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D.G Khan Cement…. Considerable Expansion!

We initiate our coverage for DGKC. Our thrust for coverage is due to their expansion in both the southern and northern zones of the country. However, we also see increase in earnings in FY17 given greater demand side economics.

We believe…

- DGKC will become second largest cement producer. It's the only manufacturer following Lucky Cement (LUCK) to have presence in both the zones.
- DGKC expansion is aligned with the rise in demand considering CPEC, public and private investments resulting in construction boom across the country. DGKC is main recipient of provincial government contracts in Punjab.

Margin galore FY17E…

We expect company to maintain increase in margins, considering our expectation of 'stability' in coal prices after a sudden surge. The impact of financial cost of borrowing for the expansion will be from FY19E onwards, hence, company can enjoy higher net margin in FY17E. In our model, we have assumed conservative increase in the bag prices of cement given producer's intention to pass on the impact at the premise of 'supply shortage'. We believe Pakistan is a developing country wherein there is scope for infrastructure development. DGKC has a broader scope since small dam construction in certain KPK areas are also in full swing.

We expect DGKC to be main supplier to dams once capacities would come online in FY18-19. We expect FY17 EPS of Rs23.18/sh (yielding FY17 PE of 8.5x & current EV EBITDA of 5.8x).

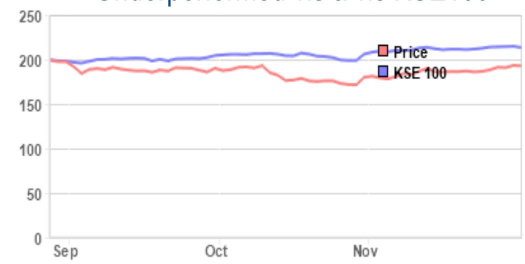
Capacity story…

Post-acquisition DGKC's operational capacity will increase to 9mn tpa (currently 4.4mn tpa) making it the second largest cement producer in the country. DGKC currently has 12% capacity-based market share of the northern zone. The increased capacity will enable DGKC to increase its market share to 16% (+4%) in the northern zone.

It will also be setting a stronghold in southern zone with capacity-based market share of 20% (currently no presence). We expect DGKC to be main brand in southern zone.

DGKC @ **195**
52 Week Low **125.25**
52 Week High **213.25**
Total no. of shares **438.12mn**
Market Capitalization **84.49bn**
Beta **1.16**
Annual EPS FY16 **20.06**

Underperformed vis a vis KSE100



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Nudging competitors, two expansions at a time…

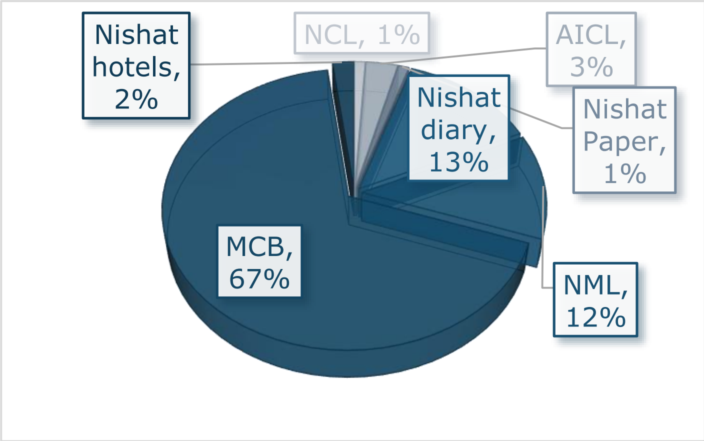
DGKC have been operating at 105% capacity utilization, which is, more than the average of the industry of 85%. Both the expansions to come live by the start of FY19. Although DGKC's expansion will be lagging behind Attock Cement's (ACPL) expansion, we believe that DGKC will be able to continue to operate at higher capacity utilization given infrastructure projects of greater public need.

The brownfield expansion of DG Khan site will be adding to 2.2mn tpa. DGKC will be able to benefit from the lower and continuous source of energy due to installation of 30MW coal based captive power plant. The company already have gas based captive power plant along with waste heat recovery for current operations.

The Greenfield expansion will be eligible for 5-year tax holiday considering it starts commercial operations before FY19. The company is setting up 3mn tpa plant in Hub, Baluchistan. Currently, company is nether installing captive power neither plant nor waste heat recovery and will also be dependent on main grid. This may result in slight lower margin as against its plants in northern zone, even though, we believe tax benefit will recoup the effects.

Portfolio…

During FY16, around 18% of DGKC's net earnings was generated in the form of other income. The investments of DGKC is spread across the *Mansha* group mainly MCB, Nishat Dairy and Nishat Mills Limited. This has resulted in a steady dividend stream. We remain positive about these investments. Other income for FY16 was Rs 2.3bn of which Rs 1.6bn was in the form of dividends from MCB.



DGKC estimated Profit & Loss

Rs000	FY19E	FY18E	FY17E	FY16
Net Sales	**68,491,604**	**35,013,623**	**34,581,683**	**29,703,758**
Cost of Sales	39,280,997	20,080,856	19,833,132	17,035,566
Gross Profit	**29,210,607**	**14,932,767**	**14,748,551**	**12,668,192**
Other income	4,109,496	3,221,253	2,769,739	2,379,053
Operating Cost	5,617,100	2,871,520	2,836,096	2,436,050
Operating Profit	**27,703,003**	**15,282,500**	**14,682,194**	**12,611,195**
Finance Cost	5,748,910	230,010	173,219.64	130,451
PBT	**21,954,093**	**15,052,490**	**14,508,975**	**12,480,744**
Tax	6,586,228	4,515,747	4,352,692	3,691,072
PAT	**15,367,865**	**10,536,743**	**10,156,282**	**8,789,672**
EPS	**35.08**	**24.05**	**23.18**	**20.06**
DPS	**8.50**	**4.50**	**6.00**	**6.00**

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