DGKC: Gearing for Expansion !

About the Company

DGKC cement plants are situated in kahirpur and DG khan site with a combined capacity of 4.2mnTpa. It is principally engaged with sale of clinker, Ordinary Portland Cement and sulphate Resistant Cement.

Marke Data

Sector	Cement	Vol Avg 12m	4.65
Shares (mn)	438	Price 12m H|L	137.62 l 71.71
Market Cap (mn)	54,134	Return 12m	43.77%
Market Cap ($mn)	530.84		

Recommendation

Last Price	125
Target Price	158
Upside	26%

Income Statement (PKR bn)

	FY14A	FY15E	FY16F
Revenue	26,543	27,665	29,425
Gross Profit	9,258	8,946	9,967
Net Income	5,965	6,872	7,448
EPS (PKR/share)	13.62	15.68	17.00
DPS (PKR/share)	3.50	4.50	5.00

Balance Sheet

	FY14A	FY15E	FY16F
Total Assets	73,282	77,660	82,065
Total Liabilities	11,766	11,299	10,490
Total Equity	61,517	66,361	71,575

Ratios

RoE (%)	11%	11%	11%
P/E (x)	9.21	7.99	7.37
Dividend Yield (%)	3%	4%	4%

Major Shareholders

Associated Companies	31%
Foreign	19%
Local	12%

We initiate our coverage on DG-Khan Cement company Limited (DGKC) with a target price of PKR 158/share offering an upside of 26% from last closing price of PKR 125/share. At current price level scrip is trading at a P/E of 7.99x, with earnings growth of 15% and 8% in FY15E and FY16F, respectively.

Margins to grow on decline in Energy cost

International coal prices have declined to its lowest rate since last 5 years due to supply glut situation in the region. The commodity prices are currently hovering around USD 62-63/ton; down by 15.5%FYTD. We have incorporated price of USD 65/ton in our model for FY15. As per our calculations every USD 5/ton decline in price will increase the company's earnings by PKR 0.44/share.
Moreover, due to reduction in power tariff owing to plunge in international crude oil prices have helped reduce DGKC's generation cost by 8% (EPS impact: PKR 0.93/share).These factors helped the company's margin to accrete by 195bps.

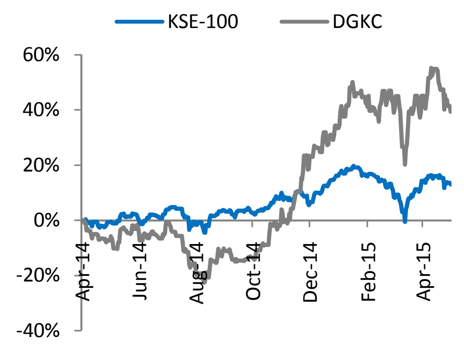
Sector demand on its peak

Historically, local dispatches witnessed swift expansion in second half of the fiscal year due to summer season. As per recent data published by APCMA, in 10MFY15; local dispatches grew by 8%YoY to 22.9mnT as compared to 20.5mnT same period last year, the sector is yet to incorporate its remaining tenacious quarter. We believe local dispatches are to accelerate in 2MFY15 owing to seasonal impingement and robust private sector development. However, as per estimates; decline in exports from Afghanistan will not affect the company's earnings due to curtailed margins.

Imposition of Anti-Dumping Duty

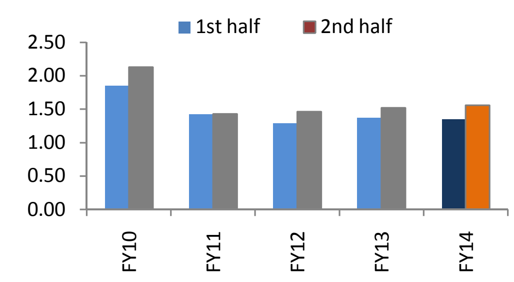
As per international trade administration commission of South Africa (ITAC), anti-dumping duty has been imposed by South African customs union on Portland cement imported from Pakistan. The duty charged on DGKC is 68.8% while, for other manufacturers it varies from 14%-77%. As per management, the company exports only 20kTons to South Africa. Resultantly, as per our estimates it has negligible impact on the earnings of the company.

Relevative Price Performance

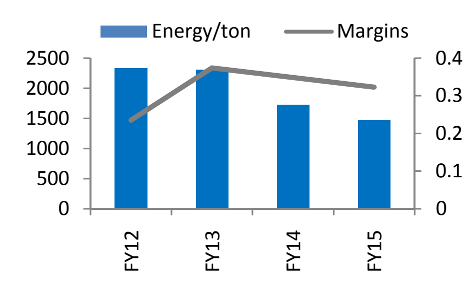


Source: IGI Research

Historic Trend



Energy/ton to Margins



Source: IGI research

Focused on cost reduction strategies

To reduce risk of fluctuating coal prices the company had already installed RDF plants at its sites. However, due to drop in coal prices DGKC is not utilizing its RDF capacity, the company is in the registration process of verified carbon standard (VCS) for Lahore and Multan projects. Other than RDF project, the company is also installing a 30MW coal based power plant to replace its dependency on national grid. The project is expected to complete by FY17 with an estimated cost USD 23.6mn. As per our calculations, the project will improve the firm's margin by 191bps (EPS impact: 1.08/share).

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Growing to seize opportunities

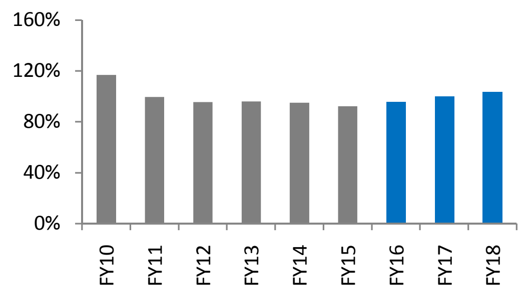
DGKC plans to bolster its operations by 2.6mntpa through Greenfield expansion in South region. The proposed investment for the project is estimated to be USD 300mn which will be financed through a proportion of 60:40 debt/equity ratios. The primary reason for expanding its operations in South is (i) Company capacity utilization is above 95% and, (ii) exploring new regions to support its deteriorating exports. The plant is likely to be operational in 3 years after the announcement of project; our recent discussion with the management suggests that they will disclose their final decision along with the supplier information with full year results of FY15. Due to lack of clarity, we have not incorporated any impact of expansionary plans in our recommendation.

Portfolio breakup

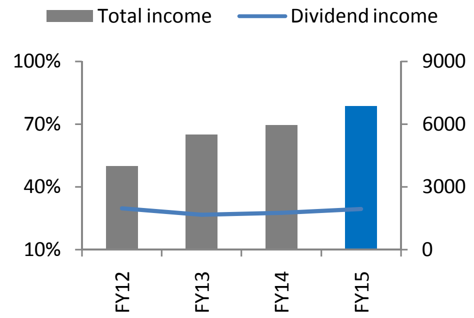
Holding Company	S.P	Equity	Value mn
MCB Bank	270	102	27,598
Nishat Mills	106	30	3,222
Adamjee Insurance	45	10	449
Nishat Chunian	34	6	205
Value before discount			31,473
Discount			30%
Value after discount			22,031
Value per share			50

Source: IGI Research

Capital Utilization (-%)



Core Earnings Breakup

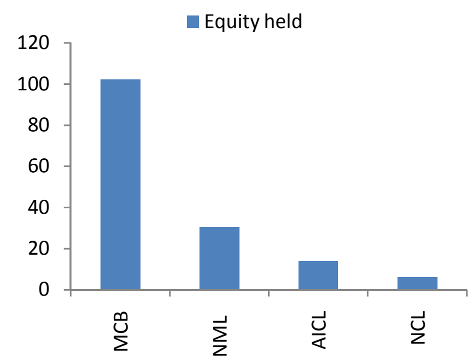


Source: IGI research

Diversified Dividend income

DGKC has diversified investments in group companies (MCB, NML, NCL and AICL). In FY14, it approximately contributed PKR 3.7/share (27%) out of PKR 13.62/share earnings. Going forward, we expect dividend income to hover around 24% and 21% of the total earnings in FY15 and FY16, respectively.

Investments in Equity (sh-mn's)



Source: IGI Research

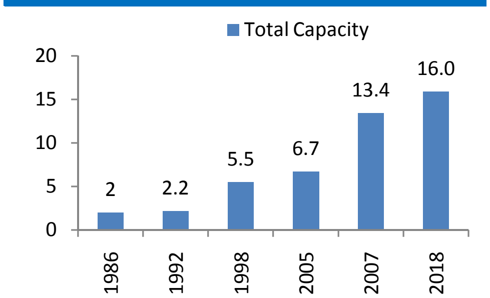
Long-Term Investment plans

DGKC has expressed its intention at the end of FY14 to further diversify its portfolio by investing in its group companies through long term equity investment plan which include (i) PKR 2.01bn in Nishat Dairy, (ii) PKR 1bn in Nishat hotels and properties and, (iii) PKR 18.1mn in Nishat paper. Going forward, we expect these companies may support DGKC's bottom-line in the future.

Retiring debt; to decrease finance cost

With strong cash flow generating capacity, DGKC is retiring its long term loans, and we believe the company will pay all its long term liabilities by the end of FY17 which will resultantly decrease the company's short term borrowings. However, DGKC will finance a portion of its expansion project through long term debt in future.

Expansion graph



Source: IGI Research

3QFY15 Review

DG khan cement (DGKC) announced its results, posting earnings of PKR 1.91bn (EPS: PKR 4.52/share) as against PKR 1.27bn (EPS: PKR 2.91/share); up by 55%YoY. Augment in earnings is primarily on the back of (i) Lower energy costs, (ii) 71%YoY decline in distribution expense, (iii) 82%YoY increase in other income owing to dividend income from MCB and AICL and (iv) 54%YoY slump in finance cost. However, revenue of the company shrank by 13%YoY to PKR 6.2bn attributable to plunge in exports by 39%YoY which was lower than expected. On the other hand, margins of the company increased by 620bpsYoY to 36%. In 9MFY15 earnings of the company clocked in at PKR 5.3bn (EPS: PKR 12.27); up by 36%YoY.

Valuation

Core valuation of company’s operation by DCF method clocks in at PKR 107/share coupled with a discounted (30%) portfolio value of PKR 50/share bringing our combined TP to PKR 157/share.

Day Break

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