Cement Sector: D.G. Khan Cement

More than a cement company!

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D.G. Khan Cement (DGKC)

More than a cement company!

- *The KSE-100 Index has surged by approximately 5.25% since Jan 01, 2010 on the back of activity in most leading scrips including those of the Nishat Group. D.G. Khan Cement Company, which maintain a large portfolio of Nishat Group scrips and thus allows a defensive exposure in those scrips has thus begun to offer value at current levels. Its portfolio value alone is currently standing at PKR30.10/- per share!*

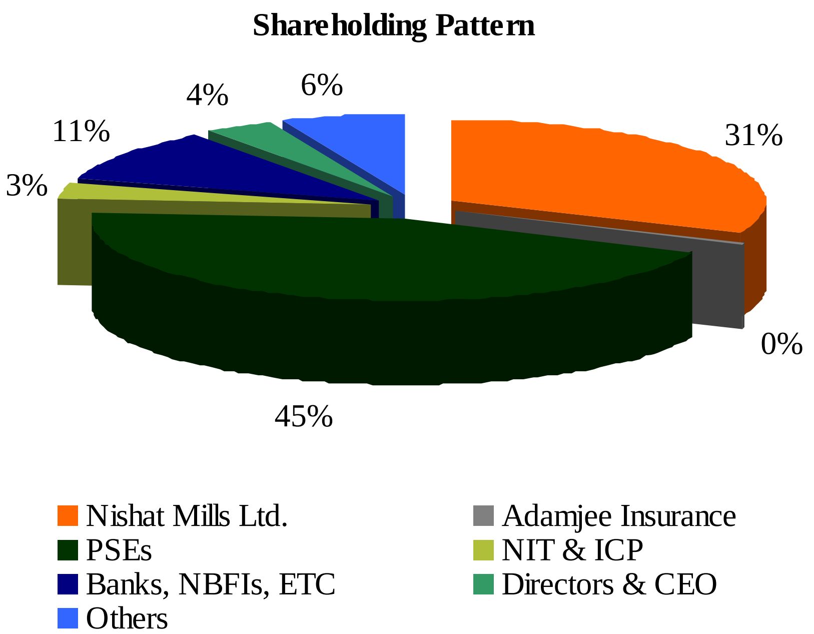
- *This report of ours values D.G. Khan Cement Company employing the Sum of The Parts (SOTP) Valuation Method and allows us to recommend a* ***'Buy'*** *stance for the Company as of today.*

Table of Contents

D.G. Khan Cement (DGKC)

Fair Value: PKR39.64, Price, Mar 11, 2010: PKR31.07, Upside: 27.59%

- **About the Company:**
  - Pakistan's third largest cement company with 4.22mn tons capacity;
  - One of the most efficient cement producers of the Country;
  - Caters to both domestic & export markets;
  - Strong brand recognition;
  - Offers two types of cements: Ordinary Portland Cement & Sulphate Resistant Cement;
  - Sponsored by Nishat Group, one of the largest business groups of Pakistan;
  - Serves as a 'mutual fund' by offering exposure in Nishat Group Companies;



D.G. Khan Cement (DGKC)

Waste Heat Recovery Project

- **Latest Position:**

- Power generation from Waste Heat Recovery Project is going as planned. Erection of both mechanical and electrical equipment is in full swing with the Project expected to start trial operations in March 2010;

Location	D.G. Khan
Capacity	10.40MW
Cost	US$19.75mn
Commercial Operation Date	Post 3QFY10
Target	To focus on non-conventional fuels as alternative or substitute fuels to conserve energy;
Basic Fuel	Municipal Solid Waste as Refused Drive Fuel as an alternative to Coal/Natural Gas/Furnace Oil;
Benefit	▪To reduce power cost & hence control rising cost of production; ▪To provide an opportunity to dispose off permanently the waste material in a controlled environment friendly sustainable fashion; ▪To ensure un-interrupted supply of primary fuel for the Companies; ▪Projects to receive 'Carbon Credits' based on reduction in SOx, NOx & CO2 emission ;
Source: CDM Pakistan	

D.G. Khan Cement (DGKC)

Right issue – Increasing the capital base

- **Issue of right shares**
  - The Board of Directors of D.G. Khan Cement recommended to issue 20% Ordinary Right Shares at PKR20/- per share (inclusive of a premium of PKR10/- per share) while declaring the Company's financial results for the half year ended Dec 31, 2009;
- **Purpose of Right Issue**
  - To finance the power generation from Waste Heat Recovery Project;
  - To finance the Refused Drive Fuel project which will help to use alternative fuels like municipal solid waste, rice husk and powder, cotton waste etc;
  - To reduce the Company's finance costs;
- **Benefits to the Company**
  - To improve liquidity & profitability;
  - Cost of production will decline;
  - Leverage risk will reduce;
  - Lenders confidence will improve;
  - Capital Base of the Company will improve;
- **Size of right issue**
  - No of share: 60.85 million
  - Value of Right shares: PKR20/- per share
  - Targeted amount: PKR1.20 billion

D.G. Khan Cement (DGKC)

Fair Value: PKR39.64, Price, Mar 11, 2010: PKR31.07, Upside: 27.59%

Financials - Key Assumptions:

- In the absence of detailed information, we have not incorporated the effect of installation of Waste Heat Recovery Project;

Sector	Cement
Symbol – KATS	DGKC
Symbol – Bloomberg	DGKC:PA
Symbol – Reuters	DGKH.KA
Market Capitalization (PKR Billion)	9.45
Price – March 11, 2010 (PKR/Share)	31.07
Outstanding Shares (Millions)	304.25
Free Float (Shares in millions)	152.12
Intrinsic Value – S.O.T.P. Based (PKR/Share)	**39.64**
Core Business – DCF Based (PKR/Share)	9.55
Portfolio Value – Discounted (PKR/Share)	30.10
Upside potential (%)	27.59
Recommendation	**Buy**
Source: AHCML Estimates	

D.G. Khan Cement (DGKC)

Sales

	FY08(A)	FY09(A)	FY10(F)	FY11(F)	FY12(F)	FY13(F)
Cement Dispatches (Thousands of tons per annum)						
Local Sales	3,572.08	2,831.12	3,573.75	3,645.23	3,727.24	3,820.43
Export Sales	661.87	1,023.83	1,293.31	1,163.98	1,105.78	1,078.13
Total (Excl. Clinker)	**4,233.95**	**3,854.95**	**4,867.06**	**4,809.21**	**4,833.02**	**4,898.56**
Average DGKC Price / Bag – Local Market (PKR / Bag)						
Cost of cement bag	205.55	310.67	209.16	219.62	228.41	236.40
Retention price/cement bag	135.84	216.10	140.49	149.26	156.63	163.34
Average DGKC Price / Ton – Export Market (US$ / Ton)						
Export price (US$ / Ton)	52.83	59.30	41.87	43.96	45.72	47.32
Break-up of Sales (PKR Million)						
Local Sales	14,685	17,591	14,950	16,011	17,027	18,063
Export Sales	2,741	5,802	5,661	5,618	5,828	6,175
Taxes & Allowances	4,980	5,355	4,909	5,130	5,350	5,582
	12,446	**18,038**	**15,703**	**16,500**	**17,504**	**18,656**
Source: AHCML Estimates						

D.G. Khan Cement (DGKC)

Profit & Loss Account

PKR Million	FY08(A)	FY09(A)	FY10(F)	FY11(F)	FY12(F)	FY13(F)
Net Sales	12,446	18,038	15,703	16,500	17,504	18,656
Cost of Sales	10,531	12,358	12,275	12,902	13,677	14,446
Gross Profit	1,915	5,680	3,427	3,598	3,827	4,210
Operating Costs	673	2,013	1,254	1,316	1,571	1,675
Operating Profits	1,242	3,666	2,174	2,282	2,255	2,535
E.B.I.T.D.A.	2,871	4,752	4,502	4,694	4,775	5,120
E.B.I.T.	1,508	3,383	2,921	3,056	3,057	3,370
Finance Costs	1,750	2,606	2,103	1,622	1,354	1,264
Profit Before Tax	(251)	777	819	1,434	1,704	2,106
Profit After Tax	(53)	526	740	1,119	1,373	1,756
Source: AHCML Estimates						

D.G. Khan Cement (DGKC)

Balance Sheet

PKR Million	FY08(A)	FY09(A)	FY10(F)	FY11(F)	FY12(F)	FY13(F)
Property, Plant & Equipment	25,471	26,096	25,846	24,678	24,501	23,019
Total Non Current Assets	32,790	29,435	30,692	29,861	29,843	28,529
Current Assets	19,203	13,288	12,856	12,761	12,464	14,861
Total Assets	51,993	42,723	43,549	42,622	42,308	43,390
Share Capital & Reserves	30,080	20,918	23,752	25,425	27,398	29,712
Long-Term Finance	8,411	4,376	2,253	1,169	235	60
Non-Current Liabilities	9,858	5,970	3,872	2,758	1,836	1,591
Current Liabilities	12,055	15,835	15,925	14,439	13,074	12,087
Source: AHCML Estimates						

D.G. Khan Cement (DGKC)

Discounted Cash Flow Analysis

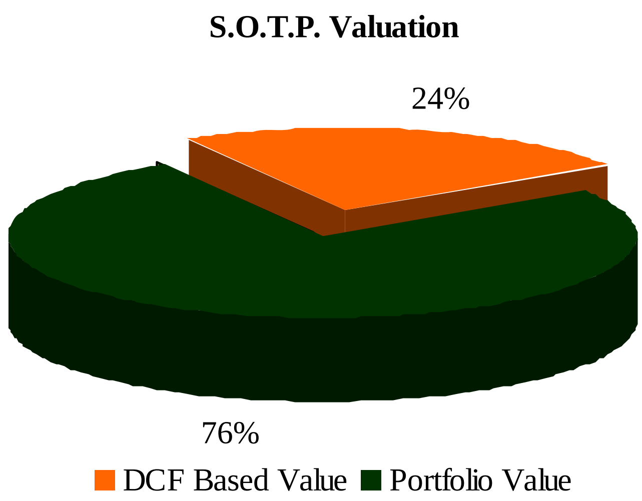
PKR Million	**FY10(F)**	**FY11(F)**	**FY12(F)**	**FY13(F)**
Operating Profit	2,138	2,244	2,218	2,493
NOPLAT	1,933	1,751	1,788	2,079
Depreciation	1,581	1,638	1,718	1,750
Changes in Working Capital	437	(183)	(205)	(305)
CAPEX	(1,330)	(470)	(1,540)	(268)
Free Cash Flow	2,621	2,736	1,760	3,256
WACC	14.52%	14.77%	15.06%	15.34%
Present Value	2,436	2,214	1,233	1,964
Terminal Value as at FY15F (‘G’: 3.0%)				10,239
Enterprise Value	20,943			
Net Debt	(18,038)			
Intrinsic Value (PKR/Share)	**9.55**			
Source: AHCML Estimate				

D.G. Khan Cement (DGKC)

S.O.T.P. Valuation

Value of Portfolio			
Company	**Shares (000)**	**Price (PKR)**	**Value (PKR Mn)**
NML	20,889	58.07	1,213
NCL	7,775	18.97	148
MCB	63,506	219.27	13,925
AICL	3,219	127.71	411
Others	106	Varied	0.8
Market Value (March 11, 2010)			**15,697**
Discount Factor			30%
Value of Portfolio (PKR/Share)			**30.10**
Note: Outstanding Shares inclusive of Right Issue @ 20%			
Source: AHCML Estimates			

S.O.T.P. Valuation	
DCF Based Value (PKR/Share)	9.55
Portfolio Value (PKR/Share)	30.10
Fair Value – S.O.T.P. Based (PKR/Share)	**39.64**



D.G. Khan Cement (DGKC)

Key ratios

Ratio	FY08(A)	FY09(A)	FY10(F)	FY11(F)	FY12(F)	FY13(F)
Current Ratio	1.59x	0.84x	0.81x	0.88x	0.95x	1.23x
Quick Ratio	1.37x	0.60x	0.59x	0.63x	0.66x	0.89x
Net Working Capital Ratio	0.14x	-0.06x	-0.07x	-0.04x	-0.01x	0.06x
Receivable Turnover Ratio	48.77x	40.99x	32.58x	35.76x	35.93x	36.01x
Inventory Turnover Ratio	33.59x	26.81x	18.21x	19.52x	19.61x	19.65x
Payable Turnover Ratio	10.38x	12.86x	11.21x	11.14x	10.12x	9.73x
Receivable Collection Period	7 days	9 days	11 days	10 days	10 days	10 days
Inventory Collection Period	11 days	14 days	20 days	19 days	19 days	19 days
Payable Payment Period	35 days	28 days	33 days	33 days	36 days	38 days
Operating Cycle	18 days	23 days	31 days	29 days	29 days	29 days
Cash Conversion Cycle	(17 days)	(06 days)	(01 days)	(04 days)	(07 days)	(09 days)

D.G. Khan Cement (DGKC)

Key ratios

Ratio	FY08(A)	FY09(A)	FY10(F)	FY11(F)	FY12(F)	FY13(F)
Total Assets Turnover Ratio	0.24x	0.38x	0.36x	0.38x	0.41x	0.44x
Equity Turnover Ratio	0.41x	0.86x	0.66x	0.65x	0.64x	0.63x
Gross Profit Margin	15.39%	31.49%	21.83%	21.81%	21.86%	22.56%
Operating Profit Margin	9.98%	20.33%	13.84%	13.83%	12.88%	13.59%
EBIT Margin	12.11%	18.76%	18.60%	18.52%	17.47%	18.06%
EBITDA Margin	23.06%	26.35%	28.67%	28.45%	27.28%	27.45%
Net Profit Margin	(0.43%)	2.91%	4.71%	6.78%	7.85%	9.41%
Return on Average Assets	(0.48%)	1.64%	1.90%	3.33%	4.01%	4.92%
Earning power	(0.10%)	1.23%	1.70%	2.62%	3.25%	4.05%

D.G. Khan Cement (DGKC)

Key ratios

Ratio	**FY08(A)**	**FY09(A)**	**FY10(F)**	**FY11(F)**	**FY12(F)**	**FY13(F)**
Interest Bearing Debt to Equity	7.40x	6.01x	4.45x	3.73x	3.08x	2.75x
LT Debt to Equity	3.35x	1.46x	0.64x	0.34x	0.09x	0.04x
Total Debt Ratio	0.40x	0.47x	0.42x	0.37x	0.32x	0.28x
Debt to Total Funded Capital	0.37x	0.45x	0.39x	0.34x	0.28x	0.24x
Interest Coverage Ratio	0.86x	1.30x	1.39x	1.88x	2.26x	2.67x
Diluted Earning Per Share (FY10 Onwards Incorporating Right Shares @ 20%)	(0.21)	1.96	2.03	3.06	3.76	4.81
Cash Dividend Per Share	-	-	-	1.00	1.00	1.25
Dividend Payout Ratio	0.00%	28.14%	17.80%	21.98%	20.73%	21.54%
Return on Equity Du-Pont	(0.18%)	2.51%	3.12%	4.40%	5.01%	5.91%
Outstanding Shares (Million Shares)	253	304	365	365	365	365
Source: AHCML Estimates						

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