Fauji Cement (FCCL) may rule…

DCF price PKR 34.8/sh…

FY25 ROE 17%…

FY25 PE and PBV 4.03x and 0.69x…

DCF Sensitivity Analysis

Terminal Growth Rate (%)	WACC (%) 16.6	17.2	17.7	18.2	19.7	21.2	22.7
1.0	29.9	28.3	26.9	25.5	22.0	19.0	16.6
2.0	32.3	30.6	28.9	27.4	23.5	20.3	17.6
3.0	35.1	33.1	31.2	29.6	25.2	21.6	18.7
4.0	38.2	36.0	33.9	32.0	27.1	23.1	19.9
5.0	42.0	39.4	37.0	34.8	29.2	24.8	21.3
6.0	46.4	43.4	40.6	38.1	31.7	26.8	22.8
7.0	51.8	48.1	44.9	41.9	34.6	29.0	24.6
8.0	58.4	54.0	50.0	46.5	38.0	31.5	26.5
9.0	66.7	61.2	56.4	52.2	42.0	34.5	28.8

Source: SCS Research

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FCCL may rule…| DCF price PKR 34.8/sh

Exp PE: 4.03
Exp PBV: 0.69
Current Price: PKR 22.9/sh
Target Price: PKR 34.8/sh
BUY

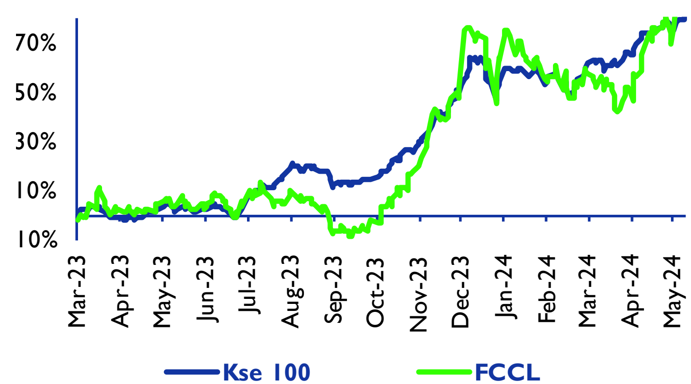
Positives in FCCL…

- We continue our coverage in FCCL, where our DCF target price is PKR 34.8/sh. Our premise for the coverage is a noticeable improvement in sales in the 9MFY24 report, wherein we expect a new capacity increase to further maximize topline. In lieu of that, we see an increase in 4QFY24 sales and the subsequent bottom line. Cement companies continue to enjoy the highest ever retention price above PKR 850/50 kg bag. The current cement bag prices are above PKR 1220 per bag. Hence, our premise in FCCL is the probable sales increase in the aftermath of the DG Khan district-based plant, which may have come online during FY24, and then it would have a magnified impact in FY25.
- We see an improvement in ROE to 17% in FY25. FCCL yields PE and PBV of 4.03x and 0.69x, respectively, wherein we recommend our **POSITIVE** stance on FCCL as per our methodology. Moreover, net margins and gross margins are expected to increase to 28% and 10%, respectively, in FY25 due to improving sales and an uptick in dispatches.
- FCCL is the **third-largest** cement manufacturer after the Askari Cement merger. We see total dispatches increasing by 1% from 3.76 million tons in 9MFY23 to 3.79 million tons in 9MFY24.

FCCL Snapshot

Market Price	22.9/sh
Market Capitalization (PKR)	56.17 bn
Market Capitalization ($)	202.7 mn
Exp FY25 PE	4.03 x
Exp FY25 PBV	0.69 x
Beta	1.5 x
Average Volume	6,145,224

Relative Index



Source: SCS Research, PSX

EPS projections: By further breaking it down, we see export sales increasing by 20%, attributed to currency devaluation, and local sales decreasing by 1% given depressed demand. We forecasted EPS by taking a capacity utilization of 48.7%, which gives total dispatches of 5.16 million tons in FY24. The expected EPS for FY24 and FY25 is 3.58/sh and 5.68/sh, respectively.

Investment Decision: We recommend a **BUY** call based on the DCF target price of PKR 35/sh which is up by 51.9%. We have calculated this target price by taking: 1) beta of 1.51x; 2) PIBs rate as a risk-free rate; 3) long-term GDP growth rate of 5% (forecasted by the IMF) as a terminal growth rate; and 4) market risk premium of 6.28%, which is a risk of the Asian Region. However, due to the limitations of the model, we have also presented a sensitivity analysis table.

Valuation Table

	FY22	FY23	FY24E	FY25F
Gross Margins (%)	28.5%	30.0%	27.0%	28.0%
Net Margins (%)	13.1%	10.9%	9.5%	10.2%
BV/s	24.5	27.7	28.3	33.3
PBV (x)	0.93	0.83	0.81	0.69
PE (x)	7.58	7.25	6.39	4.03
ROE (%)	12.3%	11.4%	12.6%	17.1%
Actual Production (Ton in mn)	5.66	4.92	5.16	5.83
Maximum Capacity (Ton in mn)	6.36	7.47	10.60	10.60
Capacity Utilization (%)	88.9%	65.8%	48.7%	55.0%
Coal Consumed in a Year (Kg in mn)	905.13	786.49	825.95	932.80
Energy Cost/Ton of Production (PKR)	4,397.79	7,002.64	8,641.02	9,361.10
Energy Cost as % of Sales	46%	51%	48%	40%
No. of Bags Produced (50 Kg Bags)	113,141,520	98,310,720	103,244,000	116,600,000

Source: SCS Research, Company Books
**One metric tons of cement require 160 Kg coal*
**Energy Cost = Fuel + Power Cost*

Coal Mix Strategy: Previously, FCCL had shifted towards Afghan coal in order to reduce costs because, at that time, Richard Bay coal was very expensive due to supply chain disruption.

FCCL finds Afghan coal a cheaper alternative. FCCL coal mix contains 50% Afghan coal and 43% local coal in FY23, along with 7% others, which included Richard Bay coal.

However, we are now seeing a rise in Afghan coal prices and a decrease in Richard Bay coal prices. According to the Pakistan International Bulk Terminal (PIBTL) report, we see a decline in Afghan coal imports and a rise in imports of Richard Bay coal in Pakistan. The import of Richard Bay coal cost around PKR 40,000 to PKR 41,000 per ton, but the import of Afghan coal cost PKR 50,000 to PKR 52,000.

If FCCL changes its coal mix instead of maintaining the previous one, then it will be better for the company.

Sector Performance: We see a decline in local sales at North-based plants by 7.91% in April 2024 as compared to April 2023. Moreover, we see that exports from North-based plants have increased by 73.11% in April 2024 as compared to April 2023.

For FCCL, we see an improvement in dispatches sold by 1% in 9MFY24 as compared to 9MFY23.

P&L Statement

PKR in (bn)	FY22	FY23	FY24E	FY25F
Revenue	54.24	68.07	92.93	136.44
COGS	-38.78	-47.65	-67.84	-98.24
Gross profit	15.46	20.42	25.09	38.20
Other income	0.23	0.44	0.58	0.86
S & D expenses	-1.60	-2.71	-4.00	-5.87
Admin Expenses	-1.30	-1.38	-1.76	-2.59
Other expenses	-0.81	-0.75	-0.91	-1.33
Operating profit	11.98	16.02	19.00	29.26
Finance cost	-1.20	-3.65	-5.90	-8.46
Finance income	0.75	0.53	0.31	0.46
PBT	11.53	12.90	13.41	21.26
Tax	-4.42	-5.46	-4.62	-7.32
PAT	7.11	7.44	8.79	13.94
EPS	3.02	3.16	3.58	5.68

Source: SCS Research, Company Books

DCF Sensitivity Analysis

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5.0	42.0	39.4	37.0	34.8	29.2	24.8	21.3
6.0	46.4	43.4	40.6	38.1	31.7	26.8	22.8
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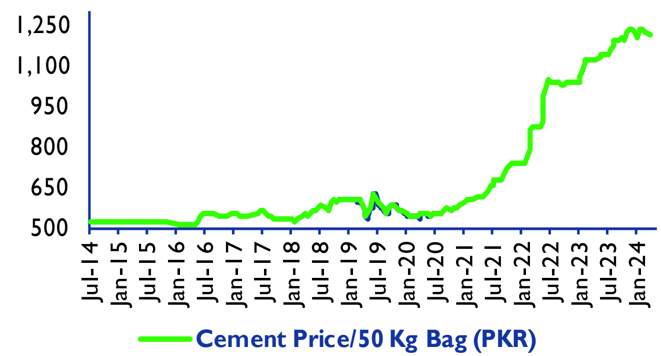
Source: SCS Research

Decrease in Cement Price: We see a decrease in the price of cement bags in the coming future due to the expected decrease in the inflation rate. According to PBS, the prices of cement declined on May 2, 2024, by 0.17% to PKR 1,215 per 50 kg bag on a weekly basis and 0.41% on a monthly basis. The decline in cement prices, along with the expected GDP growth rate in the future, will improve volumetric sales, which will be positive for FCCL.

Future Outlook: In the future, we see an improvement in the GDP growth rate and LSM index, along with a decrease in inflation and the policy rate, as projected by the IMF, which will be positive for the company.

Pakistan Cement Price



Source: SCS Research, Karandaaz

Strong Financial Position: FCCL manages its liquidity issue, operational losses, and debt repayment strategically. According to current projections, FCCL has the ability to produce enough cash flows to meet the liquidity requirements. FCCL finances its long-term debt through internal cash generation, and its working capital requirements are fulfilled by its running finances. For successful cash flow generation, we see that less expensive financing is necessary. We see a reduction in the policy rate in the upcoming year, which will be beneficial for FCCL in terms of stable cash flow generation. In case of operational losses, the company has enough running finances to cover liquidity requirements. The company has significantly increased its property plant & equipment (PPE), share capital and reserves, long-term loans, and working capital requirements over the last five years because of expansion projects, a merger with Askari Cement, and the modernization of existing manufactured capital.

Risk in our Investment Thesis: While our investment thesis on FCCL underscores substantial growth potential, it's important for investors to know about potential risks that could impact future outcomes. Key risk variables include: 1) political instability; 2) import restrictions; 3) a poor LSM index; 4) high coal prices; and 5) overestimation and underestimation of the projected GDP growth rate and inflation by the IMF.

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- (Target Price, if any/Current Price - 1) < 10% Hold
- (Target Price, if any/Current Price - 1) < -10% Negative

The time duration is the financial reporting period of Subject Company

Valuation method

Following research techniques adopted to calculate target price/recommendation

- Price to earnings & Price to Book, EV-EBITDA multiple
- Discounted Cash flows or Dividend Discount Model or Enterprise Value