



# Fecto Cement Limited

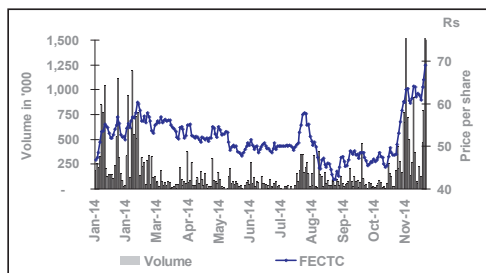
## FECTC: Appealing Valuations

We initiate coverage on Fecto Cement Limited (FECTC) with DCF based June'15 target price of Rs 94/share, offering a striking upside potential of 37% from closing price of Rs 69.02/share. Our bullish stance is based on improve local cement dispatches, firm cement prices, lower coal prices and reducing interest rate. We anticipate company's performance to be improved further as it is running at 82% capacity therefore ready to cater any increase in demand. Fecto is set to install 15MW coal fire power plant which would be completed by 2017 to add Rs 1.54/share to the EPS and Rs 9/share to the target price. The share is trading at FY15 and FY16 prospective P/E multiple of 5.1x and 4.6x respectively depicting a 43% discount to the WE Cement Universe Stocks P/E of 8.9x and 7.9x respectively. The key risks to our thesis are major slowdown in export sales cut in cement prices would squeeze margins or end of cartelization and coal prices uptick or volatility.

### KEY DATA

KATS Code	FECTC
Reuters Code	FCEM.KA
Current Price (Rs)	69.02
Year High, Low (Rs)	69.02, 41
Market Cap (Rs' bn)	3.4
Market Cap (US\$ mn)	34
Shares Outstanding (mn)	50.16

Source: KSE, Reuters & WE Research



Source: KSE & WE Research

### FECTC Financial Snapshot

	FY14A	FY15F	FY16F	FY17F
Net Sales (Rs mn)	4,724	5,047	5,406	5,794
Gross Profit (Rs mn)	1,277	1,384	1,502	1,628
Profit after Taxation (Rs mn)	595	680	792	880
EPS (Rs)	11.87	13.56	15.80	17.54
Book Value (Rs/share)	47.4	58.5	71.3	85.3
DPS (Rs)	2.50	3.00	3.50	4.00
P/E (x)	5.82	5.09	4.37	3.94
P/BV (x)	1.46	1.18	0.97	0.81
ROE (%)	25.0	23.2	22.2	20.6
ROA (%)	15.3	15.7	15.9	15.5

Source: Company Reports & WE Research



## Valuation: BUY with a Target Price of Rs 94

We have used Discounted Cash Flow (DCF) methodology with assumption of 21.1% cost of equity (12.20% Risk free rate and 6.5% market premium) and 2% growth rate, thus our June'15 Target Price for Fecto is Rs 94/share offers upside of 37%-Buy!

### DCF based value of FECTC

Rs in million	FY15E	FY16F	FY17F
Net Income	680	792	880
Non Cash Expense	107	108	108
Change in Working Capital	(86)	(52)	(50)
Capex	(21)	(22)	(23)
Principle Debt Payment	(23)	(19)	(15)
Discounted Free Cash Flow	659	667	615
(-) Debt	647		
(+) Cash	155		
Equity Value	4,735		
Shares Outstanding	50.16		
<b>Target Price Jun'15 (Rs)</b>	<b>94</b>		

Source: WE Estimates

*For calculation of Target price, we have used Discounted Cash Flow (DCF) methodology with assumption of 21.1% cost of equity (12.20% Risk free rate and 6.5% market premium) and 2% growth rate, thus our June'15 Target Price for Fecto is Rs 94/share offers upside of 37%.*

### Huge discount to peers unjustified

Although Fecto cement has posted a handsome return of 55% during CY14TD outperforming KSE return of 24% by 31%, we believe the scrip still has more to offer due to higher earnings expected driven by higher cement prices, reduction in coal prices and lower financing cost. The share is trading at FY15 and FY16 prospective P/E multiple of 5.1x and 4.6x respectively depicting a 44% discount to the WE Cement Universe Stocks P/E of 8.91x and 7.92x respectively. Hence, we believe company still offers a decent upside potential of 37% at our June'15 target price of Rs 94/share.

	PER (x)			
	FY14A	FY15E	FY16F	FY17F
ACPL	9.99	8.78	8.11	7.49
DGKC	6.78	5.91	5.59	5.20
FCCL	12.65	9.95	7.91	6.53
<b>FECTC</b>	<b>5.82</b>	<b>5.08</b>	<b>4.57</b>	<b>3.94</b>
LUCK	13.59	11.43	10.05	8.37
MLCF	6.83	5.61	4.86	4.25
PIOC	9.64	9.01	8.37	8.04
<b>Cement Sector</b>	<b>10.59</b>	<b>8.91</b>	<b>7.92</b>	<b>6.93</b>

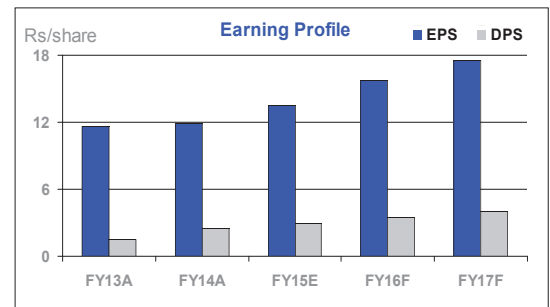
Source: WE Research



The company is likely to earn a profit after taxation of Rs 680 million (EPS: Rs 13.56) in FY15 compared to Rs 595 million (EPS: Rs 11.87) in FY14, depicting rise of 14.3%. Similarly bottom line of the company is expected to surge by a CAGR (FY15-17) of 14%

### Growth in bottom line to continue

On back of expected increase in local cement demand, lower coal prices and rising cement prices we expect the earnings of Fecto to continue moving upwards in the coming years. The company is likely to earn a profit after taxation of Rs 680 million (EPS: Rs 13.56) in FY15 compared to Rs 595 million (EPS: Rs 11.87) in FY14, depicting rise of 14.3%. Similarly bottom line of the company is expected to surge by a CAGR (FY15-17) of 14% mainly on account of above mentioned reasons. In addition to the strong profitability, the company would maintain its track record of distributing cash dividends to its share holders, where we expect the company to announce a cash dividend of Rs 3.5/share and Rs 4/share in FY15 and FY16 respectively.

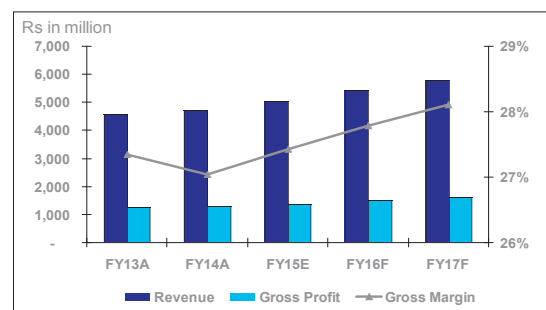


Source: WE Research

We expect the top line of the company to surge by 7.1% CAGR (FY15-17) on the back of 3.2% rise in volumetric sales and 4% surge in Ex-Factory prices.

### Top line to rise by 7%

On back of higher retention prices the top line of the company is expected to witness 7% YoY rise in FY15 reaching Rs 5,047 million against Rs 4,724 million in FY14. We expect the top line of the company to surge by 7.1% CAGR (FY15-17) on the back of 3.2% rise in volumetric sales and 4% surge in Ex-Factory prices. We expect the gross profit of the company to escalate at 3 years CAGR (FY15-17) of 8.5% to Rs 1,628 million in FY17 against Rs 1,277 million in FY14. This is expected due to lower coal prices, higher cement prices and reduction in interest rate. This would increase gross margin to surge to 28.1% in FY17 versus 27% in FY14.



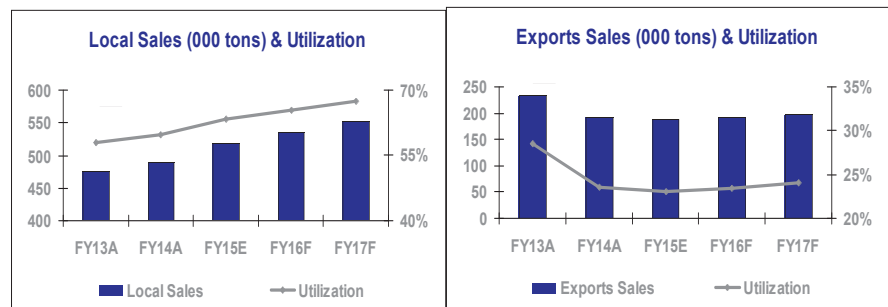
Source: WE Research



Company is producing 641k tons in FY14 against installed capacity of 780k tons /annum translating into utilization level of 82.2%. Thus we believe company capacity utilization to drive the volumetric growth. We expect the company's volumetric sales to increase at 3 years CAGR of 3.2% at a long term capacity utilization of 92%

### Rise in local demand to improve capacity utilization

Domestic cement dispatches is highly correlated to overall economic activity of the country. Thus we estimate economic growth of average 5% in next three years which would be reflected into cement dispatches which is anticipated to grow by 8% during FY15-17. The development projects by the government through PSDP would boost the demand while the private sector construction projects has also been increased in the last few months and would remain higher. Company is producing 641k tons in FY14 against installed capacity of 780k tons /annum translating into utilization level of 82.2%. Thus we believe company capacity utilization to drive the volumetric growth. We expect the company's volumetric sales to increase at 3 years CAGR of 3.2% at a long term capacity utilization of 92%. Local and exports sales are expected to contribute by 79.6% and 20.4% respectively of total sales in FY17.



Source: WE Research

Source: WE Research

As coal captures 35% of the total cost in cement manufacturing therefore it will directly impact gross margin. We have assumed coal prices of \$77/ton in FY15 and \$ 87/ton to FY16 & onwards. According to our analysis, a \$5/ton change in coal cost deviate earnings by 6% on either side.

### Falling coal price - a positive omen

Current decline in commodity prices across the board help coal prices to decline 5 year low touching \$63/ton. As coal captures 35% of the total cost in cement manufacturing therefore it will directly impact gross margin. We have assumed coal prices of \$77/ton in FY15 and \$ 87/ton to FY16 & onwards. According to our analysis, a \$5/ton change in coal cost deviate earnings by 6% on either side.

Coal prices \$/ton	FY15FE	FY16F	FY17F	TP* (Rs)
Base Case Prices	\$77	\$87	\$87	
<b>Earning per share (EPS)</b>				
Increase by \$100/ton	15.15	17.52	19.36	105
Increase by \$5/ton	14.35	16.66	18.45	100
<b>Base Case</b>	<b>13.56</b>	<b>15.80</b>	<b>17.54</b>	<b>94</b>
Decrease by \$5/ton	12.77	14.93	16.62	89
Decrease by \$10/ton	11.97	14.07	15.71	84

\*Target Price June'15

Source: WE Estimates



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*We expect cement prices to remain firm in next two years as market dynamics allow a higher equilibrium price. We have kept conservative assumption of cement prices at Rs 470/bag for our valuation period but any uptick/downtick in cement prices will affect the TP for the stock.*

*Company debt significantly declined from Rs 1,152 million in FY12 to Rs 647 million in FY15 due to better cash flows on account of sharp rise in earnings.*

### Cement prices gaining strength

With a decent growth of cement volumes in the market, cement pricing remained firm as it continuously increased since Jan'11 as industry has really gained from the consensus pricing and quota allocation agreement among manufacturers owing to no key capacity additions and stable domestic demand. However expansion of plant near Hub from DGKC would be slightly negative in medium term which would increase supply. We expect cement prices to remain firm in next two years as market dynamics allow a higher equilibrium price. We have kept conservative assumption of cement prices at Rs 470/bag for our valuation period but any uptick/downtick in cement prices will affect the TP for the stock. The sensitivity analysis has been presented below for further clarity.

Cement Ex-Factory Prices	FY15FE	FY16F	FY17F	TP* (Rs)
Base Case Prices	470	489	508	
	<b>Earning per share (EPS)</b>			
Increase by Rs 20/bag	16.12	18.63	20.58	112
Increase by Rs 10/bag	14.84	17.21	19.06	103
<b>Base Case</b>	<b>13.56</b>	<b>15.80</b>	<b>17.54</b>	<b>94</b>
Decrease by Rs 10/bag	12.28	14.38	16.01	85
Decrease by Rs 20/bag	11.00	12.96	14.49	76

\*Target Price June'15

Source: WE Estimates

### Lower interest rate & debt would reduce finance cost

During the last two years company debt significantly declined from Rs 1,152 million in FY12 to Rs 647 million in FY15 due to better cash flows on account of sharp rise in earnings. On the other hand, central bank has reduced discount rate by 50bps in Nov'14 and further 50bps expected in Jan'15 monetary policy. We expect both these measures to reduce finance cost going forward. According to our analysis, drop in interest rate by 100bps would result in improvement of profit by 2%.

### Coal-fire-power plant would reduce energy cost

Fecto cement plant uses National grid to meet energy requirements despite company has waste heat recovery plant (WHRR) of 6MW which cater only 32% of the need. For this purpose company is looking out for operational efficiencies by installing 15MW coal fire power plant. It is anticipated to come online in mid 2017 which would reduce power cost by around 22% and to add Rs 1.54/share to the EPS and Rs 9/share to the target price.



## Key Risks

### Cement Price Risk

End of cartelization will likely ignite a price war, which can pose a downside risk to our projections.

### Unexpected rise in International Coal Prices

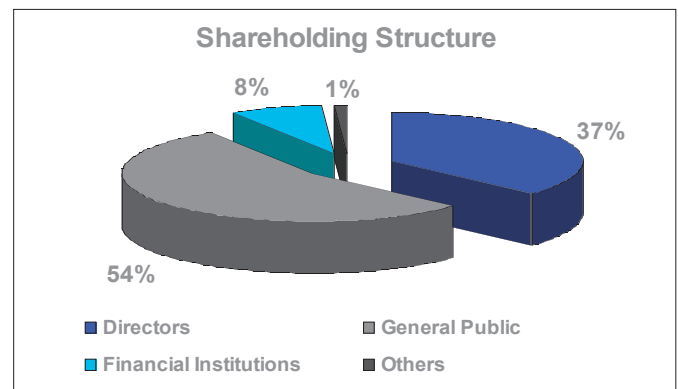
A sharp rise in international coal prices would harm gross margins of the company, resulting in a downside risk to our projections.

### Interest Rate Risk

We have incorporated discount rate at 9% (current 9.5%) in our projection; any deviation from our assumption will pose downside risk to our projections..

## Company Introduction

Fecto cement was incorporated on 28 February 1981 situated at Sangjani, Near Islamabad. Company commenced production in January 1990 with name plate clinker capacity of 780k tons and 819k tons of cement per annum. The plant was manufactured by Fuller International Inc., USA with a total project cost of Rs. 2,104 million. Company is ISO 9001:2000 certified and Pakistan's first anti-pollution cement manufacturing plant. Company is listed on three stocks exchanges. Fecto is part of the Fecto Group of Companies, with interests in paper products, agro-forestry and technology & communications.



Source: Company Report



## FECTC - Financial Highlights

### Valuation

	<b>FY14A</b>	<b>FY15F</b>	<b>FY16F</b>	<b>FY17F</b>
EPS (Rs)	11.87	13.56	15.80	17.54
Book Value (Rs/share)	47.4	58.5	71.3	85.3
DPS (Rs)	2.50	3.00	3.50	4.00
P/E (x)	5.82	5.09	4.37	3.94
P/BV(x)	1.46	1.18	0.97	0.81
Dividend Yield (%)	3.62	4.35	5.07	5.80
Payout (%)	21.1	22.1	22.2	22.8

Source: Company Reports & WE Research

### Key Ratio Analysis

	<b>FY14A</b>	<b>FY15F</b>	<b>FY16F</b>	<b>FY17F</b>
Current Ratio (x)	1.89	2.63	3.36	4.13
ROE (%)	25.0	23.2	22.2	20.6
ROA (%)	15.3	15.7	15.9	15.5
Gross Margin (%)	27.42	27.79	28.10	27.42
Net Margin (%)	12.6	13.5	14.7	15.2
Sales Growth (%)	2.96	6.83	7.12	7.17
PAT Growth (%)	2.1	14.3	16.5	11.0

Source: Company Reports & WE Research

### Income Statement

<b>Rs in million</b>	<b>FY14A</b>	<b>FY15F</b>	<b>FY16F</b>	<b>FY17F</b>
Sales	4,724	5,047	5,406	5,794
Cost of Goods Sold	3,447	3,663	3,904	4,166
Gross Profit	1,277	1,384	1,502	1,628
Administrative Expense	170	187	205	226
Distribution Cost	198	204	218	234
Other Income	21	13	31	51
Other Expenses	57	50	54	58
Operating Profit	874	956	1,056	1,161
Finance Cost	104	106	65	61
Profit before Taxation	770	850	990	1,099
Taxation	175	170	198	220
Profit after Taxation	595	680	792	880

Source: Company Reports & WE Research



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## Balance Sheet

Rs in million	FY14A	FY15F	FY16F	FY17F
Share Capital	502	502	502	502
Shareholder Equity	2,379	2,934	3,576	4,280
Non Current Liabilities	505	482	464	449
Current Liabilities	1,009	927	940	957
Total Liabilities	1,514	1,409	1,404	1,406
Non Current Assets	1,991	1,904	1,818	1,732
Current Assets	1,902	2,439	3,162	3,954
Total Assets	3,893	4,343	4,979	5,686

Source: Company Reports & WE Research

## Cash Flow Statement

Rs in million	FY14A	FY15F	FY16F	FY17F
Cash from Operations	(4)	702	848	939
Cash from Investing activities	(26)	(21)	(22)	(23)
Cash from Financing	137	(148)	(169)	(190)
Net change in Cash	107	533	657	725
Beginning Cash balance	48	155	688	1,346
Ending Cash balance	155	688	1,346	2,071

Source: Company Reports & WE Research



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## WE Financial Services

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