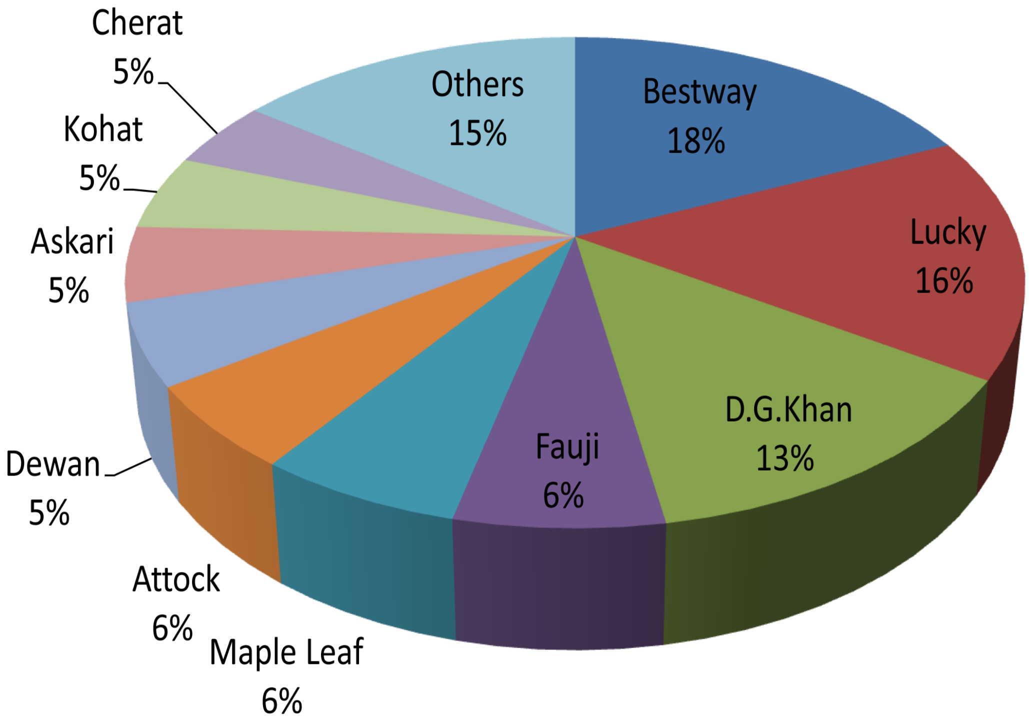
Cement Industry

February,2019

Structure of the Industry

The cement industry in Pakistan is divided into two divisions; namely Southern & Northern regions. In the province of Punjab: Khyber Pakhtunkhwa, Azad Kashmir, Gilgit Baltistan and parts of Balochistan fall in Northern region while the province of Sindh and a few parts of Balochistan fall under Southern region. In the North zone there are 13 listed companies whereas the Southern zone has 6 listed companies. North region has an annual cement manufacturing capacity of 40.24m MT and Southern region has a total capacity of 13.99m MT at end-November 2018.

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



Both regions (North & South) have their own demand and 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 Northern region; on export sales remains low; however till FY18 local demand growth in Northern region remained higher due to CPEC and other government related infrastructure projects. Key export markets for players in the Northern region include Afghanistan and India. For players in the Southern region, Sri Lanka, Bangladesh, Vietnam, Nigeria, Tanzania, Mozambique, Iraq, Ethiopia and DR Congo are major export markets.

Dispatches data for 1HFY19 indicate a reverse trend whereby sales growth was noted in the Southern region due to higher private sector demand and increase in exports. The demand was catered with sizeable capacities coming online in the South. On the other hand, dispatches in the North witnessed a decline owing to slow disbursement of PSDP and general slowdown in the economy (lower GDP growth and increasing interest rates).

Locally the industry operates under a marketing arrangement, which helps the 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, 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

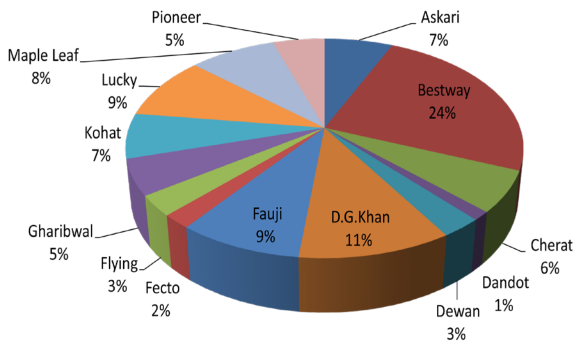


Figure 4: Final North Capacities

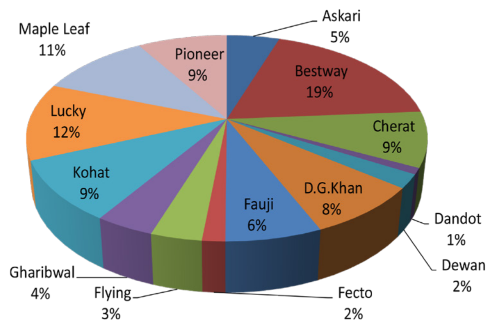


Figure 3: Existing South Capacities

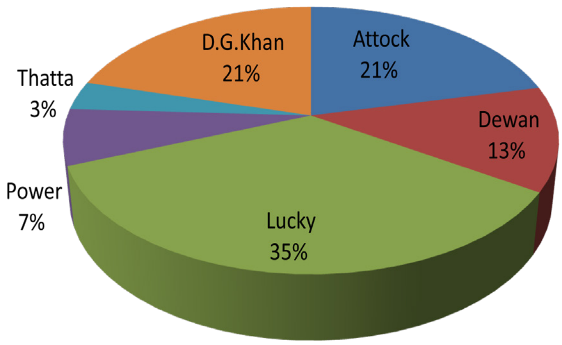
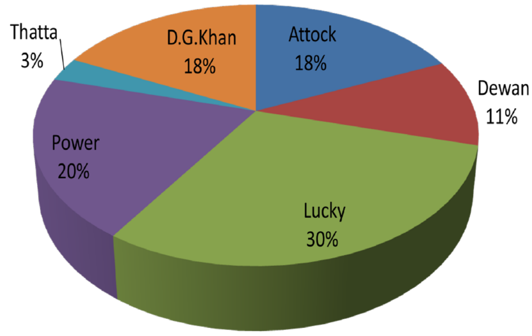


Figure 5: Final South Capacities



Capacity Utilization

Production capacity of cement sector has more than doubled over the last decade to 49.1m MT/Year (FY06; 20.8m MT/Year) at end-FY18. 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 60% of total installed capacity. Average capacity utilization was around 93% for FY18. Capacity utilization of South was 89% as compared to 96% in Northern region during FY18.

Table 1: Capacity utilization (In Million Metric Tons)

Total Industry			
Year	**Capacity**	**Total Dispatches**	**Capacity Utilization**
IHFY19*	54.4	23.2	85%
FY18	51.4	45.9	89%
FY17	47.1	40.3	85%
FY16	44.3	36.8	83%
FY15	44.3	35.4	80%
FY14	44.3	34.9	79%
FY13	44.3	33.4	75%
FY12	44.3	32.5	73%

**Utilization computed by Annualizing Dispatches*

In line with earlier estimates, capacity utilization of the industry was reported on the lower side in 1HFY19 due to sizeable capacities coming online in the South and decline in dispatches in the Northern region. Overall capacity utilization of the Southern region was supported by growth in exports. Going forward, overall capacity utilization is expected to witness further pressure in FY20 given sizeable capacities coming online in the Northern region.

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

Total Industry			
Year	**Capacity**	**Total Dispatches**	**Capacity Utilization**
IHFY19*	40.2	17.0	84%
FY18	40.2	37.0	96%
FY17	38.4	32.3	84%
FY16	36.6	30.9	84%
FY15	36.6	27.9	76%
FY14	36.6	27.1	74%
FY13	36.6	26.4	72%
FY12	36.6	25.6	70%

**Utilization computed by Annualizing Dispatches*

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

Total Industry			
Year	**Capacity**	**Total Dispatches**	**Capacity Utilization**
IHFY19*	14.1	6.2	88%
FY18**	11.2	8.8	89%
FY17	8.7	8.0	92%
FY16	7.7	5.9	77%
FY15	7.7	7.5	97%
FY14	7.7	7.8	101%
FY13	7.7	7.0	91%
FY12	7.7	6.9	90%

**Utilization computed by Annualizing Dispatches*

***- Assuming installed capacity of ACPL and LUCK for 6 months*

Sales

Table 4: Industry Dispatches

Industry Dispatches (m MT)	1HFY19	1HFY18	FY18	FY17	FY16	FY15
North						
Local	15.50	16.45	33.97	29.14	27.05	23.44
Exports	1.50	1.80	3.08	3.15	3.85	4.47
Total North Dispatches	**17.00**	**18.25**	**37.05**	**32.29**	**30.91**	**27.91**
South						
Local	4.10	3.38	7.18	6.51	5.95	4.76
Exports	2.10	0.61	1.67	1.51	2.02	2.73
Total South Dispatches	**6.20**	**3.99**	**8.84**	**8.02**	**7.97**	**7.49**
Total Industry						
Local	19.60	19.84	41.15	35.65	33.00	28.20
Exports	3.60	2.41	4.75	4.66	5.87	7.20
Total Industry Dispatches	**23.20**	**22.24**	**45.89**	**40.32**	**38.87**	**35.40**

During FY18, increase in cement dispatches is attributable to higher growth in the Northern region. Overall local dispatches recorded a healthy growth of 15.4% while export sales after declining for the past four years recorded a meager increase of 1.8% in FY18. Resultantly, proportion of local dispatches increased from 73.6% in FY12 to 89.7% during FY18 whereas proportion of exports sales has declined from 26.4% in FY12 to 10.3% in FY18.

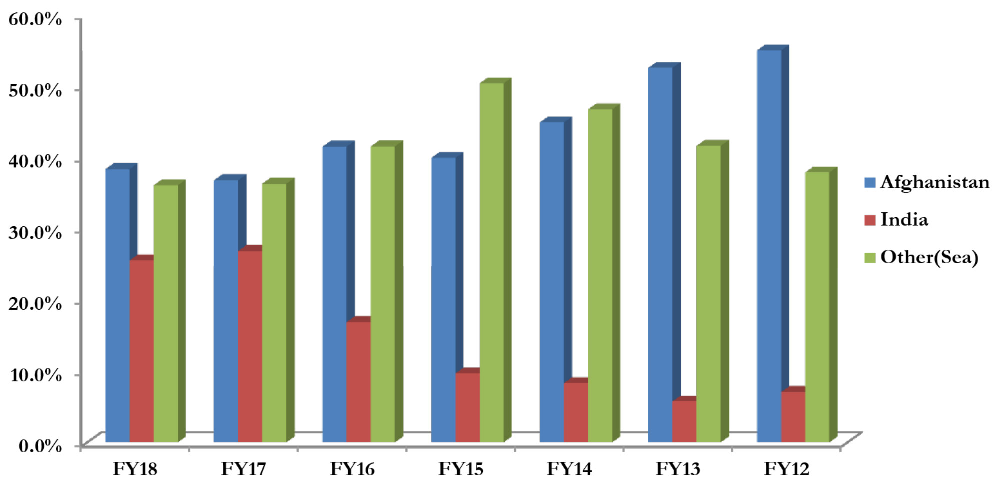
During 1HFY19, trend in growth reversed with local sales witnessing a decline of 1.4% as compared to corresponding period last year on account of weak economic conditions. Moreover, exports sales increased by 48% during this period largely due to the Southern region given sizeable capacity available.

Table 5: Sales

Year	Dispatches In Tons			Percentage	
	Local	Export	Total	Local	Exports
FY12	23,947,165	8,567,826	32,514,991	73.60%	26.40%
FY13	25,058,747	8,374,104	33,432,851	75.00%	25.00%
FY14	26,145,355	8,136,528	34,281,883	76.30%	23.70%
FY15	28,206,027	7,194,249	35,400,276	79.70%	20.30%
FY16	33,001,296	3,851,615	36,852,911	89.50%	10.50%
FY17	35,651,598	4,663,569	40,315,167	88.40%	11.60%
FY18	41,147,391	4,746,028	45,893,419	89.70%	10.30%
1HFY19	19,557,521	3,560,433	23,117,954	84.60%	15.40%
1HFY18	19,836,461	2,405,608	22,242,069	89.18%	10.82%

Volumetric increase in exports from the South Zone has been witnessed during 1HFY19 and FY18 vis-à-vis corresponding periods last year. Significant rupee depreciation has also facilitated in enhancing exports and has improved margins on the same. Margins on exports still continue to be significantly lower vis-à-vis local sales (Over $10/ton difference in margins on exports vis-à-vis local sales accounting for transportation cost and adjusting for taxes).

Figure 6: Country-wise Export

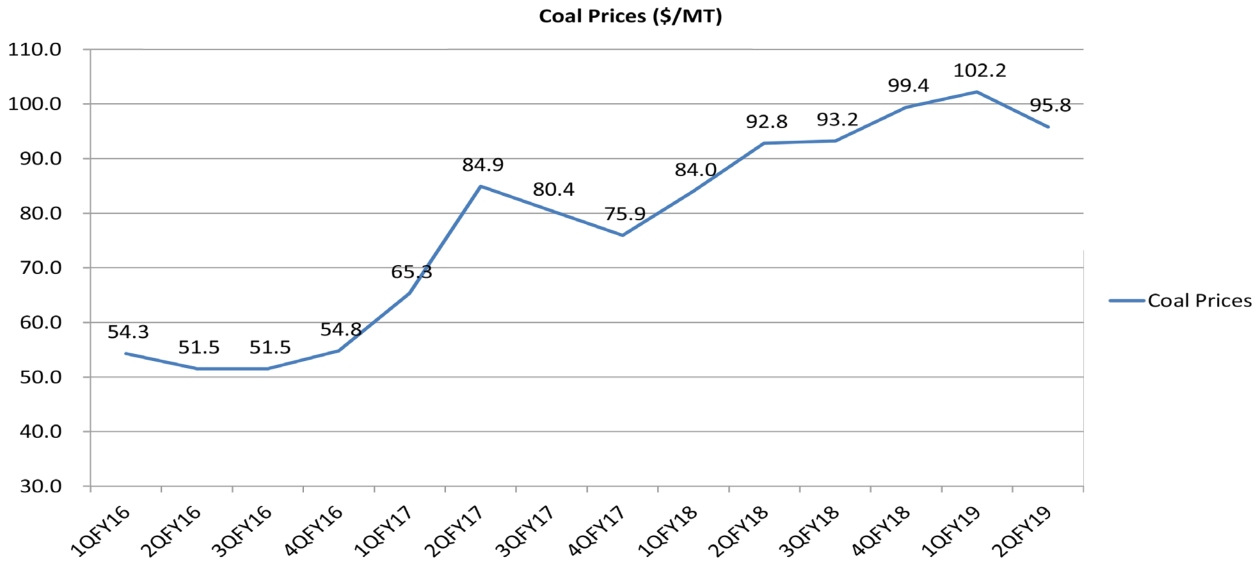


Business Risk

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 remain under pressure in the short-term. Demand is expected to pickup pace once construction of dams begins and GDP growth picks pace.

Given the increasing capacity utilization and strong demand outlook in view of ongoing and planned CPEC projects in 2014, key players in the cement sector announced capacity expansions in 2015, 2016 and 2017. Overall investment in the sector for expansion is estimated at around $1.5billion. 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 7.3m MT of cement have come online. Given the increase in capacities and projected additional capacities expected to come online, particular in the North zone, pricing power of industry players has been impacted. This along with increasing coal prices in FY18 and sizeable rupee devaluation deteriorated the industry margins.



Cyclical nature of the cement industry is a key business risk factor. As per JCR-VIS, the cement sector has now entered competitive phase with slowing demand growth and increasing capacities exerting pressure on selling prices which has been compounded by rising cost of inputs. 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 in the South zone have come online over the last 1 year. In the North zone, capacity of BWCL came online in June'2018 while sizeable capacities are expected to come online over the next 18 months. 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.

Profitability:

Table 6: Profitability Indicators

Rs. in m	Lucky Cement			Bestway Cement			Maple Leaf Cement		
	FY16	FY17	FY18	FY16	FY17	FY18	FY16	FY17	FY18
Net Sales	45,135	45,687	47,541	45,721	51,623	52,884	23,433	23,992	25,699
Gross Profit	21,746	21,298	16,952	21,148	22,533	18,955	10,022	9,482	7,516
Gross Margin	48%	47%	36%	46%	44%	36%	43%	40%	29%
Profit Before Tax	18,400	18,778	15,118	17,078	18,664	14,964	7,118	6,870	4,395
Profit After Tax	12,944	13,692	12,197	11,880	13,293	13,158	4,885	4,777	3,632
Net Margin	29%	30%	26%	26%	26%	25%	21%	20%	14%
Rs. in m	DG Khan Cement			Fauji Cement			Askari Cement		
	FY16	FY17	FY18	FY16	FY17	FY18	FY16	FY17	FY18
Net Sales	29,704	30,136	30,668	20,044	20,423	21,160	15,600	15,953	14,752
Gross Profit	12,668	11,845	8,740	9,165	4,438	5,114	5,463	5,118	3,513
Gross Margin	43%	39%	28%	46%	22%	22%	35%	32%	24%
Profit Before Tax	12,481	11,158	7,370	7,831	3,930	4,098	4,234	3,955	2,144
Profit After Tax	8,790	7,975	8,838	5,367	2,613	3,429	2,983	2,694	1,720
Net Margin	30%	26%	29%	27%	13%	16%	19%	17%	12%

Rs. in m	Attock Cement			Kohat Cement			Cherat Cement		
	FY16	FY17	FY18	FY16	FY17	FY18	FY16	FY17	FY18
Net Sales	13,918	14,736	16,884	14,020	13,540	13,438	7,079	9,645	14,388
Gross Profit	5,587	5,892	5,187	6,497	5,827	4,353	2,634	3,213	3,139
Gross Margin	40%	40%	31%	46%	43%	32%	37%	33%	22%
Profit Before Tax	4,236	4,444	3,129	6,252	5,520	3,970	2,051	2,510	2,147
Profit After Tax	2,890	3,034	4,400	4,408	3,545	2,979	1,405	1,957	2,132
Net Margin	21%	21%	26%	31%	26%	22%	20%	20%	15%

Rs. in m	Gharibwal Cement			Pioneer Cement			Thatta Cement		
	FY16	FY17	FY18	FY16	FY17	FY18	FY16	FY17	FY18
Net Sales	10,522	11,223	11,484	9,367	10,631	10,121	2,846	3,657	2,843
Gross Profit	4,172	3,854	2,712	4,005	4,428	2,810	914	1,163	756
Gross Margin	40%	34%	24%	43%	42%	28%	32%	32%	27%
Profit Before Tax	3,707	3,045	1,783	3,846	4,070	2,213	666	855	497
Profit After Tax	2,694	2,284	1,509	2,519	2,918	1,644	614	582	357
Net Margin	26%	20%	13%	27%	27%	16%	22%	16%	13%

Rs. in m	FECTO Cement			Power Cement		
	FY16	FY17	FY18	FY16	FY17	FY18
Net Sales	5,032	5,131	4,902	4,144	4,481	4,343
Gross Profit	1,623	1,557	1,027	947	981	675
Gross Margin	32%	30%	21%	23%	22%	16%
Profit Before Tax	1,159	1,091	599	765	565	349
Profit After Tax	814	761	442	486	467	320
Net Margin	16%	15%	9%	12%	10%	7%

- 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. However, cement dispatches witnessed slowdown during 1HFY19 for most industry players.
- Gross margins have depicted a sharp decline during FY18 and 1QFY19 due to inability to pass on increase in coal prices, currency devaluation and higher proportion of clinker exports for some players. Increase in gas prices and electricity tariff are also expected to result in further pressure on margins. 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.
- Overall profitability witnessed decline due to pressure on margins with most players recording double digit decline in profit before tax. Going forward, profitability is expected to remain under pressure given sizeable capacities coming online.

Liquidity:

Table 7: Liquidity Indicators

Rs. In m	Lucky Cement			Bestway Cement			Maple Leaf Cement		
	FY16	FY17	FY18	FY16	FY17	FY18	FY16	FY17	FY18
FFO	16,029	16,493	13,969	14,743	15,845	12,958	8,902	7,189	7,805
FFO/Total Debt	NA	NA	NA	0.77	1.06	0.58	2.93	1.07	0.41
Current Ratio	4.10	4.48	2.82	1.21	1.15	0.73	1.69	1.34	1.07

Rs. In m	DG Khan Cement			Fauji Cement			Askari Cement		
	FY16	FY17	FY18	FY16	FY17	FY18	FY16	FY17	FY18
FFO	9,983	7,755	6,794	8,067	3,365	3,843	3,562	3,434	1,629
FFO/Total Debt	1.43	0.36	0.21	1.97	1.87	1.42	0.48	0.42	0.15
Current Ratio	3.07	1.84	1.29	1.51	2.12	1.49	1.06	0.87	1.03
Rs. In m	Attock Cement			Kohat Cement			Cherat Cement		
	FY16	FY17	FY18	FY16	FY17	FY18	FY16	FY17	FY18
FFO	2,616	3,061	2,644	3,758	4,181	2,967	1,704	2,894	2,747
FFO/Total Debt	328.81	0.85	0.44	2.36	4.59	6.96	0.40	0.45	0.17
Current Ratio	2.63	0.53	0.87	2.83	3.21	2.83	1.11	1.78	1.72
Rs. In m	Gharibwal Cement			Pioneer Cement			Thatta Cement		
	FY16	FY17	FY18	FY16	FY17	FY18	FY16	FY17	FY18
FFO	3,455	3,116	1,911	2,641	2,915	1,326	563	771	425
FFO/Total Debt	1.10	0.69	0.39	4.10	1.26	0.12	0.44	1.04	0.62
Current Ratio	0.84	0.66	0.71	2.44	3.14	1.36	2.04	1.81	1.38
Rs. In m	FECTO Cement			Power Cement					
	FY16	FY17	FY18	FY16	FY17	FY18			
FFO	1,046	721	419	385	179	101			
FFO/Total Debt	NA	NA	22.89	0.24	0.12	0.01			
Current Ratio	5.00	5.42	5.10	0.91	2.56	1.43			

- In line with decline in profitability, cash flows from operations for most industry players have reduced.
- Debt servicing ability has weakened on a timeline basis.
- 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:

Table 8: Capitalization Indicators

Rs. In m	Lucky Cement			Bestway Cement			Maple Leaf Cement		
	FY16	FY17	FY18	FY16	FY17	FY18	FY16	FY17	FY18
Total debt	-	-	-	19,187	14,888	22,152	3,036	6,723	19,113
Total Liabilities	16,586	17,552	22,632	35,837	33,996	41,661	10,685	19,433	28,817
Total Equity	69,323	79,785	86,366	41,983	47,769	53,310	16,750	19,384	25,647
Leverage	0.24	0.22	0.26	0.85	0.71	0.78	0.64	1.00	1.12
Gearing	-	-	-	0.46	0.31	0.42	0.18	0.35	0.75
Rs. In m	DG Khan Cement			Fauji Cement			Askari Cement		
	FY16	FY17	FY18	FY16	FY17	FY18	FY16	FY17	FY18
Total debt	7,002	21,615	32,277	4,090	1,801	2,700	7,384	8,185	10,861
Total Liabilities	17,635	33,503	44,755	10,930	8,072	8,559	13,342	13,833	16,110
Total Equity	65,783	74,869	77,134	18,428	19,681	20,488	4,808	4,559	6,058
Leverage	0.27	0.45	0.58	0.59	0.41	0.42	2.77	3.03	2.66
Gearing	0.11	0.29	0.42	0.22	0.09	0.13	1.54	1.80	1.79

Rs. In m	Attock Cement			Kohat Cement			Cherat Cement		
	FY16	FY17	FY18	FY16	FY17	FY18	FY16	FY17	FY18
Total debt	8	3,585	6,065	1,593	910	426	4,231	6,401	16,064
Total Liabilities	3,980	8,762	11,533	5,575	4,886	5,339	6,322	8,345	19,346
Total Equity	10,447	11,948	14,873	13,770	15,307	17,976	9,140	10,462	11,174
Leverage	0.38	0.73	0.78	0.40	0.32	0.30	0.69	0.80	1.73
Gearing	0.00	0.30	0.41	0.12	0.06	0.02	0.46	0.61	1.44
Rs. In m	Gharibwal Cement			Pioneer Cement			Thatta Cement		
	FY16	FY17	FY18	FY16	FY17	FY18	FY16	FY17	FY18
Total debt	3,148	4,506	4,856	645	2,307	10,704	1,278	743	684
Total Liabilities	8,224	10,234	10,351	4,098	5,513	15,482	1,870	1,455	1,583
Total Equity	6,562	8,007	12,490	7,821	9,519	10,517	2,075	2,441	2,557
Leverage	1.25	1.28	0.83	0.52	0.58	1.47	0.90	0.60	0.62
Gearing	0.48	0.56	0.39	0.08	0.24	1.02	0.62	0.30	0.27
Rs. In m	FECTO Cement			Power Cement					
	FY16	FY17	FY18	FY16	FY17	FY18			
Total debt	-	-	18	1,576	1,468	10,603			
Total Liabilities	843	926	1,018	3,895	2,993	13,218			
Total Equity	3,233	3,894	4,210	2,348	8,394	11,299			
Leverage	0.26	0.24	0.24	1.66	0.36	1.17			
Gearing	-	-	0.00	0.67	0.17	0.94			

- Equity base of all players in the industry have increased during FY18 owing to internal capital generation and rights issue by select players to fund expansion.
- Total debt of players in JCR-VIS's peer group has increased by 87% from Rs. 73.1b to Rs. 136.5b in FY18.
- 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) at end-FY18. However, gearing level for players undergoing expansion is expected to increase.

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