CEMENT | FCCL | BUY

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REP # 048

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Fauji Cement Company Limited (FCCL) – "BUY"

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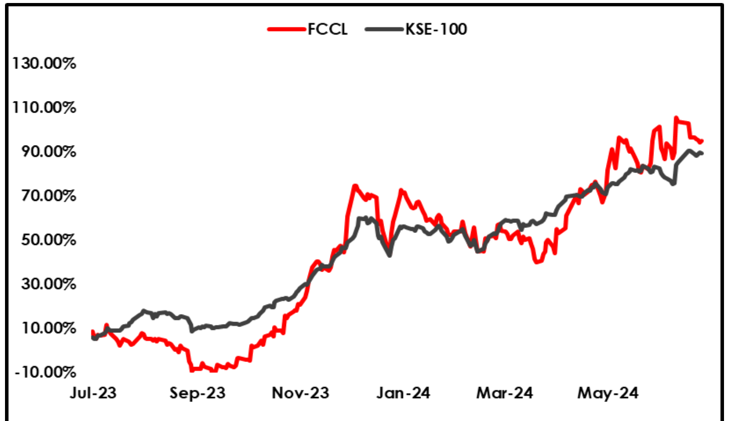
- ***We initiate our detailed coverage on Fauji Cement Company Limited (FCCL) with a FY25 target price of Rs.32/sh. offering potential upside of 42% from today close price. FCCL is our preferred pick due to: (1) extension of plant capacity to become third largest player of industry and second-largest player in north zone through merger and expansions (2) increase reliance on cheaper and self-generated power sources (3) significant increase of market share in the north zone, growing from 8% in FY21 to an impressive 15% in FY24. (4) with high debt to equity of 54% in 3QFY24, make script attractive in the expectations of interest rate cut environment.***
- FCCL has achieved attractive 3-years (FY21-FY23) revenue CAGR of 58%. Additionally, gross margin has seen a significant increase of 501bps, reaching a 30% in FY23, compared to 25% in FY21.
- We estimate EPS forecast of Rs5.06 and Rs7.12 for FY25E and FY26E respectively. We expect 3-yaers (FY24-26) earning CAGR of 31%.
- Furthermore, we also expect company to resume dividend from FY25 after investing of around Rs75bn in CAPEX. This is aimed expectation of reduction in debt. We believe payout ratio of 40% during FY25. (Historical average of 52%).

"Buy" Rated	
KATS Code	FCCL
Bloomberg Code	FCCL PA
Market Price	22.3
Target Price	31.8
Market Cap	Rs54.70bn/USD196.40mn
Free float Market Cap	Rs19.14bn/USD68.74mn
1-Yr High/ Low	Rs24.67/Rs10.42
Average Daily Volume	7,859,917
Free Float	858.50 million (35%)
Outstanding Shares	2,452.85 million

Source: PSX, ASL Research



Source: PSX, ASL Research

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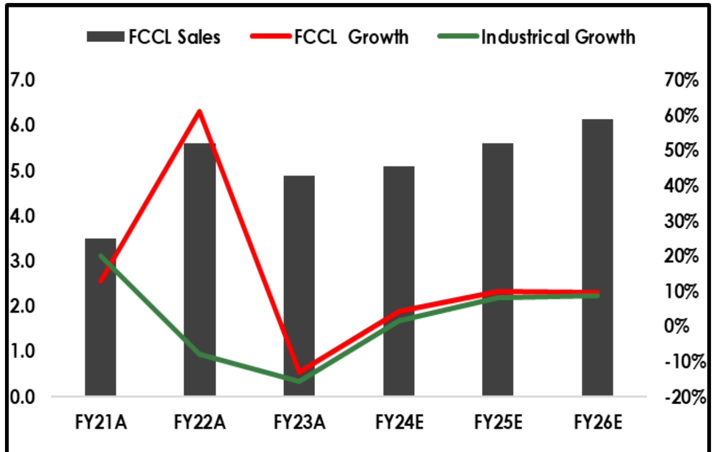
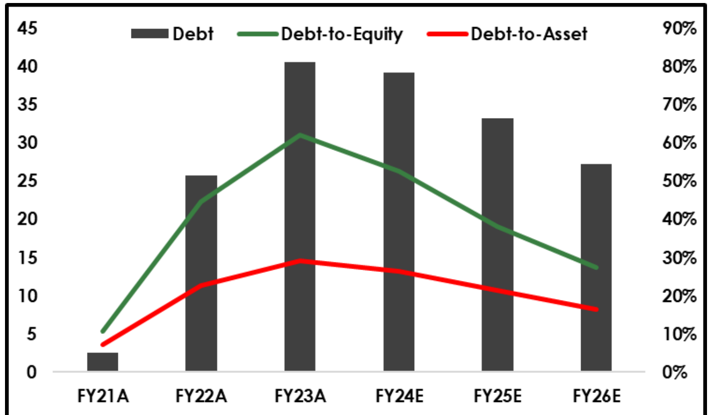
Aggressive expansion with strong market share

- FCCL has now become third largest player of the industry and second largest player in the north region with production capacity of 10.6mn tons annually. Company has achieved this millstone by acquiring local cement plant (Askari Cement) with annual capacity of 2.8mn ton and establishment of two plants DG Khan and Nizampur with production capacity of 2.1mn ton each. This has significantly increased production capacity to 10.6mn ton from 3.6mn ton in FY21.
- Aggressive Increase in production capacity resulted in strong increase of company dispatches. Company has achieved 3-yaer (FY22-FY24) CAGR of 13% against industry CAGR of -8%
- Additionally, Company market share has been increased to 11% in FY24 from 6% in FY21. It takes company north share to 15% from 8% respectively. Notably FCCL's export share has been increased to 7% from 3% in FY21.
- The company strategically expended its capacity through incurring CAPEX of more than Rs75bn, leveraging a mix of subsidized loan schemes (LTFF, TERF) which is around 36% of total debt. Company also owes Rs 7.4bn convertible interest free loan borrowed from parent company.
- As of 3QFY24, company total loan stands at Rs38bn, increasing the debt-to-asset ratio to 27%, up from 7% in FY21.



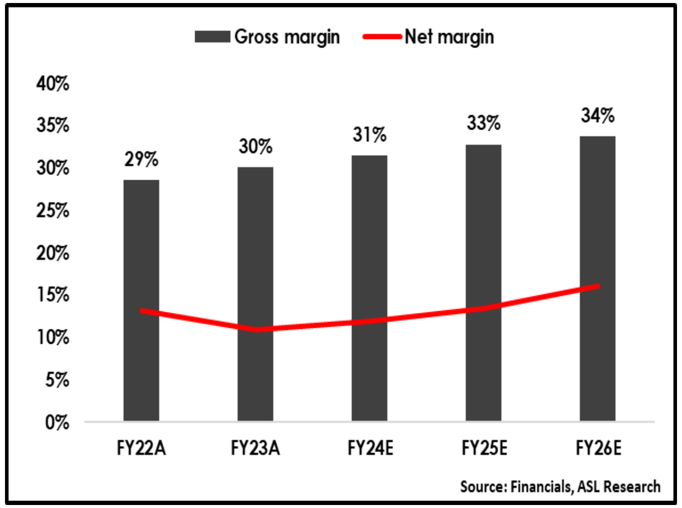
Source: APCMA ASL Research



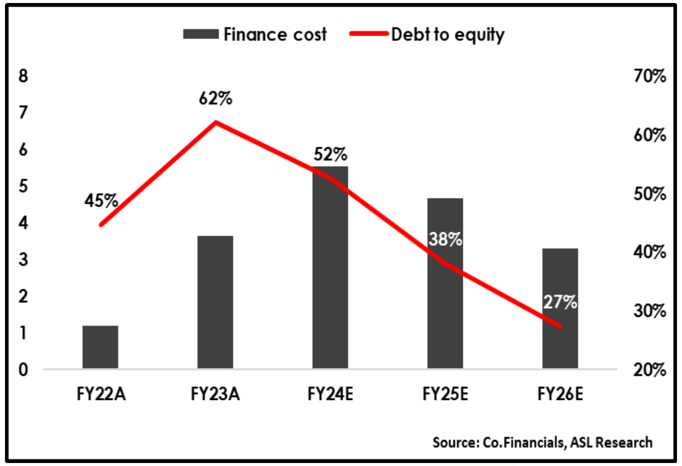
Source: Financials, ASL Research

Cost cutting efforts to improve margins

- We expect company to post gross margin of 33% in FY25 and 34% in FY26, this is amid expectation of higher cement prices, stable coal price, highly dependence own power generation source.
- In 9MFY24, company posted gross margin of 31%, compared to compared to 5-year average of 23%. Thanks to highly dependence on local coal and own power generation sources. Company meets 50% of fuel requirements through Afghan coal, followed by 43% local coal and 7% alternative fuel. Thus, we believe this will continue wherein we expect increase usage of local coal mix.
- Furthermore, to reduce the dependance on national grid (High electricity charges) company is investing in renewable energy source. Currently, FCCL is producing 40MV from solar energy and project is underway for enhancement in renewable energy capacity of the company through addition of 12.5MV solar power plant taking the total capacity to 52.5MV.
- Additionally, FCCL operates five high performance Waste Heat Recovery Power Plants (WHRPP). With the combined capacity of 52.5MV. Company meets around 55%-60% of total power requirement, which helps company to generate healthy margins.
- We expect company to post net profit of 13%-16% in FY25 and FY26 respectively. This improvement is anticipated due to an easing of monetary policy, which will reduce the company's financial cost.



Source: Financials, ASL Research



Source: Co.Financials, ASL Research

Pakistan cement sector eyes growth after three consecutive years of decline

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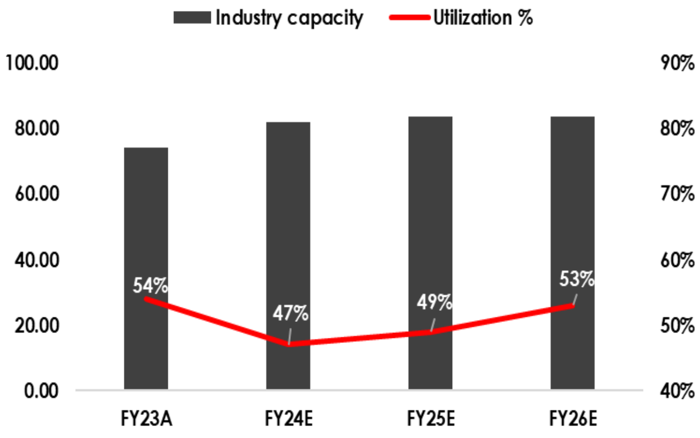
- In FY24 Pakistan economy suffered from stabilization phase. Government dedicated efforts to complete Stand-By Arrangement (SBA) which have yielded significant progress in reinstating economic stability. Economy to experience moderate growth of 2.3%-2.4% even in the cost push inflationary scenario, leading the SBP towards monetary tightening of EIR of 20.5%.
- Pakistan and International Monetary Fund (IMF) have reached Extended Fund Facility (EFF) with Pakistan for $7bn, New IMF program will strengthen fiscal, monetary policy measures and will help removing economic distortions to spur private sector-led growth
- In FY24, local cement dispatches declined by 5% to 38.18mn tons, compared to 40.01mn tons in FY23. Decline was witnessed due to (1) tight monetary policy (2) lower PSDP utilization (3) high construction cost.
- In FY24 cement exports increased by 56% YoY to 7.11mn tons. Increase in exports were noticed is due to industry's efforts to explore new markets. Notably, Pakistan made its first-ever cement shipment to the United Kingdom and is currently exploring opportunities in Mexico, France, and Germany.
- We expect cement sales to show growth of 8% and 9% with local utilization will improve from 47% to 49% and 53% in FY25 and FY26, respectively. This is, amid expectation of economic stability, robust export growth and construction of flood damaged houses in Sindh on back of $400mn loan support from ADB.

	FY23A	FY24A	FY25E	FY26E
Industry sales	44.6	45.3	49.0	53.2
YoY	-16%	2%	8%	9%
FCCL sales	4.9	5.1	5.6	6.1
YoY	-13%	4%	10%	9%
Industry exports	4.6	7.1	8.1	8.7
YoY	-13%	56%	14%	7%
FCCL exports "000"	421	519	608	637
YoY	37%	23%	17%	5%

Source: APCMA ASL Research



Source: APCMA ASL Research

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"Valuation Approach: Target Price of PKR32/share with a 42% Upside"

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- We have incorporated FCFF valuation approach to come up with a June 2025 TP of Rs32/sh. Our valuation is based on discounted cashflow (DCF) methodology. We have used a risk-free-rate of 16.6% and market risk premium of 5.6% with a beta of 1.37, our estimated cost of equity is 24.3%.
- Capital structure of FCCL is showing 34% weight in debt while remaining 66% comes from equity. Thus, arriving at WACC of 22.8% which has taken into effect and reflects as a discount factor in FCFF.
- We believe cashflows to improve in FY25 due to expectations of stable increase in exports, with rupee to devaluate on market determined basis, revival of international economy and stabilizing freight charges. We expect coal prices will remain stable during FY25 and FY26 which indicate improvement in gross margins.
- We expect that company long term barrowing will gradually improve after financing huge CAPEX of more than Rs75bn in upcoming years on back of sustainable growth.
- According to the assumptions, company's total enterprise value is Rs117bn comprised of Rs39bn value to debt holders and Rs77bn portion of equity holders, thus, recommending BUY on FCCL with TP of Rs32 for FY25, an upside of 42% against the current price.

Valuation Snapshot	FY23A	FY24E	FY25E	FY26E
Profit after tax	7,440	9,577	12,405	17,461
Depreciation & Amortization	3,634	4,281	4,044	4,173
Interest (1-tax rate)	2,102	3,707	3,118	2,218
Capax	-33,694	-6,387	-5,320	-4,140
FCFF	-17,552	11,237	11,237	25,370

Source: ASL Research

FCCL - Valuation criteria	
Risk free rate	16.6%
Market Risk Premium	5.6%
Beta	1.4
Cost of Equity	24.3%
Equity	74,753
Debt	39,215
WACC	23%

Source: ASL Research

Product Features & Capacities

About Fauji Cement Company Limited

- Incorporated in 1992, Fauji Cement Company Limited has been the benchmark setter in the cement industry for the last thirty-two years in Pakistan; The total cement production capacity of the Company has been increased to 10.6 Million Tons per annum and establishes Fauji Cement Company's position as the 3rd largest cement producer in the country.
- After completing the acquisition of Askari Cement Limited (ACL) in 2022, FCCL is strategically placed near hydroelectric power projects and has qualified for mega construction projects in the country. Currently there are 4 manufacturing locations at Jhang Bahtar, Nizampur, Wah and D.G Khan.
- Recently, the company has successfully commissioned its Green Field Cement manufacturing plant on 30th November 2023, having production capacity of 6,500 tons per day of clinker, at Shadan Lund Dera Ghazi Khan. The Green field project has been completed within a record time of 13 Months. This project include state of art manufacturing equipment and also includes emission control features and a Waste Heat Recovery Power Plant.
- **Product Features & Capacities**

• FCCL have range of products which includes Ordinary Portland Cement, Sulphate Resistant Cement, Low Alkali Cement(42.5N & 52.5N), Low Heat of Hydration Cement, Pamir Cement (Green Cement), & Fauji Tile Bond.

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To arrive at our period end Target Price, Adam Securities Limited uses different valuation methods which include:
1) Discounted Cash flow method 2) SOTP method 3) Justified Price to Book Value method and 4) FCFE or FCFF method.

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Stance Criterion	
Buy	≥15.0%
Sell	≤10.0%
Hold	Between - 10.0% to 15.0%

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