KSE100 Closing 11933.46 (17.44 points)

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Pakistan Research
Cement | Co. update

Lucky Cement: Voluminous growth…. TP Rs100.7/sh BUY @72.5

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LUCK closing	72.24
Chg	0.18%
52 week hi	79.98
52 week low	58.00
Beta	1.43
Free float	129.4mn
FY10 PE	7.5x
FY11E PE	6.6x
FY10 EVEBITDA	3.3x
FY11E EVEBITDA	3.6x

Synopsis….

We continue our coverage of Lucky Cement (LUCK) wherein we delineate our Jun' 2011 DCF value of Rs 100.7/sh. LUCK offers room for appreciation based on FY11 & FY12 PE of 6.6 x & 4.5x respectively. We expect LUCK to maintain its previous payout of Rs 4/sh (depicting 6% dividend yield which is second highest after Attock Cement's 7%).

We still see LUCK model to be a volume play (given thrust of dispatches going all across Pakistan) which has the propensity to generate free cash flows. LUCK had previously being an export margin player given its traditional market outreach through parent company business of *Younus Brothers*. We expect LUCK reaping benefits of increase in margins on local dispatches albeit cost control through Waste Heat Recovery System at Pezu. LUCK enjoys economies of scale and thus protects its cost from otherwise sky high prices of international coal and furnace oil.

We expect a gradual increase in the 4Q EPS wherein we expect LUCK FY11 EPS to reach at Rs 11.02/sh. This also depicts earnings growth of 14% in FY11.

Sale dispatches: 2 mn tons exports on the cards

LUCK's traditional forte is margins on exports. However, export markets had been in the grip of recession hence LUCK depended on local demand. Nevertheless, we expect export dispatches to increase in 4QFY11 owing to probable acceptance by India to import commodity from Pakistan wherein LUCK to attain benefit from sea route. However, LUCK can also export through *Wagha-Attari* route.

Furthermore, we expect overall cement sector dispatches to war torn Afghanistan will increase (total cement sector exports to Afghanistan increased by over 16% to Rs 3.27mn tons in recent times). We expect supplies from Pezu plant to capitalize this latent demand. In totality, we assume LUCK to export 2.0 mn tons during FY11 as against 2.7mn tons reported in FY10. LUCK's previous destinations are facing oversupply and sluggish growth except markets like Iraq and East Africa. Company expects cement exports to increase especially to Afghanistan given reconstruction activities.

Forecasted Income Statement

Rs mn	FY09	FY10	FY11E	FY12E
Net sales	26,330	24,508	25,930	28,929
GP	9,811	7,978	8,542	10,037
Gross margin	**37%**	**33%**	**33%**	**35%**
EBIT	6414	3986	4402	6008
EBIT margin	**24%**	**16%**	**17%**	**21%**
EBITDA	10,362	7,934	7,267	8,750
EBITDA margin	**39%**	**32%**	**28%**	**30%**
PAT	4,597	3,137	3,562	5,173
EPS Rs /sh	***14.21***	***9.70***	***11.02***	***16.00***
DPS Rs /sh	4.0	4.0	4.0	4.5

Source: Standard Capital Research

*ACCA (affiliate)

Increase in revenue….

We expect local dispatches to increase by 75% translating into a revenue jump of Rs 21.3bn as against Rs 14.1bn reported last year. However, export dispatches to decrease by 26% thus revenues can come down to the level of Rs 10.3bn from Rs 14.8bn reported last year.

We see cement sales have picked up in Feb' and Mar' 2011 given increase in housing needs wherein we expect LUCK to garner a bigger chunk given presence in both northern and southern zone. We have assumed local and export prices to remain dull as against previous years given break up of cartel and overall recessionary trend in the export markets.

Cost of production escalating….

Fuel and power constitute major chunk in cost of production i.e. 63% (in 9MFY11) which we anticipate to increase further as a result of soaring global coal prices and higher electricity tariffs. However, commencement of Waste Heat Recovery Project at Karachi Plant may abridge fuel and power cost in future (we have amply incorporated this impact into our cost model). The coal price index for Mar' 2011 was US$ 122.4/ton and is expected to hover in the range of US$ 136/ton - US$ 143/ton indicating hikes in upcoming production costs. We can expect reductions in cost of production as LUCK is planning to install Refused Derived Fuel (RDF) at Karachi plant to reduce its coal consumption (though initially we do not expect a huge decrease in costs). As per 9MFY11 financials, the company has already established L/cs for the import of RDF from European supplier.

	FY09	FY10	FY11E	FY12E
Sales/ton	4,460	3,697	4,683	4,832
Cost/ton	2,798	2,494	3,141	3,156
Retention/ton	***1,662***	***1,203***	***1,543***	***1,677***
EBITDA/ton	1,755	1,197	1,313	1,462

Source: Standard Capital Research

Financial charges rationalized….

There was a major decrease in the FY09 finance cost from Rs 1.24bn to Rs 0.6bn reported in FY10 (nearly 54%) which resulted from the early repayments of high mark-up carrying long term loans and from resorting to export refinance at mandatory rate albeit Foreign Currency Import Finance (FCIF) facility. We continue to see decreasing trend in financial charges (due to major repayments) in the coming period which is a good omen for LUCK's bottom-line.

Industry production capacity to increase; however, price of cement bag to remain firmed up….

As per newspaper report total capacity of the industry is in the vicinity of 47.5 tons per annum during FY11 owing to anticipated expansions undertaken by *Fauji Cement* (FCCL), a key northern zone player. We project the total capacity utilization to increase to 71.5% and 77% in the FY11 and FY12 respectively from 61% reported in FY10.

We expect northern zone capacities to pick up given enhanced housing needs in Punjab and Khyber Pakhtoonkhwa (PK) as well as commencement of China sponsored projects in many areas. Recent agreement between government of Punjab with Chinese Government to initiate electricity generation at *Taunsa Barrage* as well as spending on water reservoirs such as *Munda* at PK may help in consuming more cement (LUCK to benefit from this project). We also expect supplies to Afghanistan to increase given reconstruction needs in that war torn country.

We expect cement prices to remain firmed up given escalation of input cost viz. coal prices. We see bottom line growth in some of the big companies such as LUCK itself given increase in local dispatches (volume play) and also deceleration in financial charges (since major part of fixed loans have been adjusted).

Valuation….FY11 PE 6.6x & EV-EBITDA 3.6x……DCF price Rs 100.7/sh

LUCK is one of the better dividend payers and we expect company to announce another payout of Rs 4/sh (FY10: Rs 4/sh) which translate into a dividend yield of 6% in FY11 (one of the best after Attock Cement's 7%).

Our model yields DCF price of Rs 100.7/sh (while taking cue of our terminal growth of 3%). We see LUCK into earnings growth territory of 14% in FY11 and 45% in FY12.

LUCK depicts FY11 PE of 6.6x and EV-EBITDA of 3.6x. BUY

Valuation matrix

	FY09	FY10	FY11E	FY12E
EV/EBITDA x	**2.7**	**3.3**	**3.6**	**3.0**
Debt/Equity	26%	14%	10%	9%
Payout	28%	41%	37%	28%
PE x	**4.9**	**7.5**	**6.6**	**4.5**

Source: Standard Capital Research

Risk to Valuation….

Any variation in the taxation structure in the proposed finance bill of 2012 may affect our FY12 earnings forecast.