SECTOR UPDATE

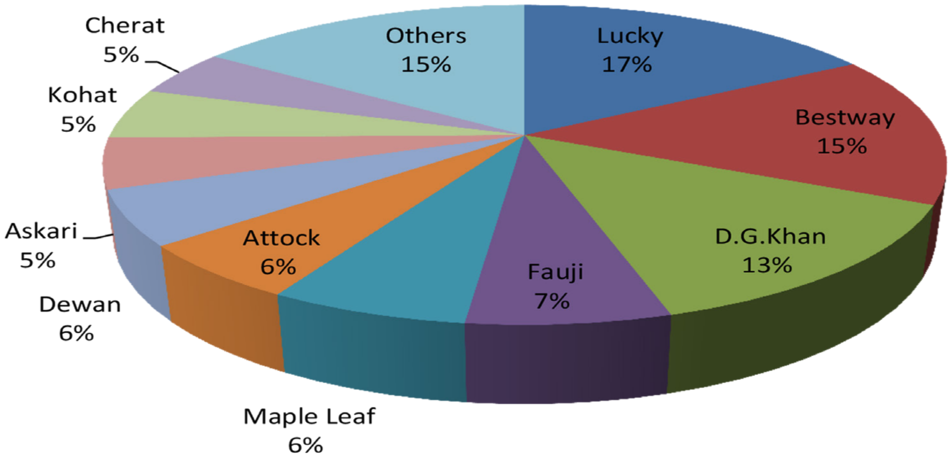
Cement Industry

September, 2018

Structure of the Industry

Geographically the cement industry in Pakistan is divided into two divisions; namely Southern & Northern region. Province of Punjab, Khyber Pakhtunkhwa, Azad Kashmir, Gilgit Baltistan and parts of Balochistan fall in North region while Province of Sindh and a few parts of Balochistan fall under South region. In the North Zone there are 14 listed companies whereas the Southern region has 5 listed companies. North region has an annual cement manufacturing capacity of 39.6m MT and South region has a total capacity of 13.89m MT.

Figure 1: Top 10 Players in the Cement Industry in terms of installed capacity



Both regions (North & South) have their own demand & supply dynamics. Players of the southern region benefit from greater export market availability given their geographical proximity to the sea; providing room for revenue diversification. Reliance of companies in the North on export sales remains low; however local demand in North Zone is higher due to CPEC and other government related infrastructure projects. Key export markets for players operating in the North Zone remains Afghanistan and India. For players operating in the South Zone, Sri Lanka, Nigeria, Tanzania, Mozambique, Iraq, Ethiopia and DR Congo are major export markets.

Locally the industry operates under a marketing arrangement which helps industry players in maintaining prices and margins. As per the arrangement, a quota is assigned to each player based on installed capacity. Given the market arrangement and demand and supply dynamics, local retention prices and margins compare favorably to export sales. In the absence of a marketing arrangement, players with higher efficiencies, wider outreach and better access to export market will enjoy competitive advantage over peers.

Figure 2: Existing North Capacities

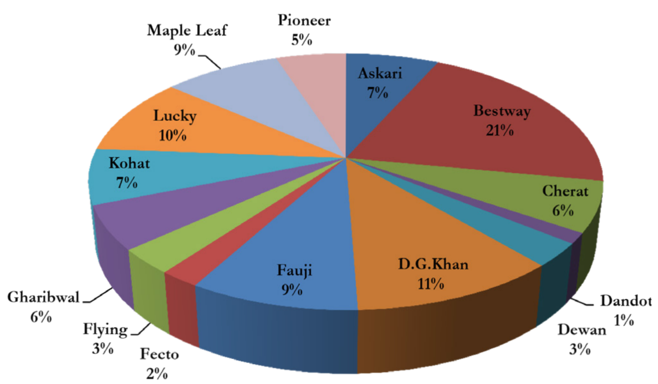


Figure 3: Final North Capacities

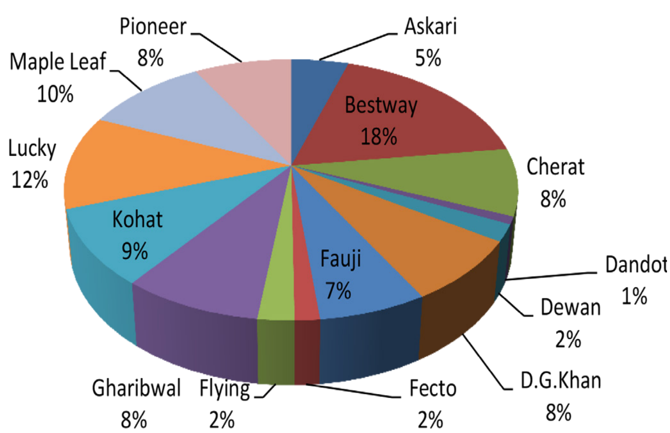


Figure 4: Existing South Capacities

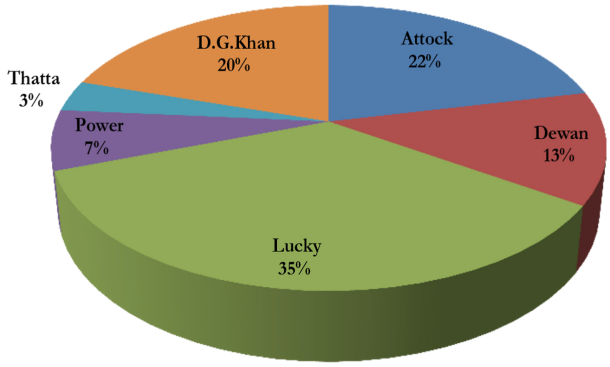
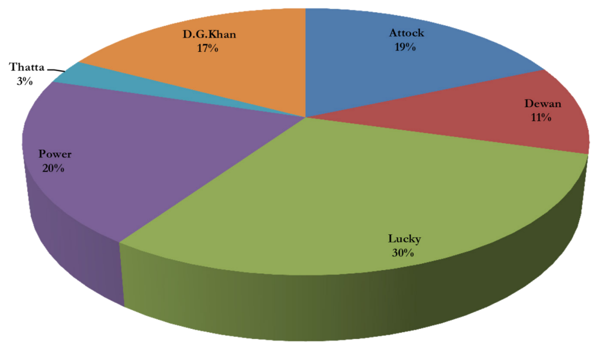


Figure 5: Final South Capacities



Capacity Utilization

Production capacity of cement sector has more than doubled over the last decade to 46.94m MT/Year (FY06; 20.8m MT/Year). Top 5 players in terms of installed capacities are Bestway Cement (BWCL), Lucky Cement (LUCK), D.G. Khan Cement (DGKC), Fauji Cement (FCCL) and Maple Leaf Cement (MLCF). These top 5 players represent 58% of total installed capacity. Average capacity utilization was around 93% for FY18. Capacity utilization of South was 90.0%[1] as compared to 93.6% in North region.

Table 1: Capacity utilization (In Million Metric Tons)

Year	Capacity	Total Dispatches	Capacity Utilization
FY18	49.5	45.9	93%
FY17	46.4	40.3	87%
FY16	45.6	38.9	85%
FY15	45.6	35.4	78%
FY14	44.6	34.3	77%
FY13	44.6	33.4	75%
FY12	44.6	32.5	73%

**Annualized*

Table 2: Capacity utilization – North (In Million Metric Tons)

Year	Capacity	Total Dispatches	Capacity Utilization
FY18	39.6[2]	37.0	93.6%
FY17	39.3	32.3	82.2%
FY16	38.0	30.9	81.4%
FY15	38.0	27.9	73.5%
FY14	37.0	27.1	73.2%
FY13	37.0	26.4	71.5%
FY12	37.0	25.6	69.3%

**Annualized*

1 Adjusted capacity utilization; taking into account 50% of incremental capacities of ACPL and LUCK

2 New capacity of Bestway is not included since it came online post FY18.

Table 3: Capacity utilization – South (In Million Metric Tons)

Year	Capacity	Total Dispatches	Capacity Utilization
FY18	13.9	8.8	90.0%
FY17	8.6	8.0	92.8%
FY16	7.7	5.9	77.6%
FY15	7.7	7.5	97.8%
FY14	7.7	7.8	101.7%
FY13	7.7	7.0	91.2%
FY12	7.7	6.9	89.9%

**Annualized*

Sales

Table 4: Industry Dispatches

Industry Dispatches (m MT)	FY15	FY16	FY17	FY18
North				
Local	23.44	27.05	29.14	33.96
Exports	4.47	3.85	3.15	3.08
Total North Dispatches	**27.91**	**30.91**	**32.29**	**37.04**
South				
Local	4.76	5.95	6.51	7.17
Exports	2.73	2.02	1.51	1.66
Total South Dispatches	**7.49**	**7.97**	**8.02**	**8.83**
Total Industry				
Local	28.20	33.00	35.65	41.13
Exports	7.20	5.87	4.66	4.74
Total Industry Dispatches	**35.40**	**38.87**	**40.32**	**45.87**

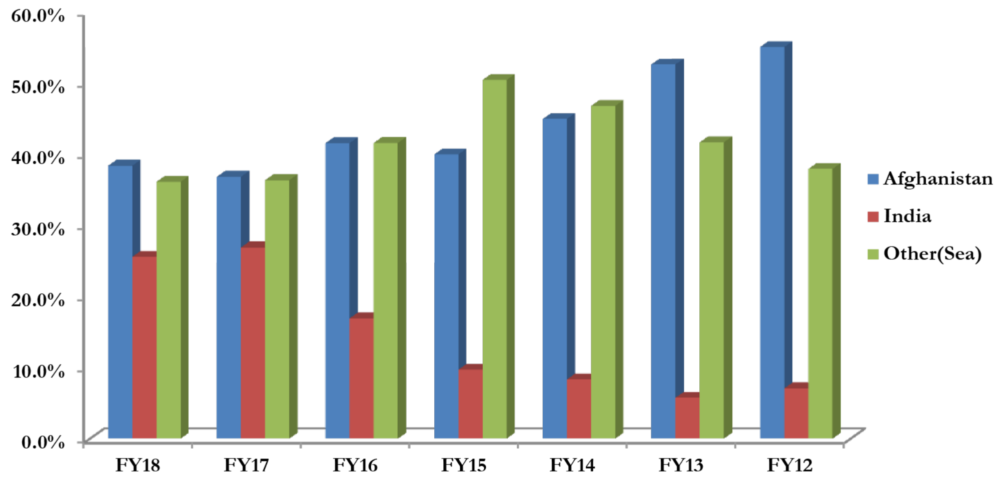
The rise in cement dispatches is attributable to rising local volumes with major contribution coming from the North Zone. Local dispatches recorded healthy growth of 15.1% while export sales after declining for the past 4 years recorded a meager increase of 1.69%. Resultantly, proportion of local dispatches has increased from 73.6% in FY12 to 89.7% during FY18 whereas proportion of export has declined from 26.4% in FY12 to 10.3% in FY18.

Table 5: Sales

Year	Dispatches In Tons			Percentage	
	Local	Exports	Total	Local	Exports
FY12	23,947,165	8,567,826	32,514,991	73.6%	26.4%
FY13	25,058,747	8,374,104	33,432,851	75.0%	25.0%
FY14	26,145,355	8,136,528	34,281,883	76.3%	23.7%
FY15	28,206,027	7,194,249	35,400,276	79.7%	20.3%
FY16	33,001,296	3,851,615	36,852,911	89.5%	10.5%
FY17	35,651,598	4,663,569	40,315,167	88.4%	11.6%
FY18	41,147,391	4,746,028	45,893,419	89.7%	10.3%

Volumetric increase in exports from the South Zone has been witnessed during FY18 vis-à-vis FY17. Going forward, with sizeable new capacities having come online in FY18 continuation of growth in exports from the South Zone is considered important. In this regard, rupee depreciation during FY18 has made exports more attractive for local manufacturers and is expected to facilitate in maintaining growth momentum in exports. JCR-VIS expects growth in exports from South Zone to outpace North Zone given the sizeable increase in capacities in the South region.

Figure 6: Country-wise Export (No need for percentages on the side)



Business Risk

Over the past few years, the cement manufacturing industry in Pakistan has shown healthy growth in terms of dispatches. Going forward, key factors which are expected to contribute towards local demand include ongoing and upcoming CPEC and infrastructure projects particularly dams and strong focus of the new government on the housing sector. However, increasing interest rates and sizeable current account deficit are expected to result in slower GDP growth. Resultantly, JCR-VIS expects cement dispatches to witness slow down vis-à-vis FY18 but growth is expected to remain higher than GDP growth.

Given the increasing capacity utilization and strong demand outlook, key players in the cement sector announced capacity expansions in 2015 and 2016. Resultantly, installed capacity in the sector is expected to increase to around 75m tons from 45.6m tons at end-FY15. Till July'2018, 5 players including Cherat Cement Company Limited (CHCC), Attock Cement Company Limited (ACPL), LUCK, DGKC and BWCL having aggregate capacity of 8.7m tons have come online. Given the increase in capacities and projected additional capacities expected to come online pricing power of industry players has been impacted. This is also evident from declining margins for industry players during FY18.

As per JCR-VIS, the cement sector is now projected to enter competitive phase with pressure expected on selling prices and rising cost of inputs. After witnessing significant decline during FY18, JCR-VIS expects industry margins to remain under pressure in FY19 on account of higher coal prices due to rupee depreciation and expected increase in competition, particularly in the South region. Expansion projects of three players (LUCK in Dec'2017, ACPL in Jan'2018 and DGKC in May'2018) representing around two-third of existing capacity have come online over the last 6 months. While the marketing arrangement has largely operated smoothly post expansion by LUCK and ACPL, JCR-VIS expects prices to come under pressure given that DGKC's plant comprises a single line and is more efficient. However, DGKC's limited presence in export markets and brand strength in the South zone compares less favorably to other two established players.

Expansion in the North Zone are coming online in a more staggered manner over the next two to three years but smooth functioning of the marketing arrangement remains a concern given the price cuts witnessed during 1HFY18 despite only CHCC having come online. Given the macroeconomic environment (increasing interest rates and slower GDP growth), those players that have completed expansions are considered to pose lower business risk. This is on account of elimination of construction and rupee depreciation risk (pertaining to imported plant and machinery) while players will also enjoy higher quota in the intervening period and lower average finance cost pertaining to the project.

Profitability:

Figure 7: Profitability Indicators

	Lucky Cement				BWCL			
Rs. In m	**FY16**	**FY17**	**9M18**	**9M17**	**FY16**	**FY17**	**9M18**	**9M17**
Net sales	45,135	45,687	35,671	35,241	45,721	51,623	40,249	39,133
Gross Profit	21,746	21,298	13,093	16,951	21,148	22,533	14,462	17,285
Gross margin	48%	47%	37%	48%	46%	44%	36%	44%
PBT	18,400	18,778	11,979	14,669	17,078	18,664	11,698	14,463
PAT	12,944	13,692	9,802	10,422	11,880	13,293	8,712	10,568
Net Margin	29%	30%	27%	30%	26%	26%	22%	27%
	MLCF				**DGKC**			
Rs. In m	**FY16**	**FY17**	**9M18**	**9M17**	**FY16**	**FY17**	**9M18**	**9M17**
Net sales	23,433	23,992	19,317	18,294	29,704	30,136	23,375	22,633
Gross Profit	10,022	9,482	7,624	7,624	12,668	11,845	7,169	9,215
Gross margin	43%	40%	32%	42%	43%	39%	31%	41%
PBT	7,118	6,870	3,886	5,697	12,481	11,158	6.688	8,722
PAT	4,885	4,777	2,854	4,052	8,790	7,975	4,970	6,454
Net Margin	21%	20%	15%	22%	30%	26%	21%	29%
	Fauji Cement				**Askari**			
Rs. In m	**FY16**	**FY17**	**9M18**	**9M17**	**FY16**	**FY17**	**9M18**	**9M17**
Net sales	20,044	20,423	15,814	15,760	15,600	15,953	11,468	12,192
Gross Profit	9,165	4,438	3,728	3,462	5,463	5,118	2,839	4,149
Gross margin	46%	22%	24%	22%	35%	32%	25%	34%
PBT	7,831	3,930	2,987	2,828	4,234	3,955	2,023	3,267
PAT	5,367	2,613	2,122	1,972	2,983	2,694	1,434	2,349
Net Margin	26.8%	12.8%	13%	13%	19%	17%	13%	19%
	ACPL				**Kohat Cement**			
Rs. In m	**FY16**	**FY17**	**9M18**	**9M17**	**FY16**	**FY17**	**9M18**	**9M17**
Net sales	13,918	14,736	12,142	11,242	14,020	13,540	10,385	10,658
Gross Profit	5,587	5,892	3,980	4,574	6,497	5,827	3,515	4,816
Gross margin	40%	40%	33%	41%	46%	43%	34%	45%
PBT	4,236	4,444	2,606	3,347	6,252	5,520	3,232	4,491
PAT	2,890	3,034	1,827	2,238	4,408	3,545	2,296	3,121
Net Margin	21%	21%	15%	20%	31%	26%	22%	29%
	CHCC				**Gharibwal**			
Rs. In m	**FY16**	**FY17**	**9M18**	**9M17**	**FY16**	**FY17**	**9M18**	**9M17**
Net sales	7,079	9,645	11,148	6,714	10,522	11,223	8,513	8,370
Gross Profit	2,634	3,213	2,569	2,515	4,172	3,854	2,061	2,886
Gross margin	37%	33%	23%	37%	40%	34%	24%	34%
PBT	2,051	2,510	1,821	2,006	3,707	3,045	1,387	2,327
PAT	1,405	1,957	1,795	1,567	2,694	2,284	1,000	1,701
Net Margin	20%	20%	16%	23%	26%	20%	12%	20%

PIOC					Thatta Cement			
Rs. In m	FY16	FY17	9M18	9M17	FY16	FY17	9M18	9M17
Net sales	9,367	10,631	7,505	8,089	2,846	3,657	2,174	2,852
Gross Profit	4,005	4,428	2,062	3,325	914	1,163	629	917
Gross margin	43%	42%	27%	41%	32%	32%	29%	32%
PBT	3,846	4,070	1,654	3,164	666	855	430	748
PAT	2,519	2,918	1,149	2,399	614	582	308	550
Net Margin	27%	27%	15%	30%	22%	16%	14%	19%
FECTO Cement					Power Cement			
Rs. In m	FY16	FY17	9M18	9M17	FY16	FY17	9M18	9M17
Net sales	5,032	5,131	3,841	4,006	4,144	4,481	3,310	3,327
Gross Profit	1,623	1,557	784	1,235	947	981	618	682
Gross margin	32%	30%	20%	31%	23%	22%	19%	21%
PBT	1,159	1,091	446	865	765	565	402	420
PAT	814	761	330	607	486	467	289	324
Net Margin	16%	15%	9%	15%	12%	10%	9%	10%

- Despite slight decline in retention prices during FY18, net sales of industry players depicted increase due to growth in dispatches. In terms of growth in dispatches, players whose capacities have online (CHCC, LUCK, and ACPL) have showcased the highest increase in net sales.

- Gross margins have depicted a sharp decline due to inability to pass on increase in coal prices, decline in retention prices and higher proportion of clinker exports for some players. Variation in gross margins across industry players is a function of differences in plant efficiencies in terms of Kcal and KWH consumption, cost of fuel being used, proportion of local and export sales in sales mix and differences in retention prices being charged. MLCF reported the highest gross margin amongst industry players during 9MFY18.

- Overall profitability witnessed decline due to pressure on margins with most players recording double digit decline in profit before tax. Only CHCC (due to higher dispatches on account of full year impact of increase in capacity) and FCCL recorded an increase in profitability. Going forward, profitability is expected to remain under pressure given sizeable capacities coming online.

Liquidity:

Figure 8: Liquidity Indicators

Lucky Cement					BWCL			
Rs. In m	**FY16**	**FY17**	**9M18**	**9M17**	**FY16**	**FY17**	**9M18**	**9M17**
FFO	16,029	16,493	10,607	13,215	14,743	15,845	10,299	12,624
FFO/Total Debt	NA	NA	NA	NA	0.77	1.06	0.69	1.40
Current Ratio	4.1	4.48	3.44	4.29	1.2	1.1	0.7	1.4
MLCF					**ACPL**			
Rs. In m	**FY16**	**FY17**	**9M18**	**9M17**	**FY16**	**FY17**	**9M18**	**9M17**
FFO	8,902	7,189	4,158	6,028	2,616	3,061	2,785	2,465
FFO/Total Debt	2.93	1.07	0.41	1.44	328.81	0.85	0.74	1.05
Current Ratio	1.7	1.3	1.1	1.4	2.6	0.5	0.7	0.7
Fauji Cement					**Askari**			
Rs. In m	**FY16**	**FY17**	**9M18**	**9M17**	**FY16**	**FY17**	**9M18**	
FFO	8,067	3,365	2,873	2,527	3,562	3,434	1,781	
FFO/Total Debt	1.97	1.87	2.44	1.47	0.48	0.42	0.22	
Current Ratio	1.5	2.1	1.8	1.7	1.1	0.9	0.6	
CHCC					**Kohat Cement**			
Rs. In m	**FY16**	**FY17**	**9M18**	**9M17**	**FY16**	**FY17**	**9M18**	**9M17**
FFO	1,704	2,894	2,491	2,284	3,758	4,181	2,292	3,549
FFO/Total Debt	0.40	0.45	0.28	0.59	2.4	4.6	4.6	3.6
Current Ratio	1.1	1.8	1.4	1.4	2.8	3.2	3.2	2.4
DGKC					**Gharibwal**			
Rs. In m	**FY16**	**FY17**	**9M18**	**9M17**	**FY16**	**FY17**	**9M18**	**9M17**
FFO	9,983	7,755	6,434	6,705	3,455	3,116	1,545	2,483
FFO/Total Debt	1.43	0.36	0.29	1.14	1.10	0.69	0.48	1.02
Current Ratio	3.1	1.8	1.7	2.5	0.8	0.7	0.7	0.6
PIOC					**Thatta Cement**			
Rs. In m	**FY16**	**FY17**	**9M18**	**9M17**	**FY16**	**FY17**	**9M18**	**9M17**
FFO	2,641	2,915	1,405	2,739	566	771	409	603
FFO/Total Debt	4.1	1.3	0.2	2.2	0.44	1.04	0.95	1.13
Current Ratio	2.4	3.1	1.7	2.7	2.0	1.8	1.6	1.7
FECTO Cement					**Power Cement**			
Rs. In m	**FY16**	**FY17**	**9M18**	**9M17**	**FY16**	**FY17**	**9M18**	**9M17**
FFO	1,046	721	430	686	385	179	155	287
FFO/Total Debt	NA	NA	29.64	NA	0.24	0.12	0.04	0.32
Current Ratio	5.0	5.4	5.0	4.8	0.9	2.6	3.1	1.4

- In line with decline in profitability, cash flows from operations for most industry players have witnessed a decline.
- Debt servicing ability for most industry players remains strong with high FFO/Total Debt ratios.
- LUCK has the strongest liquidity profile amongst industry players given the healthy cash flows, sizeable liquid investments, debt free balance sheet and highest current ratio.

Capitalization:

Figure 9: Capitalization Indicators

	Lucky Cement				BWCL			
Rs. In m	**FY16**	**FY17**	**9M18**	**9M17**	**FY16**	**FY17**	**9M18**	**9M17**
Total debt	0	0	0	0	19,187	14,888	19,836	11,985
Total Liabilities	16,586	17,552	21,976	18,401	35,837	33,996	40,345	31,952
Total Equity	69,323	79,785	84,090	76,511	41,983	47,769	50,282	47,069
Leverage	0.2	0.2	0.3	0.2	0.9	0.7	0.8	0.7
Gearing	0	0	0	0	0.5	0.3	0.4	0.3
	MLCF				**DGKC**			
Rs. In m	**FY16**	**FY17**	**9M18**	**9M17**	**FY16**	**FY17**	**9M18**	**9M17**
Total debt	3,036	6,723	13,423	5,558	7,002	21,615	29,083	7,849
Total Liabilities	10,685	19,433	24,165	15,465	17,635	33,503	42,197	29,028
Total Equity	16,750	19,384	28,958	18,605	65,783	74,869	77,313	72,747
Leverage	0.6	1.0	0.8	0.8	0.3	0.5	0.5	0.4
Gearing	0.2	0.4	0.5	0.3	0.1	0.3	0.4	0.3
	Fauji Cement				**Askari**			
Rs. In m	**FY16**	**FY17**	**9M18**	**9M17**	**FY16**	**FY17**	**9M18**	
Total debt	4,090	1,801	1,565	2,286	7,324	8,185	10,856	
Total Liabilities	10,930	8,072	8,269	9,186	13,342	13,833	16,217	
Total Equity	18,428	19,681	20,561	19,039	4,808	4,559	12,794	
Leverage	0.6	0.4	0.4	0.5	2.8	3.0	2.8	
Gearing	0.2	0.1	0.1	0.1	1.5	1.8	1.9	
	ACPL				**Kohat Cement**			
Rs. In m	**FY16**	**FY17**	**9M18**	**9M17**	**FY16**	**FY17**	**9M18**	**9M17**
Total debt	8	3,585	5,002	3,120	1,593	910	497	982
Total Liabilities	3,980	5,954	12,713	6,981	5,575	4,886	5,120	6,287
Total Equity	10,447	11,948	12,228	11,254	13,770	15,307	17,293	14,883
Leverage	0.4	0.5	1.0	0.6	0.4	0.32	0.3	0.42
Gearing	0	0.3	0.4	0.3	0.12	0.06	0.03	0.07
	CHCC				**Gharibwal**			
Rs. In m	**FY16**	**FY17**	**9M18**	**9M17**	**FY16**	**FY17**	**9M18**	**9M17**
Total debt	4,231	6,401	11,779	5,128	3,148	4,506	4,242	3,239
Total Liabilities	6,322	8,345	14,744	7,252	8,224	10,234	10,612	9,916
Total Equity	9,140	10,462	11,329	10,034	6,562	8,007	8,534	7,148
Leverage	0.7	0.8	1.3	0.7	1.3	1.3	1.2	1.4
Gearing	0.5	0.6	1.0	0.5	0.5	0.6	0.5	0.5
	PIOC				**Thatta Cement**			
Rs. In m	**FY16**	**FY17**	**9M18**	**9M17**	**FY16**	**FY17**	**9M18**	**9M17**
Total debt	645	2,307	7,360	1,269	1,278	743	573	713
Total Liabilities	4,098	5,513	11,672	5,475	1,870	1,455	1,265	1,574
Total Equity	7,821	9,519	9,994	8,974	2,075	2,441	2,514	2,413
Leverage	0.5	0.6	1.2	0.6	0.9	0.6	0.5	0.7
Gearing	0.1	0.2	0.7	0.1	0.6	0.3	0.2	0.3

	FECTO Cement				Power Cement			
Rs. In m	**FY16**	**FY17**	**9M18**	**9M17**	**FY16**	**FY17**	**9M18**	**9M17**
Total debt	0	0	19	0	1,576	1,468	5,856	1,180
Total Liabilities	843	926	1,020	982	3,895	2,993	7,223	3,441
Total Equity	3,233	3,894	4,098	3,740	2,348	8,394	11,276	3,684
Leverage	0.3	0.2	0.3	0.3	1.7	0.4	0.6	0.9
Gearing	0	0	0	0	0.7	0.2	0.5	0.3

- Equity base of a number of players have increased owing to internal capital generation and rights issue by select players to fund expansion.
- Leveraging profile of the sector has witnessed noticeable increase given the higher debt drawdown to fund expansion.
- Apart from two players, gearing ratio (interest bearing debt to equity) of all players was reported below 1(x).
- Despite expansion plans and announced expansions, Kohat Cement (KOHC), FCCL and Gharibwal Cement have witnessed a limited increase in debt levels. Leveraging profile will increase once debt draw down for the expansion happens.

Analysts Contacts

Talha Iqbal
Senior Manager
talha.iqbal@jcrvis.com.pk

Sidra Ahsan Qureshi
Assistant Manager
sidra.qureshi@jcrvis.com.pk