KSE100 Closing 11856.28 (-50.4 points) noon

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Pakistan Research
Cement | Co. update

Lucky Cement: Analyst briefing… company contemplates acquisition ....reiterate BUY

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LUCK closing	Rs69.11/sh
Chg	1.84%
52 week hi	Rs79.98/sh
52 week low	Rs58.00/sh
Beta	1.44
Free float	129.4mn
FY10 PE	7.12x
FY11E PE	6.3x
FY10 EV-EBITDA	3.3x
FY11E EV-EBITDA	3.6x

Yesterday we had the opportunity to attend the Lucky Cement's analyst briefing sponsored by Arif Habib Limited (AHL).

We have already published our report on LUCK dated April 27, 2011, with a DCF value perspective of Rs100.7/sh (this report can be viewed at our research portal www.scstrade.com).

Key takeaways from Lucky's CEO presentation…

LUCK enjoys economies of scale and therefore can thrive in the midst of economic and political turmoil. As per the presentation, LUCK is the lowest cost producer wherein cost per ton is nearly Rs 2,922/ton as against industry numbers of Rs 3,374/ton. In our call we have estimated cost per ton of Rs 3,141/ton for FY11. Moreover, LUCK's expansion cost per ton is also lowest vis-à-vis industry i.e. Rs 5,100/ton as against Rs 10,625/ton of the industry.

LUCK is one good player which is thriving on demand from southern region wherein company executive stated that the recent production line unveiling in northern zone is also creating glut like situation and also affecting price.

According to him, demand is slackened in northern zone despite all expectations of pick up in the aftermath of floods. The lack of funds allocated vide Public Sector Development Program (PSDP) is cited as one of the prime reasons behind sluggish demand in northern zone (where there is nearly 82% of country's installed capacity). However, LUCK thrives from increased southern demand and its traditional proximity to sea routes as well as presence of borders like Wakhan in the Balochistan province.

The company CEO sounds bullish on final quarter sales given latent demand from premier market Afghanistan and recent overtures with India regarding resumption of cement supplies. We have already estimated overall exports to touch 2.0mn tons in FY11 as against 2.7mn tons in FY10 given infrastructural developments emanating from Afghanistan, East African countries, Sri-Lanka to name a few.

He was particularly very bullish on developments in Sri-Lanka that had emerged as key market.

LUCK's primary markets used to be exports to GCC countries 3-years ago where 80% of its export turnover used to be consumed but with the advent of financial turmoil the supplies were diverted towards newer destinations such as Iraq, South Africa and now Sri Lanka.

LUCK is also expected to benefit from the export of commodity to India, as it is clearly facing cement shortages. However, we anticipate overall cement export to decline by 26% on account of dull prices in the export market.

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Please also download our call on LUCK dated April 27, 2011 from website www.scstrade.com

Research portal

LUCK has balanced fall in exports by shifting its main focus to the local sales especially in southern zone (company feels that it can further add to southern zone production line in order to meet demand).

Acquisition option is alive given propensity of free cash flows…

One of the biggest takeaways from the meeting is company's endeavour to acquire plant in foreign markets or to weigh options for organic growth (given amount of free cash flows available). One of the preferred destinations could be Sri-Lanka. LUCK is already cheap based on EV per ton.

We expect LUCK's local sales to increase by 75% in FY11 (given LUCK's performance in southern zone). We expect total capacity to increase to 71.5% in FY11 from 61% reported last year with total installed capacity of the industry being 44mn tons and operational capacity of 39mn tons approximately (as per company presentation).

Elaboration on Waste Heat Recovery Plant…

Cost of production of LUCK has benefited from the operation of Waste Heat Recovery Plant (WHRP) at Karachi plant and we expect it to further decline on account of the WHRP at Pezu of 10MW which commenced in the 1Q FY11. The reduction would continue to take place as LUCK is also in the course of building Refused Derived Fuel (RDF) plant (L/cs have already been established for the same) which will replace around 40% of the coal used in the Karachi plant with wood, used tires and rice husk, and will incur only minor maintenance cost, as stated by LUCK's management. Furthermore, it would leave LUCK with surplus capacity of about 75 MW to 80MW which would give it room for additional expansions.

Power sales to HESCO…

The signing of an agreement with HESCO has allowed LUCK to supply 20MW of electricity (could be improved to 49MW) and earn a revenue of Rs608mn (tax effects may reduce the figure accordingly)

Future FIFA soccer world cup event to benefit LUCK…

We expect LUCK to be a major beneficiary of the FIFA World Cup in Qatar (to take place in 2022) with cement demand to augment after 2012 till 2019.

Our recommendation – EV-EBITDA 3.6x ; PE 6.3x – dividend anticipation Rs 4/sh

We recommend to 'BUY' LUCK with DCF price perspective of Rs 100.7/sh. We are already expecting LUCK to report Rs 11.02/sh EPS in FY11 (yielding FY11 PE of 6.3x). LUCK yields EV-EBITDA of 3.6x.

LUCK is also attractive given the fact that it is one of the premier dividend payers in the cement industry. We expect LUCK to maintain FY10 payout of Rs 4/sh. We reiterate **BUY**.

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