Thursday, 16 June 2022

Fauji Cement: Amalgamation Story….The forgotten hero…

Muhammad Shahzad Khan
Research Analyst
www.scstrade.com

About the scheme….

- Fauji Cement Company Limited (FCCL) announced amalgamation scheme with Askari Cement Limited (ACL) during 1QFY22.
- The management has confirmed in directors' report in 3QFY22 that Lahore High Court (LHC) has sanctioned the scheme of arrangement for amalgamation however, certified copy has yet to be obtained.
- Moreover, management is also confident about the remaining formalities of aforesaid scheme of merger is expected to be completed in 4QFY22.
- Through the scheme, all the asset and liabilities will consolidate in FCCL against which ACL's shareholders will receive 5 shares of FCCL against 1 share of ACL.
- This merger will highly benefit the FCCL balance sheet with regards to strengthening the assets sides against the liabilities of the company.
- With the successful transition of merger phase, we are expecting noticeable improvement in current ratio, quick ratio and cash coverage ratio. Whereas, price to earning ratio, price to sales ratio and price to book value will become attractive as post-merger will provide combined earnings, sales and book value resulting in diluting the ratio figure.

FCCL	PKR 14.34
Mkt Cap	20.05 bn
Avg Vol. (12M)	2,460,844
Paid up	13.8 bn
Authorized	15 bn
52 weeks Lo	PKR 13.85
52 weeks Hi	PKR 25.10
FY21 EPS	PKR 2.52
9MFY22 EPS	PKR 2.94

Thursday, 16 June 2022

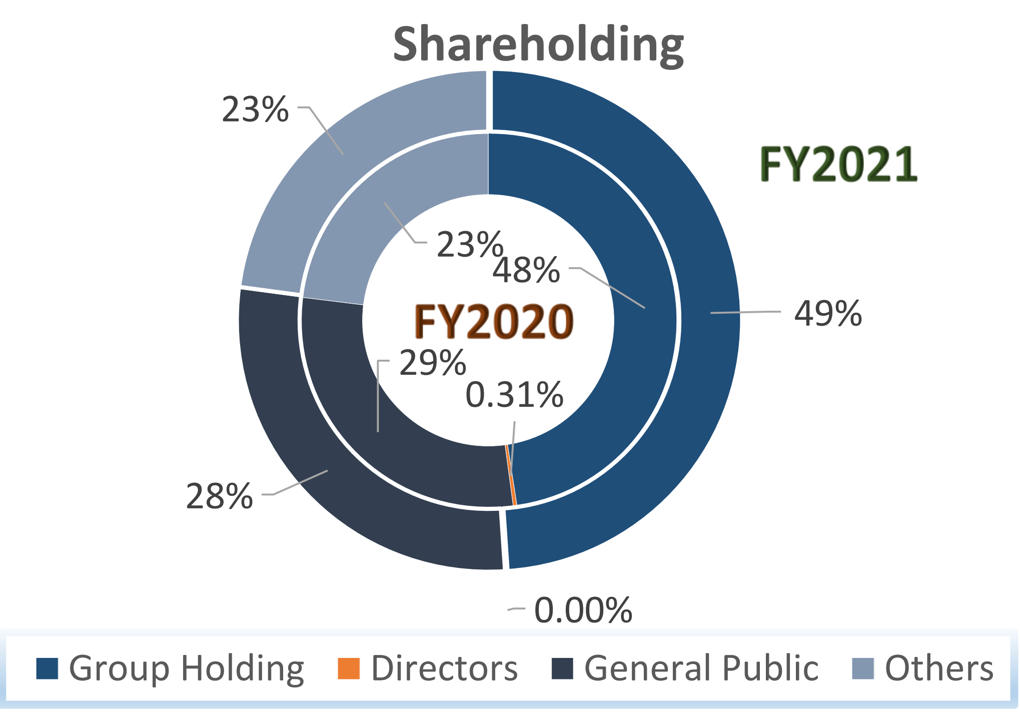
Fruits of amalgamation…….

We see this eventuality as very positive development.

- ✓ Replacement cost of a similar plant will be expensive since Tehsil Fateh Jang, District Attock and Tehsil Taxila, District Rawalpindi are now in close proximity to M1 Motorway and cost of properties in the area has gone sky high.
- ✓ We see many sprawling societies in the area which are coming up alongside motorway spelling unlimited options for cement plants like FCCL and ACL (Wah plant) etc.
- ✓ We see this merger to be a resultant synergy of both companies' investors.
- ✓ Previously, investors have viewed FCCL based on Frontier Works Organization (FWO) based infrastructure projects, road quality cement perception and export destination of Kabul, Afghanistan. However, in post merger – we expect FCCL current capacity of 3.4mn tons will be enhanced without painstakingly & cumbersome process of undertaking expansion by leveraging the balance sheet.
- ✓ We expect FCCL may again relegated to Sharia compliance category.

About the Company…

- ➢ FCCL belongs to Fauji Foundation (FF).
- ➢ The annual production capacity of the plant is ~3.4 mn ton whereas the plant can be operated at its full capacity.
- ➢ Company's annual capacity could go higher above 4mn – 5mn tons after amalgamation with Askari Cement (ACL).



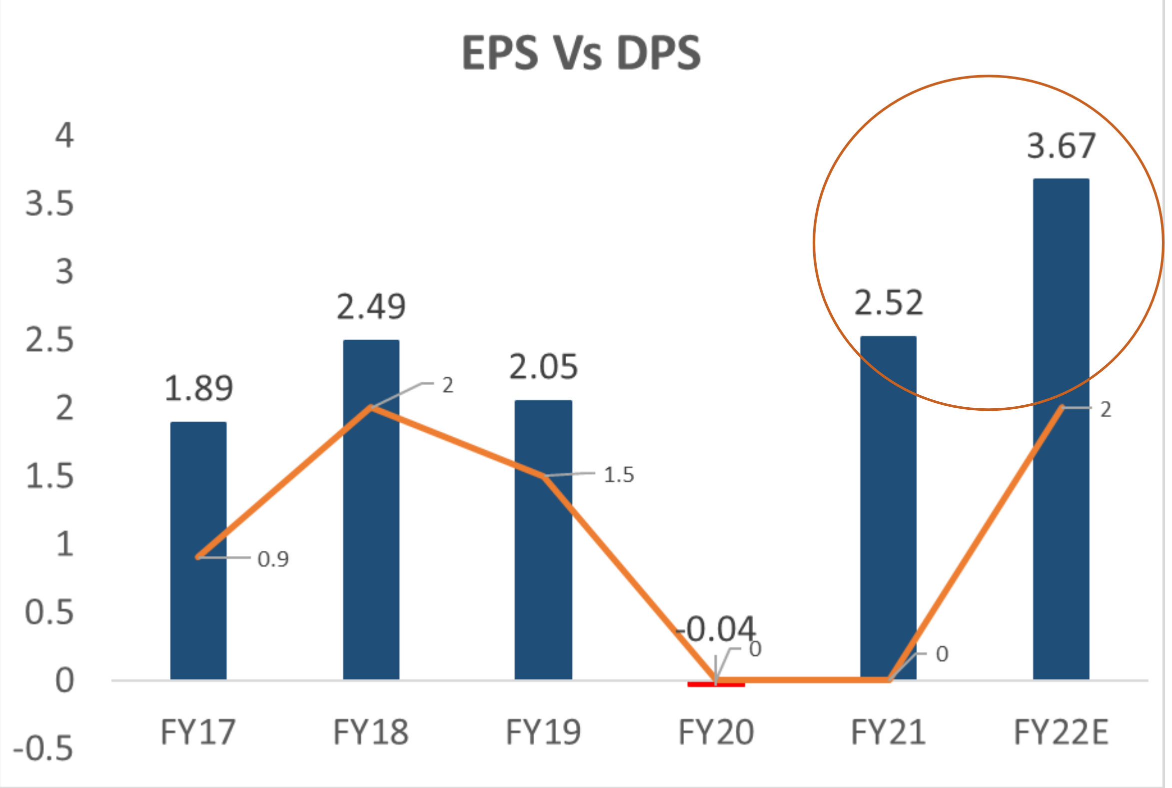
Thursday, 16 June 2022

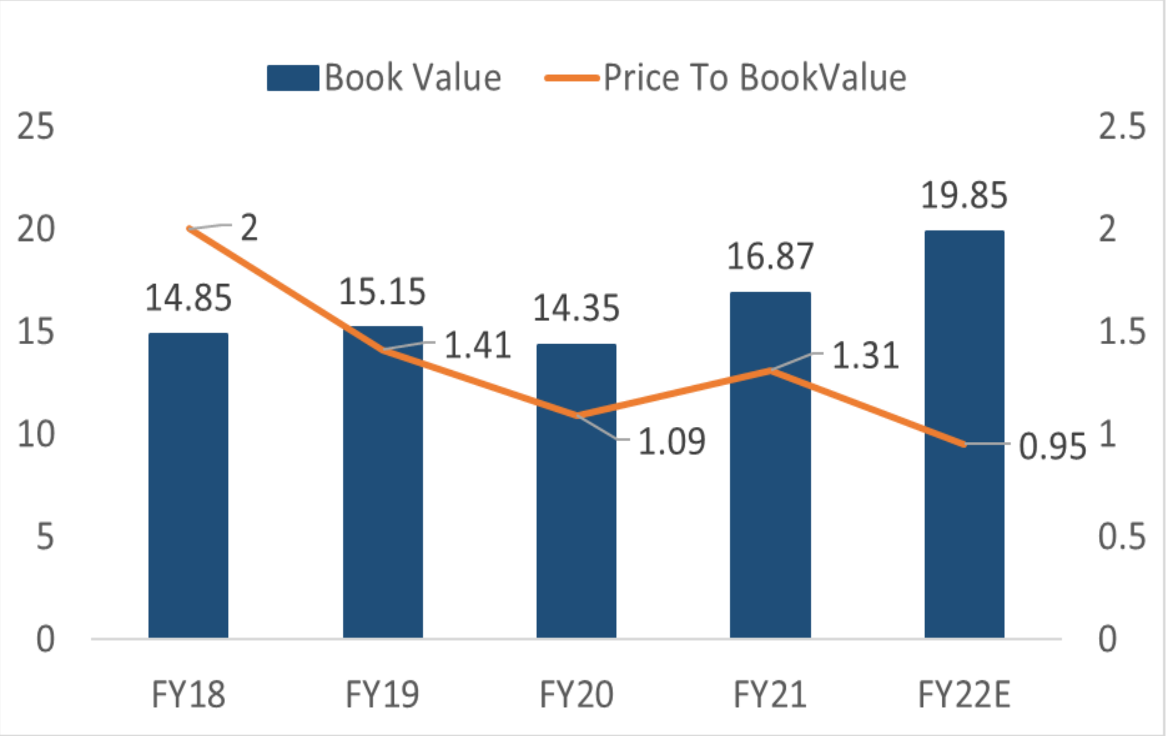
Company Performance and Expected Synergies…..

The merger will significantly increase book value per share of FCCL whereas the FCCL after the Silo incident of 2016 is now back on track with 9MFY22 reported EPS of PKR 2.94/sh whereas we expect FY22 EPS may touch PKR 3.6/sh cumulatively.

Currently FCCL's book value per share is PKR 19.85 whereas. FCCL also yields PE multiple of ~4.0x. However, post amalgamation valuations seems to be beneficial for investors in shape of:

- ✓ More capacity game which will supplement FCCL vs cement leaders viz. Bestway Cement (BWCL at Farooqia) and DG Khan Cement (DGKC) at Chakwal. It will also empower district wise 'peers' Maple Leaf Cement Factory (MLCF) in Mianwali and Kohat Cement (KOHC) in KPK province, which carried out expansions with huge capex etc.
- ✓ This will give economy of scale to FCCL and hence bottom-line will eventually come out from PKR 3 – 4 EPS trajectory to even higher.
- ✓ Given development in the area, since Fateh Jang is in close proximity with Islamabad which is seeing countless housing societies sprawling across Hazara Motorway and areas across new Islamabad airport.





Thursday, 16 June 2022

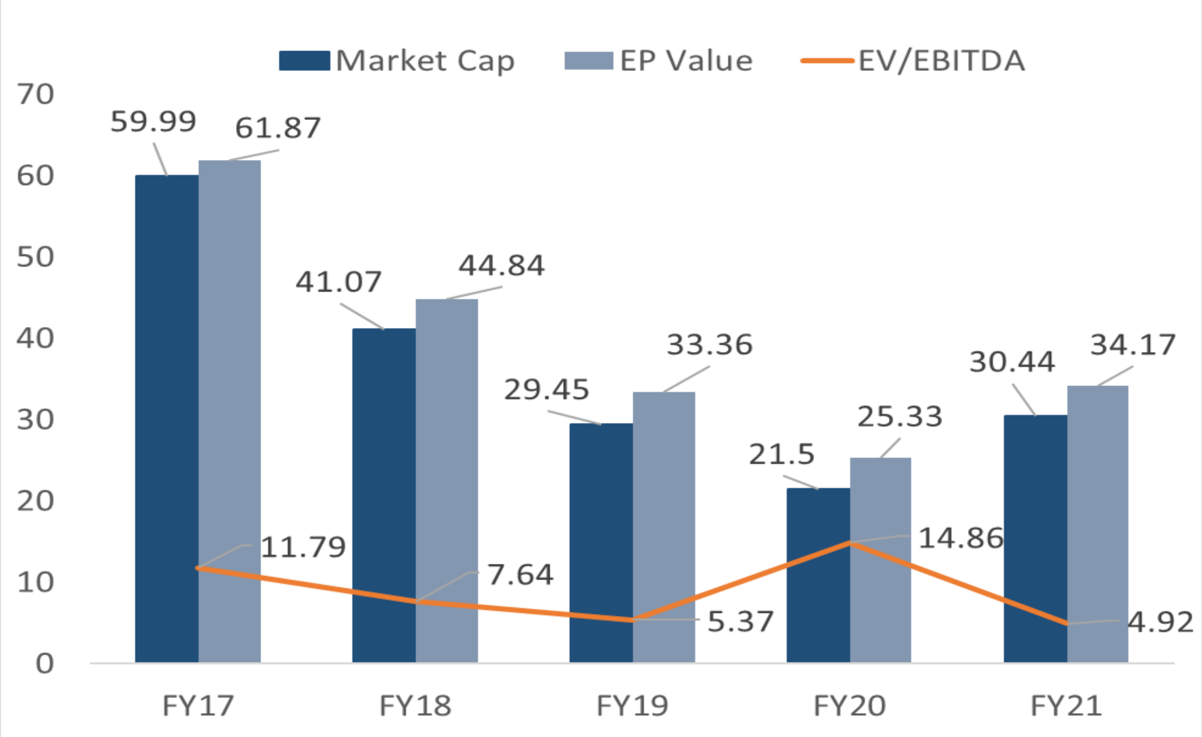
Company Valuation…..

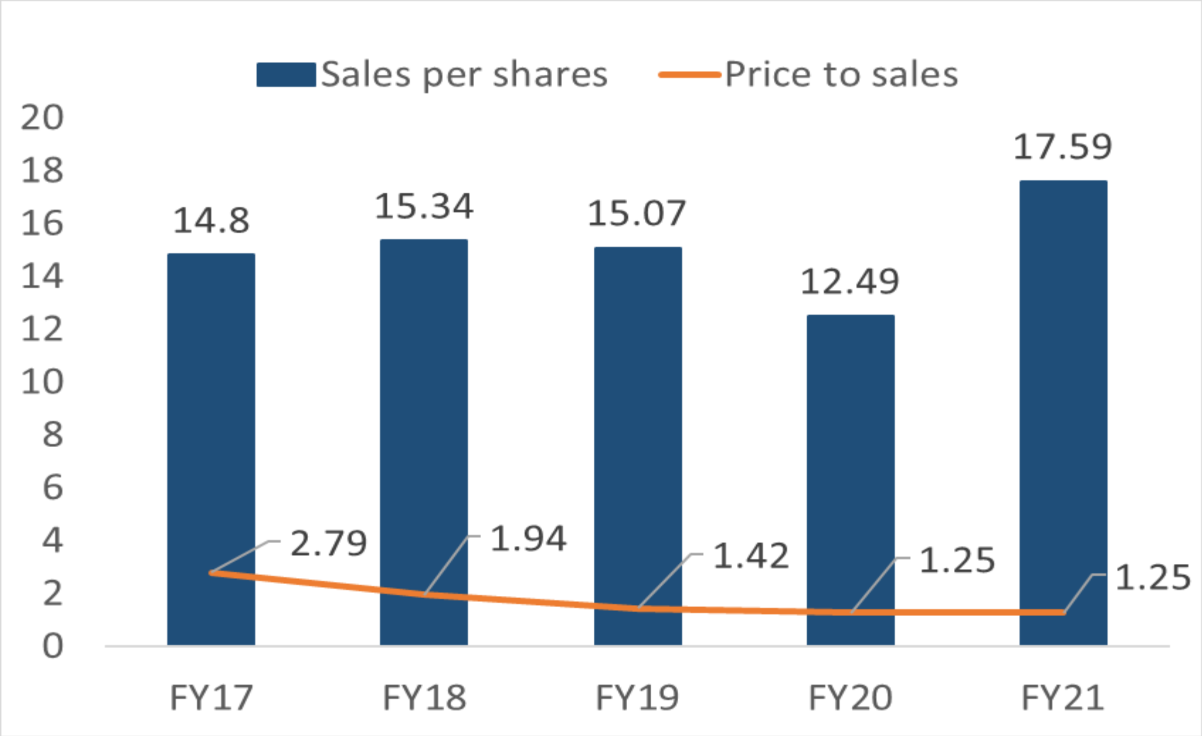
- Market cap crossed the level of 30bn in FY21 after remain low in FY19 and FY20 whereas we are expecting to further increase after amalgamation with ACL.

- Enterprise value also touched the PKR 34bn high after two years. Moreover, the value will jump with significant number since merger of well reputed companies will have synergy effect.

- The valuation tool EV/EBITDA has also reported at 4.92x in FY21 due to increased earnings. However, we are not expecting any material change into ratio due to acquisition of ACL since increase enterprise value will dilute from the increased EBITDA of both companies in denominator.

- FCCL has marked the highest sales per shares of PKR 17.59 in FY21 whereas price to sales remains unchanged from FY20. We are expecting both ratio moving positively after merger between the companies.





Thursday, 16 June 2022

Earnings Snapshot

PKR "000"	4QFY22E	3QFY22	2QFY22	1QFY22	2021	2020	2019	2018	2017	2016
Revenue	7,201,042	7,679,191	8,308,819	6,935,729	24,271,285	17,231,709	20,798,082	21,160,878	20,423,356	20,044,438
Cost of sales	(5,616,813)	(5,730,340)	(5,951,293)	(4,825,771)	(18,206,880)	(16,582,605)	(15,474,771)	(16,124,517)	(15,985,679)	(10,879,156)
Gross profit	**1,584,229**	**1,948,851**	**2,357,526**	**2,109,958**	**6,064,405**	**649,104**	**5,323,311**	**5,036,361**	**4,437,677**	**9,165,282**
Other income	57,608	43,528	34,983	8,707	81,710	36,134	148,358	104,094	136,884	268,798
S&D expenses	(72,010)	(51,102)	(58,861)	(50,557)	(189,537)	(204,344)	(210,335)	(197,707)	(166,361)	(208,777)
Admin expenses	(108,016)	(146,208)	(217,502)	(149,617)	(524,709)	(468,651)	(415,979)	(385,602)	(339,766)	(312,108)
Other expenses	(129,619)	(133,107)	(154,363)	(136,974)	(377,946)	(567)	(326,689)	(311,184)	(291,095)	(578,543)
Operating profit	**1,332,193**	**1,661,962**	**1,961,783**	**1,781,517**	**5,053,923**	**11,676**	**4,518,666**	**4,245,962**	**3,777,339**	**8,334,652**
Finance cost	(19,123)	(18,476)	(31,267)	(26,743)	(109,623)	(233,800)	(106,758)	(147,813)	(152,960)	(503,346)
Finance income	167,854	162,965	126,406	104,164	160,543	48,857	-	-	-	-
Profit / (Loss) from associate	-	-	(3,629)	-	2,849	-	-	-	-	-
Insurance claim	-	-	-	-	-	-	-	-	305,842	-
Profit/ (loss) before taxation	**1,480,924**	**1,806,451**	**2,053,293**	**1,858,938**	**5,107,692**	**(173,267)**	**4,411,908**	**4,098,149**	**3,930,221**	**7,831,306**
Income tax (expense)/ credit	(473,896)	(572,660)	(583,634)	(500,313)	(1,636,341)	113,886	(1,587,610)	(668,685)	(1,317,010)	(2,464,106)
Profit/ (loss) for the year	**1,007,028**	**1,233,791**	**1,469,659**	**1,358,625**	**3,471,351**	**(59,381)**	**2,824,298**	**3,429,464**	**2,613,211**	**5,367,200**
EPS	**0.73**	**0.89**	**1.07**	**0.98**	**2.52**	**(0.04)**	**2.05**	**2.49**	**1.89**	**3.94**
DPS	**2.00**	**-**	**-**	**-**	**-**	**-**	**1.50**	**2.00**	**0.90**	**2.75**

Disclaimer

'Research Analyst' Certification: 'Research Analyst' involves in this 'Research Report' certifies that:
- 'Research Analyst' or any of his close relatives do not have a financial interest in the securities of the 'Subject Company' aggregating more than 1% of the value of the 'Subject Company'

-Research Analyst or his close relative has neither served as a director/officer in the past 3 years nor received any compensation from the Subject Company in the previous 12 months

- His compensation will not be related to the recommendations or views given in Research Report

Distribution of 'Research Report'
Standard Capital Securities (Pvt.) Ltd. will distribute Research Report to clients in a timely manner through electronic distribution vide email or through physical distribution such as courier express. Standard Capital will make all efforts; even so it is possible that not all clients may receive Research Report at the same time given technical glitches or breakdown/slowdown of internet during the process of sending emails.

'Research Entity' Disclosures
-Standard Capital Securities (Pvt.) Ltd. or any of its officers and directors does not have a significant financial interest (above 1% of the value of the securities) of the subject company.
-Standard Capital Securities (Pvt.) Ltd. employee including directors, officers or associates has not served the subject company in preceding 36 months.
-Subject Company is not been a client for Standard Capital Securities (Pvt.) Ltd. during the publication of Research Report
-Standard Capital Securities (Pvt.) Ltd. has not managed public offering, take over or buyback of securities for the Subject Company in the past 12 months neither receives any compensation from the subject company for corporate advisory or underwriting services in the past 12 months.
-Standard Capital Securities (Pvt.) Ltd. hasn't recently underwritten/or not in the process of underwriting the securities of an issuer mentioned herein. Standard Capital Securities (Pvt.) Ltd. hasn't have provided/providing advisory services to the issuer mentioned herein.

Risk disclosures impeding target price
The Subject Company is exposed to market risks, such as changes in interest rates, exchange rates, changes in raw material prices. Subject company can also exposed to risk such as derivative transaction or certain regulatory changes from government authorities.

Rating System
- Standard Capital Securities (Pvt.) Ltd. standardized recommendation structure i.e. positive, Hold and negative, based on rating system i.e.

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

- 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