

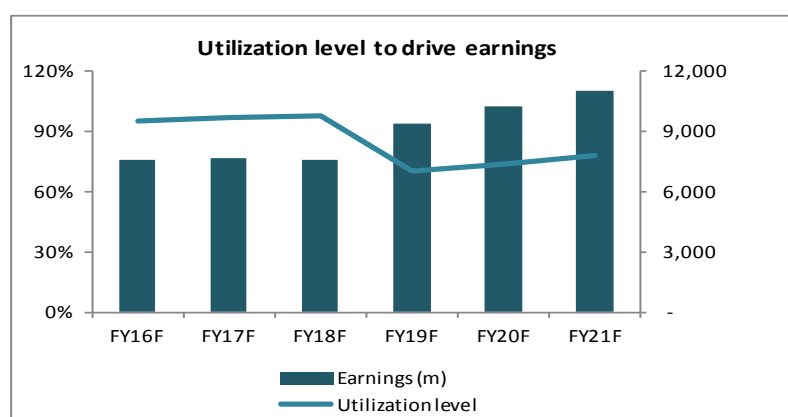
DGKC: Expansion to drive up valuations

We have reinitiated our coverage with a buy call on the DGKC, having an upside of 28.1% to our target price of PKR 211.5 per share till Dec-16. Earnings are expected to grow at a 5-year CAGR of 10% on the account of i) increased capacity utilization leading to growth in volumetric dispatches ii) completion of coal power project iii) healthy dividends from the associated to supplement core income and iii) capacity expansion in south together with demand of cement from construction projects of CPEC. Further, we have tweaked our model by incorporating future expansion and incremental earnings from coal power project. We have sanguine outlook for the scrip due to:

- ⇒ Increase in industrial utilization level from 75% for 1HFY15 to 80% in 1HFY16. As far as MRQ (Most recent quarter) is concerned, the utilization of industry ramped up to 87% against same period last year.
- ⇒ DGKC is a group play as it generates almost ~30% of its net income from associate companies.
- ⇒ 42% surge in PSDP disbursement. Releases amount to PKR 336.2 bn as compared to PKR 236.71 bn last year. Further, due to higher quarterly ceilings in the last two quarters of the fiscal year, we expect upbeat construction activity. Following table depicts the release mechanism:

First Quarter (July –September)	20%
Second Quarter (October – December)	20%
Third Quarter (January – March)	30%
Fourth Quarter (April – June)	30%

- ⇒ Electricity savings emanating from 30 MW coal power plant. We expect this plant to be fully operational by the beginning of CY17.
- ⇒ Expansion in the production capacity by 2.83 million metric ton per annum, resulting in ~ 40% increase from existing capacity. We expect this plant to be fully operational by the beginning of FY19. Further, we expect the plant to be utilized at 50% level initially after operation.
- ⇒ CPEC would be a long term impetus for the growth of cement demand as \$46 billion projects are heavily geared toward infrastructure construction
- ⇒ Downside risks to our investment thesis are i) delay in execution of projects and ii) imposition of duty on import of raw materials



REK-183

March 15, 2016

D. G. Khan Cement Co Ltd.

Target Price	211.50
Current Price	165.3
Upside	28%

Positive

Key Stats

KATS Code	DGKC
52 Week High (PKR)	166.56
52 Week Low (PKR)	106.59
Avg. daily volume ('000)	3,699.33
Market Cap (PKR Bln)	72.40
Market Cap (USD, mln)	689.52
O/S Shares (Mln)	438.12

Technical

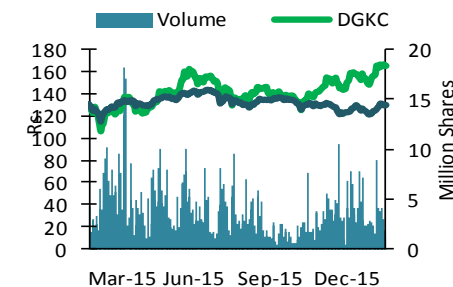
RSI	70.36
1 Month moving average	138.87
3 Month moving average	139.55
1 Year moving average	136.06

Performance

	1 M	3 M	1 Yr
Absolute	15.5%	8.20%	23.98%
*Relative	13.75%	7.82%	26.27%

*KSE-100 Index

One year price performance



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Research is also available on Bloomberg and S&P Capital IQ

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1HFY16 Overview:

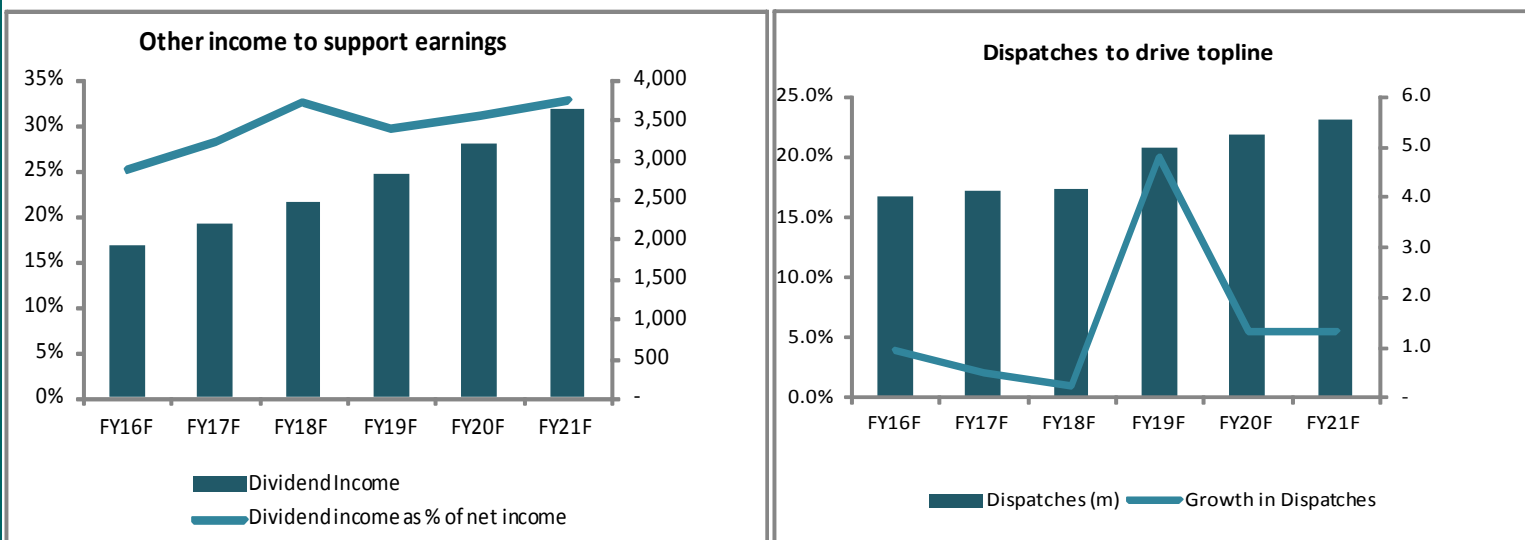
Top-line swelled by 7.75% to PKR 13.6 bn primarily due to exuberance in domestic sales volumes as local dispatches surged by 14.39% YoY coupled with a minute increase in average retention price ~1% YoY, whereas, export dispatches dipped by 21.7% YoY. COGS declined by 4.41%, despite ~7.75% increase in sales. COGS shrank mainly due to ~26.37% dive in electricity and gas expense, ramping up the gross profit to PKR 5.49 bn with a hike of 32.83% YoY.

Cost of sales were ~67% of net sales revenue in 1HFY15, now the percentage has dropped to ~60%, resulting in gross margin accretion of ~760bps. Gross profit for 1HY16 came out to be PKR 5.49 bn, expanding by 32.83%.

SG& A expense contracted by 10% owing to lower freight and handling charges, following ~22% YoY compression in exports. Moreover, other operating expenses jacked-up by ~44% YoY on account of rise in WWF (Workers Welfare Fund) and WPPF (Worker Profit Participation Fund) due to spike in profitability. Furthermore, finance cost decreased by 60.41% YoY as a result of lower interest rates. But the bottom-line was dented by souring effective interest rate, which came out to be ~27% against 17% in the corresponding period. However, PAT improved by astounding 20.23% YoY, posting 1HFY16 net profit at PKR 4.079 bn.

Future Outlook

We expect margins to remain intact even after the completion of coal power plant as the gains would be partially offset by the gradual increase in coal and other input prices. We believe coal prices have almost bottomed-out and expect a gradual increase from CY17. After beginning of the Hub plant operation, we expect the bottom-line of the company would drive largely on the back of increase sales dispatches rather than on margin accretion. Unless the company secures substantial export market, we expect dwindling exports going forward.



Valuation

We have used average of two valuation methods to calculate the target price of DGKC with a time horizon till December 2016. The target price for Dec-16 through DCF approach came out to be PKR 214 per share.

	PKR
NML Value:	
03/14/2016 share price	95.6
Shares held by DGKC (millions)	30,289,501
DGKC holding value	2,895,676,296
MCB Value:	
03/14/2016 share price	206.4
Shares held by DGKC (millions)	102,277,232
DGKC holding value	21,110,020,685
AICL Value:	
03/14/2016 share price	53.70
Shares held by DGKC (millions)	16,053,735
DGKC holding value	862,085,570
NCL Value:	
03/14/2016 share price	33.1
Shares held by DGKC (millions)	6,062,169
DGKC holding value	200,657,794
DGKC Market Value with and without holdings	
03/14/2016 share price	165.15
Shares outstanding	438,120,000
DGKC market capitalization	72,355,518,000
Value of NML	2,895,676,296
Value of MCB	21,110,020,685
Value of AICL	862,085,570
Value of NCL	200,657,794
Implied value of DGKC	47,287,077,656
Pro rata Market Value	
NML	4.0%
MCB	29.2%
AICL	1.2%
NCL	0.3%
DGKC	65.4%
Valuation	
Market value of other holdings	57.22
Adjusted stand alone EPS (TTM)	14.46
Market value of DGKC	108
P/E of DGKC	7.46
Average peer P/E	10.5
Standalone DGKC target price	151.83
Market value of other holdings	57.22
DGKC targeted share value	209

Our target price has been derived by taking an average of above mentioned valuation methodologies, the TP for Dec-16 is PKR 211.5 having a upside of 28.1% to the previous close.

Inputs for DCF valuation	
Terminal growth rate	6%
FCFE	83,472,224
Net Debt	(10,317,402)
Net Value	93,789,626
Shares	438,120
Target Price	214
Target market cap (Rsm)	93,789,626
Current price	166.15
Upside	29%

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Rating criteria	Stance
(Target Price/Current Price - 1) > 10%	Positive
(Target Price/Current Price - 1) < -10%	Negative
9% > (Target Price/Current Price -1) > -9%	Neutral

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