

Pakistan Cements

FCCL PA: Scaling to the top

Following the merger with Askari Cement and two capacity expansions i.e. greenfield and brownfield projects having capacities of ~2.05mn tons each, Fauji Cement has propelled to third-largest cement manufacturer after LUCK and BWCL. Company's total capacity now stands at ~10.5mn tons. The latest expansion in DG khan, will further augment the company's capacity based market share and can open up export avenue for the company.

We recommend a 'BUY' stance on FCCL with a DCF-based target price of PKR27 for Dec'24, offering 35% upside potential. At current valuations, FCCL is trading at EV/ton of ~US\$31 compared to 5-year average of ~US\$46. On an EV/EBIDTA basis, stock is trading at ~4.2x as compared to 5-year average of ~6.0x. Our liking for the stock emanates from the following facts i) Capacity enhancement to augment market share, ii) TERF/LTFF facility to keep finance cost in check, iii) Higher margins on the back of cost efficiency measures and iv) Embracing ESG initiatives.

Key risks to our investment thesis include: i) Slowdown in construction activity, ii) Stiff price competition due to low utilization level, iii) Increase in coal prices, iv) Higher than expected hike in energy prices and v) Change in regulatory environment.

Strong financial performance

In FY23, company has posted its highest ever topline of PKR68bn vs. PKR54bn in SPLY, up by 25.2%. The increase in revenue is due to increase in retention prices which surged by 47% YoY to clocked in at ~PKR710/ton. Similarly, profitability increased by 4.6% to clock in at PKR7.44bn (EPS:3.0/sh) vs. PKR7.11bn (EPS:2.9/sh) in SPLY. The increase in profitability is due to higher reliance on local/afghan coal and cost minimization initiatives.

The cement industry in Pakistan is currently operating at ~56% utilization due to the commencement of new capacities coupled with weak demand, both in domestic and export markets. We believe cement demand will remain muted due to burgeoning cost of construction, higher interest rates, low PSDP utilization, and political uncertainty. However, despite these headwinds, FCCL remains relatively better positioned due to new capacity expansions. which allows the company to grab more market share and also opens up potential export avenues.

Cost initiative measures to boost margins

FCCL with its two-capacity expansion of 2.05mn tons each, has now became the 3rd largest cement player in the industry, taking company's total capacity to 10.46mn tons. With new capacity expansion, company's capacity based market share has jumped to ~12.4% from ~8.9% in 2022.

Fauji Cement Company Ltd



BUY

HOLD

SELL

We recommend BUY with Dec'24 DCF based target price of PKR27/sh, providing 35% Capital Upside

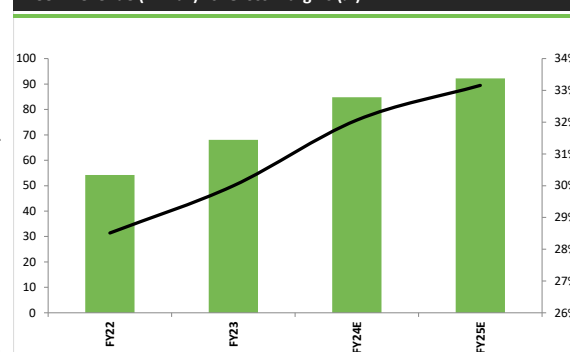
| | | |
|-----------------------|----------|-----------|
| Current Price | | 20.0 |
| Market cap | PKR b | 21.4 |
| Market cap | US\$ m | 76 |
| Free Float Market cap | US\$ m | 34 |
| 30-day Avg. turnover | m Shares | 18.2 |
| 30-day Avg. turnover | PKR m | 345.2 |
| 52 week range | PKR/sh | 10.2-21.2 |
| Shares Outstanding | m | 1,073 |
| Free float | % | 45% |

| | |
|------------------|------------------|
| Major Sponsors | Fauji Foundation |
| Bloomberg Ticker | FCCL PA |

| Financial (PKRmn) | FY23 | FY24E | FY25E |
|-------------------|--------|--------|--------|
| Sales | 68,069 | 84,765 | 92,178 |
| Cost of Sales | 47,651 | 57,585 | 61,612 |
| Gross profit | 20,418 | 27,181 | 30,566 |
| Finance cost | 3,645 | 5,358 | 3,581 |
| Profit Before Tax | 12,900 | 16,757 | 22,413 |
| Profit After Tax | 7,440 | 10,494 | 14,132 |
| Key Ratio | FY23 | FY24E | FY25E |
| EPS | 3.0 | 4.3 | 5.8 |
| DPS | - | - | 2.0 |
| Gross Margins | 30% | 32% | 33% |
| P/E | 4.0 | 4.7 | 3.5 |
| P/BV | 0.5 | 0.6 | 0.5 |
| ROE | 11% | 14% | 16% |

Source: Company Accounts, Insight Research

FCCL: Revenue (PKRbn) vs. Gross margins (%)



Source: Company accounts, Insight Research

To optimize its cost structure, company has added ~40MW of solar captive plant. Along with that, company is effectively utilizing Waste Heat Recovery (WHR) plants, with a total capacity of 54.5MW. This fulfils ~50-55% of its power requirements in a sustainable manner and reduce company's reliance on higher cost fuels. Moreover, due to FCCL's state of the art facility, company's share of local coal in fuel mix remains high compared to its peer, accounting for ~50%. To note, company's current coal mix stands at ~55% Afghan and ~45% local (Darra) coal. Due to these measures, FCCL has achieved operating margins of ~25% in 1QFY24 vs. average ISL cement universe operating margins of ~20%. We believe the company's focus on these cost-reducing measures will allow them to enjoy higher operating margins.

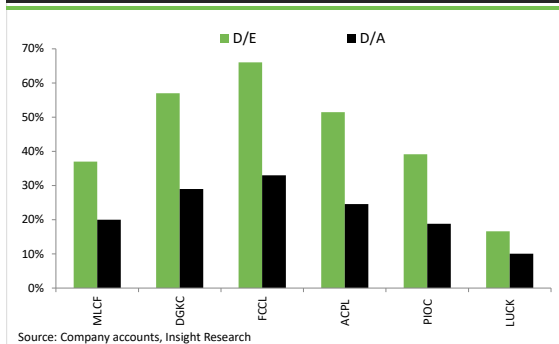
Expected interest rate cut to provide respite

Currently, FCCL has a debt-to-asset of 33% compared to average D/A of ISL cement universe of 21%. The higher D/A is primarily due to company's multiple capacity expansions which has dented company's bottom-line due to elevated interest rates. Company has a total debt of PKR44.8bn, out of which ~PKR13bn is subsidized i.e. LTFF & TERF and PKR7.38bn is interest free loan from parent company. We believe that expected cut in interest rates in CY24 will provide cushion to company's bottom-line in term of lower financial charges.

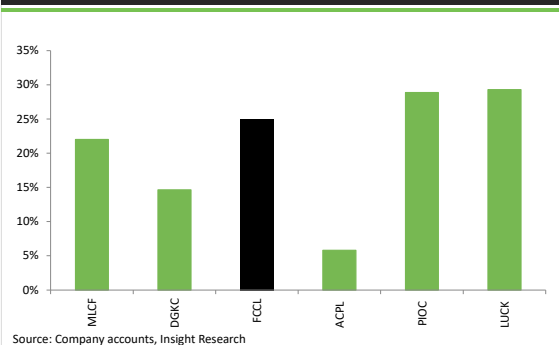
Sustainable Initiatives to unlock value

FCCL has positioned itself as a sustainable and socially responsible entity as company is actively investing in energy efficient technology which reduces company's overall energy consumption and water utilization. Moreover, Company has maintained its focus on a 'Carbon Free Pakistan' as part of its green initiatives which includes undertaking solar power projects, waste heat recovery plants and carrying out extensive plantations. This multifaceted ESG approach will allow the FCCL's stock more alluring among sustainable investors.

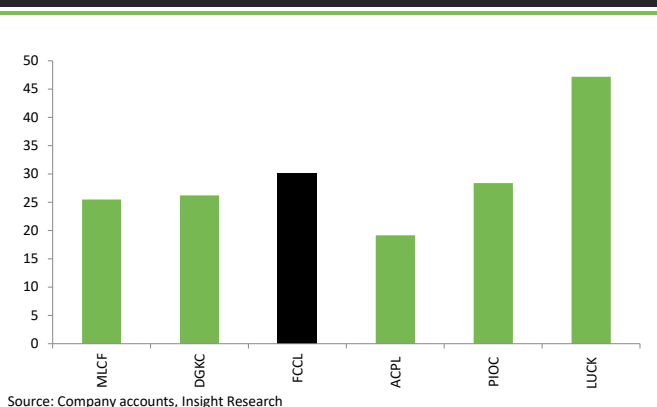
Debt to assets & Debt to equity (%): FCCL vs. ISL universe



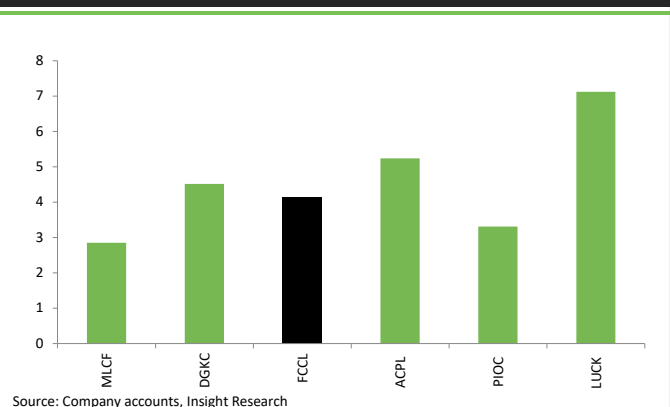
Operating margins (%): FCCL vs. ISL universe



US\$EV/ton: FCCL vs ISL cement universe



EV/EBITDA: FCCL vs ISL cement universe



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Valuation Methodology: To arrive at our period end target prices, ISL uses different valuation methodologies including

- Discounted cash flow (DCF)
- Relative Valuation (P/E, P/Bv, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)

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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