



Lucky Cement Limited

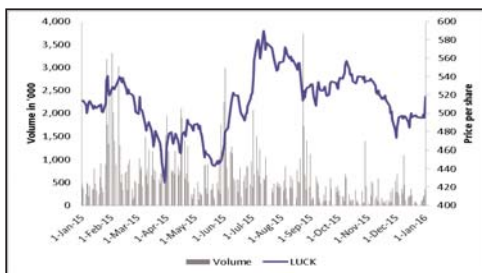
LUCK: The giant maintains its position

We initiate coverage on Lucky Cement Limited (LUCK) with DCF based Dec'16 target price of Rs 644/share, offering a prominent upside potential of 28% from closing price of Rs 501.98/share. Our bullish stance is backed by expected better gross profit that is likely to endure >40% of sales revenue; CPEC project that remain a driving catalyst for 2016; declined coal prices; peripheral growth in sales; Congo-based cement plant likely to start operation; 660 MW coal-based power plant on the papers; and cement plant establishment in Punjab division as well as in Northern region. Along with growing earning, the company is also expected to continue with its history of announcing decent dividends where it is likely to announce a cash dividend of Rs12/share during FY16 and Rs13/share in FY17. Currently the share is trading at FY16 and FY17 prospective P/E multiple of 12x and 10.9x respectively. The key risks linked to our report are international coal prices reversion; decline in exports; cement price risk; and interest rate risk.

KEY DATA

KATS Code	LUCK
Reuters Code	LUKC.KA
Current Price (Rs)	501.98
Year High, Low (Rs)	594, 424.79
Market Cap (Rs' bn)	167.45
Market Cap (US\$ mn)	16.75
Shares Outstanding (mn)	323.38

Source: KSE, Reuters & WE Research



Source: KSE & WE Research

LUCK Financial Snapshot

	FY15A	FY16E	FY17F	FY18F
Net Sales (Rs mn)	44,761	48,385	51,548	53,852
Gross Profit (Rs mn)	20,183	20,710	21,945	22,563
Profit after Taxation (Rs mn)	12,432	13,525	14,880	16,053
EPS (Rs)	38.44	41.82	46.02	49.64
Book Value (Rs/share)	183	214	248	286
DPS (Rs)	9.00	12.00	12.00	13.00
P/E (x)	13.06	12.00	10.91	10.11
P/BV (x)	2.74	2.34	2.02	1.76
ROE (%)	21.0	19.5	18.5	17.4
ROA (%)	17.0	16.6	15.7	14.9

Source: Company Reports & WE Research



Valuation: BUY with a Target Price of Rs 644

We have used Discounted Cash Flow (DCF) methodology with an assumption of 15% cost of equity (9.4% Risk free rate and 5% Risk premium) and 4% growth rate, thus our Dec'16 Target Price for LUCK is Rs 644/share; offering an upside scope of 28%-Buy!

DCF based value of LUCK

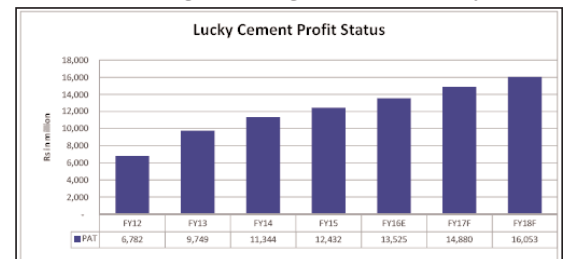
Rs in million	FY15E	FY16F	FY17F
Net Income	13,525	14,880	16,053
Non-Cash Expense	2,366	2,395	2,424
Change in Working Capital	(2,469)	1,219	(73)
Capex	(506)	(538)	(569)
Free Cash Flow to Equity	12,916	17,957	17,835
Discounted Free Cash Flow	12,916	16,745	14,463
PV of Terminal Value	136,812		
Total Value	180,936		
Investment Value	10,925		
(+) Cash	16,445		
Shares Outstanding	323.38		
Target Price Dec'16 (Rs)	644		

Source: WE Estimates

We have used Discounted Cash Flow (DCF) methodology with assumption of 9.40% Risk free rate and 5% market premium and 4% growth rate, thus our Dec'16 Target Price for LUCK is Rs 644/share offers upside of 28%.

After-tax profit is likely to remain nourishing

We anticipate Lucky Cement to prosper its profit after tax due to declined international coal prices, as well as increased domestic demand due to infrastructural developments. The increment in earnings could return after tax profit up to the extent of Rs 13,525 million (EPS: Rs 41.82/share) in FY16, which shows 9% growth YoY as against Rs 12,432 million (EPS: Rs 38.44/share) that we expect in FY15. Besides delivering strong profitability, it is likely that the cement manufacturer might distribute cash dividend of Rs 12/share in total for FY16.



Source: WE Research

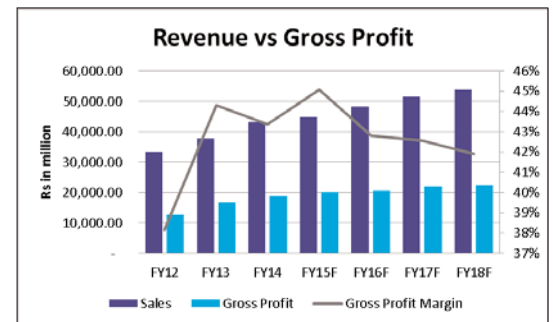


Gross margins of the company are expected to clock in at 43% during fiscal year end 2016. This could be achieved through controlled overhead costs.

We are expecting the dispatches of LUCK to cross 6.96 million tons amid financial year 2016 in which domestic dispatches to clock in at 4.85 million tons.

Gross Profit is likely to endure >40% of sales revenue

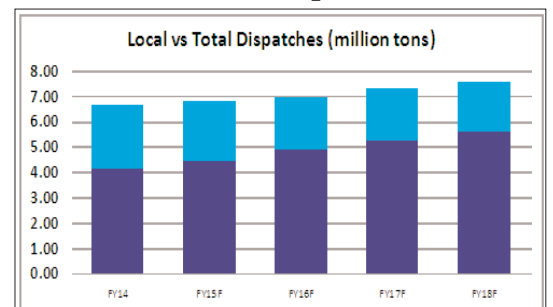
Gross margins of the company are expected to clock in at 43% during fiscal year end 2016. This could be achieved through controlled overhead costs. Further, lowering fuel and power, as well as decreased raw material cost will also take their stake in gross profit booking.



Source: WE Research

CPEC project - A driving catalyst for 2016

The cement industry is looking forward to the improvement of CPEC led project, which would change over the company's figures into multiples. Other than that, the developmental ventures by the government through PSDP and expanded construction work from the private sector will likewise get charm in the business. Less expensive Iranian cement to Afghanistan would remain the export risk for the organization however. We are expecting the dispatches of LUCK to cross 6.96 million tons amid financial year 2016 in which domestic dispatches to clock in at 4.85 million tons.



Source: WE Research

Sales showed peripheral growth

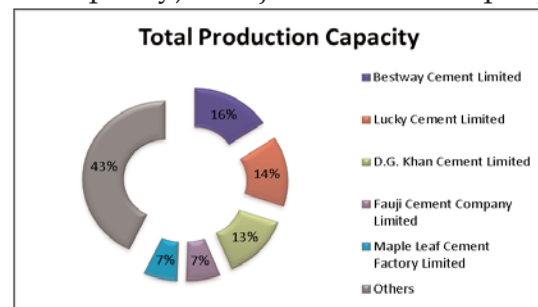
We expect Lucky cement's net sales during fiscal year 2016 to reach Rs 48,385 million attributing to higher domestic cement prices as well as better local dispatches. Local sales proceeds for the year are expected to clock in at Rs 35,936 million, whereas gross export revenue is expected to reach Rs 12,450 million, export is likely to remain under pressure during the period under review.



Among cement manufacturers, Bestway Cement Limited contains largest production capacity of 7,962,750 metric tons, followed by Lucky Cement Limited with 7,386,000 metric tons, D.G. Khan Cement Limited with 6,821,000 metric tons (including expanded production capacity), Fauji Cement Company Limited with 3,433,500 metric tons, Maple Leaf Cement Factory Limited with 3,370,500, while the rest 12 cement manufacturers contributes 21,710,000 metric tons.

Production Capacity enhanced by Cement Industries

During recent years, cement manufacturers not only lowered their leverage positions, thanks to lower interest rates, but also expanded production capacities. During 2015, D.G. Khan Cement, Attock Cement, and Cherat Cement announced production capacity enhancement by 2.6 million tons, 1.4 million tons, and 1.3 million tons, respectively. Besides, these domestic expansions, the government of Pakistan also allowed Chinese company for the installation of cement plant at Punjab district. This plant is expected to cost US\$350 million. Infrastructural growths under Public Sector Development Program (PSDP) in combination with mega projects like China Pakistan Economic Corridor (CPEC) are likely to increase cement demand during FY16. This might intensify price war prospects in near future. However, we have not merged this impact in our current calculation, since the expanded plant installations are expected not to start operations before FY18. Among cement manufacturers, Bestway Cement Limited contains largest production capacity of 7,962,750 metric tons, followed by Lucky Cement Limited with 7,386,000 metric tons, D.G. Khan Cement Limited with 6,821,000 metric tons (including expanded production capacity), Fauji Cement Company Limited with 3,433,500 metric tons, Maple Leaf Cement Factory Limited with 3,370,500, while the rest 12 cement manufacturers contributes 21,710,000 metric tons



Source: WE Research

Declined coal prices, good for Lucky Cement's business

Increased environmental concerns in developed countries are pushing coal consuming industries to divert their businesses to other energy sources. This resulted in demand supply imbalance, where supply exceeds demand. Due to this, coal is constantly declining in international market. Lucky cement covers its coal requirement through South African coal. Moving forward we anticipate that the international coal prices to stay around average \$57/ton in FY16.



As coal captures 35% of the total cost in cement manufacturing therefore it will directly impact gross margin. According to our analysis, a \$10/ton change in coal cost deviate earnings by 5% on either side.

On the back of China Pakistan Economic Corridor (CPEC) activity joined with infrastructural advancement by private division, the organization administration chose to build up 2.3 million ton, completely incorporated green field cement producing plant in Punjab. The venture is likely to include \$200 million cost, while the development work is predicted to begin amid first quarter of 2016.

Coal prices impact on company's Target Price

Current decline in commodity prices across the board help coal prices to decline multi-year low touching \$48/ton. As coal captures 35% of the total cost in cement manufacturing therefore it will directly impact gross margin. According to our analysis, a \$10/ton change in coal cost deviate earnings by 5% on either side.

Coal prices \$/ton	FY16FE	FY17F	FY18F	TP* (Rs)
Base Case Prices	\$57	\$60	\$65	
Earning per share (EPS)				
Decrease by \$10/ton	44.21	48.39	52.15	670
Decrease by \$5/ton	43.02	47.20	50.90	657
Base Case	41.82	46.02	49.64	644
Increase by \$5/ton	40.63	44.83	48.39	631
Increase by \$10/ton	39.44	43.65	47.13	618

Congo-based cement plant likely to start operation in late 2016

The cement plant project, named Nyumba Ya Akiba, in Democratic Republic of Congo is in construction phase. The company earlier announced October 2016 as its Commercial Operations Date (COD). This plant is likely to contain production capability of 3,000 tons clinker as well as 3,580 tons cement on daily basis.

660 MW coal-based power plant on the papers

The Private Power and Infrastructure Board (PPIB) provided letter of intent (LOI) on February 11, 2015 for 660 megawatt coal-based power project setup in Karachi. This setup will be run by a wholly owned subsidiary of Lucky Cement with a given name Lucky Electric Power Company Limited (LEPCL).

Lucky to establish cement plant in Punjab division

On the back of China Pakistan Economic Corridor (CPEC) activity joined with infrastructural advancement by private division, the organization administration chose to build up 2.3 million ton, completely incorporated green field cement producing plant in Punjab. The venture is likely to include \$200 million cost, while the development work is predicted to begin amid first quarter of 2016.

Lucky to expand its business in Northern region

Cement plant expansion plan is not limited to Punjab province only. On October 12, 2015, the company again made an announcement. This time the expansion plan in Pakistan's Northern Region was under consideration. In this regard, Board of directors' decision was to be made, and will be announced any time soon.



Key Risks

International Coal Prices reversion

It has been years since the coal prices are suppressed in the international market. Therefore, technically it is likely that prices might revert. In case the upside surge showed sharp recovery, the company's gross margins are anticipated to get a hit accordingly. This will bring downside risk in our projections.

Decline in Exports

All major cement manufacturers are currently facing declined international market, owing to weak economic growth. Even though these manufacturers are trying to explore new export venues, in the meantime the pressure is approaching on local sales, since companies have to meet their year-end revenue target. This pressure is a due need to get released at earliest

Cement Price Risk

Lucky Cement is considered as a trend setter in the cement industry. However, declined exports and increased local market focus could result in the end of cartelization. In such scenario, price war is expected to start. This will also bring the projections down.

Company Introduction

Lucky Cement Limited (LUCK) is one of the largest producers and leading exporters of quality cement in Pakistan, with a production capacity of 7.75 million tons per annum. Over the years, the company has grown substantially and is expanding its business operations with production facilities at strategic location in Karachi to cater to the Southern regions, Pezu and Khyber Pakhtunkhwa to furnish the Northern areas of the country. Lucky Cement is Pakistan's first company to export sizeable quantities of loose cement being the only cement manufacturer to have its own loading and storage terminal at Karachi Port. Lucky Cement Limited has embarked on the journey of global expansion by setting up cement grinding facility in Basra, Iraq and a cement manufacturing plant in Democratic Republic of Congo (DRC). Furthermore, the company has diversified into power generation by investing in a 660 MW coal-based power project in Karachi. Also the acquisition of ICI Pakistan is another noteworthy move towards the expansion of Lucky Cement's industry portfolio.



LUCK - Financial Highlights

Valuation

	FY15A	FY16E	FY17F	FY18F
EPS (Rs)	38.44	41.82	46.02	49.64
Book Value (Rs/share)	183.25	214.08	248.09	285.73
DPS (Rs)	9.00	12.00	12.00	13.00
P/E (x)	13.06	12.00	10.91	10.11
P/BV(x)	2.74	2.34	2.02	1.76
Dividend Yield (%)	1.8	2.4	2.4	2.6
Payout (%)	23.4	28.7	26.1	26.2

Source: Company Reports & WE Research

Key Ratio Analysis

	FY15E	FY16F	FY17F	FY18F
Current Ratio (x)	3.6	6.6	7.1	8.7
ROE (%)	21.0	19.5	18.5	17.4
ROA (%)	17.0	16.6	15.7	14.9
Gross Margin (%)	45.1	42.8	42.6	41.9
Net Margin (%)	27.8	28.0	28.9	29.8
Sales Growth (%)	3.9	8.1	6.5	4.5
PAT Growth (%)	9.6	8.8	10.0	7.9

Source: Company Reports & WE Research

Income Statement

Rs in million	FY15A	FY16E	FY17F	FY18F
Sales	44,761	48,385	51,548	53,852
Cost of Goods Sold	24,578	27,676	29,603	31,289
Gross Profit	20,183	20,710	21,945	22,563
Administrative Expense	918	796	862	937
Distribution Cost	3,127	2,920	2,978	2,930
Other Income	1,241	1,490	2,334	3,339
Other Expenses	1,442	1,230	1,340	1,431
Operating Profit	16,138	16,994	18,105	18,697
Finance Cost	26	26	22	23
Profit before Taxation	15,912	17,229	19,077	20,581
Taxation	3,480	3,704	4,197	4,528
Profit after Taxation	12,432	13,525	14,880	16,053

Source: WE Research & Company Reports



Balance Sheet

Rs in million	FY15A	FY16E	FY17F	FY18F
Share Capital	3,234	3,234	3,234	3,234
Shareholder Equity	59,259	69,227	80,226	92,399
Non-Current Liabilities	6,396	6,732	7,060	7,409
Current Liabilities	7,431	5,649	7,342	7,676
Total Liabilities	13,827	12,381	14,402	15,084
Non-Current Assets	46,068	44,207	42,350	40,495
Current Assets	27,018	37,400	52,278	66,988
Total Assets	73,086	81,608	94,628	107,483

Source: Company Reports & WE Research

Cash Flow Statement

Rs in million	FY15A	FY16E	FY17F	FY18F
Cash from Operations	17,996	13,422	18,494	18,404
Cash from Investing activities	(8,037)	(506)	(538)	(569)
Cash from Financing	(2,104)	(3,221)	(3,553)	(3,532)
Net change in Cash	7,854	9,695	14,404	14,303
Beginning Cash balance	8,591	16,445	26,139	40,543
Ending Cash balance	16,445	26,139	40,543	54,847

Source: Company Reports & WE Research



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