Pioneer Cement Limited (PIOC)

Bolstering presence in North

We initiate coverage on Pioneer Cement Limited (PIOC) with a BUY stance based on our Jun'21 Target Price of PKR 111.06 per share offering potential upside of 23% from current levels besides a dividend yield of 2%. This translates into a TSR of 25%. The company has been able to profusely bolster its presence in the north region of Pakistan as it more than doubled its current capacity by setting up a 10,000tpd plant and gears up to establish 24MW Coal Fired Power Plant (CFPP); commissioning during 1HFY21. The increase in capacity is higher than that of the sector which allows it to increase its footprint and rank in the cement space besides gaining from increasing domestic demand as housing activity takes center stage. The amnesty scheme for builders and developers till Dec'20 will likely play a pivotal role in providing big strides for housing activity in the country. The scrip currently trades at FY21/22/23E PE of 19.7/9.9/8.2x and an EV of USD 55/MT. Our liking for PIOC is owing to:

- **Improved footprink and rank:** With an expansion of 10,000tpd, taking annual capacity to 5.09mnMT, PIOC has gained 4 notches in rank by capacity to 6th level. With an improved domestic footprint, market share/North share is likely to nearly double from FY20 levels. Despite the rally over TTM, the expansion continues to warrant attractive valuation with EV at USD 55/MT
- **Localization is the key route:** Owing to lower export cash margins and increased local demand, concentration is likely to remain on local sales as the exports share has been dissipating over the prior years
- **Enhancing energy efficiencies:** An embedded 12MW WHR with the new 3.0mnMT line is also being accompanied by 24MW CFPP which will replace more than 50% of power requirement at a cheaper rate
- **Debt service relief:** PIOC stands extremely leveraged with 0.6x debt-to-asset ratio. The recent monetary easing is likely to keep its debt servicing costs lower and reduce interest burden in the coming years

Key risks: The major downside risks to our investment thesis include: 1) lower than expected rise in ex-factory prices, 2) higher coal prices than expected, 3) monetary contraction increasing debt servicing costs and 4) delays in housing, infrastructure and CPEC activities, and 5) higher annual PKR depreciation.

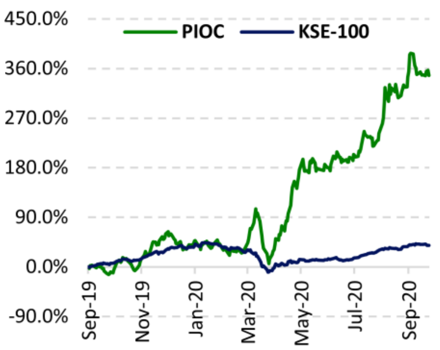
Key ratios	FY18A	FY19A	FY20E	FY21E	FY22E	FY23E	FY24E
Capacity (mnMT)	2.09	2.09	5.09	5.09	5.09	5.09	5.09
Dispatches (mnMT)	1.65	1.45	1.74	2.63	3.57	3.70	3.67
Utilization (%)	79%	69%	34%	52%	70%	73%	72%
Market share (%)	4%	3%	4%	5%	7%	7%	6%
Ex-factory price (PKR/bag)	450	499	439	483	498	512	528
Gross margin (%)	28%	22%	6%	21%	21%	21%	20%
Net Margin (%)	16%	8%	-1%	6%	8%	9%	10%
EPS (PKR)	7.24	3.48	(0.58)	4.58	9.17	11.08	11.53
DPS (PKR)	4.07	1.00	-	1.50	3.00	3.50	3.50
Dividend yield (%)	5%	2%	0%	2%	3%	4%	4%
BVPS (PKR)	60	59	57	61	68	76	84
PER (x)	10.4	11.5	(57.7)	19.7	9.9	8.2	7.8
PBR (x)	1.3	0.7	0.6	1.5	1.3	1.2	1.1
ROE (%)	13%	6%	-1%	8%	14%	15%	14%
ROA (%)	7%	2%	0%	3%	5%	6%	7%
D:E – net gearing (%)	79%	161%	151%	134%	109%	85%	60%
EV/EBITDA (x)	9.8	15.1	17.1	8.9	6.5	5.7	5.3
EV (USD/MT)	114	100	31	43	39	35	30

Source: Company Accounts, Fortune Research

Investment Case	
Target Price	**111.06**
Stance	**BUY**

Key Stats	
KATS Code	PIOC
Bloomberg Code	PIOC PA
Reuters Code	PION.KA
O/S shares (mn)	227.2
Market Cap (PKR'mn)	20,537
Market Cap (US$'mn)	123.7
Avg Daily Vol (mn)	3.4
Free Float	55.0%
Current Price	90.4
Target Price	111.1
Upside to TP	23%
52 week range (PKR)	104.9-19.1
Rating	**BUY**

52-week Performance



Performance (%)	1M	3M	12M
Absolute	-5.8	127.3	329.7
Relative	-4.8	106.3	300.8

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Investment Thesis

- Improving footprint and rank after the recent expansion
- Localizing strategically, concentrating more towards domestic sales
- Enhancing the energy efficiencies by setting up low cost WHR and CFPP
- Debt service relief from monetary easing

Key Risks

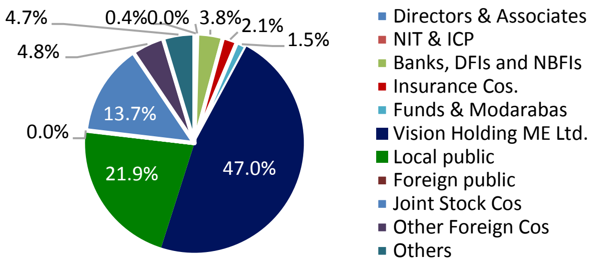
- No price discipline, affecting ex-factory prices
- Rise in coal prices
- Monetary contraction increasing debt servicing costs
- Delays in housing, infrastructure and CPEC activities
- More than expected PKR depreciation per annum

Company Profile

PIOC is engaged in the manufacture and sale of cement. The company started commercial production in 1992 and boasts strategic presence in Chenki, Punjab, 40km from Khushab. The company has a total installed capacity of 14,650tpd clinker after the recent expansion.

The company has 24MW of Waste Heat Recovery (WHR) and stands ready to commission 24MW Coal Fired Power Plant (CFPP) to cover significant energy requirements.

Shareholding Pattern



Valuation

Our DCF based Jun'21 TP of PKR 111.06 per share offers a capital yield of 23% from last close besides a 2% dividend yield (TSR of 25%).

Valuation summary	FY21E	FY22E	FY23E	FY24E	FY25E	FY26E
EBITDA	4,326	5,618	5,997	5,917	6,021	6,127
Financial income	(62)	(63)	(60)	(60)	(63)	(65)
Core EBITDA	4,264	5,555	5,936	5,857	5,958	6,061
NWC changes	(628)	(688)	(493)	497	74	(520)
CFO	3,636	4,868	5,444	6,353	6,032	5,541
Capex	(615)	(583)	(590)	(597)	(605)	(612)
Taxation	(466)	(953)	(1,155)	(1,200)	(1,323)	(1,387)
FCF	2,555	3,333	3,699	4,556	4,105	3,542
DCF	2,555	3,000	2,997	3,322	2,693	2,092

	PKRmn	PKR/share	PKR/share
PV of FCF	16,658	73.34	66%
Terminal Value	33,092	145.68	131%
Core Firm Value	**49,750**	**219.02**	**197%**
Less: Debt	25,397	111.81	101%
Add: Cash & STIs	874	3.85	3%
Equity Value	**25,226**	**111.06**	**100%**

CAPM	
RFR	9.00%
MRP	6.00%
Beta	1.32
Cost of equity	16.94%
Borrowing rate	9.00%
Tax	29.00%
Cost of debt	6.39%
Debt	55.29%
Equity	44.71%
WACC	**11.11%**
Growth	**4.50%**

Source: Fortune Research

Sensitivity Analysis

Price sensitivity	EPS (PKR)					
	FY21E	FY22E	FY23E	FY24E	FY25E	TP
***Base case (PKR/bag)**	*568*	*583*	*597*	*613*	*629*	
(- PKR 15/bag)	2.69	6.56	8.32	8.71	9.82	79.84
(- PKR 10/bag)	3.32	7.44	9.25	9.67	10.79	90.04
(- PKR 5/bag)	3.95	8.31	10.18	10.61	11.77	100.09
Base case	**4.58**	**9.17**	**11.08**	**11.53**	**12.70**	**111.06**
(+ PKR 5/bag)	7.61	13.49	15.81	16.48	17.92	165.91
(+ PKR 10/bag)	10.65	17.82	20.53	21.42	23.12	221.03
(+ PKR 15/bag)	11.27	18.68	21.45	22.35	24.08	231.19

*Source: Fortune Research, * Retail price(PKR/bag)*

Coal sensitivity	EPS (PKR)					
USD/MT	FY21E	FY22E	FY23E	FY24E	FY25E	TP
40	9.09	15.91	18.52	19.52	21.27	205.27
45	7.96	14.22	16.65	17.51	19.12	181.80
50	6.83	12.54	14.80	15.52	16.99	157.95
55	5.71	10.86	12.95	13.53	14.86	134.31
60	**4.58**	**9.17**	**11.08**	**11.53**	**12.70**	**111.06**
65	3.45	7.50	9.24	9.55	10.58	86.92
70	2.33	5.82	7.40	7.57	8.45	62.87
75	1.20	4.12	5.52	5.55	6.30	39.22
80	0.07	2.44	3.67	3.55	4.15	15.32

Source: Fortune Research

Initiating coverage with a TP of PKR 111.06/share; BUY

Initiating coverage on PIOC with a TP of PKR 111/share offering an upside of 23% as the company is expected to make a rebound in earnings in FY21 from improved domestic demand

We initiate coverage on Pioneer Cement Limited (PIOC) with a BUY stance as our DCF based Target Price of PKR 111.06 per share offers 23% upside from current levels besides a dividend yield of 2%. Capacity expansion has turned into a lucrative market share placing PIOC as the fifth highest producer in the North region and sixth highest producer in Pakistan. The company is enhancing power cost efficiency by installing a 24MW coal power plant which is expected to come online in 1HFY21. Market share is expected to take strides from 4.3% in FY20 to 5.0% in FY21 and then increase onwards. Company's EPS is expected to recover to PKR 4.58 in FY21 and then increase to PKR 9.17 and PKR 11.08 in FY22 and FY23, respectively. PIOC trades at an FY21/FY22/FY23E PE of 19.7/9.9/8.2x respectively and provides a dividend yield of 2% for FY21.

Improved footprint and rank

PIOC's expansion of 3.0mtpa is likely to take its position upward by 4 notches to 6th in terms of capacity size, thereby enabling it to increase footprint in the local arena

After expanding its cement capacity by 10,000tpd, taking annual capacity to 5.09mnMT, the company ranks 6th, gaining four notches from the pre-expansion rank (10th). While the scrip has rallied nearly 3.3x since its bottom in Aug'19, the expansion continues to warrant attractive valuations with an EV of USD 55/MT at current levels. We expect the expansion to bring 5yr CAGR to 21% in topline for FY21-25 from a slow historical 5yr CAGR of 2%. The increase in domestic footprint may likely take its market share/North share to 6.6%/9.0% by FY23 from 3.6%/4.9% in FY20, respectively.

Pre-expansion	mnMT	Rank
LUCK	7.75	2
BWCL	8.47	1
DGKC	4.22	3
MLCF	3.37	5
KOHC	2.68	7
PIOC	2.09	10
CHCC	1.05	12
FCCL	3.43	4
POWER	0.95	13
ACPL	1.83	11
DCL	3.09	6
Askari	2.68	7
GWLC	2.11	9
FECTC	0.82	14
FLYNG	0.63	15
THCCL	0.54	16
DNCC	0.50	17
	46.20	

Post-expansion	mnMT	Rank
LUCK	12.15	1
BWCL	10.54	2
DGKC	7.06	3
MLCF	5.67	4
KOHC	5.13	5
PIOC	5.09	6
CHCC	4.48	7
FCCL	3.56	8
POWER	3.37	9
ACPL	3.09	10
DCL	3.09	10
Askari	2.68	12
GWLC	2.11	13
FLYNG	1.32	15
FECTC	0.82	14
THCCL	0.54	16
DNCC	0.50	17
	71.20	

Source: APCMA, Fortune Research

Volumetric rise is the key theme for topline growth, besides the improvement in retention rates, which largely remained depressed in FY20

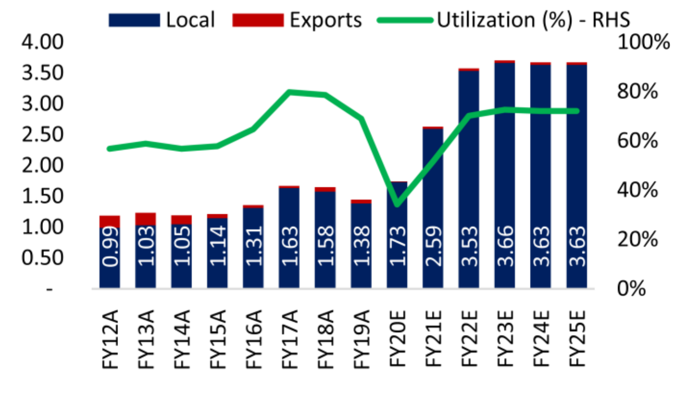
Although volumetric rise may likely be the key theme for topline growth, the company is slated to improve price retention from depressed condition of FY20 to a better profitable scheme. The increase in retention will likely be a function of demand growth from development, housing and infrastructure activity in Pakistan. We expect domestic retention to improve at 3yr CAGR of 10% to PKR 7,181/MT in FY23E; this consists of a recovery from PKR 5,428/MT in FY20 to PKR 6,417/MT in FY21 followed by 8% rise in FY22 and 4% for FY23 and onwards.

Localization is the key route

Improved focus in the local market is likely to yield better overall cash margins for PIOC

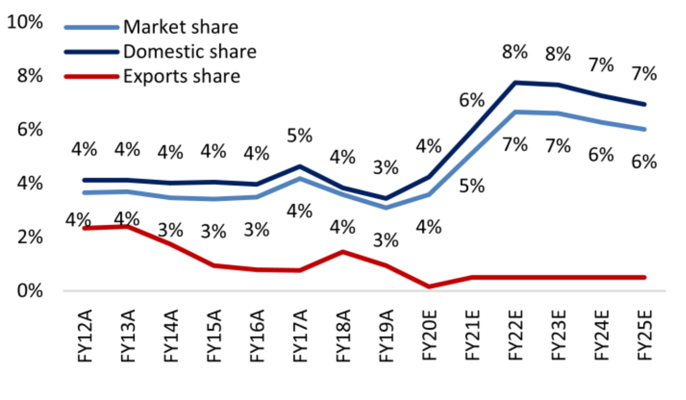
PIOC has largely concentrated on local sales historically. But the focus has also shifted away from exports gradually. Local dispatches stood at 75% of total dispatches in FY08 and 96% in FY20. This is also due to dissipating export demand from Afghanistan and declining export cash margins.

Increasing local dispatches composition



Source: Company Accounts, Fortune Research

Market share growth ahead



Source: Company Accounts, Fortune Research

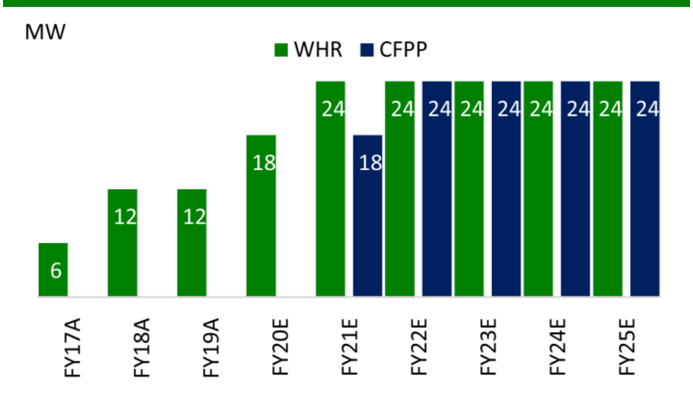
Export prices have come down from USD 51/MT in FY18 to c. USD 30/MT in FY20, translating into low cash margins from exports. Availability of nearly 3x domestic cash margin against exports is likely to keep PIOC adherent to local arena; domestic dispatches constituting around 95%. We expect improvement in net retention rates to align largely with domestic realized prices as dispatches remain skewed.

Enhancing energy efficiencies

The setup of the new line will also add 12MW WHR while the company is installing 24MW CFPP to reduce costly grid reliance

The new line of c.3.0mnMT has been installed with 24MW Coal-Fired Power Plant (CFPP) and 12MW Waste Heat Recovery (WHR). The effective power requirement of the 3.0mnMT cement plant is c. 40MW. This effectively replaces more than 50% of power requirement if the plant runs at optimum utilization levels, hence, engendering cost savings from the new line. With an expectation of CPP coming online in 1QFY21, and WHR in play, we expect cost saving of c. PKR 10/KWh under a USD 60/MT long term assumption.

Cost efficiencies to kick in ahead



Source: Company Accounts, Fortune Research, *based on availability

Weighted average power cost

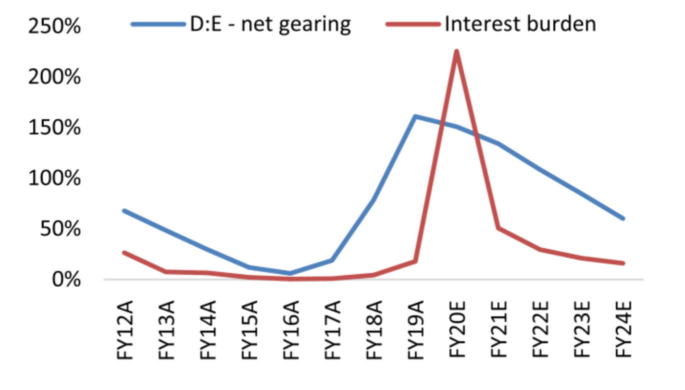
Source: Company Accounts, Fortune Research

Debt servicing relief

Being heavily leveraged, puts the company in a more sensitive position to interest rates. Current monetary easing has enabled finance cost savings

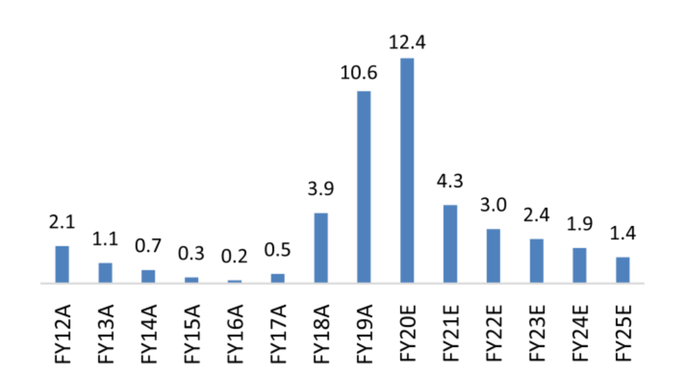
PIOC has incurred capital expenditure to the tune of PKR 30.6bn during FY16-19, 80% of which was booked in FY18-19 under which the company had setup the expansion of 10,000tpd cement plant for a cost of c. USD 58/MT. Resultantly, PIOC stands highly leveraged and sensitive to interest rates; having a debt to asset ratio of 0.6x and a debt to equity ratio of 1.9x. Due to low EBITDA generation over FY19-20, the company's net debt to EBITDA went as high as 11-12x, however, with the assumption of recovery in cement retention, we expect net debt to EBITDA level to improve to 4.3x in FY21.

Interest burden to come down significantly



Source: Company Accounts, Fortune Research

Net debt to EBITDA



Source: Company Accounts, Fortune Research

Risks to our investment thesis

- No price discipline, affecting ex-factory prices
- Rise in coal prices
- More than expected PKR depreciation per annum
- Monetary contraction increasing debt servicing costs
- Delays in housing, infrastructure and CPEC activities

Company Financials

Income statement	FY18A	FY19A	FY20E	FY21E	FY22E	FY23E
Gross Sales	**14,586**	**14,180**	**15,255**	**25,251**	**35,386**	**37,765**
Local sales	14,202	13,815	15,195	25,043	35,158	37,514
Exports	383	365	60	208	229	251
GST	2,338	2,261	2,208	4,317	5,108	5,451
FED	2,009	2,076	3,460	3,888	5,300	5,490
Net revenue	**10,121**	**9,734**	**9,451**	**16,841**	**24,700**	**26,536**
- YoY (%)	*-5%*	*-4%*	*-3%*	*78%*	*47%*	*7%*
Gross profit	**2,811**	**2,135**	**592**	**3,571**	**5,099**	**5,538**
- YoY (%)	*-37%*	*-24%*	*-72%*	*503%*	*43%*	*9%*
EBITDA	**2,760**	**2,029**	**1,577**	**4,326**	**5,618**	**5,997**
- YoY (%)	*-37%*	*-26%*	*-22%*	*174%*	*30%*	*7%*
D&A	511	507	1,368	1,385	1,402	1,419
EBIT	**2,249**	**1,521**	**210**	**2,941**	**4,216**	**4,577**
- YoY (%)	*-43%*	*-32%*	*-86%*	*1303%*	*43%*	*9%*
Finance cost	95	271	473	1,497	1,243	965
Other income	59	73	56	62	63	60
Pre-tax profit	**2,213**	**1,323**	**(207)**	**1,506**	**3,036**	**3,673**
Tax	569	533	(77)	466	953	1,155
- ETR	*26%*	*40%*	*37%*	*31%*	*31%*	*31%*
Net profit	**1,644**	**790**	**(131)**	**1,040**	**2,084**	**2,518**

Cash flow statement	FY18A	FY19A	FY20E	FY21E	FY22E
Net profit	1,644	790	(131)	1,040	2,084
D&A	511	507	1,368	1,385	1,402
WC changes	(524)	2,207	1,483	(628)	(688)
CFO	**1,632**	**3,505**	**2,720**	**1,796**	**2,798**
Interest	71	162	298	1,034	853
Capex	(11,191)	(13,692)	(411)	(615)	(583)
Investments	1,608	256	-	-	-
FCFF	**(7,881)**	**(9,769)**	**2,607**	**2,215**	**3,068**
- FCFF/share	*(35)*	*(43)*	*11*	*10*	*14*
Net debt	8,399	10,747	(1,901)	(929)	(1,799)
Interest	(71)	(162)	(298)	(1,034)	(853)
FCFE	**447**	**816**	**409**	**252**	**416**
- FCFE/share	*2*	*4*	*2*	*1*	*2*
Dividends	(761)	(924)	(227)	(136)	(477)
Equity issued	498	(173)	0	(0)	0
Net cash flow	**184**	**(282)**	**181**	**116**	**(61)**
Starting cash	**309**	**493**	**211**	**392**	**508**
Ending cash	**493**	**211**	**392**	**508**	**448**

Balance Sheet	FY18A	FY19A	FY20E	FY21E	FY22E	FY23E
Cash and STIs	1,500	939	1,121	1,236	1,176	1,115
Receivables	2,403	2,876	1,719	1,563	1,803	1,703
Inventory	2,168	2,215	2,103	3,243	3,914	3,450
Total Current Assets	**6,071**	**6,030**	**4,943**	**6,043**	**6,893**	**6,268**
Fixed Assets	22,922	36,107	35,150	34,380	33,561	32,731
Investment property	79	84	84	84	84	84
LT Investments	40	57	57	57	57	57
Total Assets	**29,111**	**42,277**	**40,234**	**40,563**	**40,595**	**39,140**
Short term debt	2,440	4,831	4,734	8,284	10,853	12,806
Current maturity	375	1,765	4,480	4,367	4,142	1,829
Trade payables	1,380	2,364	2,579	2,934	3,157	2,100
Other current liab.	256	728	728	728	728	728
Total Current Liab.	**4,451**	**9,688**	**12,520**	**16,313**	**18,880**	**17,463**
Long term debt	7,891	14,856	10,338	5,971	1,829	-
Provisions and tax	2,270	2,514	2,514	2,514	2,514	2,514
Retention money	871	1,898	1,898	1,898	1,898	1,898
Total Liabilities	**15,482**	**28,956**	**27,270**	**26,696**	**25,121**	**21,875**
Share capital	2,271	2,271	2,271	2,271	2,271	2,271
General reserve	198	198	198	198	198	198
Unapp. profit	8,048	8,036	7,678	8,582	10,189	11,980
Revaluation surplus	3,112	2,816	2,816	2,816	2,816	2,816
Shareholder's Equity	**13,629**	**13,321**	**12,963**	**13,867**	**15,474**	**17,265**
Liab. & Equity	**29,111**	**42,277**	**40,234**	**40,563**	**40,595**	**39,140**

Ratio analysis	FY18A	FY19A	FY20E	FY21E	FY22E
Valuation					
EPS (PKR)	7.24	3.48	(0.58)	4.58	9.17
DPS (PKR)	4.07	1.00	-	1.50	3.00
Dividend Yield	5%	2%	0%	2%	3%
BVPS (PKR)	60	59	57	61	68
PE (x)	10.4	11.5	-57.7	19.7	9.9
EV/EBITDA	9.8	15.1	17.1	8.9	6.5
PB (x)	1.3	0.7	0.6	1.5	1.3
EV (USD/MT)	114	100	31	43	39
Margins					
Gross margin	28%	22%	6%	21%	21%
EBITDA margin	27%	21%	17%	26%	23%
EBIT margin	22%	16%	2%	17%	17%
Net margin	16%	8%	-1%	6%	8%
Profitability					
ROE	13%	6%	-1%	8%	14%
ROA	7%	2%	0%	3%	5%
ROCE	9%	5%	1%	12%	19%
Asset management					
FA turnover (x)	0.6	0.3	0.3	0.5	0.7
Asset turnover (x)	0.4	0.3	0.2	0.4	0.6
Leverage					
Total debt / total asset	0.4	0.6	0.6	0.6	0.5
Total debt / total equity	1.0	1.9	1.9	1.7	1.4
Gearing	79%	161%	151%	134%	109%
Net debt to EBITDA (x)	3.9	10.6	12.4	4.3	3.0
Liquidity					
Interest coverage (x)	23.7	5.6	0.4	2.0	3.4

Source: Company Accounts, Fortune Research

Analyst Certification

The research analyst on the cover of this report certifies that: 1) all of the views expressed in this report accurately reflect his or her personal views about any and all of the subject securities or issuers; 2) no part of any of the research analyst's compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) expressed by the research analyst(s) in this report; 3) he/she does not have a financial interest in any and all of the subject securities or issuers aggregating more than 1% of the value of the company(s); 4) he/she or its close relative has not served as a director/officer/associate in the past three years in any and all of the subject securities or issuers; 5) he/she or its close relative has received any compensation from any and all of the subject securities or issuers in the previous 12 months; and 6) he/she has not traded in the subject security(ies) or issuer(s) in the past 7 trading days and will not trade in the next 5 trading days of issuing a coverage initiation or a material Target Price revision report.

Valuation Methodology

To arrive at period-end Target Price(s), FSL uses different valuation methodologies:

- Discounted Cash Flow (DCF, DDM)
- Relative Valuation (PE, PB, PS, PCF)
- Equity and Asset return based methodologies (EVA, RI, etc.)

Key risks

- Pricing indiscipline affecting retention rates
- Higher PKR depreciation per annum
- Increase in coal prices
- Rise in interest rates
- Fallout of housing, infrastructure and CPEC activities

Acronyms

bps	basis points	LCY	Local Currency
BVPS	Book Value per share	MRP	Market risk premium
CAGR	Compounded Annual Growth Rate	NAV	Net Asset Value
CAPM	Capital Asset Pricing Model	NPV	Net Present Value
DCF	Discounted Cash Flow	PB	Price-to-Book Value
DDM	Discounted Dividend Model	PCF	Price-to-cash flow
DE	Debt-to-Equity	PE	Price-to-Earnings
DPS	Dividend per share	PKR	Pakistani Rupee
DY	Dividend yield	ppt	percentage point
EPS	Earnings per share	PS	Price-to-Sales
EUR	Euro	PV	Present Value
EV	Enterprise Value	RFR	Risk-free rate
EVA	Economic Value Added	RI	Residual Income
FCF	Free Cash Flow	ROA	Return on Assets
FCFE	Free Cash Flow to Equity	ROE	Return on Equity
FCFF	Free Cash Flow to Firm	SOTP	Sum Of The Parts
FCY	Foreign Currency	TP	Target Price
g	Growth	TSR	Total Stock Return
IRR	Internal Rate of Return	USD	US Dollars
JPBV	Justified Price-to-Book Value	WACC	Weighted average cost of capital

Rating

BUY	TSR > 15%
HOLD	-10% > TSR > 15%
SELL	TSR < -10%
NR	Not Rated

TSR = Capital gain + DY

Old Rating

Overweight	TSR > 15%
Marketweight	0% > TSR > 15%
Underweight	TSR < 0%

Disclosure

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