March 15, 2019

PAKISTAN
CEMENT

REP-019
MARKET
VISTA

FCCL: Bound to lose market share

- **FCCL looks set to lose the market share (7.5% in FY20 vs. 9.1% in 1HFY19) as company has not opted for an expansion so far while 7.3mn tons of expansion is expected in the region by peers.**
- **The after effects of Katas Raj case have started appearing on company's income as FCCL booked a water conservation charge of PkR79.8mn, on the other hand other income is expected to subdue moving forward.**
- **Company is the first one among the local players to incorporate renewable energy sources in the mix for captive power generation, possibly laying a pathway to follow for the local industry after environmental concerns regarding cement operation were heightened due to Katas Raj case.**
- **We have a Sell stance on the stock with our TP of PkR20.1/sh implying a downside of 1.9%. The stock currently trades at FY19 P/E of 10.0x vs. market P/E of 8.2x with the company offering a 3yr earnings of CAGR of –7.0%.**

Water conservation charges have appeared: We incorporate detailed accounts of FCCL for 1HFY19 after company posted PAT of PkR1.8bn, up 44%YoY, mainly on the back of low base. To recall, partial closure of Line-II during 1HFY18 led to FCCL opting for external procurement of clinker, hurting margins and profitability in the process. For 2QFY19, PAT stood at PkR1.0bn, up 24%YoY as margins improved to 32% mainly on the back of improved local prices. The major surprise was other income which increased by 2.3/9.9x QoQ/YoY consisting of markup on bank deposits. We do not expect the same to continue for next two quarters as cash will be required to pay off debt and the recently announced dividend (PkR0.75/sh interim dividend announced for 1HFY19). Interestingly, the after effects of Katas Raj case have started showing on the company's income statement as FCCL booked PkR79.8mn in water conservation charges for 2QFY19.

FCCL to lose market share...: Despite bulk of local players going for expansion, FCCL has not announced an expansion so far which will lead to market share of the company declining to 7.5% in FY20 vs. 9.2% in FY18. Though the market share of the company remained resilient in 1HFY19 (at 9.1%) even after BWCL commencing its capacity of 1.8mn tons in 1QFY19, commissioning of CHCC's new plant has affected the company where CYTD numbers do not post a good picture of market share (market share stands at average 8.2% for 2MCY19). Moving forward, with the expansion of MLCF (2.3mn tons) expected to come online in 4QFY19, market share of the company looks set to slide further down by the end of FY19 and then reach 7.5% in FY20 as more expansions come online in the region. The misery will increase further as decreasing market share, coupled with pressure on prices with weak demand in the backdrop will prove to be a double whammy for the company. We expect EBITDA margins to decline to 21% in FY20 from 32% in 1HFY19 and consequently, the company is expected to post the largest earnings decline in our universe with the 3yr CAGR for FY19-22 standing at –7.0%.

...where efficiency gains are not expected to provide much support: With a D/E of 3% against 38% of our universe and no debt financing expected for the upcoming capex requirements, FCCL stands shielded against the increasing interest rates, providing it an edge versus the highly leveraged peers. Moreover, company has also been working on the efficiency projects where upcoming 12.5MW solar power plant will be building up on the previous projects. To recall, company installed a 9MW waste heat recovery plant on its line-1 in 4QFY18 taking its total WHR capacity to 21MW. FCCL will be the first local player to move towards renewable energy for captive power generation, possibly shedding light on the future pathway for the local industry where Katas Raj case has already led to a rise in concerns over environmental costs of the cement operations. However, efficiency gains will fail to counter the effect of decreasing prices and market share, making expansion a necessity to protect market share (company was the last one to expand during industry's last expansion cycle). In that case, debt financing will have to be opted for as current cash balance of PkR1.4bn remains insufficient.

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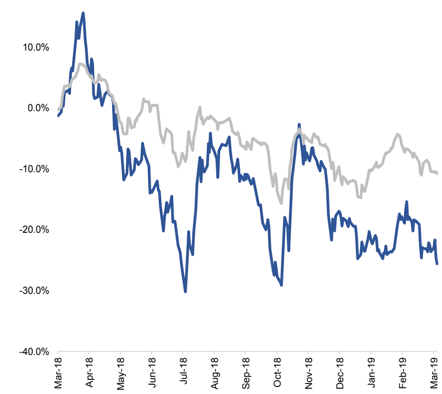
SELL

TARGET PRICE (PkR)	SHARE PRICE (PkR)
20.1	**20.5**
UPSIDE/(DOWNSIDE)	DIV. YIELD
(1.9%)	**8.8%**

FCCL share performance



Source: PSX & AKD Research

Valuation Stats

	FY18A	FY19F	FY20F
EPS	2.49	2.05	1.69
EPS Growth	31%	-17%	-18%
D/Y	10%	9%	7%
P/E (x)	8.3	10.0	12.2
EBITDA Margin	27%	27%	21%
ROE	17%	13%	11%
P/B	1.4	1.3	1.3

Source: Company Reports & AKD Research

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New Rating Definitions	
Buy	**> 19% expected total return (Rf: 13% + Rp: 6%)**
Neutral	**> 13% to < 19% expected total return**
Sell	**< 13% expected total return (Rf: 13%)**

Old Rating Definitions (Discontinued)	
Buy	**> 20% upside potential**
Accumulate	**> 5% to < 20% upside potential**
Neutral	**< 5% to > -5% potential**
Reduce	**< -5% to > -20% downside potential**
Sell	**< -20% downside potential**
Not Rated	**No investment opinion or recommendation**

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

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