Fauji Cement (FCCL) – Buy with a TP of PkR 20/sh

Stellar 4Q result reinforces our investment case

Monday, October 2, 2023

We reiterate our BUY stance on Fauji Cement (FCCL) with a Jun24 target of PkR 20/sh (upside 79%). Our favorable view is underpinned by: 1) the projected growth in the company's capacity and market share, 2) enhanced focus on production efficiencies, 3) strong industry pricing power, and 4) historically low valuations with an EV/MT of USD 21. The company's stellar 4QFY23 results reinforced our investment case, given the sharp rise in the company's gross margins.

Focus on production efficiencies paying dividends: Fauji Cement saw an enhanced focus on its production efficiencies through the use of green technologies. After its recent installation, the company enhanced its solar production capacity to 40MW. With the potential to generate 60GWh annually, the **solar facilities could yield annual savings of PkR 2.1bn**.

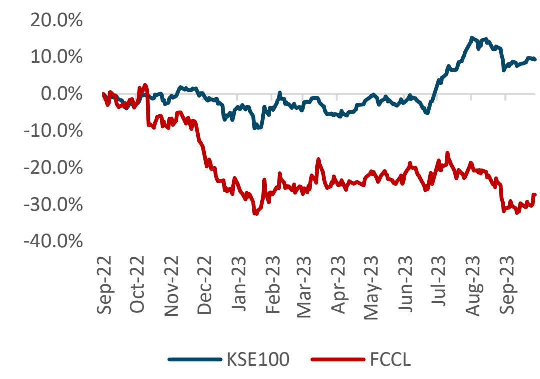
In tandem with its installed 48MW Waste Heat Recovery (WHR) plant, FCCL fulfills 50% of its electricity requirements through cheaper energy sources.

Kiln fuel mix tilted towards domestic resources: Since the surge in global coal prices, FCCL has leaned on Afghan and local coal for its kilning fuel needs. During FY23, local coal constituted 53% of the company's kilning fuel while the remainder was fulfilled by its Afghan counterpart. We estimate that the increased use of local coal has enabled the company to yield production savings of around PkR 600/MT (PkR 30/bag). Moreover, the company is also utilizing alternative fuel sources, including tyres and poultry waste, to further insulate itself from rising energy costs.

Strong pricing power enabling improvement in margins: Pakistan's cement sector has demonstrated significant resilience amidst the unpredictable economic landscape. The industry has been able to pass on most of its inflationary pressure through timely price hikes, allowing the sector to enhance its margins despite an unfavorable environment.

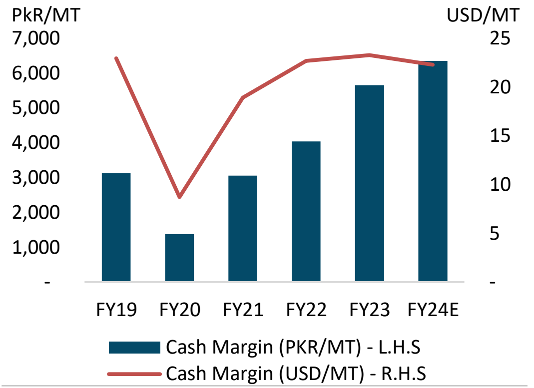
4QFY23 saw the FCCL's margins climb to 39% (vs. 26% the last quarter), driven by effective coal inventory management, timely price hikes, and cost savings realized through utilizing alternative energy sources. For FY24, we project the company's cash margins to rise by 13% YoY to PkR 6,400/MT (USD 22/MT), supported by the industry's strong pricing power.

KSE100 vs FCCL



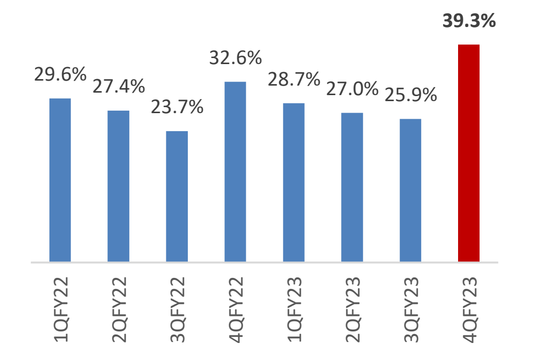
Source: Company Accounts, BMA Research

FCCL Cash Margins



Source: Company Reports, BMA Research

Domestic Cement Prices



Source: Bloomberg, BMA Research

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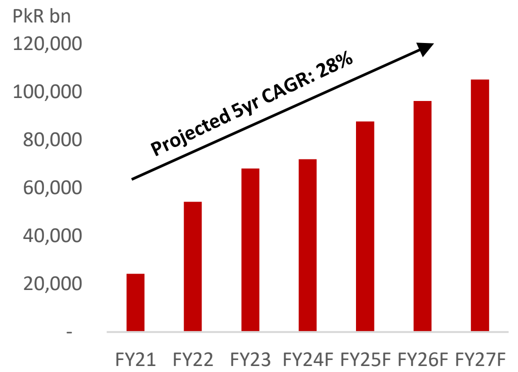
New expansions will allow market share growth: Fauji Cement's expansion at its DG Khan site (scheduled COD: 2QFY24) will enhance the company's annual production capacity to 10.5mn MT, cementing itself as the **third-largest cement producer in the country.** Moreover, we anticipate FCCL's domestic share in the northern market to rise by 7.3pps to 15.3% by FY25. Given support from its expansions, we project FCCL to register a 5-year sales CAGR of 28% to PkR 105bn by FY27.

Concessionary debt insulating the company from monetary tightening: Fauji Cement has benefitted from raising subsidized debt via TERF and LTFF for its expansions, insulating the company against higher interest rates. As per the management, nearly 50% of the debt raised was financed through the aforementioned discounted avenues, **yielding potential savings of around PkR 2.0bn.**

Trading at one of the lowest valuations: Fauji Cement is presently trading at one of the lowest valuations in the industry at an **EV per MT of USD 21**, a discount of 76% from its replacement cost. The stock trades at an FY25 PE of 2.21, a significant discount given its **5-year projected earnings CAGR of 20%.**

FCCL Sales Projections



Source: Company Accounts, BMA Research

FCCL's valuations

PKR	FY24F	FY25F	FY26F
EPS (PKR)	3.47	5.05	6.27
DPS (PkR)	0.00	0.00	1.00
PE (x)	3.21	2.21	1.78
GP Margin (%)	28%	31%	32%
EBITDA Margin (%)	31%	32%	34%
ROE (%)	11%	15%	16%
ROA (%)	6%	8%	10%

Source: Company Reports, BMA Research

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Old rating system

Valuation Methodology

To arrive at our period end target prices, BMA Capital uses different valuation methodologies including

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