

January 26, 2021

Cement: 2Q Preview & Outlook

We expect our cement sample to post 2x jump in quarterly earnings on a sequential basis. We base our forecast on double-digit growth in local offtake, higher retention prices and operational efficiency steps undertaken by manufacturers.

Net revenue to grow 17% on higher volumes

Based on 11% jump in volumetric sales, total revenue of our sample stocks is estimated to grow by 17% QoQ.

Government support in the form of construction amnesty and revival of stuck-up projects tossed the local offtake up by 18% QoQ to 12.8mn tons. On the other hand, exports have been lackluster (down 17% QoQ to 2.3mn tons) due to pandemic-led trade restrictions and port congestion.

In our sample, PIOC is well placed to book highest volumetric growth of 29% QoQ, followed by 14% for CHCC and 9% for MLCF in 2QFY21.

Gross margins to improve by 3ppts on sequential basis

With higher sales and rising retail prices (up Rs23/bag), our sample companies' gross margin is likely to grow by 3ppts to around 18% from 15% in 1QFY21. Although, rising international coal price (up 29% QoQ to US\$72/ton) is a major dampener, large coal inventories of around 1-1.5 months will keep margins elevated in 2QFY21. In addition, in-house cheap power generation plants coming online will also reduce production costs for most players, widening their gross margins.

'Over-Weight' maintained

Though expensive on PE, as most companies underwent expansion in last two years, the sector is attractive on cash earnings. Our cement universe is trading at an average price to cash earnings (P/CEPS) of 7.9x during FY21-22. In near term, all eyes would be on coal price trend. With gradual ease in global port congestion/lock down and rise in temperature, price of heating coal is expected to decline.

In our forecast, we have assumed average coal price of US\$74/ton during CY21 versus existing FOB price of US\$90/ton. For every US\$5/ton change in coal price, our cement sector's annualized earnings are likely to alter by 10%.

Our top picks are PIOC, FCCL and DGKC, trading at P/CEPS of around 8.4x, 5.2x and 8.3x, respectively.

Sector Name
Stance

Cement
Over-Weight

Sector Key Data

Current Market Cap. (Rs bn)	619
Current Turnover (mn sh)	30.4
Current Traded Value (Rs bn)	1.7

Source: PSX, Sherman Research

Cement Sector - EPS Estimates

(Rs)	2Q20A	2Q21E	%Δ	1Q21A	%Δ
PIOC	0.3	0.8	157%	(0.2)	NM
FCCL	0.1	0.6	NM	0.5	13%
DGKC	1.3	1.0	-24%	(0.8)	NM
CHCC	(1.1)	1.9	NM	1.6	19%
KOHC	0.0	2.8	NM	2.5	11%
MLCF	(1.0)	0.5	NM	0.3	87%

Source: Company Accounts, Sherman Research

Sherman Research is also available on S&P Capital IQ,
Thomson Reuters Eikon, FactSet and MG-Link

► Analyst Certification and other disclosures on next page

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Risks to valuation:

Risk to valuation includes: 1) Change in coal and oil prices. 2) Lower than expected growth in dispatches. 3) Change in cement prices.

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Price Methodology:

To arrive at our period end Target Price, Sherman Securities uses different valuation methods which include : 1) Discounted Cash flow method 2) Relative Valuation method and 3) Justified Price to Book Value method.

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Rating Interpretation	
Buy	≥ 15.0%.
Sell	≤ -10%
Hold	Between -10% to 15.0%.