

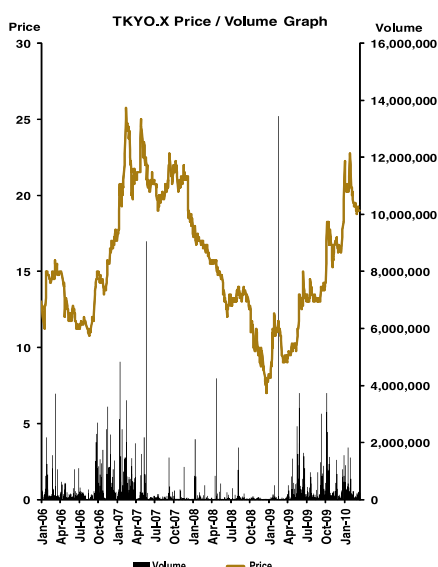
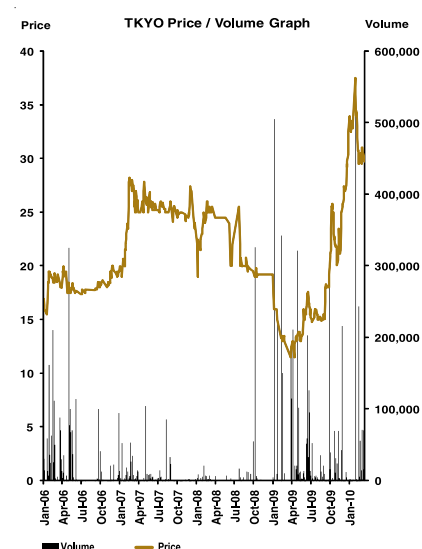


Tokyo Cement Company Lanka PLC (TKYO)

TKYO.N - Rs. 31.25; TKYO.X - Rs. 22.00

BUY

TKYO		Fiscal year	Net Profit (Rs m)	EPS (Rs)	EPS Growth (%)	PER (X) Voting	PER (X) Non-Voting	ROE (%)
Reuters Code	TKYO.CM							
Bloomberg Code	TKYO.SL	2008	554	1.82	-31.94	17.13	12.06	11.07
Share Price LKR		2009	347	1.14	-37.36	27.36	19.26	6.62
Voting	31.25	2010	291	0.96	-16.14	32.62	22.96	5.34
Non-Voting	22.00	2011E	797	2.62	173.73	11.92	8.39	13.23
Issued Share Capital (Shares)		2012E	1138	3.75	42.87	8.34	5.87	16.42
Voting	201,500,000	2013E	1550	5.10	36.23	6.12	4.31	18.78
Non-Voting	101,250,000							
Voting 12 mth High/Low (Rs.)	37.50 / 14.90							
Non-Voting 12 mth High/Low (Rs.)	25.25 / 13.00							
Average Daily Volume - TKYO.N	60,117							
Average Daily Volume - TKYO.X	371,091							
Market Capitalisation Rs. mn (Voting)	6,297							
Price Performance (%)	1 mth 6 mth 12mth							
ASPI	6.95 30.19 95.48							
TKYO.N	-10.71 -6.72 108.33							
TKYO.X	0.00 7.23 71.15							



>> FY08 and 09 were difficult years for the Sri Lankan economy and the construction sector in particular which consequently led to a decline in revenue and volumes for Tokyo Cement. However we expect a rebound and then exceptional earnings in the coming years thanks to the anticipated boom driven by reconstruction in the North and East as well as by the massive infrastructure undertakings all over the island.

>> The long awaited post-war reconstruction boom appears to be finally building momentum and we expect intensive rebuilding in the war torn North and East during the latter half of 2010. Evidence for this can be found in figures for 1Q:CY2010 which showed that GDP growth of 7.1% was exceeded by the Construction sub-sector which grew at 8.5% for the period. The end of the North-East conflict and the rebuilding effort through housing and infrastructure projects is expected to fast track the growth momentum in the industry indicating a 10% plus growth rate through CY12.

>> A doubling of grinding capacity in FY09 to 1.8m MT has boosted total

installed capacity to 2.4m MT per annum. Tokyo Cement completed its long delayed 10MW Bio Mass power plant in FY09 which will provide its total electricity requirement while qualifying for gaining carbon credits bringing in additional revenue to the company. The company's grinding facility is located in the Eastern sea port of Trincomalee, ideally located for the rebuilding boom.

>> The cement industry imports half of its requirement providing domestic producers ample ground for expansion. With the construction industry expected to boom, cement growth is expected to increase by 15% in FY11.

>> Tokyo Cement earnings declined 16% to Rs.291m for FY10 on account of lower revenues as construction activity remained on hold. Clinker prices have softened since 3QFY09, and gross operating margins improved to 21.2% from 15.3% an year ago.

>> Given the large scale infrastructure projects in the pipeline and the expected boom in cement demand we expect TKYO revenue prospects to be healthy. With the 10MW bio mass power plant now completed saving on energy

costs and clinker prices declining, Tokyo Cement should significantly improve its margins.

Profile

>> Tokyo Cement Company (Lanka) PLC (TKYO) is one of the largest grinders of Portland and Pozzollana cement in Sri Lanka on a joint venture between local conglomerate St. Antony's Consolidated and Nippon Coke & Engineering Company of Japan. The group structure consists of 3 subsidiaries out of which Fuji Cement Company (Lanka) Ltd. (FCCL) and Tokyo Super Cement Company Lanka (Pvt) Ltd. (TSCCL) are fully owned while Tokyo Cement Colombo Terminal (Pvt) Ltd. (TCCT) is a 56.85% subsidiary.

>> Tokyo Cement operates a cement grinding plant with a capacity of 600,000 MT while FCCL cement grinding plant capacity is 300,000 MT. Both plants are situated in Trincomalee where the company owns a private 100 metre jetty, which can berth 25,000 tonnage ships. TCCT operates a bagging plant within the Port of Colombo consisting of 600,000 MT.

>> The newly constructed grinding plant of 900,000 MT capacity in Trincomalee is fully owned by TSCCL and has doubled the grinding capacity of the Group to 1.8m MT while the total capacity extends to 2.4m MT with the bagging plant in Colombo.

>> The group currently owns 3 ships with capacities of 17,500 MT, 20,000 MT & 22,000 MT respectively to ensure an uninterrupted supply of raw materials, predominantly clinker.

Construction Industry

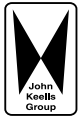
>> The construction industry boomed in 2006 & 2007 as growth rates picked up by 9.2% and 9% respectively on the back of rapid escalation of housing and condominium projects. Growth in the sector slipped during the next two years, with inflation and interest rates skyrocketing, as the civil war came to its conclusion. Construction sector growth consequently lost pace slowing down to 7.8% in CY08 and 5.6% for CY09.

>> However the latter half of the period saw the commencement of large scale infrastructure projects in the country which multiplied with the liberation of the Eastern Province.

>> The burst of the commodity bubble saw lower commodity and especially energy prices bringing inflation to a manageable level. The point to point inflation in June stood at 3.3%. The Central Bank has cut interest rates 5 times with moderate inflation expected during the rest of 2010, signaling a buoyant period for the construction sector towards the latter half of CY10.

Conflict Zone

>> Similar to the era of the ceasefire agreement in 2002-2005, the end of the conflict is expected to result in a construction boom, particularly in the North and East. The Government had already pledged to launch the program "Uthuru



Vasanthaya” aimed at re-developing the North with houses, roads, bridges and electrification.

Cement Industry

>> The cement industry has shown considerable growth in the last few years with cement consumption growing at a CAGR of 9.4% from CY03- CY07 while CY07 consumption grew 10.6% but declined to 6% in 2008. Production in the first quarter of CY10 improved by 11.6% The current total cement consumption is approximately 4.2m MT per annum with domestic production at almost 2m MT and the rest imported from countries such as India, China, Thailand and Indonesia.

>> The domestic production of cement is dominated by Tokyo Cement and Holcim Lanka each having a 30% market share (including imported cement). Both companies are looking to expand production capacity with only 47% of the demand met by domestic production and grinding. Tokyo Cement already doubled its grinding capacity in CY08 while Holcim which obtained approval to expand to Trinco will be starting construction in CY09. Tokyo Cement has capacity of 2.4m MT per annum while Holcim has 1.4m MT per annum.

>> A slowing down in private construction activities which are mainly housing and commercial projects was due to the increased cost of borrowing and raw materials in CY09. The rise in demand from resettlement and rehabilitation activities in the Eastern province, continuation of tsunami reconstruction activities and state infrastructure development projects, managed to partially offset the decreased demand of cement from the private sector construction activities. With the end of the conflict we expect demand for cement to grow as the construction sector is likely to pickup with the government aiming to fast track the re-building process in the North and East.

>> Apart from the North and East resettlement Sri Lanka suffers from an overall estimated shortage of 400,000 housing units countrywide with the gap estimated to increase to 650,000 over the next few years by the Central Bank. Some estimates of the housing market in the Western Province put annual demand at 40,000 units. The majority of cement sales in the country are predominantly retail driven but with increasing economic development we expect the proportion of commercial usage to correspondingly increase.

Clinker

>> Clinker cost is the largest cost for the Group amounting to approximately 85% of production cost (including freight). Prices have broadly eased up in 2009 as construction activity slowed regionwide.

>> Tokyo cement imports clinker mainly from Thailand, Indonesia and Malaysia while powder for the bagging plant of TCCTL is imported from Indonesia. The Group purchased 3 vessels with the intention of saving on freight charges which amounts to almost 39% of production cost. The company experiences a considerable saving on freight by maintaining its own fleet of ships.



10MW Bio Mass Power Plant

>> Being in an energy intensive industry, Tokyo uses approximately 40kWh of energy annually. The company satisfies its energy requirement through its own 3.5MW thermal power plant and partly by the national grid. The energy costs account for 6% of the group production costs.

>> Tokyo Cement commissioned a 10MW Bio Mass power plant which would meet the entire energy requirement of the Group with the excess power being sold to the National Grid. The power plant uses paddy husks available especially in the North Central and the Eastern Provinces, where rice mills are in abundance. Fuel wood is to be obtained from Gliricidia plantations.

>> Apart from the considerable cost savings with the Bio Mass power plant the company now qualifies for carbon credits worth of Rs.20m-30m. Tokyo Cement is also testing 'green cement' products, made using clean energy for electricity and admixtures like fly ash and burnt rice husk ash, which have good binding properties, as a component of cement.

Taxation

>> Sri Lanka customs filed a case against Tokyo Cement, on an under invoicing allegation. Under normal rules a company importing goods has to disclose the Cost of the Goods, Insurance paid and the Cost of Freight (CIF). Customs duty, VAT and Ports and Airport

>> Levy is charged on this sum. Resulting from the usage of their own ships the group is claimed to have shown only part of their freight costs and thereby declaring a lower sum when bringing goods into the country.

>> Tokyo Cement states it had agreed to co-operate with Customs in an under-invoicing investigation and that the authorities had agreed not to press action to recover value added tax amounting to Rs.146.7m. TKYO informed that the amount pending to be investigated by the Sri Lanka Customs is Rs.46m while it was also opined that the amount claimed is above the expressed provisions of the law.

Earnings

>> Tokyo Cement earnings declined over FY10 as lower sales volume were recorded with the slowdown in the construction sector. Revenue declined 17% cumulatively for FY10 while declining 27% YoY for the final quarter to March.

>> Although margins have improved thanks to the drop in clinker prices, prices have also dropped sharply over the last year with prices dropping from Rs.750 per bag to Rs.700 or lower. Volumes and revenues should pick up by the middle of this calendar year once construction starts up with the end of the election cycle.

>> Longer term borrowings have increased to Rs.1.8bn for 4Q:FY10 resulting from debt financing of the Bio Mass power plant and the Vertical Roller Mill projects. The drop in interest rates will favour the group with lower finance costs going forward



>> We expect finance costs to reach Rs.608m for the full year of FY2011 due to lower debt financing and lower average interest rates. The debt was incurred for the installation of the new vertical roller mill which doubled the grinding capacity of the Group.

Valuations

>> We expect Tokyo Cement revenue to reach almost Rs.18bn for FY11 in spite of the previous year's drop in sales prices with the decline in raw material prices. TKYO volumes are expected to pick up as the construction sector is likely to improve with favourable macro economic conditions.

>> In addition to the declining interest rates and inflation, the reconstruction efforts should pave the way for rapid development in the cleared provinces. Given the number of infrastructure projects in the pipeline, the rebuilding of the North and East with houses, schools, hospitals, roads and bridges would indicate a considerable growth in the sector, signaling a significant boost in demand for cement.

>> We expect TKYO to post earnings of Rs.797m and Rs.1138m for FY11E and FY12E respectively excluding the customs duty claim. At Rs. 31.25, the voting share trades at a PER of 11.9 FY11 earnings and 8.3x FY12 earnings. At Rs. 22.00, the non-voting share trades at a PER of 8.4x FY11 earnings and 5.9x FY12 earnings. With the stock being one of the better exposures to the expected boom in North East infrastructure building, we recommend BUY.

Income Statement	2008	2009	2010	2011E	2012E	2013E
Year ending 31st March	Rs. mn	Rs. mn	Rs. mn	Rs. mn	Rs. mn	Rs. mn
Revenue	14,029	17,652	14,634	17,914	20,064	22,772
Cost of Services	(11,977)	(14,952)	(12,353)	(14,998)	(16,752)	(18,673)
Gross profit	2,052	2,700	2,281	2,916	3,311	4,099
Other operating income	101	204	175	101	101	101
Selling and distribution	(1,036)	(1,095)	(1,029)	(1,209)	(1,403)	(1,767)
Admin expenses	(184)	(328)	(289)	(355)	(398)	(529)
Other expenses	-	-	-	(12)	(12)	(12)
Operating profit	933	1,481	1,138	1,441	1,600	1,892
Finance cost	(392)	(834)	(868)	(608)	(425)	(298)
PBT	541	647	270	834	1,175	1,594
Tax	31	(289)	12	(10)	(12)	(12)
Minority interest	(18)	(11)	9	(27)	(25)	(32)
Net Earnings	554	347	291	797	1,138	1,550



Balance Sheet	2008	2009	2010	2011E	2012E	2013E
As at 31st March	Rs. mn	Rs. mn	Rs. mn	Rs. mn	Rs. mn	Rs. mn
Fixed Assets						
PP&E	4,687	9,359	8,587	8,930	9,288	9,659
Capital WIP	3,698	397	518	518	518	518
Goodwill	13	13	13	13	13	13
Other	83	77	73	73	73	73
	8,481	9,846	9,191	9,534	9,892	10,263
Current Assets						
Inventories	1,212	1,388	535	537	542	592
Trade and other receivables	1,468	1,882	1,689	1,612	1,806	2,050
Cash and equivalents	181	311	462	1,288	2,401	3,829
	2,861	3,581	2,686	3,437	4,748	6,471
Current Liabilities						
Trade and other payables	2,269	3,823	2,194	3,045	3,411	3,871
Current tax liabilities	(36)	(71)				
Borrowings	2,594	3,015	1,957	2,348	2,818	3,381
	4,827	6,767	4,151	5,393	6,228	7,252
Non current Liabilities						
Borrowings	1,273	864	1,792	1,049	947	663
Deferred tax liabilities			213	213	213	213
Retirement benefit obligation	23	23	28	28	28	28
Other	67	372	90	90	90	90
	1,363	1,259	2,123	1,380	1,278	994
Net Assets	5,152	5,401	5,603	6,199	7,134	8,488
Stated Capital	1,793	1,793	1,793	1,793	1,793	1,793
Reserves	3,212	3,450	3,661	4,229	5,139	6,462
Shareholder's Funds	5,005	5,243	5,454	6,022	6,932	8,255
Minority interest	147	158	149	176	201	233
Total Equity	5,152	5,401	5,603	6,199	7,134	8,488
Cash flow statement	2008	2009	2010	2011E	2012E	2013E
Year ending 31st March	Rs. mn	Rs. mn	Rs. mn	Rs. mn	Rs. mn	Rs. mn
PBT	541	647	270	834	1,175	1,594
Adjustments	990	1822	1,944	886	717	604
Changes in Working Capital	201	939	(626)	1,317	637	730
Interest paid	-386	-791	(868)	(608)	(425)	(298)
Tax Paid	-51	-93		(10)	(12)	(12)
Defined Benefit Obligations paid	-1	0				
Net cashflow from operating activities	1,294	2,524	720	2,418	2,092	2,619
Investing Activities						
Fixed Assets	-611	-1917	(357)	(621)	(649)	(678)
Interest received	4	0				
Expenditure on capital WIP	-1309	-328				
Other	2	0				
Net cashflow from investing activities	-1914	-2245	(357)	(621)	(649)	(678)
Financing Activities						
Proceeds from issued capital	0	0				
Receipt / (Repayment) of term loans	300	-75	(69)	(743)	(102)	(284)
Dividends	-33	-108	(81)	(228)	(228)	(228)
Other	-22	-54				
Net Cashflow from financing activities	245	-237	(150)	(971)	(330)	(512)
Net cash and cash equivalents	-375	42	213	825	1,113	1,429
Cash and cash equivalents						
At start of the year	203	-172	(130)	83	908	2,021
Increase / (Decrease)	-375	42	213	825	1,113	1,429
At end of period	-172	-130	83	908	2,021	3,450

