Fauji Cement Company Limited

PKR18.9 - BUY

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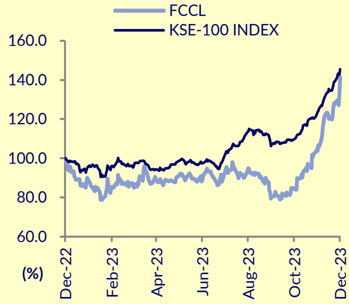
Pakistan

Cements

Bloomberg	**FCCL PA**
Reuters	**FAUC.PSX**
Priced on 01 December 2023	
KSE100 @ 61,691.2	
12M hi/lo	PKR18.9/10.5
Jun-24 price target	PKR28.9
±% potential	+53.3%
Shares in issue	2,452.8m
Free float	35.0%
Mkt. cap	USD162.3m
3M ADV	USD0.3m

FCCL vs KSE100 performance



Source: PSX, Bloomberg

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Deep value interlacing high cash profit

Expansion makes FCCL the third largest cement manufacturer

FCCL has commissioned its 2.1MTPA Greenfield plant in D.G. Khan and has thus become third largest cement manufacturer of the country with 10.6MTPA capacity. Consequent to this development, the company's capacity based market share has increased to 16% in North and thus the company's offtake are likely to increase to 5.18/5.86 MT in FY24/FY25 respectively. This will increase profitability of company by ~17% in FY25. Cash generation of company remains stellar, with FY25 cash generation at around 34% of current market capitalization. Debt level, despite of its high absolute level is easily manageable as interest coverage ratio is estimated to be 6.5/9.8/14.3 times in FY25/FY26/FY27 respectively. At our Jun-24 target price of PKR28.9/sh, FCCL offers upside potential of 53.3% from the last close. If sponsor loan is eventually converted, then diluted target price is PKR24.6/sh.

Debt level remains comfortable: Company's total debt stock stood at PKR44.9bn at the end of 1QFY24. Debt level declined slightly during the outgoing quarter as the company retired PKR2.8bn short term debt due to ample cash generation, leaving total short term debt stock at just PKR1.7bn.

Long term portion, excluding sponsor support, stand at PKR35.8bn. Of this PKR13.7bn is concessionary in nature utilizing facilities such as TERF, LTFF and renewable energy finance. The weighted average financing rate on this debt component is just 3.1%. This leaves just PKR22.1bn syndicate financing agreements at average financing rate of Kibor+0.9%. Thus, even after commissioning of this new line, quarterly finance cost won't increase beyond PKR1.6bn resulting in interest coverage ratio of 4.9x in the coming quarter. This ratio will improve further to 6.5/9.8/14.3 times in FY25/FY26/FY27 respectively as interest rates decline.

Remaining PKR7.4bn is interest free loan provided by parent (Fauji Foundation) to erstwhile Askari cement for Nizampur expansion. Sponsor may convert that amount to equity at any time. Thus it is relevant to adjust earnings for this potential dilution impact as well.

Cash generation can be utilized for dividend payment: Cash generation of the company is stellar and is enough to retire all debt in 3 years. Current market capitalization is attractive as it is just at 2.9x of FY25 cash generation. Profit after tax is estimated to be PKR 13.2/17.1/18.5 billion for FY 24/25/26 respectively. Debt repayments, after immediate retirement of short term debt including that of 1QFY24, are estimated to be PKR 6.3/3.1/5.2 billion in FY 24/25/26 respectively. Thus, this leaves PKR 5.9/14.0/13.3 billion excess profit - excluding depreciation

Financials Snapshot

Key metrics	FY23A	FY24E	FY25E	FY26E
EPS	3.03	5.38	6.95	7.54
Earning Growth	28%	77%	30%	9%
P/E	5.8	3.3	2.5	2.3
DPS	0	0	0	3.8
Dividend Yield	0%	0%	0%	22%
P/BV	0.66	0.55	0.45	0.41
BVPS	26.6	31.9	38.9	42.7
ROA	5.9%	9.0%	10.7%	11.1%
ROE	12.1%	18.4%	19.6%	18.5%

Source: Company Accounts, Alfalah CLSA Research and working capital needs – which can be disbursed to shareholders. If fully paid out, this can result in dividend of PKR 2.4/5.7/5.4 per share respectively. However, we have remained conservative in our assumptions and have not incorporated this potential dividend until all non-concessionary loan is paid-off by FY26.

Reliance on local coal lends cost advantage: Company's production facilities lie at close proximity to Darra Adam Khel as three Northern sites (Nizampur, Jhang Bahtar and Wah lie within 100 to 150 kilometers of Akhurwal mines. Thus local coal constitute more than half of total fuel mix. Since local coal trades at discount to Afghan coal (PKR 41K/Ton vs PKR53K/Ton), it lends cost advantage to the company. Resultantly, FY23 fuel and power cost of FCC clocked in at PKR7,003/Ton against AFSCLSA universe average of PKR7,089/Ton despite relying on grid for significant part of power needs.

Working on energy efficiency: Company is continuously working on in-house power generation and recently installed 20MW solar power. This takes total solar capacity to 39.6MW, with all of it installed during last 4 years. This along with waste heat recovery plants are capable of meeting 42% of power needs in FY24. Moreover, dual fuel generators at Jhang Bahtar site can also contribute to 17% of power needs, if utilized fully. Company used them intermittently in FY23 as well. Lastly, if company decides to deploy just FY25 excess cash in energy efficiency projects, then it can procure ~37MW coal power plant – i.e. a capacity similar to that of MLCF - without resorting to debt making the company self-reliant in power.

Capacity expansion to improve profitability profile: Industry offtake levels have remained supressed of late, with 1QFY24 local despatches clocking in at 10.2MT translating into around 50 percent of installed capacity. Post Nizampur expansion, company has been supplying around 13.5% of Northern industry offtake, which will now increase to around 16%. Even in low offtake scenario, this expansion bodes well for the company if price consensus remains intact. Additional finance cost and depreciation expense are estimated to be PKR1.9/1.7bn per annum respectively, while gross contribution to profitability from new line even in this depressed offtake environment is estimated to be PKR7.7bn. Thus, company's earnings are estimated to increase by ~17% due to this expansion.

Trading at attractive multiples: Company is currently trading at steep discount to historical multiples. FY24E P/E is 3.4x while P/FCF is at 4.0x. P/B is at distressed level of 0.6x. 5/10 years historic P/E is 6.2x/9.7x, P/FCF is 5.9x/7.5x, while P/B is 0.9x/1.6x. Hence, only partial rerating provides significant upside. EV/Ton also currently stand at USD28, i.e. less than half of replacement cost.

Financial Projections: Company's financial position is expected to remain strong with decreasing leverage while earnings are expected to improve continuously. A brief snapshot of financial outlook is presented in tables below.

Figure 1

Income Statement (PKR Mn)	FY23A	FY24E	FY25E	FY26E
Net Sales	68,069	93,882	109,785	118,427
Cost of Sales	47,651	62,075	72,213	80,278
Gross Profit	20,418	31,806	37,572	38,149
Operating Profit	16,330	26,658	31,532	31,357
EBIT	16,369	26,023	31,405	31,749
PBT	12,899	20,374	26,363	28,569
PAT	7,439	13,199	17,039	18,483
EPS	3.03	5.38	6.95	7.54

Source: Company Accounts, Alfalah CLSA Research

Figure 2

Balance Sheet (PKR Mn)	FY23A	FY24E	FY25E	FY26E
PPE	104,607	110,163	107,723	105,336
Total Non-Current Assets	**115,695**	**121,198**	**118,758**	**116,371**
Stores and Spares	8,011	11,783	12,558	13,685
Stock In Trade	7,112	9,333	9,881	10,927
Cash & Short Term Investments	1220	4,809	17,935	23,282
Total Current Assets	**23,134**	**32,445**	**47,257**	**55,305**
Total Assets	**138,829**	**153,643**	**166,015**	**171,676**
Long Term Financing	31,896	33,699	28,854	24,705
Total Non-Current Liabilities	**45,166**	**47,016**	**42,171**	**38,022**
Trade and Other Payables	6,516	9,893	10,809	12,009
Total Current Liabilities	**28,486**	**28,250**	**28,428**	**28,997**
Equity	65,177	78,376	95,416	104,657
Total Liabilities and Equity	**138,829**	**153,643**	**166,015**	**171,676**

Source: Company Accounts, Alfalah CLSA Research

Recommendation: We have used free cash flow methodology to value FCCL. Our parametric assumptions include risk free rate of 17%, terminal growth rate of 3% and equity risk premium of 6%. Using these estimates, we arrive at June-24 target price of PKR28.9/sh, providing upside of 53.3% from last close.

Sensitivity analysis: In the table below, we present earnings sensitivity to change in coal prices, cement prices and local dispatches. Our base case assumptions for FY24 include PKR 1,300/bag retail cement price of Industry in North, USD 120/Ton coal cost which after applying discount of Local/Afghan coal becomes PKR 44,100/Ton factory gate delivered and local dispatches up 7% YoY leading to EPS of PKR6.95/sh.

Figure 3

FY25E EPS Sensitivity

		Cement Price in North (PKR / Bag)				
FY25 Dispatches	Coal price	1,200	1,250	1,300	1,350	1,400
Up 14% YoY	USD 100/Ton	6.57	7.47	8.37	9.27	10.17
	USD 110/Ton	6.19	7.09	7.99	8.89	9.79
	USD 120/Ton	5.81	6.71	7.61	8.51	9.41
	USD 130/Ton	5.43	6.33	7.23	8.13	9.03
	USD 140/Ton	5.05	5.95	6.85	7.75	8.65
Up 7% YoY	USD 100/Ton	5.91	6.81	7.71	8.61	9.51
	USD 110/Ton	5.53	6.43	7.33	8.23	9.13
	USD 120/Ton	4.95	5.85	**6.95**	7.85	8.75
	USD 130/Ton	4.78	5.68	6.58	7.48	8.38
	USD 140/Ton	4.40	5.30	6.20	7.10	8.00
Stable YoY	USD 100/Ton	5.25	6.15	7.05	7.95	8.85
	USD 110/Ton	4.87	5.77	6.67	7.57	8.47
	USD 120/Ton	4.49	5.39	6.29	7.19	8.09
	USD 130/Ton	4.11	5.01	5.91	6.81	7.71
	USD 140/Ton	3.73	4.63	5.53	6.43	7.33
Down 7%	USD 100/Ton	4.59	5.49	6.39	7.29	8.19
	USD 110/Ton	4.21	5.11	6.01	6.91	7.81
	USD 120/Ton	3.83	4.73	5.63	6.53	7.43
	USD 130/Ton	3.45	4.35	5.25	6.15	7.05
	USD 140/Ton	3.07	3.97	4.87	5.77	6.67

Source: Company Accounts, Alfalah CLSA Research

Upside Risks

Lower than assumed coal cost

Higher than expected demand growth

Lower than expected currency depreciation.

Downside Risks

Higher than assumed coal cost

Higher than assumed financing rate

More pressures on macro level

Pricing Indiscipline.

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