Monday, 04 December 2023

Fauji Cement…| Improved outlook … | Buy@PKR 18.86….

- FCCL have increase in EPS in FY23 as compared to FY22. But the next financial year will be tough for Pakistan economy because of inflation.
- In cement markets demands will continue to remain depressed in domestic market with some hope of recovery in the 2nd half of FY24 after the elections. However exports will increase because of currency devaluation.
- The exports to Afghanistan are showing promise with good recovery in FY23 and the momentum is expected to continue in the next Financial Year. The Management will try and continue to increase its market share especially with the completion of the Greenfield Expansion at D.G. Khan.
- FCCL has acquired Askari Cement in FY21. Thus on paper FCCL market share increased with skyrocketing revenue growth of 123.5% in FY22.
- FCCL had signed EPC contracts with renowned Chinese company for two projects of 6500 TPD cement plants in March and April 2021. Nizampur Project has been successfully commissioned and started commercial production in October 2022.
- The other project i.e. greenfield project at D.G. Khan has completed its installation on 30th Nov, 23, as per company notice at PSX. The production capacity has increased to 10.6 mn ton/annum from 7.5 ton/annum.
- Company uses local as well as imported coal. During FY23, 53% local and 47% imported coal was used by the Company and this imported coal is forex sensitive.
- Cash dividend was not declared by FCCL much to the dismay of the shareholders, which may have to do with meeting funding requirements of expansion projects. As per our initial model based estimates, we see FCCL EPS to remain above PKR 5.0/sh in FY24 and may increase up to PKR 6.0/sh in FY25 despite hefty retention prices enjoyed by the northern zone companies which could be to the extent of PKR 800/50kg bag or even above. However, we may see FCCL capacity utilization could increase given its proximity with Hazara Motorway and development of housing in and around Islamabad, Taxla, Wah, Haripur, Fatah Jang etc. We expect capacity utilization may increase in 2HFY24.

FCCL Snapshot	
Price	18.86
Mkt Cap	46.26bn
Avg Vol (12m)	3,587,520
Paid-up	24.52 bn
Authorized Cap	15 bn
Beta	1.44
Exp PE latest	3.7x
Par Value	10
52 weeks low	10.24
52 weeks high	18.86

Source: Scs Research

Sensitivity Analysis for EPS (FY24)

Change in Cement Selling Price (Per 50 kg bag) \ Change in Annual Production (Metric Ton)	32.4%	33.4%	34.4%	35.4%	36.4%	37.4%	38.4%
6.0%	4.41	4.45	4.49	4.52	4.56	4.60	4.64
7.0%	4.55	4.59	4.63	4.67	4.71	4.75	4.79
8.0%	4.69	4.73	4.77	4.81	4.85	4.89	4.93
9.0%	4.83	4.87	4.91	4.95	4.99	5.03	5.08
10.0%	4.97	5.01	5.05	5.09	5.14	5.18	5.22
11.0%	5.10	5.15	5.19	5.24	5.28	5.32	5.37
12.0%	5.24	5.29	5.33	5.38	5.42	5.47	5.51
13.0%	5.38	5.43	5.47	5.52	5.57	5.61	5.66
14.0%	5.52	5.57	5.61	5.66	5.71	5.76	5.80

Source: Scs Research

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Fauji Cement..| Earning Jump with additions in PPE.....

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- The projected revenue in FY24 is expected to grow at 48.96% by assuming 10% increase in selling price of cement per 50kg bag and 35.4% increase in annual cement production per ton. However it can vary because production capacity has increased after completion of DG Khan's project and revenues can rise by huge amount depending on demands. This we have already discussed given many housing schemes in the area close to motorway.

- During FY23 a huge increase is witnessed in per ton cost of production as compared to last year FY22. The reasons is currency depreciation and higher fuel and coal costs resulting in higher power cost. However the company may optimize costs by following strategies such as higher use of local coal because it is cheaper than imported coal; reducing cost of power by increasing captive power generation and enhancing green energy; thus rationalization of fixed costs.

- FCCL fuel consumption in FY23 is from 50% Afghan Coal, 43% local Coal and 7% alternative energy. Thus we believe this will continue wherein we expect increase usage of local coal mix.

- Since 2018, admin cost has increased at an average of 11% per year compared to average inflation of 12% in the country.

- As observed in 1QFY24 the sales have improved and EPS for this quarter is PKR 1.07/sh and we expect FCCL EPS target of PKR 5.09/sh in FY24 alongside token dividend because of new plant installation earnings are expected to rise.

- Property, plant and equipment (PPE) have grown by 40.87% in FY23 because of expansion projects at Nizampur and DG Khan. This is a single biggest catalyst in the model.

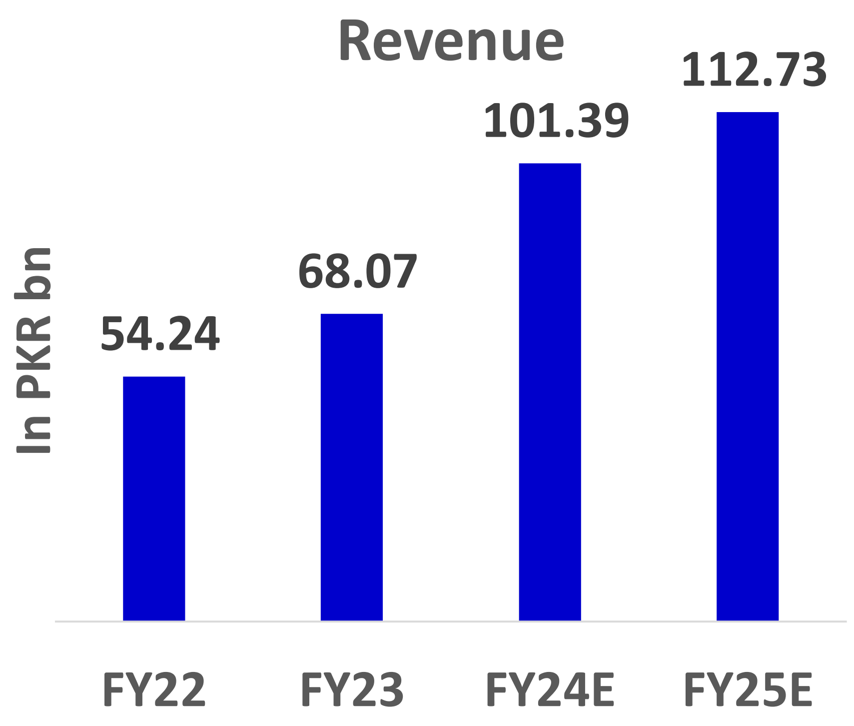
- FCCL yield FY24 PE of 3.7x as against KSE100 PE of 5.2x. FCCL to show double digit sales growth.

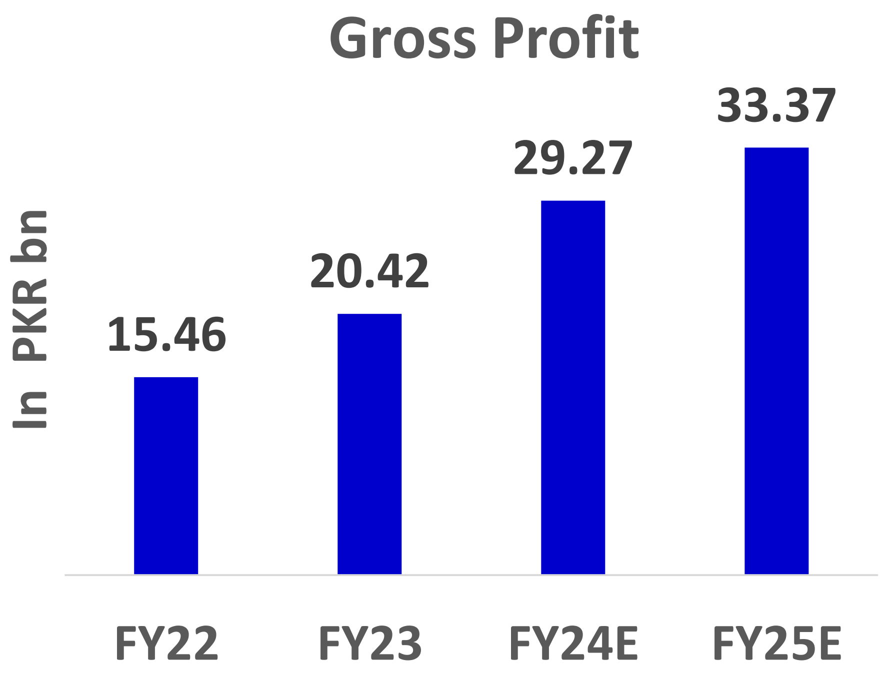
PKR in "000"	FY22	FY23	FY24E	FY25E
Revenue	54,243,118	68,069,282	101,394,868	112,730,814
Cost of Goods Sol	(38,779,542)	(47,650,809)	(72,127,980)	(79,362,369)
Gross Profit	**15,463,576**	**20,418,473**	**29,266,888**	**33,368,445**
Expenses				
Selling Expenses	(1,603,323)	(2,705,263)	(3,513,377)	(3,906,172)
Admin Expenses	(1,299,439)	(1,381,633)	(2,243,528)	(2,494,354)
Finance cost	(1,201,612)	(3,645,265)	(3,561,389)	(3,280,180)
Finance income	745,852	527,702	558,446	600,945
Other income	230,695	436,173	458,432	466,004
Other Expense	(808,964)	(750,078)	(1,314,737)	(1,461,724)
Total Expenses	**(3,936,791)**	**(7,518,364)**	**(9,616,152)**	**(10,075,482)**
Profit before tax	**11,526,785**	**12,900,109**	**19,650,736**	**23,292,964**
Tax	(4,415,553)	(5,460,428)	(7,663,787)	(9,317,185)
Profit after tax	**7,111,232**	**7,439,681**	**11,986,949**	**13,975,778**
EPS	**3.02**	**3.16**	**5.09**	**5.94**
Net Margins	**13.11%**	**10.93%**	**11.82%**	**12.40%**
Sales Growth	**123.49%**	**25.49%**	**48.96%**	**11.18%**

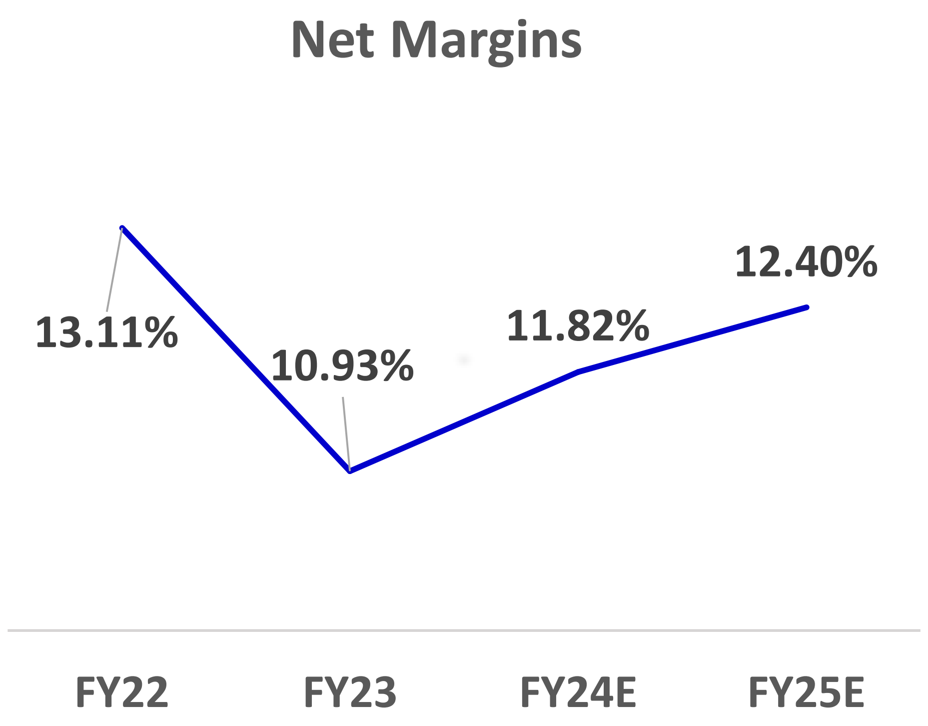
Source: Scs Research

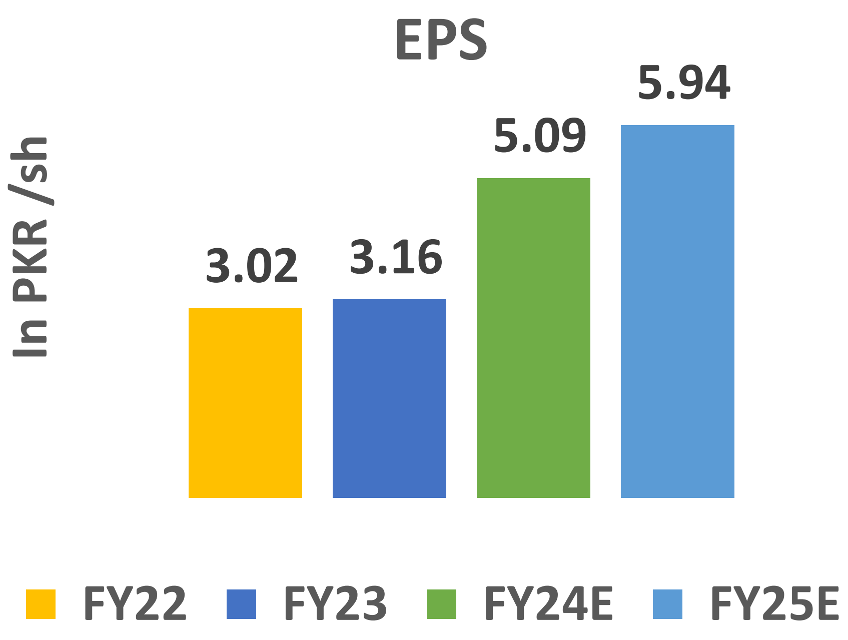
PKR in '000'	1QFY24
Reveneue	20,313,087
Cost of Goods Sold (COGS)	(13,991,877)
Gross profit	6,321,210
Operating profit / (loss)	5,077,369
Earnings Before Tax	4,007,731
Taxation	(1,393,729)
Net Earnings	2,614,002
EPS	1.07
Net Margin	12.9%

Fauji Cement...| Earning Jump.....









Overview of Cement Industry

- Pakistan's cement industry has seen growth in cement and clinker exports in the **1QFY24**, attributed to the ongoing depreciation of the Pakistani rupee and declining coal prices. Despite a decrease in the average value of exports to $39.82/ton from $49.23/ton, the export volume has increased significantly, rising by 43.9% to $66.68m (1.675Mt) compared to $46.35m (941,529t) in the same period last year. The export revenue, when calculated in Pakistani rupees, experienced substantial growth of 85.5%, reaching PKR19.49bn during this export period, supported by the depreciation of the local currency against the US dollar.

- The data on exports and imports released by PBS revealed that MoM, cement and clinker exports registered 15.1 per cent growth in terms of value in September 2023 to $27.04m (693,023t)) compared to $23.49m (569,376t) in August 2023. In terms of dispatch volumes, the MoM increase was 21.7 per cent.

- In FY23, the cement sector faced challenges, witnessing a double-digit decline in overall dispatches (imports and exports combined) due to economic slowdown and increased construction material costs. Domestic dispatches dropped by 16%, from 47.6 million tons to 40 million tons, while exports declined by 13.1%, from 5.3 million tons to 4.6 million tons. However, in 1QFY24, the cement industry in Pakistan is gearing up for a remarkable surge in exports, with experts predicting a staggering 159% year-on-year increase, reaching 0.4 million ton. According to a Topline Securities' report, this positive trajectory is mainly attributed to the recent decline in coal prices, making cement exports economically viable once again. The upward trend in cement exports is expected to have a positive impact on the nation's economy and the cement sector.

- According to PACRA, in FY22, the industry's debt to capital ratio was approx 32% (FY21: ~31%), as both short and long term debt grew by 21% YoY.

- At 1HFY23 end, industry gearing ratio stood at ~35% as long term debt grew by ~12%, short term debt grew by ~29% and equity only grew by ~5% in the first half of the current fiscal year. Coverage ratio grew to ~8x in FY22 (FY21: ~7x) as industry EBITDA increased by ~25%, and finance cost increased by ~13% YoY.

- However in 1HFY22 coverage dipped to ~6x, as EBITDA grew by ~24% YoY while finance cost grew by ~90% owing to hawkish monetary stance by the SBP.

- In FY22 industry effective cost of debt marginally reduced to ~6.5% (FY21: ~6.9%). In 1HFY23 effective cost of debt grew to ~9.4% following multiple upward revisions in the policy rate by the SBP.

- Despite a decrease in international coal prices, the impact on reducing costs and cement prices was limited due to rupee devaluation. Other factors contributing to cost increases included rising fuel prices and electricity tariffs. Although manufacturers managed to pass on the cost increase, concerns arise about the declining purchasing power of consumers amid record inflation in the country.

- Cement sales typically peak during spring and summer months with increased daytime construction activity, while dispatches slow down slightly during normal monsoon and winter seasons, especially in the North.

Fauji Cement .....| SWOT favors cement sector cycle

STRENGHT

- Increased Production Capacity at several sites provides it with greater freedom to run cutting-edge, energy-efficient European/Chinese hybrid technology production lines.
- Power facilities that generate renewable energy and multiple fuels under captivity, including waste heat recovery, solar, and multifuel generators.

WEAKNESS

- Operating in a industry with is highly taxed in the country.
- Plant locations mostly in the North of the Country make it uncompetitive for exports by Sea.
- Axle load control regime will be implemented which will cause challenges for transporting cement to the port and rest of the country.

OPPORTUNITY

- Significant growth opportunities in the domestic market due to Pakistan's low per capita cement consumption, growing population and increasing urbanization.
- Continuous Government spending on infrastructure development and hydropower projects including major dams.
- Cost rationalization through innovation and process efficiencies.

THREAT

- Continuous pass on of increase in input costs to consumers with ever-high cement prices effects demand.
- Rising input costs due to the increase in Power, coal and other fuel prices, as well as the devaluation of PKR.
- High general inflation rate with highest ever construction material costs impacting the construction activity.
- All time High interest rates translate into high finance cost.

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Discounted Cash flows or Dividend Discount Model or Enterprise Value