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MARKET VISTA

PAKISTAN CEMENTS

FCCL: Sticking to basics

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- **We revise our estimates for FCCL incorporating detailed accounts for 1QFY21 along with recent cost saving measures including expansion of solar power plant's capacity by 2.5MW (incremental earnings of 3.4/3.4% for FY22/23), shared services agreement with Askari Cement and up-gradation of clinker cooler decreasing heat requirement for production for clinker.**
- **After opting against an expansion during last expansion cycle, FCCL is in process of obtaining a lease in DG Khan for establishing a new cement plant where capacity could be in the range of 1.9-2.1mn tons.**
- **As per our estimates, expansion can entail a CAPEX of PkR26-33bn which can be comfortably finance under a 60/40 debt/equity scenario given minimal leverage on the balance sheet currently (D/E: 6.4% as Sep'20) while average CFO for FY21-23 at PkR4.4bn is sufficient to finance equity portion.**
- **Recent decline in stock price on the back of market sources suggesting low dispatches during the ongoing month coupled with increase in coal prices has opened up upside. Our TP of PkR22.7/sh provides an upside of 9.7% while dividend yield at current prices stands at 6.8% - Buy. However, we highlight ongoing increase in COVID-19 cases can keep index and hence FCCL under pressure in near term.**

BUY

TARGET PRICE (PkR)	SHARE PRICE (PkR)
22.7	20.7
UPSIDE/DOWNSIDE	**DIV. YIELD**
9.7%	6.8%

FCCL: Valuation snapshot

	FY19	FY20	FY21F	FY22F
EPS (PkR)	2.0	0.0	1.8	2.1
EPS Growth (%)	-18%	NM	NM	17%
D/Y (%)	7%	0%	7%	8%
P/E (x)	10.1	NM	11.8	10.1
ROE (%)	14%	0%	12%	14%
P/B (x)	1.4	1.4	1.4	1.4
Payout Ratio (%)	73%	0%	80%	80%
BVPS (x)	15.1	14.4	14.7	15.1
Gross Margin (%)	26%	4%	19%	19%
Net Margin	14%	0%	11%	11%

Source: Company Reports & AKD Research

Working capital normalization and loan deferral to improve liquidity: We revise our estimates for FCCL incorporating detailed accounts for 1QFY21 along with recent cost saving measures including expansion of solar power plant's capacity by 2.5MW to 17.5MW, shared services agreement with Askari Cement and up-gradation of clinker cooler decreasing heat requirement for production for clinker. After pioneering the use of solar-based captive power generation among local cement producers, FCCL is in process of increasing its solar power project's capacity. Slated for commissioning in 3QFY21, the EPS impact of the project stands at PkR0.07/0.07/sh for FY22/23 (3.4/3.4% of the EPS). Compared to other power sources, the impact remains low given low load factor of solar power plants. Additional cost savings are expected from installation of clinker cooler, decreasing the heat requirement for production of clinker by ~2.5%. Moreover, recently signed shared services agreement with Askari Cement is expected to result in cost savings to the tune of PkR80-100mn as company looks to cut down on marketing and promotion expenses under the agreement.

Increase in WHR capacity to further uplift earnings: During the last expansion cycle, cement manufacturers in Northern region expanded capacity by ~14mn ton to ~50mn tons, however FCCL opted against expanding and resultantly company's market share has declined to 8.4% for 1QFY21 against pre-expansion cycle level of 9.1/9.6% in FY16/17. Moving forward, company is in process of attaining lease in DG Khan to establish a cement plant where potential expansion can be in the range of 6500-7000 tpd (1.9-20mn tons). To note, all the expansions carried out in the region during last expansion cycle were brownfield, hence if the company moves forward with the project, it will be the first Greenfield project of the latest expansion cycle. Taking cue from recent expansion, assuming cost of Greenfield expansion between USD80-100/ton, CAPEX can be expected to clock in at the range of PkR26-33bn. With minimal leverage on balance sheet, company can be expected to comfortably finance the expansion where assuming a 60/40 debt/equity ratio, debt financing will stand around PkR16-20bn of which PkR5bn can be obtained under SBP's TERF while average CFO generation of PkR4.5bn over FY21-23 stands sufficient to finance equity portion. If the aforesaid project materializes, assuming it comes online in FY24, it is expected to uplift EPS of FY24/25 by PkR0.97/0.88 (36/28% of the EPS) while elevating company's market share to 10.9% in North.

Investment Perspective: Recent decline in stock price on the back of news coming out of low dispatches during the ongoing month coupled with increase in coal prices has opened up upside. Moving forward, overall improvement in sector dynamics with increase in dispatches post seasonal slowdown in winter and resultant strong local prices is expected to translate into positive price movement. Our TP of PkR22.7/sh provides an upside of 9.7% while dividend yield at current prices stands at 6.8% - Buy. However, we highlight that ongoing increase in COVID-19 cases can keep index and hence FCCL under pressure in near term.

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

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Neutral	**＞ 8.5% to ＜ 14.5% expected total return**
Sell	**＜ 8.5% expected total return（Rf: 8.5%）**

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