

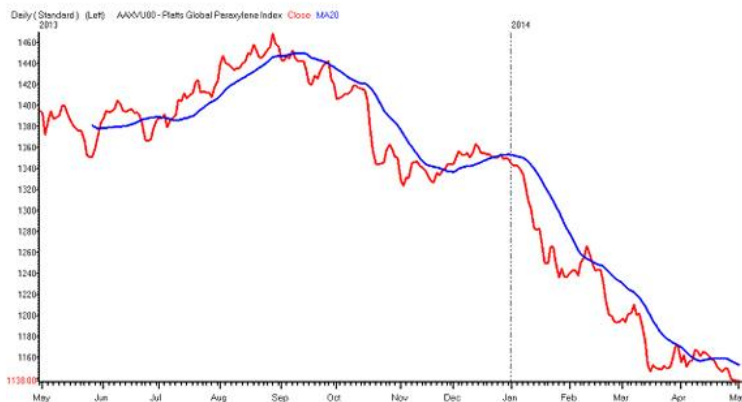
## LOTCHEM – Underachiever ~ Yet BUY!!

### PTA-Px margin to increase in favour of Lotchem

The price spread between feedstock paraxylene (Px) and **purified terephthalic acid** (PTA) was at around \$60/tonne as of 30 January. Px spot prices on an FOB (free on board) Korea basis began on a downtrend from mid-December, falling to \$1,301.50/tonne in February from \$1,425.50/tonne. In near future Px prices are expected to fall as in the middle of February **PetroChina** plans to start up its new 650,000 tonne/year PX unit at Pengzhou in Sichuan province which will result in ample supply of Px ~ this will bring down Px prices thus a good omen for Pakistan based producer of PTA viz. Lotchem.

In 2013, the spread between feedstock Px and PTA ranged from as low as \$63-64/tonne (€46-47/tonne) in October and November to a year-high of \$119-121/tonne in July and August, with an average spread of \$92/tonne as of November 2013.

### Platts Global Paraxylene (Px) Price Index



The trigger remains

- increasing margins and
- pumped up sales of Lotchem to local Polyester Fiber (PSF) producers albeit government effort to revitalize textile industry
- financial turnaround for Lotchem ~ we see their Korean based management to get incentives from present business savvy government.

#### Lotchem Statistics

Avg Volume (12M)	3,034,751
52 weeks high	9.13
52 weeks low	6.4
Market capitalization (bn)	10.6
Beta	1
Total no. of shares(mn)	1,514.2
Free float	424,855

Source: www.scstrade.com

#### Lotte Chemical

##### Profit and Loss Statement

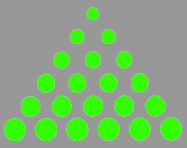
(Rupees in million)	1QCY14	1QCY13	Change
Revenue	12,389.00	13,031.00	-5%
Cost of Sales	(13,017.00)	(13,372.00)	-3%
Gross Loss	(628.00)	(340.00)	85%
Distribution & Selling Expense:	24.00	19.00	26%
Administrative Expenses	83.00	77.00	8%
Other Expenses	0.64	0.78	-18%
Other Income	176.00	287.00	-39%
Finance Cost	19.00	43.00	-56%
Loss Before Taxation	(579.00)	(193.00)	200%
Taxation	66.00	69.00	-4%
Loss After Taxation	(512.00)	(124.00)	313%
Loss Per Share	-0.34	-0.08	325%

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[www.scstrade.com](http://www.scstrade.com)



## Sensitivity Analysis

(Rs in mn)	1QCY14	CY14E
Total (Loss)/Profit	(512.0)	2,197.0
Production of PTA	125,000.0	375,000.0
(Loss)/Profit per tonne	(4,102.0)	4,200.0
Avg PTA-PX margins in US \$ per ton	70.0	107.0
EPS	-0.33	1.11

source: scs research

PTA-Px margins were shrink in 1QCY14 and averaged around US \$70 per ton while in coming quarters of the year we believe that margins will improved and averaged around US \$107 per tonne.

## Assumptions for our call

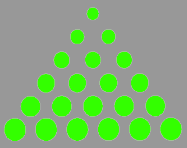
- Tongkun has delayed the start of a new PTA plant which was earlier schedule to start in 2016, hence PTA will not be in sufficient supply as it could have been.
- Global demand for PTA is to grow at a CAGR of 5.4% from 2011, reaching to 66 mn ton in 2020
- Ibrahim fibre is one of the main user of PTA hence increasing in textile exports will result in higher PTA demand
- PET accounts for less than 30% of the total PTA consumption in the world, We believe that demand for PET made bottles will increase in future in line with population as the standard of living has improved.

## Overview~

Lotchem remained under duress since two years given unfavourable PTA-Px margins. Lotchem is a sole PTA producer in Pakistan. PTA is a chemical which helps in manufacturing PSF. We expect PSF industry in Pakistan to show resurgence given emphasis of the present government to revive textile sector exports. Recent Chinese investments in various textile mills of Punjab are a great development which would invariably benefit Lotchem local sales.

## Textile Sector~ Time to rise

Pakistans textile exports touched \$10.3 billion mark in 9M FY14, a growth of 7.9 percent over the corresponding period of last year, as per Pakistan Bureau of Statistics. According to Federal textile minister Abbas Khan Afridi textile exports are expected to rise up by 10 -15%. He added that textile industry is working on new textile policy envisaging measures for expansion of industry to cope with the rising demand because of the GSP + scheme. The EU Ambassador Lars Gunnar Wigemark state that the the GSP plus facility for Pakistan will be for a period of 10 years with provisional reviews after every two years while Gohar Ejaz states that value added exports of Pakistan have risen by 25% in first 3 months of the year. And according to the new policy government designed total textile exports were to reach US \$26bn over the next five years(2014-2019). Currently there are some factors which are acting as a hurdle for the industry such as gas, electricity issues and devaluation of dollar against Pak rupee. Downside in dollar is not expected as Government also assures the industry regarding the dollar devaluation. While Government need to take some serious action regarding Gas and Electricity issues if these are to be resolved situation will be in favour of textile industry.



## World Cotton Statistics;

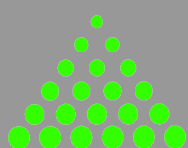
	World Cotton Supply and Distribution					
	2012/13	2013/14	2014/15	2012/13	2013/14	2014/15
	mn Tons			Change from Previous Months mn Ton		
Production	26.88	25.7	25.6	0.05	-0.03	-0.16
Consumption	23.34	23.55	24.33	0	0	0
Import	9.83	8.72	8.17	0	0	0.03
Export	10.08	8.72	8.17	0.02	0	0.03
Ending Stock	17.89	20.24	20.87	0.03	0	-0.17

Above fig. Explains world demand and supply of cotton globally which shows a decline in supply of cotton which results in a hike in cotton prices and on the other end textile sector is growing which will increase the demand of cotton and so this shortage will give a rise in cotton prices.

The official spot rate retained week-end earlier this month level at Rs 6,500, they added. In the ready session, above 6000 bales of cotton changed hands between Rs 6600-6650, dealers said. According to the market sources, the sellers held the stock of best types in expectations of further gains in prices. In India trading activity picked up, in China activity is improving, so that local cotton traders were hoping further betterment. According to business recorder the official spot rate held the overnight level at Rs 6,950 on Wednesday 28 May.

## Financial Highlights:

*Financial Highlights which need to consider before making Investment Decision~*



# Standard Capital

Securities (Pvt) Ltd

<b>Statement of Financial Position</b>				
<b>(Rs in million)</b>	<b>2012</b>	<b>2013</b>	<b>2014E</b>	<b>2015E</b>
<b>Assets</b>				
Non-Current Assets	10,192.0	8,819.0	8,275.0	7,879.0
Current Assets	10,866.0	11,077.0	13,850.0	16,669.0
<b>Total Assets</b>	<b>21,058.0</b>	<b>19,896.0</b>	<b>22,125.0</b>	<b>24,548.0</b>
<b>Equity</b>				
<b>Share Capital and Reserves</b>				
Share Capital	15,142.0	15,142.0	15,142.0	15,142.0
Capital Reserve	2.0	2.0	2.0	2.0
Accumulated Losses	(2,839.0)	(3,334.0)	(1,649.0)	(153.0)
	12,305.0	11,810.0	13,495.0	14,991.0
Non Current Liabilities	806.0	434.0	514.0	609.0
Current Liabilities	7,947.0	7,652.0	8,116.0	8,948.0
<b>Total Equity and Liabilities</b>	<b>21,058.0</b>	<b>19,896.0</b>	<b>22,125.0</b>	<b>24,548.0</b>

source: scs research

- We believe that Current Assets will be increasing in coming years mainly Trade Debts and Stock in Trade
- While Accumulated losses are expected to go down as profitability is expected to improve
- Current Liabilities will too be increasing as according to purchases (Trade Payables) will rise

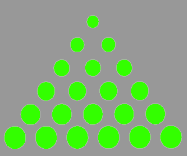
<b>Profit and Loss Statement</b>				
<b>(Rs in million)</b>	<b>2012</b>	<b>2013</b>	<b>2014E</b>	<b>2015E</b>
Revenue	52,823.0	57,069.0	62,570.0	68,616.0
Cost of Sales	52,617.0	56,920.0	59,692.0	66,000.0
Gross Profit	206.0	149.0	2,878.0	2,616.0
Expenses	482.0	544.0	552.0	576.0
Other Income	70.0	51.0	26.0	16.0
Operating Profit/(Loss)	(206.0)	(344.0)	2,383.0	2,111.0
Finance Income	291.0	128.0	122.0	134.0
Finance Cost	146.0	83.0	64.0	51.0
Taxation	62.0	197.0	722.0	641.0
Profit after Tax	3.5	(497.0)	1,685.0	1,496.0
EPS	0.0024	-0.33	1.11	0.99

source: scs research

- We see revenue to increase from 37.9 per share in CY13 to 41 in CY14 and 45 in CY15
- While Margins are expected to improve as Paraxylene (Px) prices to remain under duress
- Finance Cost is reducing as we don't expect any Long term loan in coming years.

<b>Cash Flow Statement (Rs in million)</b>	<b>2012</b>	<b>2013</b>	<b>2014E</b>	<b>2015E</b>
<b>Cash flow from operating activities</b>				
Cash generated from operations	1,516.00	3,022.00	3,633.00	3,418.00
<b>Net Cash generated from operations</b>	<b>965.00</b>	<b>2,339.00</b>	<b>3,096.00</b>	<b>2,980.00</b>
Net cash used in Investing activities	(1,720.00)	(150.00)	(194.00)	(168.00)
Net Cash used in financing activities	(2,850.00)	(0.12)	(217.00)	(217.00)
Inc/Dec in Cash and Cash Equivalents	(3,605.00)	2,188.00	2,685.00	2,594.00
Cash and Cash Equivalent at start of year	4,505.00	899.00	3,088.00	5,774.00
<b>Cash and Cash Equivalent at End of Year</b>	<b>899.00</b>	<b>3,088.00</b>	<b>5,774.00</b>	<b>8,369.00</b>

source: scs research



- We don't see any major increase in CAPEX as the company is currently not having any intention of expansion.
- Cash flow per share are expected to be of Rs 2 in CY14 as compare to 1.5 in CY13 and 1.98 in CY15

Profitability Ratios	CY12	CY13	CY14E	CY15E
Net Profit	-0.34%	-0.96%	2.70%	2.18%
Gross Profit	-0.40%	-1.25%	4.60%	3.81%
Return on Equity	-1.49%	-4.72%	12.48%	10.00%
ROCE	-1.49%	-4.56%	11.17%	8.91%
EPS	-0.12	-0.36	1.11	0.99
Revenue Per Share	34.88	37.68	41.3	45.31

source: scs research

Efficiency Ratios	CY12	CY13	CY14E	CY15E
Asset Turnover	2.35	2.78	2.82	2.8
Inventory Turnover	11.59	15.5	12.26	10.2
Receivable Turnover	16.4	18.77	20.21	22.18
Payable Turnover	36.35	34.09	52	51

source: scs research

Liquidity Ratios	CY12	CY13	CY14E	CY15E
Current Ratio	1.28	1.37	1.7	1.86
Quick Ratio	0.63	0.88	1.19	1.23

source: scs research

- Company is currently having a healthy Current ratio and is expected to improved further in coming years
- Margins are expected to rise in CY14 as compare to CY13

## Future Outlook

As Pakistan EU's GSP plus status have increased the textile exports which have led the local industry to produce more as according to Pakistan Cotton Ginners Association (PCGA) total output of cotton have risen in current year as compare to last year. Cotton Prices have increased as the US cotton futures closed higher on Friday after hitting a five-week high. If this rise remains persistent then demand for PTA will increases and help LOTCHEM to recover its losses and can prevent themselves from Gross loss. All of the textile exports does not produce by 100% cotton as PSF produced goods also have a wide market internationally. According to Platts Global Paraxylene prices have fallen in the 1Q of 2014 but still Lotchem faces Gross loss which might be possible due to Inventory being stored at higher prices which does not led the company to gain advantage from lower prices of Px in 1Q. In 2Q we expect that company should revised its Px prices with suppliers and will show a Gross Profit. Demand for PET made products have also increased in last few years and this is expected to rise in coming years as PET bottles have a wide market and is expanding gradually. While around 30% of the PTA is supplied to PET producers this demand of PTA from PET manufacturers might increase in coming years.

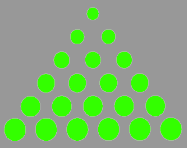
**LOTCHEM~** We re-initiate our coverage with a BUY CALL on LOTCHEM as according to our calculations we see fair value of a scrip of Rs.17/Share which indicated that currently the scrip is under-performing and have a room to expand in near future. While in CY14 we expect an EPS of Rs.1.11 and Rs.0.99 in CY15 hence showing a positive stance over the scrip.

While improvements in Cash flows of the company will make it further valuable.

## Valuation

Lotchem is looking good based on

- Px prices to remain under pressure
- GSP plus status (Rise in Textile Exports)
- Increase in Cotton Prices



We Issue our **BUY** stance as we see Company to recover from losses.