INITIATION

EQUITY RESEARCH - REP 099

ATTOCK CEMENT PAKISTAN LTD (ACPL)

Oct 06, 2016

BUY

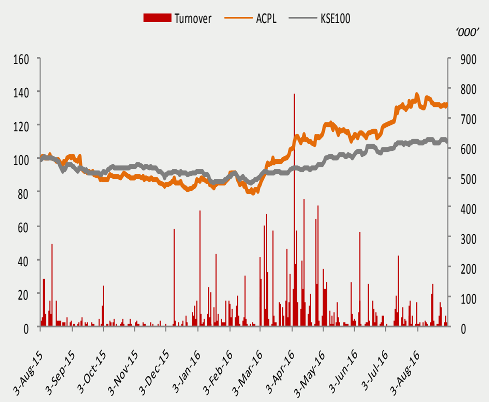
Price Target : PKR 338.30/share

Closing Price : PKR 246.71/share

COMPANY DATA	
52-week Price Range (PKR)	157.74 - 275.91
No. of Shares Outstanding (mn)	114.52
Market Cap (PKR mn)	28253.84
Market Cap (USD mn)	270.41
Free Float (mn shares)	22.90
Year End	Jun
KATS Code	ACPL

Source: PSX

CHART: STOCK PERFORMANCE



Source: PSX

- **We initiate our coverage on ACPL with 'Buy' rating:** Our Jun-17 DCF based price target of PKR 338/sh implies 37% upside from current price levels of PKR 247/sh. The stock offers a prospective dividend yield of ~5%.
- **Falcons of south - aiming to strike northbound growth:** ACPL has planned to install a new production line of 1.2mn tpa at its existing site. The project is expected to commence commercial operations by 3QFY18E with estimated total outlay of USD 130mn. This brownfield expansion is aimed to sustain its market share in south.
- **WHR power plant of 15MW to be installed at Line III:** In order to reduce its reliance on grid, company is installing a 15MW WHR power plant at line III. The new WHR plant is likely to translate in after tax savings of PKR ~2.8/sh and PKR ~6.1/sh during FY18E and FY19E respectively.
- **All eyes on Enhancing Production Capacity - Other projects put under shelve:** Due to scarcity of water supply in Hub Dam since last one year, being the only source of water for plant operations , work on Coal based CPP (40MW) has been halted. On the other hand, project pertaining to setting a cement grinding unit (0.9mn tons/yr) in Iraq is delayed due to some legal issues. As per the company officials, the issues with the local authorities shall be resolved by Dec'16.
- **Financing of Expansion:** The company has entered into a syndicated finance agreement with a consortium of banks for a term finance facility of PKR 7bn (~50% of total outlay). The remaining amount will be financed through internal cash generation and liquidation of existing short term investments.
- **Investment Risk:** The key risk to our investment thesis are 1) Delay in Expansion 2) Breakdown of Price arrangement 3) Declining local demand 4) Inflating Coal prices 5) Increase in Interest rates and 6) Tax Break.

ACPL FINANCIAL HIGHLIGHTS

	FY15	FY16	FY17E	FY18E	FY19E	FY20E	FY21E
EPS	19.26	25.24	25.53	26.36	27.72	30.73	32.11
DPS	15.0	12.5	12.5	12.5	20.0	22.0	24.0
BVPS	78	91	104	118	133	144	154
PE (x)	12.81	9.78	9.66	9.36	8.90	8.03	7.68
Div Payout (%)	78%	50%	49%	47%	72%	72%	75%
EBITDA Margin (%)	28%	34%	32%	35%	38%	36%	34%
ROA (%)	18%	20%	15%	12%	12%	14%	15%
ROE (%)	25%	28%	24%	22%	21%	21%	21%
Gross Margin (%)	34%	40%	38%	38%	38%	37%	36%
Net Profit Margin (%)	17%	21%	20%	20%	19%	19%	19%

Source: Company Accounts, Nael Research

Jawad Ameer Ali AC
jawad@naelcapital.com
(+92-21) 32461812-13

Valuation

We initiate coverage on Attock Cement Pakistan Limited (ACPL), with '**Buy'** rating and a PT of PKR 338/sh, implying 37% upside potential from its closing price of Oct 05, 2016. We have used Free Cash Flow to Firm (FCFF) methodology to derive the intrinsic value of ACPL. The stock offers a prospective dividend yield of ~5%. Following assumptions have been used to arrive at our target price:

- Terminal growth rate of 4%
- RFR of 7.72% (PIB 10yr), Adjusted Beta of 0.84 (using 5yr), and Market Risk Premium of 6%

	FY17E	FY18E	FY19E	FY20E	FY21E
PV of FCFF	(4,975)	(1,956)	3,636	3,231	2,995
WACC	11%	10%	11%	11%	12%
Sum of FCFF	2,932				
Terminal Value	62,253				
PV of Terminal Value	39,811				
Ent Value	42,743				
PV of Debt	4,000				
Equity Value	38,743				
Target Price 6/30/2017	338				
Current Price	247				
Upside	37%				

Financial Performance - FY16

ACPL posted net earnings of PKR 2.9bn (EPS: PKR 25.24) in FY16, up by 31%YoY as against PKR 2.2bn (EPS: PKR 19.26) witnessed in FY15. The company announced a final cash dividend of PKR 12.5/sh.

The growth in earnings is attributable to 1) higher volumetric sales (5%YoY growth in total dispatches) 2) margin expansion of 654bps and 3) fuel price adjustment.

The company achieved an all time high utilization rate of 108% (highest ever kiln working days) due to continuous investments in BMR in some of the major plant processes.

PKR 'mn'	FY16	FY15	YoY	4QFY16	4QFY15	YoY
Net Sales	13,918	13,086	6%	3,604	3,296	9%
GP	5,587	4,396	27%	1,615	1,218	33%
Admin Exp	402	347	16%	46	83	-44%
Dist Exp	955	987	-3%	204	207	-1%
EBIT	4,257	3,247	31%	1,366	938	46%
Fin cost	21	26	-18%	6	5	11%
PBT	4,236	3,221	32%	1,360	933	46%
PAT	2,890	2,206	31%	796	562	42%
EPS	25.24	19.26	31%	6.95	4.91	42%

Source: Company Accounts (FY16), Nael Research

Company Overview

Attock Cement Pakistan Limited (ACPL) started its commercial production in 1988 and is amongst the leading cement player in southern region. The company is primarily engaged in producing and selling grey cement in domestic and foreign markets. It has a capacity based market share of 21% in south.

The company is a mid sized cement manufacturer located in Hub, Balochistan with rated capacity of ~1.8mn tons/yr from two cement lines.

ACPL is a subsidiary of Pharaon Investment Group Limited Holding (PIGL), having diversified interest in multiple sectors such as cement, oil & gas, power generation and information technology. PIGL has a strong presence in the oil sector with investment in Pakistan Oilfields Limited, Attock Refinery Limited, National Refinery Limited and Attock Petroleum Limited. PIGL has 84% stake in Attock Cement Pakistan Ltd. In case of downturn, we anticipate support from its sponsoring company.

Shareholding Pattern

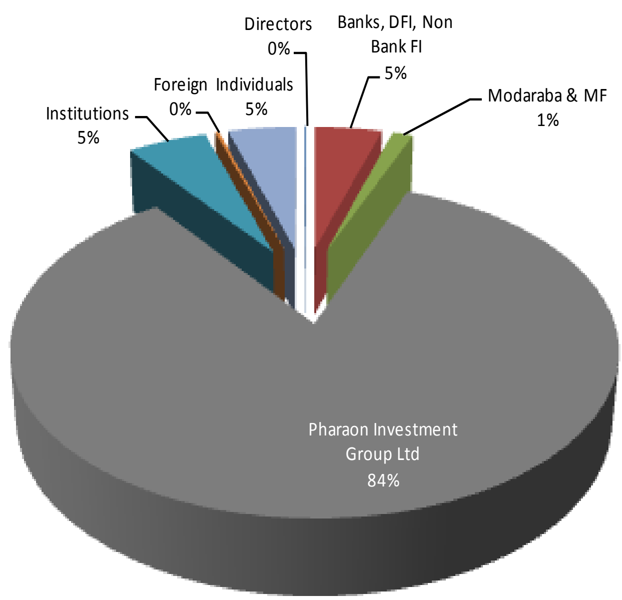
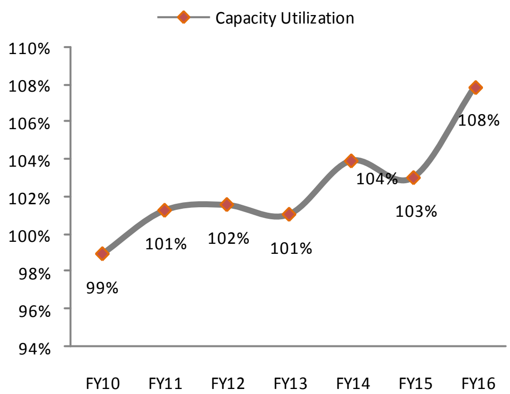
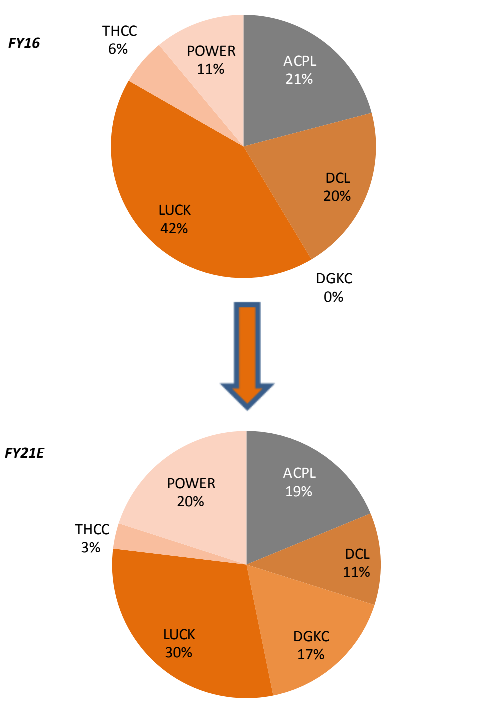


Fig: 1 **Attock's Capacity Utilization**



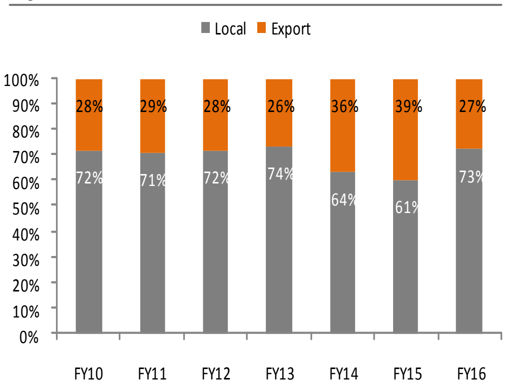
Source: Company Accounts, Nael Research

Fig: 2 **South - Capacity based Market Share**



Source: APCMA, Nael Research

Fig: 3 **Attock's sales mix**



Source: Company Accounts, Nael Research

Investment Argument

Our investment view on ACPL is based on strong earnings growth post expansion supported by various underlying factors.

Falcons of south - aiming to strike northbound growth

ACPL is one of the prominent cement manufacturers in the southern region having capacity based market share of 21% as of FY16. ACPL is currently operating with line I and II with rated capacity of 1.8mn tpa of cement production. The capacity utilization of ACPL has remained over 100% (refer to Fig: 1) during the last five years albeit 84% average utilization rate in southern market compared in the same period. Ability to tap export market has allowed the company to achieve over 100% capacity utilization.

- **Enhancement of Production Capacity**

The management of ACPL has announced an agreement with Hefei Cement Research and Design Institute (HCRDI) to set up a new cement line of 4000tpd. With the addition of Line III, total rated capacity for production is expected to increase to ~3mn tpa. This brownfield expansion is aimed to sustain its market share (refer to Fig: 2) in south where capacity addition announced by other players accumulates to 7.35mn tpa (86% upsurge in southern addition). Apart from maintaining market share, Line III expansion of the company will facilitate in improved profitability given higher efficiency of Line III vis-a-vis existing lines. The project cost of Line III (4000 tpd) and WHR power plant (15MW) is estimated at USD 130mn.

- **Initiating Expansion in South**

The utilization level of south is already hovering near its rated potential capacity (92% as of FY16). The rising domestic demand across regions have shifted the sales mix concentration of south towards higher retention local demand i.e. 60% local share in FY11 vs. 74% during FY16. Similar trend in near term is likely to heat up all capacities in south. We anticipate the utilization level to reach 98% by FY17E.

The untapped growth potential of ACPL marred by its existing capacity is anticipated to reap benefits once new line commence commercial operations. Although expansion in south is led by ACPL but the competitive advantage of first mover advantage in our opinion is short lived unlike Cherat's expansion (3QFY17E) in north. Expansion of DGKC (2.7mn tpa) and LUCK (1.2mn tpa) in south is likely to materialize within the next quarter (4QFY18E) once Attock's plant get online in 3QFY18E. Ability to tap export market will bode well for the company in unfavorable circumstances.

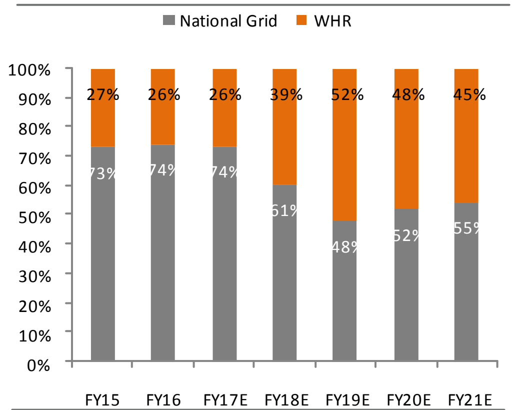
- **Export Avenues - Exploring new Markets**

The company is exploring new regional markets where Sri Lanka and Yemen are potentially added in list. A significant export volumes to Sri Lanka was witnessed in FY16. While export sales have on average represented around 30% of total dispatches over the last five years, growth in local dispatches in the FY16 and diversification into new export markets have compensated for decline in exports due to anti-dumping duty imposed on exports to South Africa.

- **Tax Break**

There exist a legal debate whether company is subject to 5yr tax holiday or tax credit on plant & machinery. We haven't incorporated any tax benefit from its brownfield expansion in Hub. We wait for further clarity from the company and tax authorities to incorporate its impact on our valuation.

Fig: 4 **Attock's Reliance on Grid**



Source: Company Accounts

WHR power plant of 15MW to be installed at Line III

The reliance of ACPL for electricity requirement on national grid (refer to Fig: 4) is higher as compared to other prominent players owing to unavailability of captive power plants. The initiative of installing one such plant was hampered due to scarcity of water supply for operational purpose (refer to sub head. "Coal Fired CPP 40MW").

Based on our discussion with management, company is installing a 15MW WHR power plant at its new line III to curb its power requirement from grid. The company already has a 12MW WHR plant installed at Line II with operational efficiency of 8MW (67%). Assuming the same efficiency rate for new WHR power plant (15MW) to be installed at Line III, we anticipate electricity requirement from national grid to reduce from 74% to 48% in FY19E (refer to Fig: 4).

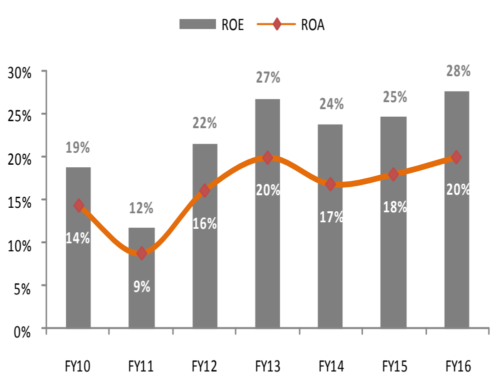
The new WHR plant (15MW) is likely to translate in after tax savings of PKR 2.8/sh and PKR 6.1/sh during FY18E and FY19E respectively.

All eyes on Enhancing Production Capacity - Other projects put under shelve

- **Coal Fired Captive Power Plant 40MW**

Realizing the importance of cost effective power generation and uninterrupted power supply, ACPL announced its plan of installing a coal based CPP of 40MW. Due to scarcity of water supply in Hub Dam since last one year, being the only source of water for plant operations, work on project has been halted. As per the management, as soon as the availability of water reaches at desirable level, work on project would be re-initiated.

Fig: 5 **Profitability**



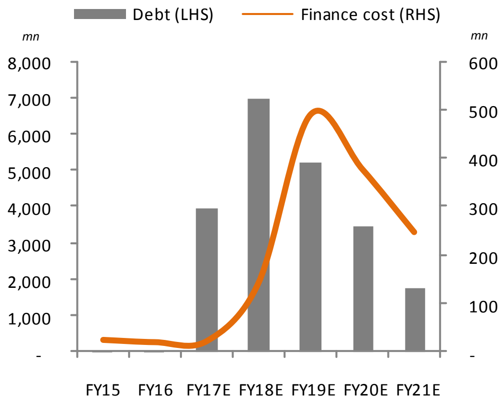
Source: Company Accounts, Nael Research

- **Cement Grinding Unit at Basra, Iraq**

In order to expand its footprints across borders, ACPL entered into a joint venture agreement with Al-Geetan Commercial Agencies, Iraq, to form a limited liability company. The principal activity of the company is aimed to build and operate a cement grinding plant having production capacity of approximately 0.9mn tons/yr. The new limited liability company, established by the name Saqr Al-Keetan has a share capital of IQD 30mn. ACPL will hold 60% share in the company. The expected investment of the company in foreign subsidiary would be USD 24mn.

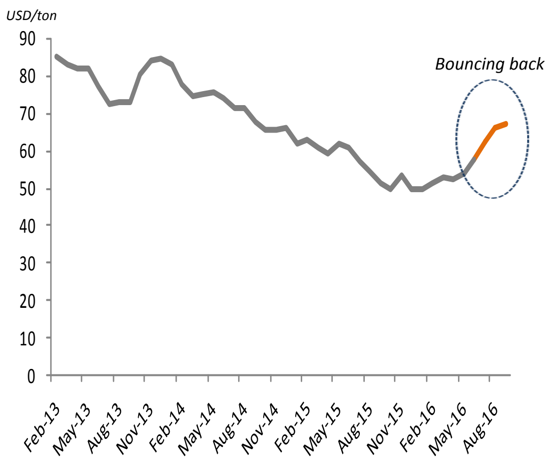
The project is delayed due to some legal issues. As per the company officials, the issues with the local authorities shall be resolved by Dec'16. No repatriation of the said amount is made yet.

Fig: 6 **Debt Financing**



Source: Company Accounts, Nael Research

Fig: 7 **Coal Prices**



Source: World Bank, Nael Research

Financing of Expansion

The total estimated cost of expansion is PKR ~14bn. As per our discussion with the management, debt financing will approximately constitute 50% of the total outlay.

The company has entered into a syndicated finance agreement with a consortium of banks for a term finance facility of PKR 7bn for the installation of new production line and WHR power plant. The facility carries a mark-up of 3M KIBOR + 0.25%, payable on quarterly basis. The tenure of this facility is 6yrs including the grace period of 2 yrs. No draw down was made up unto June 30, 2016. We expect drawdown to start in mid FY17.

The remaining PKR 7bn will be financed through internal cash generation and liquidation of existing short term investments on balance sheet worth PKR 4.3bn (FY16).

Rebounding Coal prices - Possibility of retreat as production caps lift

International coal prices have risen above USD 60/tons in the past few weeks after remaining subdued for several months owing to output cuts by China and supply disruptions. New mining rules in China designed to curtail production have created a shortage and led to a surge in imports. Augmenting fuel in fire, this development has coincided at times where china has clamped down illegal mines and cut down production due to safety issues during a period of prolonged low prices.

In our view, the current breakneck rally in coal prices is overshooting. It may continue in near term but environmental regulations supporting clean energy will squeeze coal share in the market in the form of weakening global demand in longer run. It is not fueled by increase in demand but rather by a short term delay for supply capacity to adjust to demand. We believe there is a possibility of retreat once production caps are lifted.

- **Sensitivity of coal prices**

We have performed a scenario analysis to evaluate the impact of changes in earnings, and gross margins due to changes in coal prices. The following impact is observed by keeping cement prices constant based on inflating coal prices.

	FY17E	FY18E	FY19E	FY20E	FY21E
Scenario A					
Coal Prices (USD/ton)	64	66	68	69	70
EPS	25.35	25.39	25.81	28.04	28.50
GM	38%	37%	36%	35%	33%
Scenario B					
Coal Prices (USD/ton)	70	73	75	76	77
EPS	24.63	24.30	24.47	26.41	26.58
GM	37%	35%	35%	34%	32%

PT Sensitivity

Figure: A

		Risk Free Rate				
		6.72%	7.22%	7.72%	8.22%	8.72%
Growth Rate	3.00%	341	317	296	276	259
	3.50%	367	340	316	294	275
	4.00%	395	365	**338**	314	293
	4.50%	429	394	364	337	313
	5.00%	467	428	393	363	335

Source: Nael Research

Key Risks

Upside Risk:

Tax Break

The impact of tax credit on plant & machinery or tax holiday for 5yrs whichever is subject to said company will impact positively on earnings of the company.

Downside Risk:

Delay in Expansion plans

The company will not be subject to benefits of first mover advantage in case of delay in expansion of project line III. Delay of WHR plant will translate in increased reliance on national grid for power generation. This implies higher tariffs and power cost.

Breakdown of Price arrangement

The profitability of cement sector is highly dependent on price arrangement between local players. The breakdown in price arrangement will negatively impact the profitability outlook of the sector.

Declining local demand

Domestic demand has a very high correlation with Public sector development fund and GDP. Lower than budgeted disbursement of PSDP will result in decline of local sales. Similarly, if demand expected from CPEC is hampered then the industry is expected to witness a setback.

Inflating Coal prices

The recent bounce in coal prices has posed a point of concern for companies with high sensitivity to coal. Similar trend in future will result in declining margins and reduce profitability as coal constitute a significant fuel cost.

Increase in Interest rates

The company has availed a PKR 7bn term finance facility to finance its project line III and WHR power plant. This is anticipated to increase financial leverage of ACPL. Reversal in interest rates is likely to elevate finance cost resulting in a decline in bottomline.

Financials

Income Statement (PKR mn)	FY15	FY16	FY17E	FY18E	FY19E	FY20E	FY21E
Net Sales	13,086	13,918	14,565	15,422	16,759	18,316	19,573
Cost of sales	8,690	8,332	8,969	9,624	10,428	11,460	12,488
Gross Profit	4,396	5,587	5,596	5,799	6,331	6,856	7,085
Admin Expenses	347	402	404	450	502	540	570
Distribution Expenses	987	955	779	750	810	915	1,047
Operating Profit	3,063	4,230	4,414	4,599	5,019	5,400	5,468
Other operating expenses	239	314	318	323	340	377	394
Other operating income	423	341	165	183	348	384	429
EBIT	3,247	4,257	4,261	4,458	5,027	5,407	5,503
Financial Charges	26	21	24	145	492	379	249
Profit before taxation	3,221	4,236	4,237	4,313	4,535	5,028	5,254
Taxation	1,015	1,346	1,314	1,294	1,360	1,508	1,576
Profit after Tax	2,206	2,890	2,924	3,019	3,174	3,520	3,678
EPS	19.26	25.24	25.53	26.36	27.72	30.73	32.11

Source: Company Accounts, Nael Research

Balance Sheet (PKR mn)	FY15	FY16	FY17E	FY18E	FY19E	FY20E	FY21E
Current Asset	6,132	7,197	6,594	8,055	9,276	9,926	10,287
Non current Asset	6,103	7,230	12,739	17,705	16,696	15,767	15,058
Total Asset	12,235	14,426	19,333	25,760	25,972	25,693	25,345
Current Liabilities	2,226	2,741	2,159	3,999	4,218	4,459	4,703
Long Term Financing	8	4	4,000	7,000	5,250	3,500	1,750
Other non current Liabilities	1,066	1,235	1,235	1,235	1,235	1,235	1,235
Long term Liabilities	1,074	1,239	5,235	8,235	6,485	4,735	2,985
Total Liabilities	3,299	3,980	7,394	12,234	10,702	9,194	7,688
Share capital	1,145	1,145	1,145	1,145	1,145	1,145	1,145
Reserves	7,790	9,302	10,794	12,382	14,125	15,354	16,512
Total Equity	8,935	10,447	11,939	13,527	15,270	16,499	17,657

Source: Company Accounts, Nael Research

Chief Executive Officer

Ashraf Bava, CFA	(92-21) 32461812-13	abava@naelcapital.com

Equity Sales

Muhammad Shakeel, Director Equity Sales	(92-21) 32461819-22	shakeel@naelcapital.com
Nasir Muqeet, Institutional Sales	(92-21) 32461819-22	nmuqeet@naelcapital.com
Irshad Ul Haq Khan, Institutional Sales	(92-21) 32461819-22	irshad@naelcapital.com

Research

Jawad Ameer Ali, Research Analyst	(92-21) 32461812-13	jawad@naelcapital.com
Taha Rehman, Research Associate	(92-21) 32461812-13	taha@naelcapital.com

Disclosure Related to Author

The analyst mentioned on the cover of this report, primarily involved in the preparation of this report, certifies that (1) the views expressed in this report accurately reflect his/her personal views about all of the subject companies/securities and (2) no part of his/her compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

Disclaimer

The report has been prepared by Nael Capital (Pvt.) Ltd and is for information purpose only. The information and opinions contained herein have been compiled or arrived at, based upon information obtained from sources, believed to be reliable and in good faith. Such information has not been independently verified and no guaranty, representation or warranty, expressed or implied is made as to its accuracy, completeness or correctness. All such information and opinions are subject to change without notice. Descriptions of any company or companies or their securities mentioned herein are not intended to be complete and this document is not, and should not be consulted as, an offer, or solicitation of an offer, to buy or sell any securities or other financial instruments.

Research Dissemination Policy

Nael Capital (Pvt.) Ltd. endeavors to make all reasonable efforts to disseminate research to all eligible clients in a timely manner through either physical or electronic distribution such as mail, fax and/or email. Nevertheless, not all clients may receive the material at the same time.

Company Specific Disclosures

Nael Capital (Pvt.) Ltd. as per the applicable law or regulation, prohibits its respective directors, officers, representatives, employees and/or related persons to make a purchase and/or sale, or offer to make a purchase and/or sale of any such securities or other financial instruments during the restricted period specified in the company policy.

Other Important Disclosures

Foreign currency denominated securities is subject to exchange rate fluctuations which could have an adverse effect on their value or price, or the income derived from them. In addition, investors in securities such as ADRs, the values of which are influenced by foreign currencies effectively assume currency risk.

Stock Recommendation	Return
BUY	> 15%
HOLD	> -15% to < 15%
SELL	< -15%