

DGKC

Use of Afghan coal to support sustainable gross margins

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We initiate our coverage on D.G Khan Cement Company Limited (DGKC) with a DCF based Dec-22 TP of Rs.100 which provides an upside potential of 49%

Sales in value terms, increased from 21.86bn to 27.43bn in 1HFY22, registering a growth of 25.5% which is primarily due to increasing local cement prices amid a surge in international coal prices

The use of Afghan coal in the North gave a sufficient buffer to cement companies that gave them room to keep their margins sustained in the short to medium term

Going forward, we expect the company's revenues to grow at a 5-year CAGR of 13.5% to Rs108bn by FY26 as the expansionary phase of the economy to support cement dispatches as well as prices in the future

Company Overview

DGKC is a public limited company incorporated in 1978 as a limited liability company. The Company is primarily engaged in the production and sale of Clinker and Cement with its plants stretched from North to Center to South. The company also enjoys a notable presence in foreign markets including Bangladesh, Afghanistan, China, Sri Lanka, and other parts of central Africa. The Company is also trying to find new export markets through its HUB plant close to the port. The total market share of the company is about 11%.

Substantial Growth in Gross Margins

Sales in value terms, increased from 21.86bn to 27.43bn in 1HFY22, registering a growth of 25.5% which is primarily due to increasing local cement prices. However, there was pressure on costs related to rising coal prices in the 1st and 2nd quarters that affected gross margins. Moreover, profit after tax has improved from 0.80bn to 2.17bn in 1HFY22. Going forward, we expect the company's revenues to grow at a 5-year CAGR of 14% to Rs108bn by FY26 as the upcoming expansion of the economy, construction of dams, the continuation of Naya Pakistan Housing Scheme, and government's policies to invest in real estate via Roshan digital account would further bolster the cement demand in the near future.

WHR and Captive Power Plants to Bring Efficiency

WHR power plant became operational at the HUB site in the second half of the year that offsetting some of the cost pressure. Furthermore, Company has entered into an agreement with Sinoma Energy Conservation Ltd, China for the supply of a Coal-Fired Power Plant (CFPP) of 30MW at the Hub Cement plant. Machinery and equipment of power plant are based on air cooling system that would reduce the water consumption drastically, CFPP is the first of its types in Pakistan energy conversant with "Reheat System" consisting of two turbines. It is expected that coal consumption per KWh is about 1% less than what is being used for their existing coal-fired power plant.

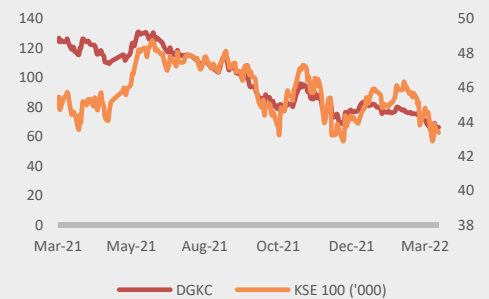
Use of Afghan coal in North Helping Maintain Gross Margins

The Russia-Ukraine war had created huge volatility in the commodity market, hence global coal prices rallied amid intensified and tight supplies in strategic European countries, instigating European buyers to look for alternative regions like the USA, Asia, Colombia, and South Africa. Currently, the price of benchmark Richard Bay coal prices climbed to a lifetime high of \$460/ton thus raising long-term risks of financial

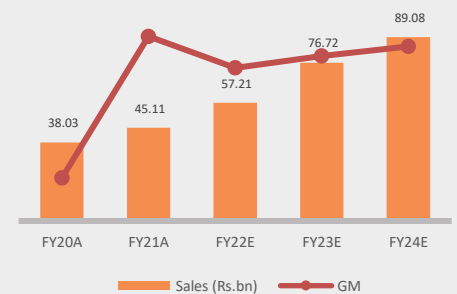
Key Statistics

Symbol	DGKC
TP - Dec 22	100.00
LDPC	67.00
Upside (%)	49.00
Free Float ('mn)	219
Market Cap. (Rs.'mn)	29,209

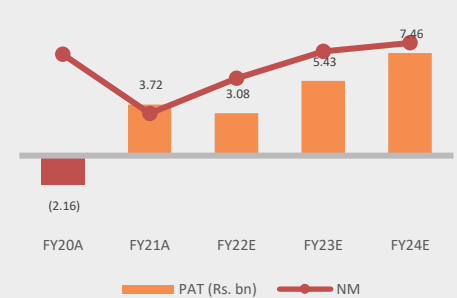
DGKC vs KSE 100



Sales (Rs'bn) vs Gross Margin



PAT (Rs'bn) vs Net Margin



Sources: ACPL Research, Company Financials, PSX.

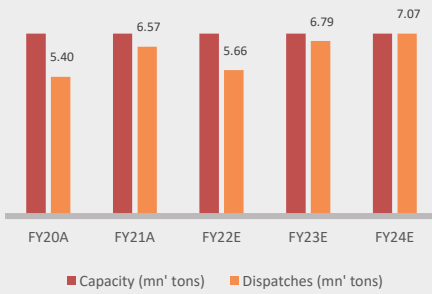
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Key Statistics

DGKC Dispatches vs Capacity



hardships for the cement industry. To tackle the situation Cement factories in the North have mostly switched to utilizing a mix of Afghan and coal sourced from other countries, they are currently using 70 percent Afghan coal and are considering adding 20 percent more local rocky fuel to the mix. The majority of the northern players have landed the cost of closing inventory at \$150-\$170/ton for approximately 70 days of inventory being held which gave a sufficient buffer to cement companies that gave them room to keep their margins sustained in short to medium term. However, with time, we are seeing a reversal in the international commodity prices and that would also ease the matter for companies to maintain their gross profit margins.

Regional Diversification to Remain a Key Strength

DGKC is the only company after LUCK which have their presence in both the north and south zone due to which they have export opportunities to Afghanistan and Iran through the north zone. On the other hand, the company has ample export opportunities via sea from its south zone to Bangladesh, Sri Lanka, South Africa. Moreover, DGKC has significant investments in companies like MCB, NML, and NPL, whose dividends also enhance the bottom line of the company.

Valuation

DGKC is currently trading at FY22E P/E of 9.54x. Furthermore, the scrip is also trading at FY22E P/B of 0.26x which offers a discount of 37% relative to its historical 5-year average of 0.42x. We have a **BUY** stance on the scrip with a DCF based Dec-22 TP of Rs.100 which provides an upside potential of 49%.

Key Risks to Valuation

- More than expected depreciation of PKR
- Hike in prices of raw material
- Covid-19 (Omicron) scenario
- Less than expected growth in demand

Sources: ACPL Research, Company Financials.

Financial Projections

Rupees' millions	FY19A	FY20A	FY21A	FY22E	FY23E	FY24E	FY25E
Net sales	40,517	38,033	45,108	57,211	76,716	89,082	98,765
Cost of sale	35,154	36,447	37,036	48,724	64,452	74,002	81,789
Gross profit	5,362	1,586	8,072	8,487	12,264	15,080	16,976
Selling and promotion expenses	629	659	647	767	1,028	1,194	1,323
Administration expenses	1,306	1,783	1,950	2,100	2,815	3,269	3,625
Other operating expenses	538	530	414	692	928	1,078	1,195
Operating Profit	2,868	- 1,532	5,165	4,929	7,492	9,539	10,833
Other operating income	2,427	2,430	2,527	2,526	2,526	2,526	2,526
Finance cost	3,304	4,653	2,921	3,061	2,266	1,404	950
Profit before taxation	1,991	- 3,756	4,771	4,394	7,751	10,661	12,408
Taxation	381	- 1,598	1,050	1,318	2,325	3,198	3,722
Profit after taxation	1,610	- 2,159	3,721	3,076	5,426	7,462	8,686
EPS	3.67	- 4.93	8.49	7.02	12.38	17.03	19.83

Source: ACPL Research, Company Financials

Horizontal Analysis

	FY19A	FY20A	FY21A	FY22E	FY23E	FY24E	FY25E
Net sales	32.1%	-6.1%	18.6%	26.8%	34.1%	16.1%	10.9%
Cost of sale	60.3%	3.7%	1.6%	31.6%	32.3%	14.8%	10.5%
Gross profit	-38.6%	-70.4%	409.0%	5.1%	44.5%	23.0%	12.6%
Selling and promotion expenses	0.6%	4.8%	-1.8%	18.5%	34.1%	16.1%	10.9%
Administration expenses	45.4%	36.6%	9.3%	7.7%	34.1%	16.1%	10.9%
Other operating expenses	-77.1%	-1.6%	-21.8%	67.1%	34.1%	16.1%	10.9%
Operating Profit	-41.0%	-153.4%	-437.1%	-4.6%	52.0%	27.3%	13.6%
Other operating income	-19.8%	0.1%	4.0%	0.0%	0.0%	0.0%	0.0%
Finance cost	536.3%	40.8%	-37.2%	4.8%	-25.9%	-38.0%	-32.3%
Profit before taxation	-73.0%	-288.7%	-227.0%	-7.9%	76.4%	37.5%	16.4%
Taxation	-126.0%	-519.2%	-165.7%	25.5%	76.4%	37.5%	16.4%
Profit after taxation	-81.8%	-234.1%	-272.4%	-17.3%	76.4%	37.5%	16.4%
EPS	-81.8%	-234.1%	272.4%	-17.3%	76.4%	37.5%	16.4%

Source: ACPL Research, Company Financials

Key Ratios

Profitability Ratios		FY19A	FY20A	FY21A	FY22E	FY23E	FY24E	FY25E
GP Margin	%	13.24	4.17	17.89	14.83	15.99	16.93	17.19
NP Margin	%	3.97	-5.68	8.25	5.38	7.07	8.38	8.79
OP Margin	%	7.08	-4.03	11.45	8.61	9.77	10.71	10.97
ROE	%	2.27	-3.24	5.06	2.78	4.68	6.08	6.66
ROCE	%	1.43	-1.89	3.17	2.13	3.80	5.24	5.95
ROA	%	1.28	-1.67	2.70	2.85	4.79	6.10	6.49
Cost per ton	'mn	6.71	6.86	5.39	8.61	9.49	10.46	11.56
EBITDA per ton	'mn	1.13	0.40	1.33	1.51	1.64	1.86	2.05
Liquidity Ratios		FY19A	FY20A	FY21A	FY22E	FY23E	FY24E	FY25E
Current	x	0.98	0.91	0.91	0.43	0.55	0.77	1.01
Acid-test	x	0.46	0.42	0.38	-0.18	-0.18	-0.02	0.20
Cash to current liab.	x	0.01	0.01	0.02	-0.62	-0.62	-0.46	-0.23
Activity Ratios		FY19A	FY20A	FY21A	FY22E	FY23E	FY24E	FY25E
Average Inventory		2,545,827	4,033,527	3,540,792	3,435,820	4,811,750	5,886,467	6,623,559
Inventory Turnover	x	14	9	10	14	13	13	12
Inventory Days		26	40	35	26	27	29	30
Receivables Days		11	22	14	14	14	14	14
Payables Days		83	113	147	104	104	104	104
Operating Cycle		-46	-51	-99	-65	-63	-61	-61
Utilization	%	79	76	93	80	96	100	100
Export Revenue	%	95	81	71	74	75	74	74
Local Revenue	%	5	19	29	26	25	26	26
Export Market Share	%	0	0	0	0	0	0	0
Local Market Share	%	0	0	0	0	0	0	0
Total Market Share	%	0	0	0	0	0	0	0
Investment Ratios		FY19A	FY20A	FY21A	FY22E	FY23E	FY24E	FY25E
EPS		3.67	-4.93	8.49	7.02	12.38	17.03	19.83
DPS		1.00	0.00	1.00	0.83	1.46	2.01	2.33
Div. Yield	%	1.49	0.00	1.49	1.23	2.18	2.99	3.48
Dividend Cover		3.67	0.00	8.49	8.49	8.49	8.49	8.49
BVPS		161.89	152.11	167.71	252.85	264.40	279.98	297.80
Payout	%	27.22	0.00	11.77	11.77	11.77	11.77	11.77
Retention	%	72.78	100.00	88.23	88.23	88.23	88.23	88.23
No. of Shares	'mn	438	438	438	438	438	438	438
P/E		18.24	-13.60	7.89	9.54	5.41	3.93	3.38
Sales per share		92.48	86.81	102.96	130.58	175.10	203.33	225.43
P/BV		0.41	0.44	0.40	0.26	0.25	0.24	0.22
Price to Sales		0.72	0.77	0.65	0.51	0.38	0.33	0.30
Gearing Ratios		FY19A	FY20E	FY21A	FY22E	FY23E	FY24E	FY25E
Debt to Equity	x	0.58	0.71	0.60	0.30	0.23	0.16	0.12
L.T. Debt to Equity	x	0.23	0.33	0.26	0.13	0.09	0.04	0.00
Total Debt to Assets		0.33	0.37	0.32	0.31	0.24	0.16	0.12
L.T. Debt to Assets		0.13	0.17	0.14	0.13	0.09	0.04	0.00
Interest Cover	x	0.87	-0.33	1.77	1.61	3.31	6.79	11.40

Source: ACPL Research, Company Financials

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TP	Target Price	CAGR	Compound Annual Growth Rate	FCF	Free Cash Flows
FCFE	Free Cash Flows to Equity	FCFF	Free Cash Flows to Firm	DCF	Discounted Cash Flows
PE	Price to Earnings Ratio	PB	Price to Book Ratio	BVPS	Book Value Per Share
EPS	Earnings Per Share	DPS	Dividend Per Share	ROE	Return of Equity
ROA	Return on Assets	SOTP	Sum of the Parts	LDCP	Last Day Closing Price

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HOLD	Between -5% to 15%
SELL	Less than and equal to -5%

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Market Weight	Neutral
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