

Pakistan Cements

Coal prices reverting to mean

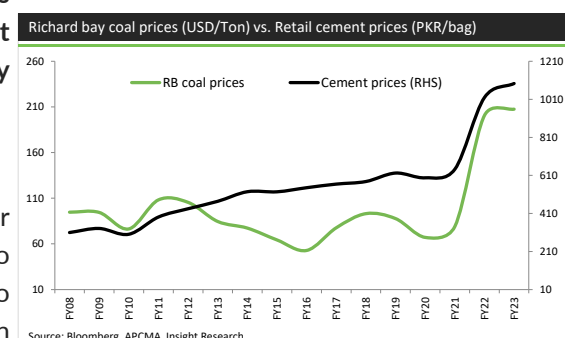
International coal prices have undergone a substantial downturn in last few weeks, to stand at ~US\$100/ton, lowest in last 26 months, as compared to US\$334/ton in SPLY, down by 70%. Richard Bay coal prices have recorded a massive decline of ~78%, from peak of US\$453/ton in Mar'22. Since Dec'22, coal prices have been gradually declining due to multiple factors such as i) Economic recovery in China remains weak, with muted industrial activity, ii) Buildup of coal inventory in China reached historical high amid low demand and imports, iii) Improving supply from India & China and iv) Decline in natural gas prices prompted Europe to reduce its reliance on coal. Furthermore, Afghan coal prices have also witnessed a decline in tandem with international coal prices, to clock in at PKR44k/ton, mainly due to reductions in duty and royalty. Given the massive fall in coal prices, cement manufacturers will witness an improvement in their margins as coal is key input for cement players.

A Catalyst for Margin Expansion

Recently, Afghan government has reduced royalty and custom tariffs for Afghan coal by US\$5/ton and US\$15/ton, respectively, which translate into reduction of ~PKR5.7k/ton. This has brought down Afghan coal prices to PKR44k/ton from its high of ~PKR60K/ton. To recall, due to steep rise in international coal prices, local cement manufacturers found peace in Afghan and local coal amid administrative control on imports and discount between international and local coal prices. However, when international coal price started coming down from ~US\$400/ton to ~US\$175/ton, Afghan coal prices didn't fall in similar manner, as import restrictions made it difficult to procure international coal. In this scenario, Afghan coal prices remained sticky and were trading at premium to RB coal. However, another steep fall in international coal prices, coupled with the settlement of import payments against export proceeds, forced Afghan government to reduce duties on coal. To note, Afghan coal prices witnessed a decline of ~27% from its high in order to compete in local market of Pakistan. This development bodes well for local cement manufacturers due to their significant reliance on Afghan coal. We expect gross margins of domestic cement manufacturers to enhance by ~300bps-400bps (varying on coal mix) on an annualized basis.

Outlook

We believe Richard Bay coal prices are likely to remain bearish in the near term as demand headwinds show no signs of abating and supply cuts have so far been insufficient to rebalance the market. However, prices may find a floor at current levels if production cuts accelerate. Moreover, as more countries adopt renewable energy sources, the demand for coal is likely to decline, which could further impact the prices of coal. However, above average winter in European region is likely to pose an upside risk as unavailability of gas from Russia is still an issue that cannot be negated.



Industry Coal Mix as of 3QFY23		
LUCK		
Afghan		30%-40%
Local		60%-70%
DGKC		
Afghan		70%
Local		30%
PIOC		
Aghan		35%
Local		65%
MLCF		
Local		70%
Afghan		25%
Alternative fuel		5%

Source: Company Presentation, Insight Research

On domestic front, cement prices are likely to remain muted despite decline in coal prices. Given the slowdown in domestic demand, market participants were expecting a price war, as witnessed in past. However, prices have remained firm in last 12 months or so due to strong pricing arrangements and respite from export sales. we believe, with massive fall in coal prices, cement manufacturers can pass on the impact while maintaining their margins without indulging in price war to grab market share. However, any further demand destruction in local market or another round of currency depreciation can impact pricing discipline.

ACPL: FY24 Earning sensitivity to coal prices

		USD/PKR				
		265.00	280.0	295.0	310.0	325.0
RB coal price (USD/Ton)	80	36.93	37.24	37.55	37.85	38.15
	90	33.02	33.09	33.15	33.20	33.25
	100	29.11	28.93	28.74	28.55	28.35
	110	25.20	24.78	24.34	23.90	23.45
	120	21.29	20.62	19.94	19.25	18.55
	130	17.38	16.47	15.54	14.60	13.65
	140	13.47	12.31	11.14	9.95	8.75

Source: Insight Research

FCCL: FY24 Earning sensitivity to coal prices

		USD/PKR				
		265	280	295	310	325
RB coal price (USD/Ton)	80	5.12	4.88	4.65	4.41	4.18
	90	4.68	4.42	4.17	3.91	3.65
	100	4.25	3.97	3.68	3.40	3.12
	110	3.82	3.51	3.20	2.89	2.59
	120	3.38	3.05	2.72	2.39	2.05
	130	2.95	2.59	2.24	1.88	1.52
	140	2.52	2.14	1.75	1.37	0.99

Source: Insight Research

LUCK: FY24 Earning sensitivity to coal prices

		USD/PKR				
		265	280	295	310	325
RB coal price (USD/Ton)	80	83.4	82.2	81.0	79.9	78.7
	90	78.6	77.2	75.8	74.3	72.9
	100	73.9	72.2	70.5	68.8	67.1
	110	69.1	67.2	65.2	63.2	61.2
	120	64.4	62.2	59.9	57.7	55.4
	130	59.7	57.2	54.6	52.1	49.6
	140	54.9	52.1	49.4	46.6	43.8

Source: Insight Research

DGKC: FY24 Earning sensitivity to coal prices

		USD/PKR				
		265.0	280.0	295.0	310.0	325.0
RB coal price (USD/Ton)	80	23.44	22.92	22.40	21.86	21.32
	90	20.48	19.78	19.07	18.35	17.62
	100	17.53	16.64	15.75	14.84	13.92
	110	14.57	13.50	12.42	11.33	10.22
	120	11.61	10.36	9.10	7.82	6.52
	130	8.66	7.22	5.77	4.30	2.82
	140	5.70	4.08	2.45	0.79	-0.88

Source: Insight Research

MLCF: FY24 Earning sensitivity to coal prices

		USD/PKR				
		265	280	295	310	325
RB coal price (USD/Ton)	80	10.97	10.51	10.06	9.60	9.14
	90	10.12	9.61	9.11	8.60	8.09
	100	9.27	8.71	8.16	7.60	7.04
	110	8.42	7.81	7.21	6.60	5.99
	120	7.57	6.91	6.26	5.60	4.94
	130	6.72	6.01	5.31	4.60	3.89
	140	5.86	5.11	4.36	3.60	2.84

Source: Insight Research

PIOC: FY24 Earning sensitivity to coal prices

		USD/PKR				
		265	280	295	310	325
RB coal price (USD/Ton)	80	23.69	21.88	20.07	18.26	16.45
	90	20.76	18.78	16.81	14.83	12.86
	100	17.83	15.68	13.54	11.40	9.26
	110	14.89	12.59	10.28	7.97	5.66
	120	11.96	9.49	7.01	4.54	2.07
	130	9.03	6.39	3.75	1.11	-1.53
	140	6.10	3.29	0.49	-2.32	-5.13

Source: Insight Research

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Frequently Used Acronyms

TP	Target Price	DCF	Discounted Cash Flows	FCF	Free Cash Flows
FCFE	Free Cash Flows to Equity	FCFF	Free Cash Flows to Firm	DDM	Dividend Discount Model
SOTP	Sum of the Parts	P/E	Price to Earnings ratio	P/Bv	Price to Book ratio
P/S	Price to Sales	EVA	Economic Valued Added	BVPS	Book Value per Share
EPS	Earnings per Share	DPS	Dividend per Share	DY	Dividend Yield
ROE	Return on Equity	ROA	Return on Assets	CAGR	Compounded Annual Growth Rate

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