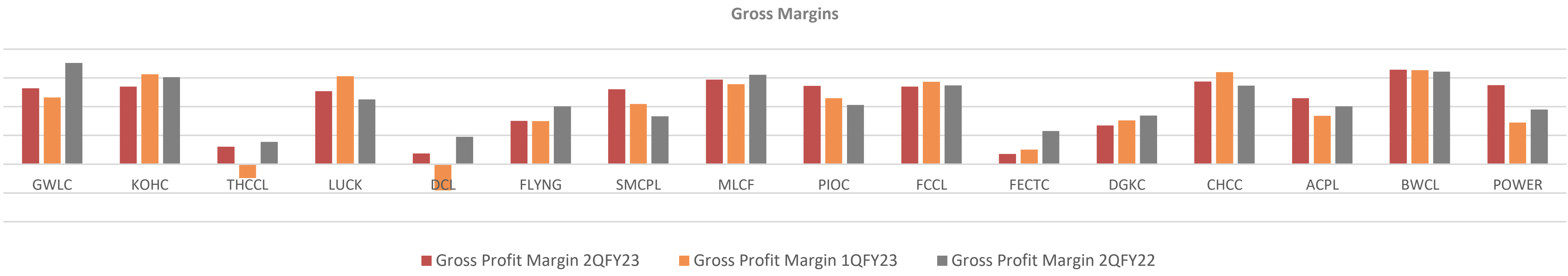
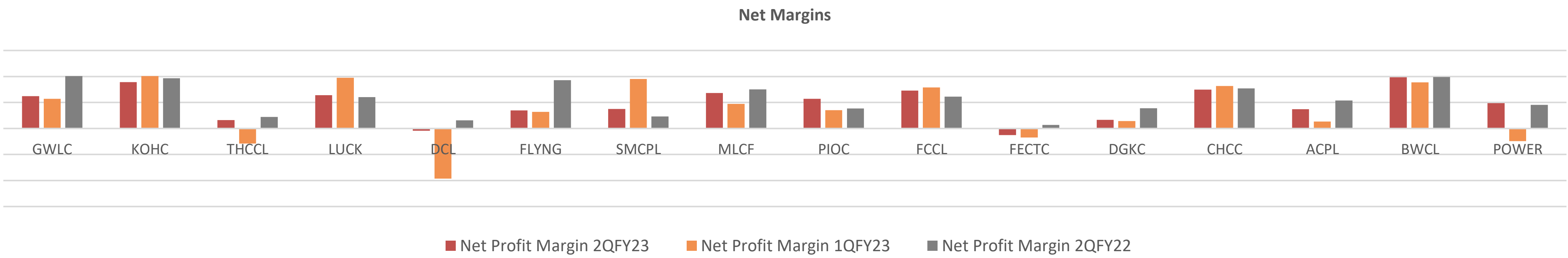
Cement Stocks on the Rise Amid Improved Margins

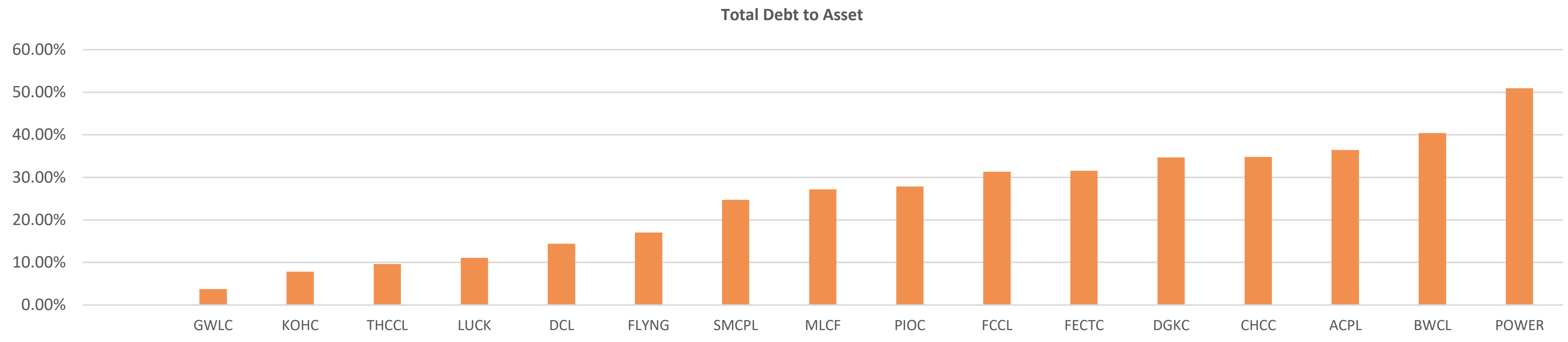
Monday, 13 March, 2023



In the second quarter of FY23, the cement industry's revenue increased by approximately 23%, resulting in a total sales figure of PKR 167.8 billion for the first half of the fiscal year, which represents a 22.4% increase. This increase in revenue can primarily be attributed to a 56% increase in the retention price. On the other hand, local cement dispatches decreased by around 17%, while exports fell by around 49%, reaching a total of 21.7 million tons. The decrease in sales can be attributed to several factors, including rising construction costs, higher interest rates, low utilization of PSDP, and political instability, which were exacerbated by severe flooding in the country. However, despite the decrease in sales volume, the increase in retention prices helped to mitigate the impact on revenue during this period.

In the past few days, there has been a significant decline in International Coal Prices, with Richard Bay dropping from US$187/ton at the beginning of the year to US$124/ton. If coal prices continue to remain stable or decrease further, the export market for sea exports is likely to experience growth, as it would become more economically feasible. However, there is a risk associated with LC issues, which could hinder the export process.





The cement industry is anticipated to face ongoing challenges primarily due to the current economic uncertainty, which includes an increase in interest rates, reductions in government spending, and a rise in the prices of construction materials. Companies that have taken on significant debt are particularly vulnerable to a decline in profitability caused by higher finance costs that could negatively impact their overall performance in a high-interest rate environment, where the policy rate is currently 20%.

A few of the companies with strong fundamentals are as follows

- **Kohat Cement Company Limited (KOHC):** At present, the company has a P/E ratio of 5.64 and a total debt-to-total asset ratio of only 7.8%, which will enable the company to sustain its profitability and thrive with enhanced margins.
- **Gharibwal Cement Limited (GWLC):** The company is trading at the P/E ratio of 5.6 while having the lowest debt to total debt to total asset ratio of just 3.72%. During 2QFY23 gross margins for the company improved to 26.41% QoQ from 23.24% while net margins improved from 11.4% to 12.4%.
- **Bestway Cement Limited (BWCL):** Compared to its peers, the company boasts the most impressive gross and net margins. In the 2QFY23, the gross margin reached 32.82%, and the net margin was 19.71%. However, the company's total debt-to-asset ratio is 40.38%, which resulted in a decline of the interest coverage ratio to 6.76 in 2QFY23, compared to 22.32% in SPLY.
- **Cherat Cement Company Limited (CHCC):** At present, the company has a P/E ratio of 4.5. The company has the third highest margins in the sector with a gross margin for 2QFY23 clocking at 28.74% and a net margin of 14.95%. However, the company's total debt-to-asset ratio is 34.8%, which resulted in a decline of the interest coverage ratio to 5.16 in 2QFY23, compared to 6.39 in the same period last year.
- **Fauji Cement Company Limited (FCCL):** Among its peers, the company's P/E ratio is one of the lowest at 3.17. Additionally, the company has robust margins and has experienced an increase in net margins, reaching 14.57% in 2QFY23 compared to 12.22% in the same period last year. The company's interest coverage also improved to 9.21, compared to 8.39 in the SPLY.
- **Maple Leaf Cement Factory Limited (MLCF):** The company has healthy margins with a P/E ratio of 5.93. It has a total debt-to-asset ratio of 27.2% which resulted in a decline of the interest coverage ratio to 6.74 in 2QFY23, compared to 7.67 in the same period last year.

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DEFINITION OF TERMS

TP	Target Price	DDM	Dividend Discount Model	FCF	Free Cash Flows
FCFE	Free Cash Flows to Equity	FCFF	Free Cash Flows to Firm	DCF	Discounted Cash Flows
PE	Price to Earnings Ratio	PB	Price to Book Ratio	BVPS	Book Value Per Share
EPS	Earnings Per Share	DPS	Dividend Per Share	ROE	Return of Equity
ROA	Return on Assets	SOTP	Sum of the Parts	JPB	Justified Price to Book

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II. Dividend Discount Model
III. Relative Valuation Model
IV. Sum of Parts Valuation

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HOLD	Between -5% to 15%
SELL	Less than and equal to -5%

Sector Rating	Sector Outlook
Overweight	Positive
Market Weight	Neutral
Underweight	Negative

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