FAUJI CEMENT COMPANY LTD. (FCCL)

November 17, 2016

BUY

Price Target : PKR 46.3/share

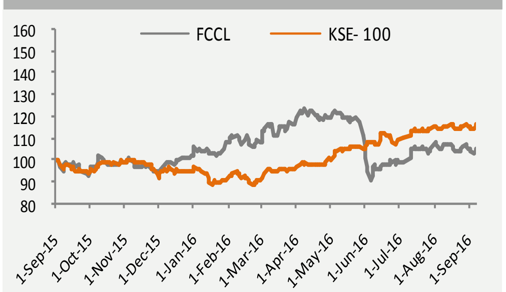
COMPANY DATA	
52-week Price Range (PKR)	44.7—32.8
No. of Shares Outstanding (mn)	1379.8
Market Cap (PKR mn)	53,536.8
Market Cap (USD mn)	511.1
Free Float (%)	55%
Year End	Jun
KATS Code	FCCL

Source: PSX

Key Ratios	FY16A	FY17E	FY18E	FY19E
GP Margins %	46%	28%	42%	40%
NP Margins %	27%	16%	26%	25%
EBITDA Margins	48%	30%	44%	42%
DPS	2.75	1.50	3.00	3.00
D/Y%	7.5%	4.1%	8.2%	8.2%

Source: Company Accounts, Nael Research

RELATIVE TO KSE—100



Source: PSX

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- **We revise our estimates on FCCL with 'Buy' rating:** on account of 1) Incorporation of cost uptick owing to clinker purchase, 2) Stable Volumetric Growth and 3) Resumption of line II, with '**Buy'** rating and a PT of PKR 46.3/sh, implying 19% upside potential from its closing price of PKR 38.8/sh.
- **Hefty volumes of clicker purchases denting margins..** The incident of destruction of raw meal silo and coal mill of FCCL's Line II lead to severe consequences. Recently, during the previous quarter of 1QFY17A the company incurred a noteworthy cost of ~PKR 2.8bn for purchasing clinker which lead to a drop in margins to ~23% in comparison to 43% of 1QFY16A.
- **Partial payment of PKR 300mn by insures…** The claim has already been lodged by the company which sums up to PKR 1.4bn out of which insurers have released a partial compensation of PKR 300mn and agreed to disburse the remaining dues ..
- **Noteworthy earnings potential post resumption of Line II..** Earnings of FCCL are anticipated to surge massively post resumption of line II (2.1mn tpa) from mere PKR 2.39/sh in FY17E to PKR 4.38/sh in FY19E an upside of 83%. This upsurge is primarily projected due to key demand triggers .
- **Investment Risk:** Key risks to our investment thesis are 1) Delay in resumption of line II, 2) Decline in PSDP, 3) Volatility in international oil/coal prices and 4) Increase in discount rate.

Hefty volumes of clicker purchases denting margins .. The incident of destruction of raw meal silo and coal mill of FCCL's Line II lead to severe consequences. With a choice of retaining the market share and not compromising their brand image the company sacrificed on its margins by purchasing heavy clinker volumes in order to continue catering their customers with the same market share retention approach. Recently, during the previous quarter of 1QFY17A the company incurred a noteworthy cost of ~PKR 2.8bn for purchasing clinker which lead to a drop in margins to ~23% in comparison to 43% of 1QFY16A. The management is of the view that until line II start operations the company will keep purchasing clinker.

Partial payment of PKR 300mn by insures… The claim has already been lodged by the company which sums up to PKR 1.4bn out of which insurers have acknowledged PKR 1.15bn and already released a partial compensation of PKR 300mn for initial work. The insurers have also assured to disburse the remaining from the amount due against filing which is expected to be paid in partial payments as well.

Noteworthy earnings potential post resumption of Line II.. Earnings of FCCL are anticipated to surge massively post resumption of line II (2.1mn tpa) from mere PKR 2.39/sh in FY17E to PKR 4.38/sh in FY19E an upside of 83%. This upsurge is primarily projected due to key demand triggers i.e. 1) Higher PSDP allocation, 2) Positive outlook in CPEC's continuation, 3) Better economic playfield and 4) Company's market share retention approach. The management of the company is of the view that line II is likely to commence operations from 4QFY17E, therefore we have incorporated its impact in our model from the said quarter. Due to material clinker purchasing cost we expect the gross margins of FCCL to remain suppressed in comparison to the previous years.

Investment Case

We revise our investment case on Fauji Cement (FCCL) with '**Buy'** rating and a PT of PKR 46.3/sh, implying 19% upside potential from closing price of PKR 38.8/sh. We have used discounted cash flow (Free Cash Flow to Firm) methodology to derive the intrinsic value of FCCL at PKR 46.3/sh. The stock offers a dividend yield of 4.1%. Following assumptions have been used to arrive at our price target:

- Terminal growth rate of 4%
- Risk free rate of 7.8% (PIB 10yr)
- Adjusted Beta of 1.20 (using 5yr)
- Market Risk Premium of 6%

FINANCIAL HIGHLIGHTS

PKR 'mn'	FY16A	FY17E	FY18E	FY19E	FY20E	FY21E
Net Sales	20,044	20,982	22,718	23,726	24,515	26,253
Cost of sales	10,879	15,169	13,162	14,244	15,337	16,650
Gross Profit	9,165	5,813	9,556	9,482	9,178	9,602
Admin. Exp.	312	330	362	379	392	391
Dist. Exp.	209	155	184	193	200	200
Other Op. Exp.	579	615	663	651	716	766
Other Op. Inc.	269	270	358	462	485	510
PBT	7,831	4,715	8,545	8,637	8,294	8,730
Taxation	2,464	1,414	2,563	2,591	2,488	2,619
PAT	5,367	3,300	5,981	6,046	5,806	6,111
EPS	3.98	2.39	4.33	4.38	4.21	4.43

Source: Company Accounts, Nael Research

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Stock Recommendation	Return
BUY	> 15%
HOLD	> -15% to < 15%
SELL	< -15%