morning shout

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Pakistan Daily Notes

Cement: 2QFY10 hammered by prices

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- Oct-Dec 09 was a weak quarter for Pak cement producers with the industry moving from profit to loss, led by domestic price weakness post Aug-09 price war. Demand recovery was meanwhile the key positive takeaway.
- YTD FY10 domestic cement prices have dropped 26%, dragging down EBITDA margins to an 18-mth low of ~14%. More than 75% of the industry is currently operating at sub break-even where only South based exporters remain profitable.
- While we believe 2QFY10 has likely marked the bottom for margins, we caution that margin recovery may not be as sharp as seen in the past in absence of consensus pricing. Key risk to margins in our view is rising coal prices for Apr-Jul shipment.
- We maintain our cautious stance on Pak cements where the latest wave of concern is on debt servicing. In relative terms, we prefer Lucky Cement to peers given (1) lower-than-peers leverage & fixed cost; (2) exposure to higher margin exports.

2QFY10 sector profits hammered by price weakness

Oct-Dec 09 results were a weak showing for Pak cement producers. Massive decline in sector profitability (industry shifted from profit in 1Q to loss in 2Q) reflected the full brunt of post Aug-09 domestic price war, where domestic cement prices have dropped 26% YTD FY10 (Jul-Jun). With 13% QoQ lower industry sales and 875bp QoQ decline in operating margins in 2QFY10, majority of North based producers reported losses. Southern players fared relatively better on account of access to higher priced export markets (African demand has picked up the slack from UAE slowdown) & relatively better domestic prices (South prices down 12% YTD vs. 34% drop in North).

Is this the bottom for margins?

With sector EBITDA margin down to ~14% (lowest since 4QFY08) and retail prices still 7-17% below industry breakeven (PRs176/bag), key question is whether 2QFY10 has already marked the bottom for margins. While we believe this is likely to be the case, sharp upturn in sector cash margins appears unlikely in our view. While Jan-10 to date has witnessed some price recovery (PRs10-15/bag) the same is primarily cost-push (higher gas & furnace oil prices). While we believe incremental cost hikes are likely to be passed through in prices, prospects of return to consensus pricing mode look low for now.

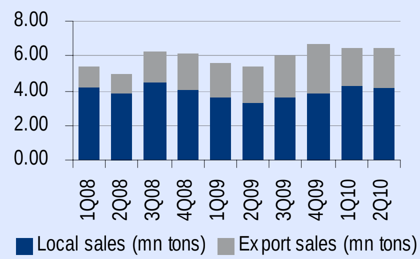
Rising coal prices & debt servicing are the key risk

In such a scenario, rising coal prices are the key risk to margins where supply bottlenecks risk further tightening of the Asian seaborne market. Our channel checks with cement producers suggest that orders booked for Apr-10 onwards are at ~20% price premium to Jan-Mar orders. We estimate the same would require ~PRs13/bag (7%) hike in domestic cement prices to maintain margins. Another key concern we flag is debt servicing, where sector's interest cover is down to under 1.0x with sector's 2QFY10 EBITDA down 42% QoQ to PRs3.09bn while net debt is up by PRs3.50bn to PRs93bn.

Positive surprise on the demand front

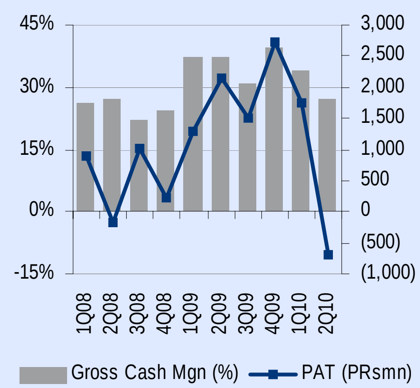
Demand recovery on the domestic front (+12.6% YoY in 7MFY10 to 12.5mn tons) and sustained export growth (+13.8% YoY to 6.6mn tons) meanwhile are key positive takeaways. While domestic sales have been bolstered by private sector demand, export upside is driven largely by tapping alternate markets in Africa and Iraq to replace dwindling UAE demand. That said export gains are becoming increasingly limited for North based producers (regional price decline makes incurring inland freight less feasible) and in the absence of govt proposed export freight subsidy, we believe export market share will consolidate with companies who have location advantages. Note that despite lower YoY prices, exports still net US$50-53/ton vs domestic retention of US$37-38/ton, significantly boosting margins for exporters (such as Lucky) vis-à-vis peers.

Chart 2: Volumes up from 2009 lows



Source: Company Accounts, APCMA

Chart 2: Profits hammered by weak prices



Source: Company Accounts, KASB Estimates

Morning News

- Nomura Bank offers convertible bond at 7.75% for OGDCL (BR)

Reportedly, the government is considering a proposal from Nomura Bank to issue an OGDC's convertible bond of US$400-500mn at YTM of 7.75%. The government had asked other financial institutions to express interest for appointment of advisor. We believe the proposal is still infancy stage. We believe the core objective is to generate hard currency/foreign flows. Given OGDC's current and future balance sheet position, and cap-ex requirement for future exploration and development plans, we estimate OGDC can comfortably meet cash requirement without resorting to leveraging balance sheet. Earlier, the governmental has toyed with the idea of (1) exchangeable bond; & (2) asset sell off (Qadirpur field divestment). Assuming US$500mn worth of convertible bond, we see possible dilution of 8-9% at an exchange rate of PRs85/US$ and convertible price of PRs110/sh of OGDC stock.

Technical View

Aiyaz M. Hassan

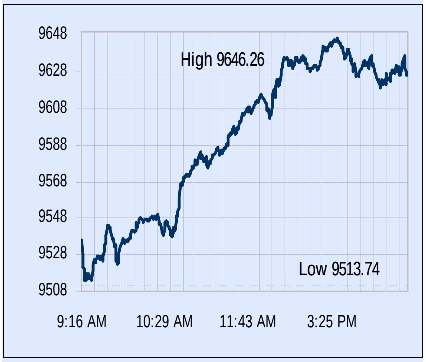
First support 9,579 points, second support 9,491 points; first resistance 9,678 points, second resistance 9,730 points

The index opened on a positive note and took to a steady uptrend to close well into the green. Volume showed a marginal decline of 2.24% and stood at 157 mln. The index managed to sustain itself above the 100-DMA, which suggests that the pullback is likely to continue. However, the alarming fact is that the 30-DMA is on the verge of cutting the 50-DMA from above, which is a bearish signal.

The Stochastic Oscillator on the daily chart has taken to an uptrend after becoming oversold, which suggests that a short-term pullback is possible, but it is likely to be short-lived as on the weekly chart it maintains its sell signal. Moreover the 14-period RSI on the daily chart is likely to face resistance from its former support trendline (blue line, lower portion). Additionally the MACD on the daily and weekly chart has maintains its downtrend as well as its sell signal.

The first support is at 9,579 points and the second support is at 9,491 points. The first resistance is at 9,678 points and the second resistance is at 9,730 points.

KSE-100 Intra-day Movement



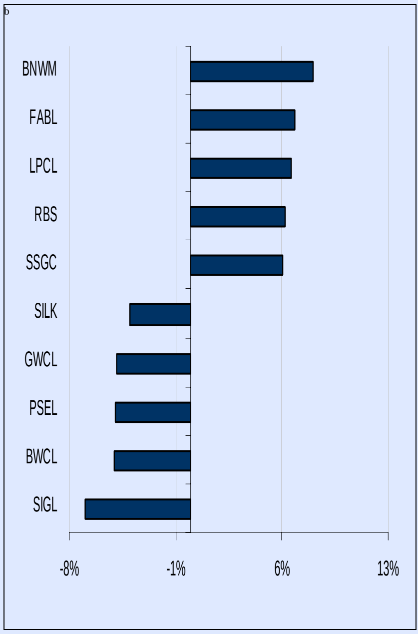
Source: KSE

Index Data & Volume Leaders

	Close	% Chg	Vol. US$mn
KSE30	10,101.48	1.33%	75.84
KSE100	9,626.29	1.21%	81.16
KSE All Share	6,807.76	1.21%	84.31
NBP	93.01	0.50%	20.12
POL	237.25	2.65%	10.88
AICL	122.47	5.00%	5.60
LUCK	73.25	2.85%	4.47
AHSL	45.10	4.18%	4.30

Source: KSE

KSE-100: Top Gainers & Losers



Source: KSE

World Markets and Commodity Prices

International Equity Markets

Asian Markets (Closing Rates)

	Price	Abs. Chg.	% Chg.
All Ordinaries	4,774.70	17.10	0.36
Shanghai Composite	3,031.07	7.69	0.25
Hang Seng	20,787.97	212.19	1.03
BSE 30	16,994.49	22.79	0.13
Jakarta Composite	2,578.77	13.13	0.51
KLSE Composite	1,299.78	15.69	1.22
Nikkei 225	10,368.96	223.24	2.20
NZSE 50	3,214.64	1.09	0.03
Straits Times	2,790.29	21.59	0.78
Seoul Composite	1,634.57	16.37	1.01
Taiwan Weighted	7,666.26	96.46	1.27
KSE-100 Index	9,626.29	114.76	1.21

Source: Bloomberg

European Markets (Last Trading Session's Rates)

	Price	Abs. Chg.	% Chg.
ATX	2,455.78	46.24	1.92
BEL-20	2,611.03	28.07	1.09
CAC 40	3,910.42	82.01	2.14
DAX	5,877.36	82.04	1.42
AEX General	338.68	6.23	1.87
Swiss Market	6,847.78	42.91	0.63
FTSE 100	5,599.76	72.60	1.31
American Markets			
Dow Jones Ind. Average	10,566.20	122.06	1.17
NASDAQ Composite	2,326.35	34.04	1.48
NASDAQ -100	1,888.56	28.84	1.55
S&P 500 Index, RTH	1,138.69	15.72	1.40

Foreign Portfolio Investment in Equities

Country	Day (US$mn)	WTD (US$mn)	MTD (US$mn)	YTD (US$mn)	YTD Net (US$mn)	Date
Pakistan	10.0	27.6	27.6	59.6	NA	03-05
India	151.1	705.3	705.3	939.0	151.3%	03-04
Indonesia	6.0	88.3	88.3	-75.1	56.3%	03-05
Japan	Na	646.5	2970.4	21,110.1	187.0%	02-26
Philippines	2.1	-3.8	-3.8	118.0	323.4%	03.05
South Korea	122.5	687.7	687.7	1,252.0	275.5%	03-05
Taiwan	365.5	657.7	657.7	-2,216.2	7.6%	03-05
Thailand	70.3	322.3	322.3	259.8	196.2%	03.05
Vietnam	-0.3	-8.4	-8.4	49.7	715.2%	03-05

Source: Bloomberg, NCCPL

Forex and Money Market snapshot

	Current	Previous	Chg.
6-Month KIBOR (Offer)	12.41	12.39	0.02
12-M T-Bill (Average)	12.25	12.25	0.00
10- year PIB (Average)	12.63	12.63	0.00
PkR/ US$	84.72	84.94	-0.22

Source: KASB Money Market

Commodity Prices

	Price	Abs. Chg.	% Chg.
WTI (Crude Oil)	81.5	1.29	1.61
Gold	1,134.3	1.20	0.11
CRB Index (Mar 4th)	429.89	-0.52	-0.12

Source: Bloomberg

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