

Sector Update

Construction & Materials

Sector Earnings Up By 24% Y/Y - 1HFY16

The top eight companies in the sector (mkt-cap basis) posted remarkable earnings growth in 1HFY16. The sector posted earnings growth of 24% Y/Y with FCCL, KOHC and MLCF being the star performers. Higher retention prices coupled with low international coal and FO prices contributed significantly to earnings enlargement while lower interest rate environment bodes well for leveraged companies (FCCL and MLCF). Moreover, no major announcements related to expansions or investments were disclosed in this season. The key highlights of 1HFY16 results are discussed below.

Robust Domestic Sales; Exports in Terrible Shape

Domestic dispatches during the 1HFY16 touched record high at 15.20mn tons; up by 16% Y/Y that largely neutralizes the brunt of depressed export sales. Higher disbursement of PKR 270bn under PSDP (↑ 86 % Y/Y) along with development on CPEC and sizzling private sector consumption supported the demand. In contrast, exports are in dire straits as it receded by 26% Y/Y to 3.06mn tons caused by the influx of cheap Iranian cement in Afghanistan and imposition of 13% - 69% anti dumping duty by South African authority. With higher share of local dispatches in overall sales mix (83%), average retention prices surged by 6% Y/Y to PKR 355/bag against PKR 335/bag recorded in 1HFY15.

Gross Margins At A Decade High

The commodity rout in international market became a blessing for cement sector. In 1HFY15, international coal prices which were hovering around USD 67.88/ton have slipped to USD 52.76/ton during the period under review, down by 22% Y/Y. Moreover, decline in FO prices have also allowed the companies to operate their diesel engines due to the better feasibility, reducing their dependence on national grid. The cost of electricity purchased from national grid is now ~30% - 35% expensive in comparison with electricity generated through in house FO engine. Thus, cost of production reduced by 4% Y/Y to PKR 204/bag against PKR 213/bag recorded in same period last year.

Sector Review for 1HFY16

PKR mn	1HFY16	1HFY15	Y/Y	2QFY16	2QFY15	Y/Y
Net Sales	77,610	72,247	7%	42,006	37,816	11%
COGS	44,658	45,850	-3%	23,521	23,517	0%
Gross Profit	32,952	26,396	25%	18,485	14,298	29%
Op. Exp.	6,663	6,641	0%	3,472	3,390	2%
EBIT	26,290	19,755	33%	15,014	10,908	38%
Other income	2,595	2,952	-12%	1,406	1,916	-27%
Finance Cost	775	1,286	-40%	327	477	-31%
PBT	28,110	21,421	31%	16,093	12,346	30%
Tax	7,737	5,002	55%	4,488	2,645	70%
PAT	20,372	16,419	24%	11,604	9,702	20%

Source: Company Accounts & HMFS Research

Note: Please refer to the last page for Analyst Certification and other important disclosures.



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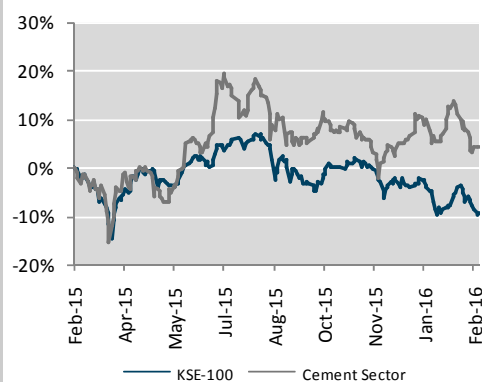
EPS for 1HFY16 (PKR/share)

	1HFY16	1HFY15	Y/Y	2QFY16	Y/Y
LUCK	19.34	17.32	12%	10.16	12%
DGKC	9.31	7.75	20%	5.38	5%
FCCL	2.09	1.25	67%	1.26	58%
MLCF	4.44	2.72	63%	2.84	69%
ACPL	10.07	8.95	13%	5.86	21%
KOHC	13.36	8.84	51%	7.47	69%
CHCC	3.83	3.63	6%	2.31	5%
PIOC	4.35	5.69	-24%	2.45	-42%

Source: Company Accounts & HMFS Research

Kumail Chevelwalla AC
kumail.c@hmfs.com.pk

KSE 100 Index Vs Const & Materials Sector



Source: HMFS Research

Margins - 1HFY16

	GM%	EBIT%	NM%
LUCK	46.7%	36.0%	28.6%
DGKC	40.2%	32.3%	29.9%
FCCL	46.0%	40.7%	27.9%
MLCF	40.6%	30.8%	21.6%
ACPL	35.1%	22.6%	18.0%
KOHC	43.8%	38.7%	29.8%
CHCC	34.3%	26.4%	19.4%
PIOC	39.6%	35.4%	22.6%
Sector Avg.	42.5%	33.9%	26.3%

Source: Company Accounts & HMFS Research

Interest Rate at Record Low

Low interest rate is not of much benefit for cement manufacturers as majority of the players have significantly reduced debt. However, FCCL and MLCF are the only companies with debt to capital ratio of above 0.15 (FCCL 0.20 & MLCF 0.18) while CHCC has recently acquired loan of PKR 2.1bn for the new production line. Nevertheless, cheap money is going to benefit the upcoming expansions as major portion of the cost will be financed via debt.

Updates on Investment Plans

- MLCF has opened letter of credit (LC) of USD 27.20mn for the import of coal fired power plant of 40MW for its subsidiary Maple Leaf Power Limited. The project is expected to start commercial production in FY18
- LUCK has announced to setup another 10MW WHR at its Pezu plant. The plant is expected to be operational by 3QFY17
- Management of LUCK is in the negotiation process with the Government of Punjab for the acquisition of land while the contract for the supply of machinery is expected to be finalized in 3QFY16
- ACPL has awarded the contract for supply of plant and machinery for new production line (4000/tons per day) to Chinese company
- 15MW WHR of KOHC is in commissioning stage and expected to be operational in 3QFY16

Investment Perspective

We expect domestic sales to rebound sharply from March due to post winter season and higher PSDP disbursement in 3Q and 4Q while the international fuel prices is likely to remain subdued in 2HFY16. However, the recent downtick in KSE-100 index has unlocked the upside potential in majority of the cement scrips. We recommend "BUY" on LUCK, CHCC and PIOC with Dec'16 TP of PKR 672/share, PKR 120/share and PKR 105/share respectively.

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