Day Break

Friday, 14 September 2018

COMPANY UPDATE

Fauji Cement Company Limited
Cement

Recommendation		**BUY**
Target Price:		28.3
Last Closing:	13-Sep-18	24.6
Upside:		15.1
Valuation Methodology:		Discounted Cash Flow (DCF)
Time Horizon:		Dec-18

Market Data

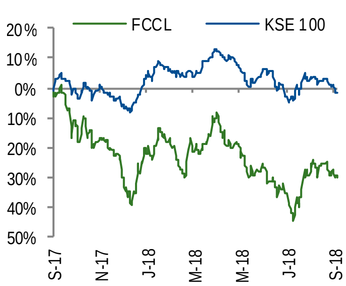
Bloomberg Tkr.		FCCL PA
Shares (mn)		1,379.8
Free Float Shares (mn)		758.9
Free Float Shares (%)		55.0%
Market Cap (PKRbn | USDmn)	33.9	275.4
Exchange		KSE 100

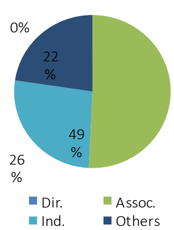
Price Info.	90D	06M	12M
Abs. Return	(4.7)	(10.9)	(30.3)
Lo	19.2	19.2	19.2
Hi	26.4	31.9	35.2

Key Company Financials
Period End: Jun

PKRbn	**FY18A**	**FY19E**	**FY20F**	**FY21F**
Total Revenue	21.2	23.3	21.4	20.7
Net Income	3.4	4.4	4.2	4.2
EPS (PKR)	2.5	3.2	3.1	3.0
DPS (PKR)	2.0	2.5	2.5	2.5
Total Assets	27.8	29.0	27.3	27.7
Total Equity	20.5	21.5	22.3	23.0
Key Financial Ratios				
ROE (%)	16.7	20.6	19.1	18.2
P/E (x)	9.9	7.7	8.0	8.1
P/B (x)	0.7	1.7	1.6	1.5
DY (%)	8.1	10.2	10.2	10.2

Relative Price Performance





About the Company

Fauji Cement Company Limited is a public limited company incorporated in Pakistan on November 23, 1992 and commenced its business w.e.f. May 22, 1993. The principal activity of the company is manufacturing and sale of ordinary portland cement.

Source: Bloomberg, PSX & IGI Research

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Cements

FCCL: Rehabilitation of production line II and hefty tax reversals boost earning by +31%YoY to PKR 2.49/share

- Fauji Cement Company Limited (FCCL) registered a remarkable increase of+31%YoY in earning to PKR 3.43bn (EPS: PKR 2.49) in FY18.
- The rehabilitation of production line II has had a profound impact on FY18 profitability, reducing cost of sales by a significant 14%YoY in a period which was severely marred by continued uplift in global Coal and FO prices.
- Reduction in deferred tax liability (income), largely due to gradual reduction in corporate tax rates as prescribed by Finance Act 2018-19, has led to earnings accretion worth PKR 681mn (PKR 0.49/share)
- We maintain a 'BUY' call on the scrip with a Dec-18 based target price of PKR 28.3/share, offering a +15% upside from its last close. The Company is currently trading at FY19 P/E of 7.65x and offers a healthy dividend yield of 10.2%, the highest amongst our coverage companies.

FY18 earnings review: Rehabilitation of Production Line II and substantial tax credits boost earnings amid rising input cost situation

Fauji Cement Company Limited (FCCL) registered a remarkable increase of+31%YoY in earnings to PKR 3.43bn (EPS: PKR 2.49) in FY18 as against PKR 2.61bn (EPS: PKR 1.89) reported in the similar period last year. The performance was primarily driven by recommencement of operations of production line II, bringing significant operational efficiencies along with useful investment tax credits; and material positive deferred tax implications arising from amendments made in Finance Act 2018-19.

The Company also announced cash dividend of PKR 1.00/share along with the result, taking FY18 cumulative dividends to PKR 2.00/share.

Exhibit:
FCCL Result Highlights

Period end (JUN) - PKRmn	FY18	FY17	YoY	4QFY18	4QFY17	YoY
Net Sales	21,161	20,423	4%	5,347	4,664	15%
Gross Profit	5,115	4,438	15%	1,386	976	42%
Sell. / Dist. & Admin	662	506	31%	196	142	38%
Non-Operating Income	104	443	-76%	32	345	-91%
EBIT	4,246	4,083	4%	1,139	1,096	4%
Financial Charges	148	153	-3%	27	(7)	n/m
Pre-tax Profits	4,098	3,930	4%	1,112	1,103	1%
Taxation	669	1,317	-49%	(196)	461	n/m
Post-tax Profits	3,429	2,613	31%	1,307	641	104%
EPS	2.49	1.89		0.95	0.46	104%
DPS	2.00	0.90		1.00	0.90	
Key Ratios						
Gross Margin (%)	24.2	21.7		25.9	20.9	
Net Margin (%)	16.2	12.8		24.5	13.7	
Effective Tax Rate (%)	16.3	33.5		(17.6)	41.9	

Source: Company Accounts, IGI Research *No. of Share: 1380mn*

Margins improve amid rising commodity prices, courtesy recommencement of Production Line II

To recall, FCCL's production line II was damaged due to an accident that took place back in FY16 (May-16 to be exact), resulting in management procuring expensive clinker from regional players in order to sustain market share at the cost of modest margins. During the year, however FCCL's management successfully rehabilitated the damaged production line and accordingly notified the exchange on Oct-17 about the recommencement of its operations.

The rehabilitation of production line II has had a profound impact on FY18 profitability, reducing cost of sales by a significant 14%YoY in a period which was severely marred by continued uplift in global Coal and FO prices (up by +20%YoY and +29%YoY respectively) which represent roughly >50% of the total cost of producing cement and fall in cement sales prices.

Exhibit:

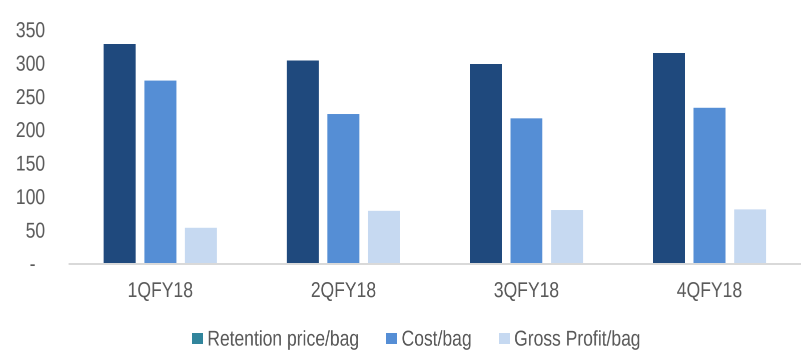
Key financial performance indicators of FCCL for the last 5 years

	FY14	FY15	FY16	FY17	FY18
Total dispatches (mn tons)	2.48	2.58	2.81	2.93	3.41
Growth in dispatches	-1%	4%	9%	4%	16%
Net Sales - PKR/Bag	354	362	357	349	311
Cost of Sales - PKR/Bag	231	225	194	273	236
Gross Profit - PKR/Bag	123	136	163	76	75
Gross Margin (%)	35%	38%	46%	22%	24%
Inc/(Dec) in Avg. Cement Prices	14%	2%	-1%	6%	-1%
Inc/(Dec) in Coal Prices	-10%	-17%	-18%	47%	20%
Inc/(Dec) in FO Prices	1%	-33%	-44%	19%	29%
Inc/(Dec) in Cost of Sales	N/A	-2%	-14%	41%	-14%

Source: IGI Research, Company Accounts

Exhibit:

FCCL's cost structure improved following rehabilitation of Production Line II in 2QFY18



Source: IGI Research, Company Accounts

Enormous Tax benefit paves way for remarkable bottom line

Besides achieving operational efficiencies from commencement of production line II, the bottom line of FCCL's FY18 P&L was largely influenced by a positive tax reversal position sourced from:

- Tax credit on investment made in plant and machinery (largely on account of reestablishment of production line II) estimated at ~PKR 200mn as per Section 65B of the Income Tax Ordinance.

- Reduction in deferred tax liability (income) worth PKR 681mn, largely due to lowering corporate tax rates in the upcoming years as stated by the recently enacted Finance Act 2018-19.

To recall the previous government in its final Budget presentation had promulgated a gradual reduction of corporate tax rate (presently 30%) by 1% from FY19 onwards to 25% till FY23. With future tax rates lowered, corporates such as FCCL that carry significant deferred tax liabilities on their balance sheets (FY18: PKR 3.60bn | FY17: PKR 4.28bn) will end up paying lower taxes as against previously determined amount.

Accordingly, FCCL ended up recording a tax reversal of PKR 196mn as against charge of PKR 461mn in the similar period of the preceding year, taking its effective tax rate to -17.6% as compared to 42% in the comparative period.

Details provided by Management

The Board of Directors in their report have highlighted the following key points

Commitment to undergo expansion: The Board has expressed the importance of keeping up pace with the major player's expansion initiatives and as such has reaffirmed its plan to establish an additional plant, necessary preparations of which are underway.

Concentrated efforts over operational efficiencies: Apart from mentioning the 12.5MW Solar Power plant, the Board of Directors has also revealed various upgradation projects undergoing currently which are intended to further improve the cost structure going forward.

Sector Outlook: The Directors' believe that cement sales for FY19 are expected to continue the remarkable trend of growth in the local front with CPEC activities and household sectors being the primary contributors, however, high demand will keep margins and cement sales prices under pressure during the period. They also highlight the expected negative impact on cost structure due to occur on account of rising coal and FO prices globally, upward trending inflation and a weakening PKR, however feel that this will fuel export sales simultaneously.

Emerging concerns; newly formed government expected to hike energy prices

The newly formed government has hinted towards enforcing severe measures in order to shape up the out of order economy. With parliamentarians brainstorming over likely surge in gas prices and power tariff, serious concerns over sector performance have emerged.

Presently Punjab based cement manufacturing companies, FCCL being a major one, are provided with RLNG and therefore appear least likely to be impacted over any adverse changes in domestically sourced natural gas.

However, a possible rise in power tariff will materially alter earnings forecast of FCCL and consequently its Target Price. Although NEPRA has presented a recommendation summary of increasing the power tariff by PKR 4.00/KwH to PKR 16.9/KwH, parliamentarians also mull to reduce the power tariff in line with regional competitors to make domestic products competitive in the international market.

Exhibit:
EPS and Target Price Sensitivity to hike in power tariff

	Power Tariff Assumption (PKR/KwH)			EPS (PKR)				
Scenarios	FY19	FY20	FY21	FY19	FY20	FY21	Target Prices (PKR) - Dec 18	Upside from LDCP
Bear	16.90	16.90	16.90	3.00	2.92	2.90	26.91	10%
Base	12.90	12.90	12.90	3.21	3.08	3.03	28.26	15%
Bull	8.90	8.90	8.90	3.42	3.22	3.16	29.61	21%

Source: IGI Research

Recommendation

We maintain a **'BUY'** call on the scrip with a Dec-18 based target price of PKR 28.3/share, offering a +15% upside from its last close. The Company is currently trading at FY19 P/E of 7.65x and offers a healthy dividend yield of 10.2%, the highest amongst our coverage companies.

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Recommendation	Rating System
Buy	If target price on aforementioned security(ies) is more than 10%, from its last closing price(s)
Hold	If target price on aforementioned security(ies) is in between -10% and 10%, from its last closing price(s)
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Time Horizon: Dec – 2018

Valuation Methodology: The analyst(s) has used following valuation methodology to arrive at the target price of the said security (ies):
(Discounted Cash Flow)

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