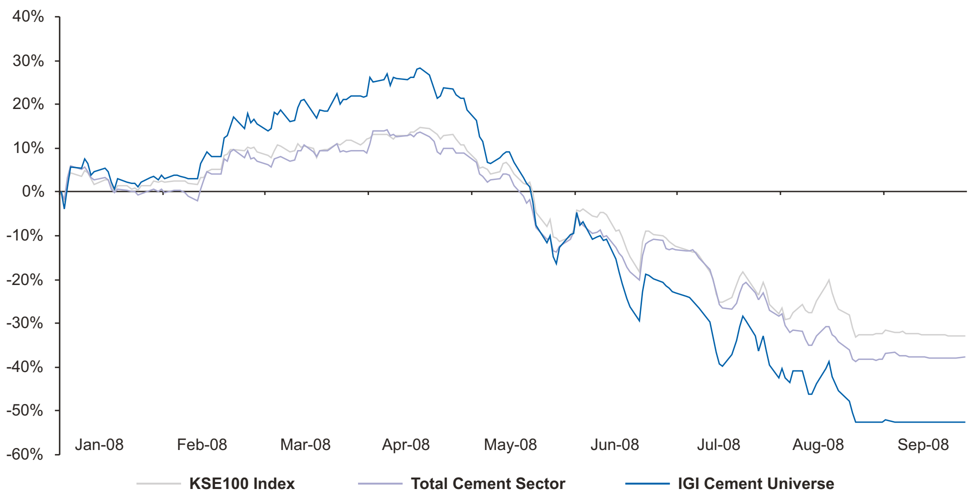
Upcoming expansions to contract margins

Additional capacities of approximately 5.45mn MT are likely to come online during FY09, while total capacity is expected to reach 51mn MT by FY11. In view of diminished demand, we expect prices to decline by PKR 15/bag in Dec08 and average at PKR 325/bag during FY09 resulting in a lower topline and compressed gross margins.

Outlook remains cautious due to abnormal equity market conditions

Out of the total of 24, 19 companies are currently listed on the stock exchange. The cement sector has underperformed the KSE100 Index by 5% since Jan08 to date, while the IGI Cement Universe underperformed the benchmark index by 20% during the period under review, owing largely to the deteriorating fundamentals of the cement companies and liquidity constraints in the market. Going forward, we advise a cautious approach on the sector on account of both liquidity and regulatory risk.

Market Activity (Relative Comparison)



Source: Bloomberg & IGI Research

Industry Overview

Local demand trajectory depicts bleak ST profitability prospects

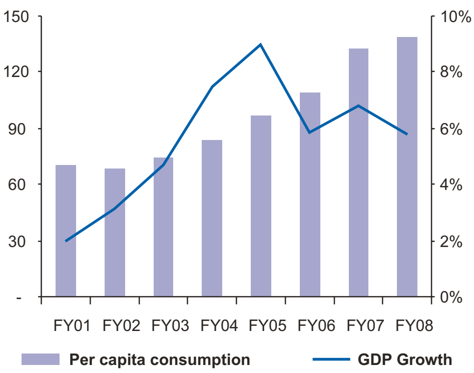
With a wave of supply expansions bringing total cement manufacturers' capacity to 37.16mn MT by Jun08, the cement industry faces an excess supply situation with local FY08 consumption standing at 22.4mn MT.

Local demand showed sluggish growth of 6% YoY from 21.03mn MT in FY07. The growth slowdown was a result of stalling public and private investment in infrastructure and housing sectors. Due to the deteriorating fiscal position, the government slashed PSDP utilization to just 88% of the PKR 520bn target in FY08. Meanwhile PSDP spending was slashed by 69% in 1Q FY09 to PKR 40bn. This raises the stakes against future infrastructure development and is likely to dent cement dispatches going forward.

Demand correlation with GDP indicates slowdown ahead

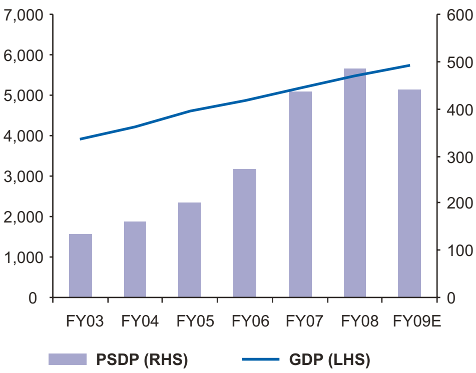
Pakistan witnessed robust economic growth is the past 3yrs as GDP growth marked a 5yr CAGR of 7% in FY07. However we have now entered a cyclical trough with GDP growth expected at the lowest level in 5yrs at 3.5% in FY09. According to our estimates, local FY09 consumption is expected to decline to 20.1mn MT in line with inflation, development spending cuts and a growth slowdown in line with global trends. However, we are bullish on domestic demand in the medium term as the economy stabilizes and enters a new growth phase.

Consumption pattern (kg)



Source: Economic Survey & IGI Research

PSDP allocation vs. GDP (PKR bn)



Source: Economic Survey & IGI Research

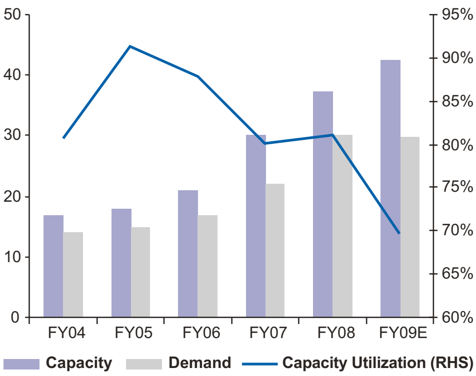
Upcoming expansions likely to compress margins

Additional capacities of approximately 5.45mn MT by Lucky (1.25mn MT), Gharibwal (2.1mn MT), Kohat (2.1mn MT) are likely to come online during FY09, while total capacity is expected to reach 51mn MT by FY11. The transactional cost of expansion has increased unprecedentedly with both interest rates and exchange rates on the rise; the impact of which is likely to materialize fully by mid CY09. Consequently manufacturers attempted to compensate for compressed margins by operating at full capacity and increasing volumetric growth. Moving forward however we expect capacity utilization to average at a mere 47%; which shifts the onus demand onto regional markets of India, GCC and Africa in addition to the already captive Afghanistan.

Regional demand to support volumetric growth

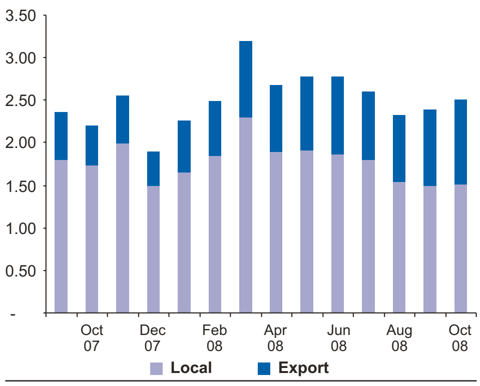
The construction boom has given rise to an acute cement shortage in the region, resulting in increased demand for Pakistani exports. Afghanistan accounted for 34% of total cement export receipts during FY08 and is the leading exportable market for Pakistan. We expect external aid and infrastructure development to maintain at current levels during the Obama regime, which is likely to lend support to Pakistan's cement exports. Going forward, we forecast export dispatches to reach 9.6mn MT by the end of FY09, which is likely to increase the combined (export and local) capacity utilization to approximately 70%. However, regional demand only shows promise till FY10, when expansions of approximately 231mn MT are expected to come online in the surrounding countries, reducing reliance on Pakistani cement.

Industry Supply & Demand (mn MT)



Source: APCMA & IGI Research

Cement Dispatches (mn MT)



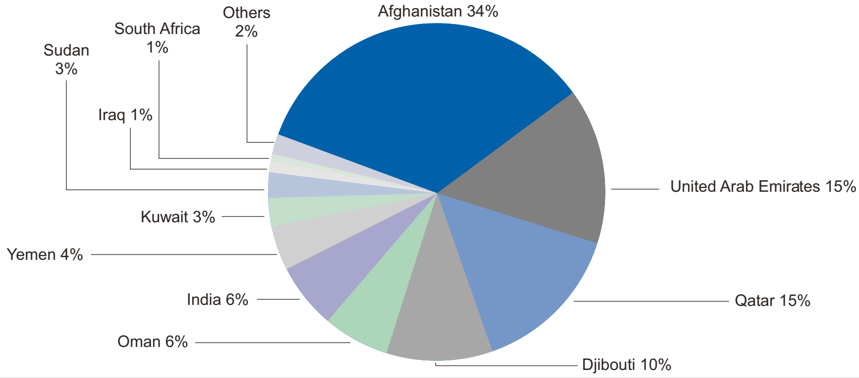
Source: APCMA & IGI Research

Low per capita consumption indicates demand revival in the medium term

Overall dispatches for FY08 marked an all-time high at 30.11mn MT as compared to 24.22mn MT in FY07, primarily on the back of surging exports. Meanwhile, local consumption for 2mo FY09 declined by 15% to 3.3mn MT, while exports continued their upward trajectory to grow by 57% as compared to the corresponding period last year.

With local demand dwindling due to the law and order situation in the country, the last wave of expansions is expected to further aggravate the supply-demand imbalance in the country and adversely affect the pricing power of manufacturers resulting in margin compression. However, low per capita consumption of 139/kg in the country suggests a revival in demand growth which can be expected around FY11 as inflationary pressures ease off and the recessionary phase of the economy comes to an end. In the mean time, manufacturers are likely to target higher margin exports to improve their retention rates and offset sluggish local demand.

FY08 share in export receipts

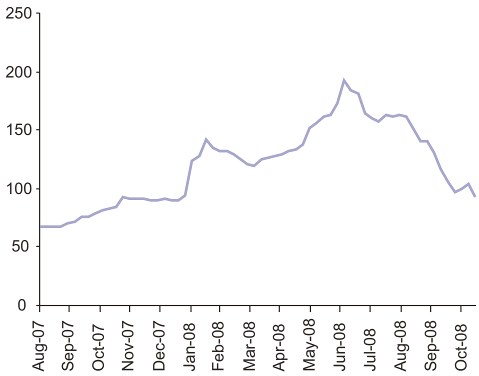


Source: FBS & IGI Research

Slide in global coal prices to ease margin pressure

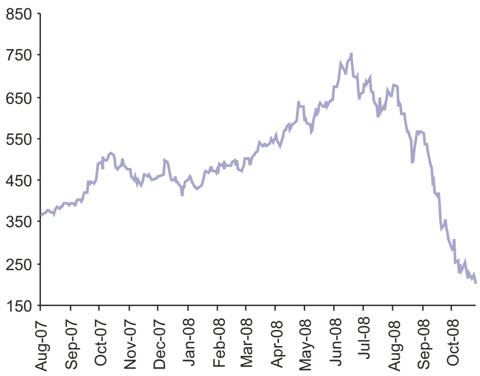
Coal prices have started a downward trend from a record high of USD 192.50/MT in Jul08, amid news of increased supply from China, the largest consumer and producer of the commodity. For the week ended Nov 14'08, FOB coal prices were recorded at USD 93/MT (Newcastle Port Index), marking a decline of 34% from the peak. We expect the downtrend in coal prices to continue in tandem with the decline in crude prices. Depending on plant configurations (European vs. Chinese), the manufacturers are likely to witness a slight improvement in the margins as the positive impact of declining energy costs on gross margins is likely to remain muted due to the deteriorating exchange rate parity.

Coal Prices (Newcastle Port Index) (USD/MT)



Source: Bloomberg

International FO Prices (FOB) (USD/MT)

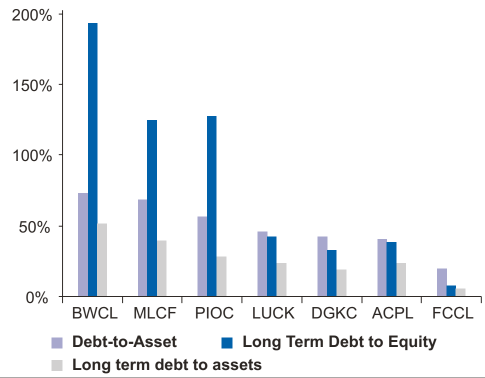


Source: Bloomberg

Profitability to contract in higher interest rate environment

Long term debt is usually pegged to the 6M KIBOR which has risen by 620bps to 15.7% since Jun07 and is expected to remain near current levels during FY09. With the cement industry debt-to-asset ratio averaging at 55% and LTD-to-assets averaging at 35%, cement companies' are likely to witness a manifold increase in their financial charges, causing depletion in profitability.

Leverage FY08

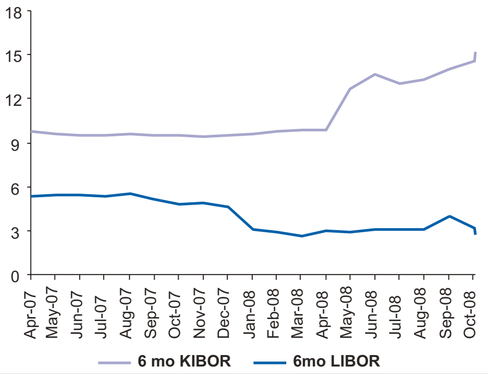


Source: Company Reports & IGI Research

PKR depreciation results in exchange losses on cross currency swaps

Moreover, some companies, including DGKC, LUCK and MLCF had entered into cross currency interest rate swap agreement linked to LIBOR to offset finance costs through savings from the interest rate differential. During the previous year, owing to the agreement, the companies realized a positive interest rate differential between KIBOR and LIBOR, thus offsetting total financing costs of the company. However, an unprecedented 12% depreciation of the PKR against the USD by Jun 30'08 led MLCF, DGKC and LUCK to suffer losses on their cross currency swap agreements in 4Q FY08. The companies, with the exception of MLCF have since then retired most of their cross currency agreements which led them to incur a one-time exchange loss during 1Q FY09. However in the long term, the companies' balance sheets now bear the risk of higher financial charges through expected hikes in interest rates.

Interest Rate Volatility **(%)**



Source: Bloomberg

Sustainability of implicit price agreement remains questionable amid demand slowdown Escalating coal prices, increasing interest rates and a rise in the Federal Excise Duty (FED) by PKR 250/MT have led to skyrocketing retail cement prices in the local market. According to latest data by the FBS, cement retail prices average at PKR 365 – PKR 375 per 50kg bag in different parts of the country, a massive rise of 48% from Feb08 levels of PKR 235 – PKR 245 per 50kg bag. In the immediate term, we expect cement prices to decline by PKR 20/bag during Dec08 as the winter season commences, followed by the religious holidays in the immediate term, while average retail prices for FY09 are expected to range at PKR 325/bag. Given the lower capacity utilization levels, we expect cracks in the implicit price arrangement which, coupled with nose-diving coal prices and higher construction costs, is likely to result in a slowdown in cement prices. However, with the industry's leverage ratio averaging at 1.4x some risk of a price war will remain restrained as the manufacturers strive to maintain a positive bottomline.

Risks to our valuations

- A lower than expected slowdown in coal prices could result in depressed margins and a downside to our valuations.
- A recessionary phase in our exportable countries may dampen export demand.
- Given the surplus capacity and lower capacity utilization by manufacturers, a breakdown of the implicit pricing arrangement may result in a price war and compress margins for the manufacturers.
- Currently, for LT loans with floating interest payments, 6M KIBOR has been assumed at 15.7%. A further increase in the same could lead to erosion of company bottomlines.

Demand Outlook

	FY07A	FY08A	FY09E	FY10E	FY11E	FY12E
Local Demand	21.0	22.4	20.1	21.1	23.2	26.7
Growth %	24%	7%	-10%	5%	10%	15%
Export Demand	3.1	7.7	9.6	9.1	8.9	8.8
Growth %	107%	148%	25%	-5%	-2%	-2%
Total	24.1	30.1	29.7	30.2	32.2	35.5
Growth %	31%	25%	-1%	2%	6%	10%

Source: APCMA & IGI Research

Stock Summaries

D.G. Khan Cement Company Ltd.

Recommendation: BUY

Fair Value: PKR 49

Investment Consideration

Pioneering exports through land routes

For FY08, DGKC's exports surged by 4x to reach 0.66mn MT. In line with the industry's expectations, export growth for FY09 is likely to range around 25%. Being the market leader in the northern region with 4.22mn MT of capacity and a 17% market share in terms of total dispatches, DGKC has the ability to cater to the local market while also exploring avenues in NWFP, Afghanistan and India through land routes. However, export growth through sea routes remains muted due to location disadvantage which may subject DGKC to a stagnant or a shrinking bottomline in the long term.

Investment portfolio to hedge against bottomline erosion

Having a strong backing by the Mansha Group, DGKC's bottomline is highly dependant on dividend income from subsidiaries primarily MCB, Adamjee, Nishat Mills and Nishat Chunian. We expect DGKC's dividend income to increase marginally by 1% to 858mn during FY09 and support weak earnings from core operations on account of declining cement demand.

European plant to reward operational efficiency

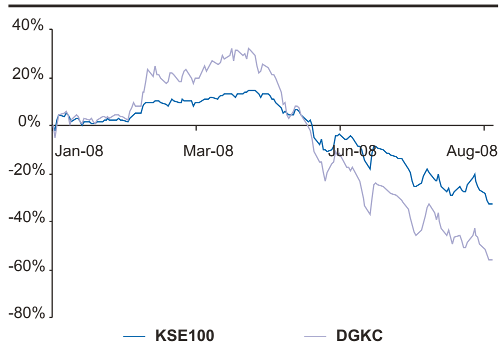
DGKC's plant configuration as per FL Smidth technology enables the manufacturer to obtain a high run factor, allowing cost efficiencies through economies of scale. Low fuel and power costs coupled with fewer maintenance shutdown periods are likely to result in improved margins in the long term. During FY09, capacity utilization for DGKC is likely to average close to 100%, surpassing the industry capacity utilization by 30%.

Valuation

A drastic drop in stock market valuations has resulted DGKC's stock to trade a 25% discount to our fair value of PKR 49/share based on SOTP valuation. We recommend BUY on DGKC however encourage investors to remain cautious in view of liquidity constraints, a decline in public development spending and a potential slowdown in demand for cement in DGKC's exportable countries particularly India and Afghanistan.

Bloomberg Code	*DGKC PA*
Current Price (PKR per share)	*39.28*
Average Daily Volume (mn shares)	*1.23*
Market Capitalization (PKR mn)	*9,959.05*
Shares Outstanding (mn)	*253.54*
Weightage in KSE100 (%)	*0.40%*
Average Price (PKR per share)	*56.01*

DGKC Relative Price Performance



Source: KSE & IGI Research

DGKC: Estimates

	FY07A	FY08A	FY09E	FY10E	FY11E	FY12E
Net income (PKR mn)	1,622	(53)	149	1,465	1,717	2,094
Dividend per share (PKR)	1.4	1.5	-	1.0	1.0	1.0
Earning per share (PKR)	6.4	(0.2)	0.6	5.8	6.8	8.3
Price/Book	0.6	0.7	0.3	0.3	0.3	0.3
Price/Earning	12.6		66.9	6.8	5.8	4.8
Dividend yield	1.7%	1.9%	0.0%	2.5%	2.5%	2.5%

Source: Company Reports & IGI Research

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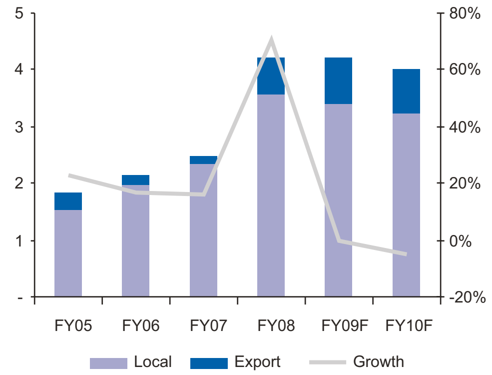
Company Update

Dampening local dispatches to be offset by higher margin exports

Post expansion, DGKC's overall dispatches increased by 71% YoY during FY08. Local dispatches marked an increase of 52% to 3.57mn MT, while exports surged by 4x to 0.66mn MT during the period under review. For FY09, we expect a 5% decline in local sales to 3.4mn MT while exports are likely to post a 25% increase to 0.83mn MT. Going forward, as local demand eases, DGKC is likely to increase the share of exports in their total sales mix in an effort to boost topline through improved margins on export sales which are currently exempt from the PKR 900/MT FED, 16% GST and are eligible for a PKR 25.08/MT export rebate. However, with higher exports, DGKC will incur higher distribution costs which may offset the higher margins earned by the company.

DGKC dispatches (mn MT)

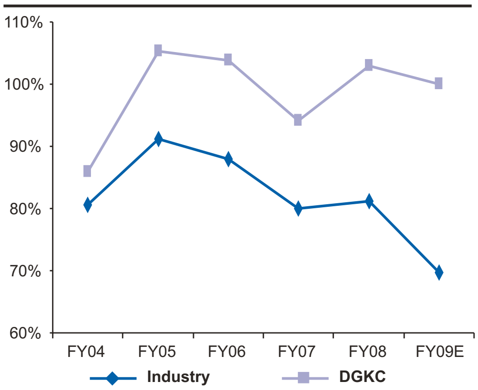


Source: APCMA & IGI Research

Plant's operational efficiencies to give a competitive edge over industry players

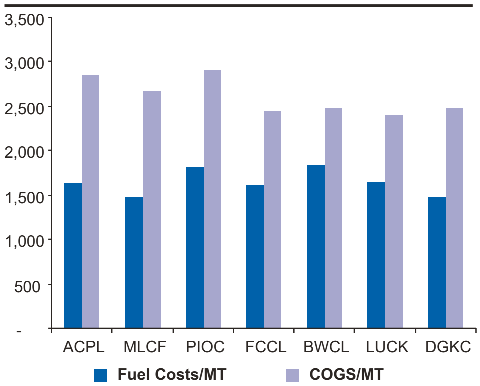
Both units of DGKC plants run on 100% FL Smidth technology (European), allowing it better fuel efficiency and capacity utilization as compared to peers. DGKC has been operating above their installed capacity by operating the plant for 340 days a year against the average of 300 days. The high run factor enables DGKC to realize better margins than the industry. During FY08, DGKC's fuel and power costs averaged at PKR 1,474/MT, while the industry averaged at approximately PKR 1,641/MT. Moreover, capacity utilization for FY08 averaged at 103%, for DGKC while the industry capacity utilization was recorded at 81%. Likewise, capacity utilization for DGKC is likely to average close to 100%, surpassing the industry capacity utilization by 30% during FY09.

Capacity Utilization



Source: APCMA & IGI Research

Operational Efficiency FY08 (PKR/MT)



Source: APCMA & IGI Research

Investment portfolio to hedge against lower income from core operations

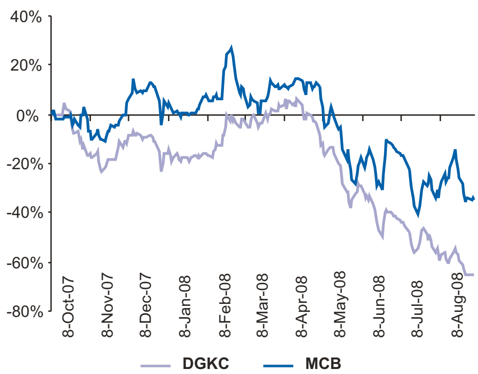
Being the only company in the cement sector with a diversified portfolio of assets, DGKC's bottomline is largely insulated by the investments in sister concerns, particularly MCB. For FY08, dividend income amounted to PKR 847mn creating a per share impact of PKR 3.34. In view of the weak outlook surrounding the textile and the banking sector, we expect DGKC's dividend income to increase marginally by 1% to 858mn during FY09 (assuming no change to the portfolio and MCB's DPS to amount PKR 14 during FY09). However, with the excess capacity surrounding the industry indicating lower retention rates and consequently margin compression in the medium term, we expect DGKC's investment portfolio to give its bottomline a distinct advantage over competitors in the event of insufficient income from core operations.

DGKC Investment Portfolio

	Strategic	AFS	Total Shares
MCB	12,026,299	45,706,541	57,732,840
NML	18,281,733	1,875,658	20,157,391
NCL	6,917,421	151,199	7,068,620
AICL	2,926,770		2,926,770
Others		17,100	17,100

Source: Company Reports

DGKC & MCB Relative Price Performance

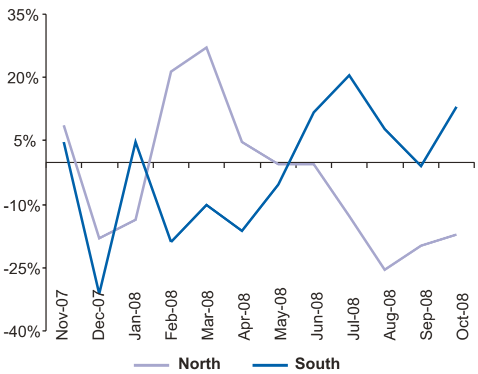


Source: Bloomberg & IGI Research

Location restricts export growth

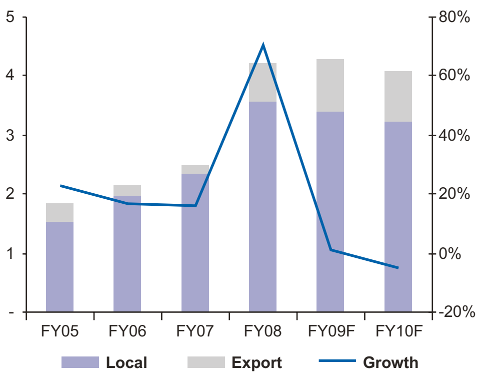
DGKC's presence in the north enables it to maintain a dominant position in the northern market. Moreover, after set up of the new plant in Chakwal, DGKC is in an advantageous position to further penetrate into the northern market, while also exploring avenues in NWFP, Afghanistan and India through land routes. However, penetration in the north provides hindered access to sea routes leading DGKC to incur an additional USD 20/MT in freight charges in the event of exports through sea. Moreover, it makes DGKC highly dependant on local consumption and does not allow the manufacturer to capture booming export markets such as China, GCC and South Africa. Consequently, as local demand subsides and retention rates continue to decline, DGKC may be subjected to a stagnant or a shrinking bottomline in the long term. Although exports to India through the Wagah Border may provide some respite to the sluggish bottomline, Indian demand is likely to subside by FY10 as their local capacities come online. Meanwhile an immediate downside risk also lies in INR depreciation against the USD which could result in higher landed cost of Pakistani exports and a consequent reduction in demand for the same.

North vs. South Dispatches Growth



Source: APCMA & IGI Research

DGKC dispatches (mn MT)



Source: APCMA & IGI Research

Valuation

Based on our SOTP valuation of DGKC, we arrive at a fair value of PKR 49/share. Value from core operations amounts to PKR 13/share, while that from the equity portfolio comes up to PKR 36/share. For valuation purposes, we have applied a 35% discount factor to the NAV of the equity portfolio, while core operations have been valued using a DCF model with a WACC of 19.9% and a growth rate of 4%. At current levels, the scrip is trading at a 25% discount to our fair value and we hold a BUY stance on DGKC.

DGKC: Sensitivity Table (PKR'000)

WACC	NPV of FCF	Term Val.	PV of Term Val.	Enterprise Value	Equity Value	Portfolio Value (PKR/sh)	Equity Value (PKR/sh)
14.9%	12,281,912	35,844,700	18,669,041	30,950,953	12,481,646	36.00	85
15.9%	12,044,631	32,833,206	16,418,679	28,463,310	9,994,003	36.00	75
16.9%	11,815,841	30,288,515	14,547,306	26,363,147	7,893,840	36.00	67
17.9%	11,595,138	28,109,897	12,971,577	24,566,715	6,097,408	36.00	60
18.9%	11,382,143	26,223,660	11,630,609	23,012,752	4,543,445	36.00	54
19.9%	**11,176,498**	**24,574,646**	**10,478,914**	**21,655,412**	**3,186,105**	**36.00**	**49**
20.9%	10,977,863	23,120,751	9,481,842	20,459,705	1,990,398	36.00	44
21.9%	10,785,921	21,829,279	8,612,543	19,398,464	929,157	36.00	40
22.9%	10,600,369	20,674,451	7,849,907	18,450,276	-19,031	36.00	36
23.9%	10,420,922	19,635,671	7,177,113	17,598,036	-871,271	36.00	33
24.9%	10,247,311	18,696,284	6,580,603	16,827,914	-1,641,393	36.00	30

Source: Company Reports & IGI Research

DGKC: Sensitivity analysis (Core Operations)

		Terminal growth rate				
		3.0%	**3.5%**	**4.0%**	**4.5%**	**5.0%**
WACC	18.4%	18	19	21	23	24
	18.9%	15	16	18	20	21
	19.4%	13	14	15	17	18
	19.9%	10	11	**13**	14	15
	20.4%	8	9	10	11	13
	20.9%	6	7	8	9	10
	21.4%	4	5	6	7	8

Source: Company Reports & IGI Research

D.G. Khan Cement Company Ltd.

Income Statement (PKR '000)	FY07	FY08	FY09E	FY10E	FY11E	FY12E
Net Sales	6,419,625	12,445,996	16,273,654	16,146,858	16,314,296	17,489,953
Cost of Goods Sold	4,387,640	10,530,723	13,014,758	12,301,243	12,855,072	13,662,325
Operating Profit	1,862,694	1,242,150	1,995,174	2,978,400	2,580,139	2,884,487
EBITDA	2,836,319	3,452,531	4,088,400	4,884,480	4,465,809	4,919,010
Net Income	1,622,471	(53,230)	148,849	1,465,278	1,717,084	2,093,675
Balance Sheet (PKR '000)						
Current Assets	19,214,954	19,202,591	18,577,761	14,289,759	13,127,763	13,894,139
Operating Assets	22,117,551	22,977,894	22,868,718	22,590,475	22,257,146	21,748,520
Long Term Loans	8,686,447	8,411,051	5,568,224	2,228,462	903,649	-
Total Equity	33,923,185	30,080,257	30,229,106	31,440,842	32,904,386	34,744,520
Per Share						
No. Of Share	253,541	253,541	253,541	253,541	253,541	253,541
Book Value	133.80	118.64	119.23	124.01	129.78	137.04
Earning Per Share (EPS)	6.40	(0.21)	0.59	5.78	6.77	8.26
DPS	1.36	1.50	-	1.00	1.00	1.00
Sales Per Share	25.32	49.09	64.19	63.69	64.35	68.98
Price per Sales per Share (PSR)	3.17	1.64	0.61	0.62	0.61	0.57
Price Earning Ratio (PER)	12.56	(382.81)	66.91	6.80	5.80	4.76
Price Per Cash Flow (PCF)	(4.46)	(26.73)	2.08	3.31	3.89	3.24
Price to Book Value (PBR)	0.60	0.68	0.33	0.32	0.30	0.29
Profitability						
Gross Profit Margin	31.65%	15.39%	20.03%	23.82%	21.20%	21.88%
Operating Profit Margins	29.02%	9.98%	12.26%	18.45%	15.82%	16.49%
EBITDA Margins	44.18%	27.74%	25.12%	30.25%	27.37%	28.12%
EBIT Margins	36.48%	16.79%	17.53%	23.95%	21.45%	21.93%
Pre- Tax Margins	26.80%	-2.02%	1.35%	13.35%	15.48%	17.60%
Net Profit Margins	25.27%	-0.43%	0.91%	9.07%	10.53%	11.97%
Return On Equity (ROE)	4.78%	-0.18%	0.49%	4.66%	5.22%	6.03%
Return On Assets (ROA)	3.14%	-0.10%	0.30%	3.23%	3.86%	4.61%
Return On Common Stockholders Equity (ROCE)	4.78%	-0.18%	0.49%	4.66%	5.22%	6.03%
Dividend Payout	21.31%	-714.47%	0.00%	17.30%	14.77%	12.11%
Retention Rate	78.69%	814.47%	100.00%	82.70%	85.23%	87.89%
Asset Turnover	12.41%	23.94%	33.00%	35.62%	36.68%	38.51%
Liquidity						
Current Ratio	2.60	1.59	1.54	1.40	1.43	1.51
Acid Test Ratio	0.04	0.05	0.04	0.05	0.07	0.08
Quick Ratio	2.56	1.56	1.49	1.34	1.35	1.44
Days' R/B	13.04	22.94	12.84	13.96	15.70	16.36
Days' Inventories	24.55	15.45	17.71	19.44	19.20	17.96
Days' Payables	58.41	40.19	37.78	36.09	37.34	37.03
Operating Cycle	-20.82	-1.79	-7.22	-2.69	-2.44	-2.70
Solvency						
Debt to Total Assets	28.35%	35.96%	31.49%	23.00%	18.06%	15.46%
Total Debt to Equity	52.53%	72.85%	63.14%	44.19%	35.16%	30.72%
Long Term Debt to Equity	25.61%	27.96%	18.42%	7.09%	2.75%	0.00%
Net Debt to Equity	42.91%	61.40%	50.68%	32.55%	23.70%	19.35%
Interest Coverage Ratio	500.71%	119.41%	113.38%	240.14%	409.19%	626.99%
Asset to Equity	152.53%	172.85%	163.14%	144.19%	135.16%	130.72%
Net Debt	14,556,668	18,469,307	15,318,694	10,233,113	7,797,928	6,721,937
Market Value of Equity	20,377,103	20,377,103	9,959,097	9,959,097	9,959,097	9,959,097
Enterprise Value (EV)	34,933,771	38,846,410	25,277,791	20,192,210	17,757,025	16,681,034
EV/ EBITDA	12	11	6	4	4	3
EV/ Ton of Sales	13,961	9,175	5,896	4,958	4,464	4,100
EV/Ton in $	229	150	97	81	73	67
EV/ Share	138	153	100	80	70	66
EV/ Ton of Capacity	15,629	9,663	6,288	5,023	4,417	4,150
EV/Ton in $	256	158	103	82	72	68
Gross Price per Ton (Ex-Fact)	3,756	4,116	5,231	5,429	5,645	5,919
Gross Price per Bag (Ex-Fact)	188	206	262	271	282	296
Net price per ton	2,565	2,940	3,796	3,965	4,102	4,299
Net price per bag	128	147	190	198	205	215
CGS per ton	1,946	2,806	3,321	3,268	3,472	3,622
CGM per ton	1,974	2,813	3,313	3,268	3,474	3,624
CGS per Bag	97	140	166	163	174	181
CGM per Bag	99	141	166	163	174	181
Working Capital	11,824,725	7,147,873	6,530,425	4,092,718	3,931,627	4,698,842
Change in Working Capital	7,930,266	(4,676,852)	(617,448)	(2,437,707)	(161,092)	767,215
Capital Expenditure	15,090,033	2,223,380	1,126,027	739,784	633,206	574,593

Source: Bloomberg

Lucky Cement Limited

Recommendation: NEUTRAL

Fair Value: PKR 57

Investment Consideration

Revenue growth of 29% expected in FY09

With capacity expansion of 1.25mn MT expected in the southern plant during FY09, coupled with an increase in cement prices and a concentration towards higher margin exports, LUCK is expected to post revenue growth of 29% during the period under review. Consequently, net sales are expected to range at PKR 21.9bn against PKR 16.9bn in the corresponding period last year.

Location benefits export growth

With rising export demand, LUCK's presence in both north and south has put it in a favorable position to fulfill exports by rail and through sea, while saving on inland freight costs of approximately USD 10/MT. For FY09-FY13, we expect exports to range around 50%-53% of LUCK's total sales mix. However, export demand may taper off post FY10 as regional capacities commence operations.

New projects likely to improve margins

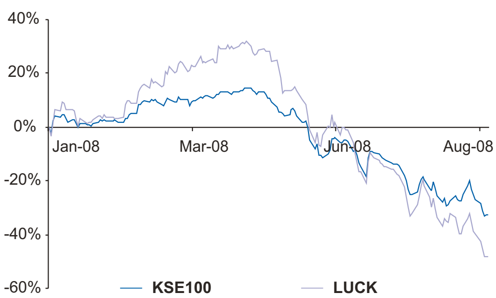
The Waste Heat Recovery project is expected to cost around USD 40mn and is set for completion by the end of FY09 whereby, cheap electricity will be generated by recycling waste heat from the process. Additionally, the Refuse Derived Fuel project may result in cost savings of approximately 60% when implemented. Conversion of existing plants from FO based to a mix of gas and FO is also likely to reduce cost of sales in the long term.

Valuation

Based on DCF approach, with a terminal growth rate of 4% and a WACC of 18.33%, we value LUCK at PKR 57/share. With the price floor intact, LUCK is currently trading at PKR 57.77, therefore we maintain a NEUTRAL stance on the scrip.

Bloomberg Code	*LUCK PA*
Current Price (PKR per share)	*57.77*
Average Daily Volume (mn shares)	*6.70*
Market Capitalization (PKR mn)	*18,681.66*
Shares Outstanding (mn)	*323.38*
Weightage in KSE100 (%)	*0.75%*
Average Price (PKR per share)	*112.14*

LUCK Relative Price Performance



Source: KSE & IGI Research

LUCK: Estimates

	FY07	FY08	FY09E	FY10E	FY11E	FY12E
Net income (PKR mn)	2,547	2,678	2,320	3,158	3,695	3,766
Dividend per share (PKR)	1.0	1.0	-	-	1.3	1.3
Earnings per share (PKR)	9.7	8.3	7.2	9.8	11.4	11.6
Price/Book	2.7	1.9	0.9	0.8	0.7	0.6
Price/Earning	9.9	13.5	8.1	5.9	5.1	5.0
Dividend yield	1.0%	0.9%	0.0%	0.0%	2.2%	2.2%
ROE	27.2%	14.4%	11.1%	13.1%	13.5%	12.2%
ROA	9.9%	7.8%	6.7%	8.9%	10.3%	9.8%

Source: Company Reports & IGI Research

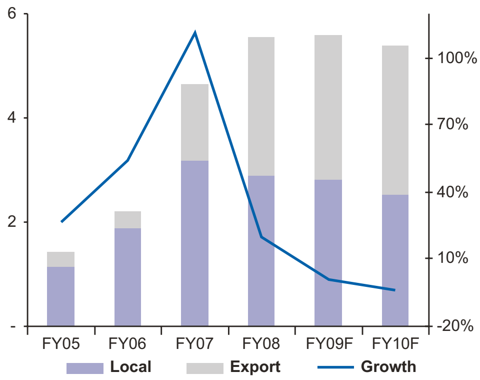
IGI Securities

Company Update

Exports to support margins

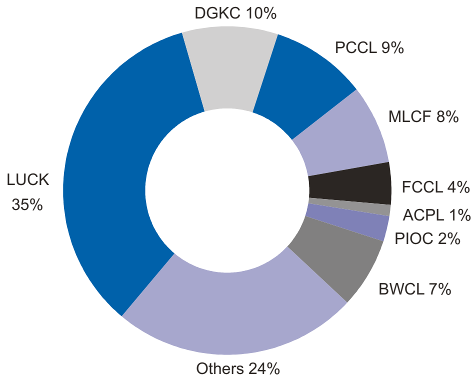
Lucky Cement's simultaneous presence in both the northern and the southern region has put it in a favourable position to fuel topline growth by catering to local demand through its northern plant, while leaving the southern plant to explore export avenues through sea routes, enabling them to save inland freight charges of approximately USD 10/MT. Excess capacity in both regions led the manufacturer to secure a 12% local market share and a 35% export market share in FY08, a trend which is expected to be maintained in the medium term. Additionally, LUCK has also entered into a Memorandum of Understanding with Noor Financial Investment Company for supply of 500,000 MT of clinker per year for a period of 5 years, enabling it to guarantee future off-take and utilization of 8%-10% at current capacity of 6.5mn MT, and 7%-8% of post expansion capacity of 7.75mn MT. However, export demand is likely to taper off after FY10 on account of regional expansions while LUCK's export dispatches are expected to post a CAGR of 2% till FY13. Nonetheless, of LUCK's total sales mix, 48% is still likely to account for export which will boost the topline through higher retention prices.

LUCK dispatches (mn MT)



Source: Company Reports & IGI Research

Export Market Share

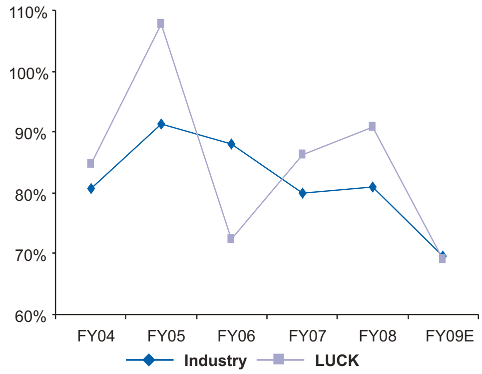


Source: Company Reports & IGI Research

New projects to boost bottomline through volumetric growth and cost efficiencies

The planned expansion of 2.5mn MT in LUCK's southern plant is expected to come in two phases. One plant of 1.25mn MT is expected to be operational by Dec08, while the other plant will commence operations during FY10. This expansion will increase the total capacity to 9mn MT and will boost production, thus leading to a surge in sales revenue through volumetric growth. This expansion is expected to cost USD 135mn and is financed from the USD 109.3mn raised through the GDR issue while the deficit is raised through debt financing. Post expansion, we expect utilization levels to fall to around 60% from the 75% expected during FY09.

LUCK Capacity Utilization



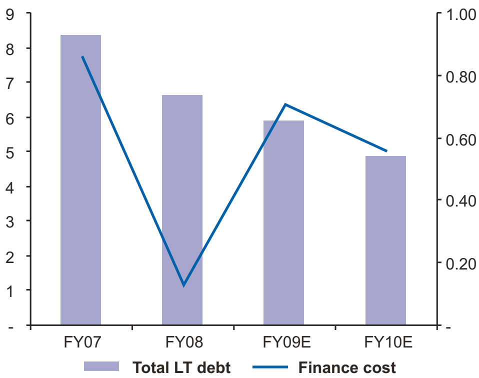
Source: APCMA & IGI Research

In an effort to fight soaring energy costs, the company has also initiated two new projects that are likely to reduce cost of sales in the long term.

The Waste Heat Recovery project is expected to cost around USD 40mn and is set for completion by the end of FY09 whereby, cheap electricity of about 15 MW at Karachi Plant and 10 MW at Pezu Pant will be generated by recycling waste heat from the process. Additionally, the Refuse Derived Fuel project is still in initial stages and is expected to result in cost savings of approximately 60% when implemented, according to industry sources.

Termination of cross currency swap agreements to increase interest rate risk
Owing to a 13% depreciation in the PKR against the USD, LUCK incurred losses of PKR 800mn on its cross currency swap agreements during FY08. In order to mitigate the risk of the further depreciation in the PKR, LUCK terminated its swap agreements during 1Q FY09 leading to one-time loss of approximately PKR 318mn. On account of this, we expect the company's financial charges to increase to PKR 703mn, while a one-off exchange loss of PKR 420mn incurred during 1Q FY09 will boost other charges to PKR 604mn during FY09. The swap arrangement had enabled the company to realize a positive interest rate differential between the KIBOR and the LIBOR. However, post termination of swaps, the long-term loans have now been refinanced and linked solely to the KIBOR which currently averages at 15.7% and is expected to be curtailed at current levels despite the recent 200bps hike in the discount rate. Going forward, the refinancing may provide a hedge against exchange rate volatility while exposing the company greatly to interest rate risk in case of a further appreciation in the discount rate and subsequently KIBOR.

LT debt vs. Finance cost (PKR bn)



Source: Company Reports & IGI Research

EBITDA/MT (PKR/MT)

Source: Company Reports & IGI Research

Valuation

Going forward, merely 1% volumetric growth is expected for FY09 compared to the corresponding period last year due to dwindling local demand slowdown in export growth. Nevertheless, owing to high prices of cement and increased exports, this is likely to translate into top line growth of 29% compared to FY08. However the burden of financial obligations falling due during to next 5 years acts as a dampener to the scrip's valuations. According to DCF approach, using a WACC of 18.33% a terminal growth rate of 4% and a share capital of 323.4mn shares, we estimate LUCK's fair value at PKR 57. At current levels, the scrip is trading at par to our fair value; therefore we hold a NEUTRAL stance on LUCK. Based on the prevailing law and order situation in the country, inflationary pressures and fears of a global growth slowdown, we reiterate a cautious approach on the sector in the long term.

LUCK: Sensitivity Table **(PKR'000)**

WACC	NPV of FCF	Term Val. at 2012	PV of Term Val.	Enterprise Value	Equity Value	Equity Value (PKR/sh)
12.33%	11,855,646	69,262,594	40,588,283	52,443,930	42,232,230	130.60
13.33%	11,528,345	61,835,041	34,788,610	46,316,954	36,105,255	111.65
14.33%	11,214,041	55,846,227	30,175,345	41,389,386	31,177,686	96.41
15.33%	10,912,088	50,915,032	26,430,976	37,343,064	27,131,364	83.90
16.33%	10,621,876	46,784,025	23,341,227	33,963,103	23,751,404	73.45
17.33%	10,342,832	43,273,052	20,756,310	31,099,142	20,887,442	64.59
18.33%	**10,074,416**	**40,252,265**	**18,568,401**	**28,642,817**	**18,431,118**	**57.00**
19.33%	9,816,117	37,625,705	16,697,946	26,514,063	16,302,364	50.41
20.33%	9,567,455	35,320,927	15,084,989	24,652,444	14,440,744	44.66
21.33%	9,327,978	33,282,212	13,683,509	23,011,487	12,799,787	39.58
22.33%	9,097,257	31,466,002	12,457,616	21,554,873	11,343,174	35.08

Source: Company Reports & IGI Research

LUCK: Sensitivity analysis

	Terminal growth rate				
WACC	**3.0%**	**3.5%**	**4.0%**	**4.5%**	**5.0%**
16.8%	64	66	69	72	75
17.3%	60	62	65	67	70
17.8%	57	59	61	63	65
18.3%	53	55	**57**	59	61
18.8%	50	52	54	56	58
19.3%	47	49	50	52	54
19.8%	45	46	47	49	51

Source: Company Reports & IGI Research

Lucky Cement Company Ltd.						
Income Statement (PKR '000)	**FY07**	**FY08**	**FY09E**	**FY10E**	**FY11E**	**FY12E**
Net Sales	12,521,861	16,957,879	21,956,286	22,361,312	23,768,111	25,508,296
Cost of Goods Sold	8,846,708	12,595,158	16,076,375	15,814,650	16,660,347	17,907,943
Operating Profit	3,066,113	3,076,367	4,401,090	4,985,850	5,426,445	5,801,192
EBITDA	4,578,527	4,056,629	5,650,203	6,382,544	6,940,666	7,392,840
Finance Costs	862,847	126,743	703,640	554,278	241,056	516,127
Taxation	143,059	(371,141)	773,447	1,052,681	1,231,695	1,255,372
Net Income	2,547,292	2,677,670	2,320,341	3,158,042	3,695,085	3,766,115
EPS - basic & diluted	9.67	8.28	7.18	9.77	11.43	11.65
Balance Sheet (PKR '000)						
Current Assets	5,402,678	8,407,379	5,835,770	4,954,290	4,486,543	4,826,664
Operating Assets	20,116,388	21,050,119	26,003,734	28,302,598	29,732,922	-
Total Fixed Assets	20,318,908	25,829,520	28,855,753	30,574,551	31,235,735	31,135,985
Current Liabilities	6,352,556	7,686,897	6,664,550	5,512,342	3,324,614	3,871,554
Long Term Loans	8,329,012	6,633,333	5,913,281	4,855,750	4,045,937	9,361,840
Total Non-Current Liabilities	10,017,655	7,896,754	7,053,385	5,884,869	4,975,169	3,715,253
Total Equity	9,353,550	18,655,423	20,975,763	24,133,805	27,424,671	7,597,761
Per Share						
No. Of Share	263,375	323,375	323,375	323,375	323,375	323,375
Book Value	35.51	57.69	64.87	74.63	84.81	95.20
Earning Per Share (EPS)	9.67	8.28	7.18	9.77	11.43	11.65
DPS	1.00	1.02	-	-	1.25	1.25
Sales Per Share	47.54	52.44	67.90	69.15	73.50	78.88
Price per Sales per Share (PSR)	2.01	2.12	0.85	0.84	0.79	0.73
Price Earning Ratio (PER)	9.86	13.45	8.05	5.92	5.06	4.96
Price Per Cash Flow (PCF)	85.52	(8.17)	53.75	6.22	5.74	3.64
Price to Book Value (PBR)	2.68	1.93	0.89	0.77	0.68	0.61
Profitability						
Gross Profit Margin	29.35%	25.73%	26.78%	29.28%	29.90%	29.80%
Operating Profit Margins	24.49%	18.14%	20.04%	22.30%	22.83%	22.74%
EBITDA Margins	36.56%	23.92%	25.73%	28.54%	29.20%	28.98%
EBIT Margins	29.51%	18.15%	20.05%	22.30%	22.84%	22.75%
Pre- Tax Margins	21.49%	13.60%	14.09%	18.83%	20.73%	19.69%
Net Profit Margins	20.34%	15.79%	10.57%	14.12%	15.55%	14.76%
Return On Equity (ROE)	27.23%	14.35%	11.06%	13.09%	13.47%	12.23%
Return On Assets (ROA)	9.90%	7.82%	6.69%	8.89%	10.34%	9.81%
Return On Common Stockholders Equity (ROCE)	27.23%	14.35%	11.06%	13.09%	13.47%	12.23%
Dividend Payout	10.34%	12.29%	0.00%	0.00%	10.94%	10.73%
Retention Rate	89.66%	87.71%	100.00%	100.00%	89.06%	89.27%
Asset Turnover	48.68%	49.53%	63.29%	62.93%	66.53%	66.47%
Liquidity						
Current Ratio	0.85	1.09	0.88	0.90	1.35	1.87
Acid Test Ratio	0.27	0.13	-0.36	-0.59	-0.91	-0.22
Quick Ratio	0.74	1.00	0.74	0.74	0.95	1.50
Days' R/B	29.65	54.83	54.83	54.83	31.03	31.03
Days' Inventories	27.90	20.56	20.52	20.60	29.22	29.21
Days' Payables	45.09	76.40	61.27	59.41	25.61	25.63
Operating Cycle	12.46	-1.01	14.08	16.02	34.64	34.60
Solvency						
Debt to Total Assets	63.64%	45.51%	39.54%	32.08%	23.23%	19.77%
Total Debt to Equity	175.02%	83.53%	65.40%	47.23%	30.26%	24.64%
Long Term Debt to Equity	89.05%	35.56%	28.19%	20.12%	14.75%	9.34%
Net Debt to Equity	123.69%	54.74%	58.15%	45.30%	35.33%	22.16%
Interest Coverage Ratio	4.28	24.28	6.26	9.00	22.52	11.24
Asset to Equity	275.02%	183.53%	165.40%	147.23%	130.26%	124.64%
Net Debt	11,569,403	10,211,699	12,197,543	10,931,927	9,690,141	6,821,224
Market Value of Equity	25,112,806	36,023,972	18,681,372	18,681,372	18,681,372	18,681,372
Enterprise Value (EV)	36,682,209	46,235,671	30,878,915	29,613,300	28,371,513	25,502,596
EV/ EBITDA	8	11	5	5	4	3
EV/ Ton of Sales	7,906	8,321	5,511	5,477	5,145	4,472
EV/Ton in $	130	136	90	90	84	73
EV/ Share	139	143	95	92	88	79
EV/ Ton of Capacity	5,850	7,135	4,283	3,544	3,159	2,840
EV/Ton in $	96	117	70	58	52	47
Gross Price per Ton (Ex-Fact)	3,583	3,747	4,756	4,923	5,108	5,295
Gross Price per Bag (Ex-Fact)	179	187	238	246	255	265
Net price per ton	2,699	3,052	3,919	4,136	4,310	4,473
Net price per bag	135	153	196	207	216	224
CGS per ton	2,091	2,433	3,079	3,168	3,279	3,403
CGM per ton	2,109	2,429	3,070	3,169	3,282	3,404
CGS per Bag	105	122	154	158	164	170
CGM per Bag	105	121	153	158	164	170
Working Capital	(949,878)	720,482	(828,780)	(558,052)	1,161,929	3,363,660
Change in Working Capital	(653,337)	1,670,360	(1,549,261)	270,727	1,719,981	2,201,731
Capital Expenditure	4,635,798	1,912,700	6,201,410	3,694,212	2,943,173	1,938,303

Source: Bloomberg

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Analyst Certification

I, Sarah Junejo, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject, securities and issuers. I also certify that no part of my 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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