

## Afghan Coal The New Gold

Friday, March 11, 2022

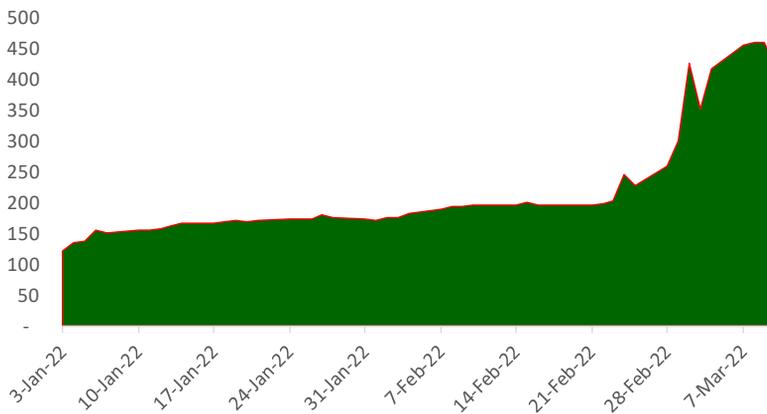
### Coal prices to escalate due to Russia-Ukraine tensions & worsen supply

Geopolitical situation between Russia-Ukraine created huge volatility in commodity market hence global coal prices rallied amid intensified & tight supplies in strategic European countries which instigated European buyers to look for alternate regions like USA, Asia, Colombia and South Africa.

Another factor is rise in alternate fuels like crude oil and natural gas. In a flash back scenario coal prices heightened to touch at \$240/ton in the mid of Oct'21 due to gas shortages in Europe after which they started to ease off and recorded on average at a price of \$147/ton till 22<sup>nd</sup> Feb '22 but this was a momentary scenario. As rigidities started between Russia-Ukraine from 24<sup>th</sup> Feb '22 prices started to gain and skyrocketed to post level sanctions, as Europe expected again tightened supply of gas resulting another hike in gas prices which caused these economies to switch from gas to coal based power generation plants.

In Asia and Australia supply was already tightened due to Indonesia's ban on coal export and heavy rainfall in Australia created distortion in supply chain. Currently, the price of benchmark Richard Bay coal prices climbed to life time high recorded at \$460 per ton thus increasing the risks of longer-term pain to cement industry. If this situation prolongs and direct and indirect sanctions that western countries have put on Russia and second expected ban on export of Indonesian coal may come early at the end of this month which will put more pressure on coal supplies and on prices as a consequence coal expected to shoot up towards \$480-\$500/ton in the near term. Thus, cement industry is expected to face maximum impact in the long run.

Coal USD/Ton



Source (s): Bloomberg, DSL Research

### Margin curve protected by Afghan coal, which came as a blessing

Afghan coal gave a sufficient buffer to cement companies that gave them room to keep their margins sustained in short to medium period of time. As per market sources and interaction with the companies' management suggest that northern players have started to use a maximum of 70% Afghan coal and further 20% local coal is also being considered as well.

Previously Afghan coal used to trade at 25-30% discounted to benchmark RBI but currently this discount differential jumped significantly in prices as Afghan and Local coal is currently trading at \$200-\$170 per ton approx. thus at around 53%/60% discounted to RB1 which is currently stands at \$425/ton as of 10<sup>th</sup> March '22. As per our conversation with industry experts, majority of the northern players have landed cost of closing inventory at PKR27,000-PKR31,000 per ton for approx. 70 days of inventory being held, except for MLCF they have 4-5 months of coal inventory on hand.

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### Southern Players facing the toughest situation

Whereas southern players facing toughest situation as Afghan coal is not being utilized due to significant freight charges around PKR15k-20k per ton, whereas exports orders also being halted due to a low price of clinker. While they are prioritizing the local market to grab the demand where they can improve their durability of presence on current cost of coal.

### Our best picks

We continue to prefer MLCF, FCCL and KOHC from our DSL cement universe due to low leverage with healthy financial position and cost competent players relative to their peers allowing them to persist in crucial times where efficiencies due to internal power generation and better inventory management of coal will bring fruits of additional cost-effective measures to the front.

<i>Average monthly Prices</i>			
Month	North Avg/bag in PKR	South Avg/bag in PKR	Rbay Coal Monthly Avg price USD/ton
20-Nov	547	612	70
20-Dec	564	612	88
21-Jan	582	612	86
21-Feb	601	615	84
21-Mar	604	621	90
21-Apr	605	634	91
21-May	604	637	99
21-Jun	626	636	110
21-Jul	641	665	125
21-Aug	668	679	138
21-Sep	669	691	161
21-Oct	706	720	223
21-Nov	735	750	136
21-Dec	729	762	135
22-Jan	722	766	162
22-Feb	723	768	200
22-Mar	810	830	412

Source (s): Bloomberg, Company Financials, DSL Research

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**Rating System:**

If;

- **Expected return >15%** - Buy Call
- **Expected Return is in between 0% to 15%** - Neutral/Hold Call
- **Expected Return <0%** - Sell Call

**Valuation Methodology**

To arrive at our period end target prices, DSL uses different valuation methodologies including:

- Discounted cash flow (DCF, DDM)
- Justified price to book (JPB)
- Relative Valuation (P/E, P/B, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)

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