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KSE-100 Index  
 11,166.10

KSE Market Cap  
 PkR2,976bn (US\$34,405mn)

Construction & Material Sector Market Cap.  
 PkR66,525mn (US\$768.98mn)

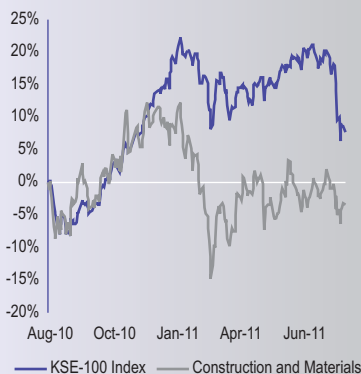
**Stocks Covered**

KATS - Price - Bloomberg  
 DGKC - PkR20.89 - DGKC PA  
 LUCK - PkR72.81 - LUCK PA

**Construction & Material Sector Performance**

	1M	3M	6M	12M
Absolute (%)	4.4	5.5	2.1	2.9
Rel. Index (%)	13.9	12.2	9.7	(10.8)

**AKD Universe Cement Sector vs. KSE-100 Index**

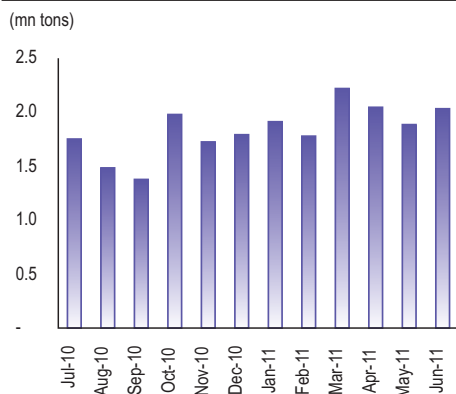


## Cementing Positives!

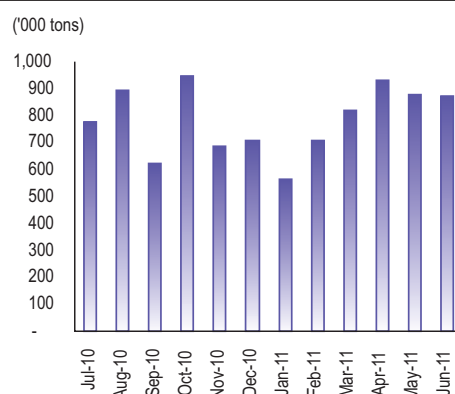
Coming off a below par price performance in FY11 (-ve 25% versus the KSE), we expect our cement coverage cluster to pare price gains in FY12 versus the broader market. Moving past the trough in the seasonal demand cycle, we expect local cement offtake to improve with a low base set last year. Higher volume coupled with likely margin expansion underpinned by the recent hike in bag prices as well as retention of benefits through budgetary measures should buoy earnings for our coverage cement cluster. To recall, the FY12 Budget announced a host of positives with cuts in GST and FED with zero rating of SED impacting per bag prices in the range of PkR21/bag-PkR23/bag. Post the budget announcement cement manufacturers reduced prices by only PkR6/bag-PkR10/bag and subsequently increased prices in mid July 2011 by PkR10/bag-PkR12/bag. This, buttressed by declining coal prices (currently lower by 8% from the latest peak of US\$129.75/ton), should support margin expansion. While dispatches in FY12 should move on a gradual clip through the lower end of the demand cycle, there should be incremental improvement going forward. We expect total volumetric growth of 5%YoY in FY12 (local - low base due to FY11 floods and export - greater demand from Afghanistan). This gels in well with expectations of higher margins through FY12. That said, the recent sell-off in the KSE-100 index led to an absolute decline of 3.6% in the cement sector. Considering this an opportunity, we remain optimistic on the local cement sector, with LUCK (FY12F PER: 5.64x) our preferred play, offering an upside of 20.3% to our target price of PkR87.6/share. Investors looking for more than just a cement play may also consider DGKC (FY12 PER: 9.78x) which offers an upside of 37.5% to our target price of PkR28.7/share.

**FY11 Dispatches Recap:** Total industry dispatches declined by 8%YoY to 31.4mn tons in FY11. Local dispatches declined by 7%YoY to 22.0mn tons with the contraction

### Local Dispatches-FY11



### Export Dispatches-FY11



Source: Company Reports, Economic Survey and AKD Research

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### Gross Margins Trend

	1QFY11	2QFY11	3QFY11
LUCK	31%	35%	32%
DGKC	19%	22%	26%
ACPL	14%	17%	21%
FCCL	21%	17%	13%
BWCL	14%	16%	24%
AACIL	-5%	-11%	5%
CHCC	11%	14%	12%
DCL	-11%	-6%	-2%
FECTC	16%	17%	14%
FLYNG	-57%	-27%	-42%
GWLC	-5%	-6%	11%
KOHC	13%	12%	15%
LPCL	14%	26%	21%
MLCF	11%	16%	19%
MUCL	16%	10%	4%
PIOC	9%	10%	13%
THCCL	22%	20%	0%

### Net Margins Trend

	1QFY11	2QFY11	3QFY11
LUCK	13%	11%	16%
DGKC	1%	4%	0%
ACPL	6%	7%	8%
FCCL	11%	12%	5%
BWCL	-7%	-9%	8%
AACIL	-47%	-81%	-21%
CHCC	2%	0%	1%
DCL	-19%	-13%	-7%
FECTC	3%	8%	-5%
FLYNG	-53%	-24%	-119%
GWLC	-87%	-36%	-13%
KOHC	-9%	1%	1%
LPCL	-21%	5%	1%
MLCF	-21%	-15%	-13%
MUCL	-7%	-12%	-16%
PIOC	-8%	-6%	-2%
THCCL	0%	0%	-17%

### Key Ratios

9MFY11	Interest Coverage(x)	Debt/Asset	EV/ton of Cement (US\$)
LUCK	7.54	22%	49.65
DGKC	1.27	35%	72.96
ACPL	36.01	7%	26.48
FCCL	20.67	60%	227.13
BWCL	0.96	65%	60.57
AACIL	-0.86	279%	96.58
CHCC	0.92	47%	35.10
DCL	-163.44	37%	24.90
FECTC	1.22	41%	21.09
FLYNG	-2.56	16%	10.32
GWLC	-0.16	40%	30.22
KOHC	0.97	61%	164.22
LPCL (1QCY11)	1.08	40%	61.74
MLCF	0.04	54%	47.69
MUCL	0.42	53%	72.63
PIOC	0.72	40%	27.91
THCCL	-0.10	37%	77.70

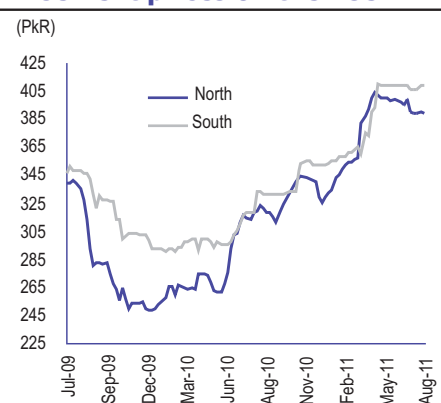
primarily due to the Aug'10 floods and slowdown in construction activities in their immediate aftermath. At the same time, export dispatches registered a decline of 12%YoY to stand at 9.4mn tons in FY11 with a shrinkage in sea exports on the back of an improved international supply position (increased capacity in East Africa and Saudi Arabia). In our view, FY12F dispatches should depict improved performance coming off a low base on the domestic front and likely improved demand from Afghanistan. Further impetus may arise if 1) PSDP allocation is not slashed wholesale, 2) continuing focus on dams (see table on the next page) and 3) new export markets in Africa/Far East are explored.

**Good Budget for Cements:** In order to boost domestic reconstruction activities in the aftermath of the devastating Aug'10 floods, GoP announced a host of incentives for the Cement sector in the FY12 Budget. Specifically, GST was reduced by 1ppt to 16%, FED was reduced by PkR10/bag (to PkR25/bag) and 2.5% SED was eliminated. All in all, these measures were expected to reduce cement prices by PkR21/bag-PkR23/bag. In contrast, cement manufacturers reduced prices by PkR6/bag-PkR10/bag, clearly retaining the bulk of the FY12 incentives through an increase in margins. Following on, cement prices were increased by PkR10/bag-PkR12/bag in mid-Jul'11 with manufacturers citing higher demand.

### Down 8% from the latest peak



### Cement prices on the rise



Source: Bloomberg & AKD Research

**Margins on the Up:** Local cement prices presently stand at PkR387/bag in the North and PkR416/bag in the South where prices have in general depicted a rising trend post the Aug'10 floods. In this regard, FY11 average prices mark a growth of ~41%YoY. While the initial spurt in cement prices came in response to higher coal prices, the subsequent price increases are reflective of margin expansion for cement manufacturers. In this regard, after peaking at US\$129.75/ton in mid FY11 (on the back of Australian floods), coal prices have now started to settle down. Current coal prices stand at ~US\$118/ton, marking a decline of 8% from the recent peak. Going forward, while higher domestic demand should lead to higher cement prices across FY12, leading to sustained high margins for cement manufacturers. In this regard, while coal price trend represents a key swing factor, we note that cement manufacturers are increasingly looking towards alternative fuels to substitute coal. Specifically, the Tire Derived Fuel (TDF) fuel for LUCK is expected to commission by Oct'11.

**FY12 Outlook:** With Cements getting off to a good start in the new Fiscal Year, we remain optimistic over the prospects for dispatches in FY12F. On the domestic front, volumetric growth should come from long awaited post-flood reconstruction (delayed due to Rabi harvest followed by anticipation of incentives for Cements in FY12 Budget). We conservatively expect local dispatches to revert back to normalized FY10 levels

**Projects to be completed during FY12**

Project	Location
Mangla Dam Raising	AJK
Greater Thal Canal	Punjab
Khan Khwar	KPK
Allai Khwar	KPK
Duber Khwar	KPK
Jinnah	Punjab
Gomal Zam Dam	FATA/KPK
Satpara Dam	Gilgit Baltistan

Source: WAPDA

**Projects under Construction**

Neelum Jhelum	AJK
Tarbela 4th Extension	KPK
Golen Gol	KPK
Jabban	KPK
Kachhi Canal	Balochistan
Rainee Canal	Sindh
Small & Medium Dams (Darwat, Nai Gaj, Naulong, Ghabir)	

Source: WAPDA

(23mn tons) at the very least, with added impetus to arise from potential dams construction. While FY11 exports were disappointing, we expect exports in FY12F to depict moderate improvement as cement companies move towards smaller African countries (e.g. Congo) and expand into the Far East markets. That said, the bulk of export demand is expected to arise from Afghanistan (where we export ~50% of our total exports). Over the medium-term, if the US plan to pull troops out of Afghanistan is on track, post-war reconstruction in Afghanistan may lead to heightened demand over the longer term.

**Top Picks:** This year we expect cement manufacturers to benefit from both higher dispatches and a surge in cement prices, leading to margin expansion. While we expect local dispatches to revert back to FY10 levels (23mn tons), export dispatches should also depict a growth of 6%YoY to stand at ~10mn tons in FY12F. Other than the positives announced in the FY12 Budget, selected Cement players should also benefit from plans of using alternate fuels (to coal). We remain positive over the prospects of the local Cement industry, which has outperformed the KSE-100 index by 7% since the budget announcement. At current levels, our preferred play is LUCK (FY12F PER: 5.64x) which offers an upside of 20.3% to our target price of PkR87.6/share. Investors looking for more than just a cement play may also consider DGKC (FY12 PER: 9.78x) which offers an upside of 37.5% to our target price of PkR28.7/share.

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### *Rating Definitions*

Buy	≥ 20% upside potential
Accumulate	> 5% to < 20% upside potential
Neutral	≤ 5% to ≥ -5% potential
Reduce	≤ -5% to > -20% downside potential
Sell	< -20% downside potential

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