

Day Break

Monday, 03 October 2016

Company Update

Fauji Fertilizer Co. Ltd.

Fertilizer

Recommendation	HOLD
Target Price	106.5
Last Closing	104.0
Upside	2%

Market Data

Bloomberg Tkr.	FFC PA
Shares (mn)	1,272.2
Market Cap (PKRbn USDmn)	132.3 1,266.5
Exchange	KSE 100

Price Info.

	90D	180D	365D
Abs. Return	(9.4)	(3.2)	(16.2)
Low	103.3	103.3	103.3
High	118.3	121.5	129.5

Key Company Financials

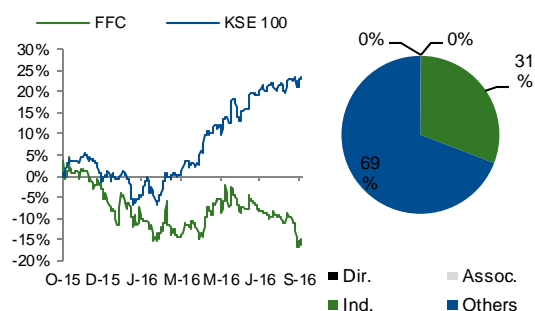
Period End: Dec

PKRbn	CY15A	CY16E	CY17F	CY18F
Total Revenue	84.8	63.8	72.4	76.3
Net Income	16.8	12.0	12.3	11.2
EPS (PKR)	13.2	9.4	9.7	8.8
DPS (PKR)	11.9	8.5	9.2	8.3
Total Assets	80.1	73.7	71.9	72.7
Total Equity	27.3	28.5	29.1	29.7

Key Financial Ratios

ROE (%)	61%	42%	42%	38%
P/E (x)	7.9	11.1	10.8	11.9
P/B (x)	4.8	4.6	4.5	4.5
DY (%)	11.4	8.1	8.8	8.0

Relative Price Performance & Shareholding



About the Company

The Company is a public limited company incorporated in Pakistan. The Company is in the business of manufacturing, purchasing and marketing of fertilizers, chemicals including investment in other fertilizer, chemical, banking and others manufacturing and energy generation.

Source: Bloomberg, KSE 100 & IGI Research

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Fauji Fertilizer Company Limited

Dwindling Performance amid Lower Urea Offtake and Prices

- FFC's earnings for 2QCY16 diluted by 8%YoY to PKR 2.2bn (EPS PKR 1.7) owing to 3%YoY contraction in urea sales and +2.49x higher financial cost. Company also announced cash dividend of PKR 1.55/share in 2QCY16, taking the cumulative to PKR 3.4/share in 1HCY16.
- Earnings are expected to remain dismal as higher gas prices amid lower urea/DAP prices would keep margins under pressure in near future. Higher borrowing is also likely to erode earnings due to higher financial cost whereas other income is probable to contract as we foresee lower dividends from FFBL due to its diversification into other sectors.
- We have rolled forward our target price for FFC to Jun-17 at PKR 107/share which implies a +2% capital upside along with CY16E 8% dividend yield. Hence we recommend 'HOLD' stance on the stock.

Performance dented by Industry's Weak Fundamentals

Fauji Fertilizer Company Limited (FFC) reported a decline of 41%YoY in profitability to PKR 4.9bn (EPS PKR 3.85) in 1HCY16 as compared to PKR 8.3bn (EPS PKR 6.50) in 1HCY15. This dismal performance is primarily owing to a) 23%YoY decline in urea offtake to 940k tons, b) 7%YoY reduction in Urea price coupled with higher gas price, c) 2.7x rise in finance cost to PKR 1.2bn as company had to borrow for working capital and GIDC payments (made last year), and d) +46%YoY increase in debt position to PKR 39bn as compared to PKR 27bn in same period last year. However, +47% elevated other income on the back of higher dividends by associated companies, PKR 1,380bn subsidy for urea/DAP and 31%YoY drop in other expenses supported the downward movement in earnings

For the 2QCY16, earnings diluted by 8%YoY to PKR 2.2bn (EPS PKR 1.7) owing to 3%YoY contraction in urea sales and +2.49x higher financial cost. Company also announced cash dividend of PKR 1.55/share in 2QCY16, taking the cumulative to PKR 3.4/share in 1HCY16.

Exhibit: Financial Highlights

PKR mn	2QCY16	2QCY16	YoY	1HCY16	1HCY15	YoY
Net Sales	16,676	18,778	-11%	28,322	39,186	-28%
Cost	11,401	12,399	-8%	19,995	24,504	-18%
Gross Profit	5,275	6,379	-17%	8,327	14,682	-43%
Dist. Expense	1,587	1,588	0%	3,104	3,169	-2%
Opt. income	1,561	488	220%	4,299	2,933	47%
Other Expenses	441	447	-1%	814	1,181	-31%
EBIT	4,808	4,831	0%	8,708	13,265	-34%
Interest Expense	617	248	149%	1,178	443	166%
PBT	4,191	4,584	-9%	7,530	12,822	-41%
Tax	2,026	2,225	-9%	2,637	4,556	-42%
PAT	2,165	2,359	-8%	4,893	8,266	-41%
EPS	1.70	1.85		3.85	6.50	
DPS	1.55	1.75		3.40	5.69	
<i>Key Ratios</i>						
Gross Margin	32%	34%		29%	37%	
Net Margin	13%	13%		17%	21%	
Effective Tax Rate	48%	49%		35%	36%	

Source: IGI Research, Company Financials

Inventory levels cooling down

Industry's inventory rose to as high as 1.7mn tons in May-16 as the weak demand and higher production created the supply glut of urea. However, with government's incentive in federal budget, inventory level has eased down to 1.4mn ton in Aug-16. FFC's inventory level has also come down from a high of 549k tons in May-16 to 292k tons in Aug-16.

Outlook

Earnings are expected to remain dismal as higher gas prices amid lower urea/DAP prices would keep margins under pressure in near future. Higher borrowing is also likely to erode earnings due to higher financial cost whereas other income is probable to contract as we foresee lower dividends from FFBL due to its diversification into other sectors.

Recommendation

We have rolled forward our target price for FFC to Jun-17 at PKR 107/share which implies a +2% capital upside along with CY16E 8% dividend yield. Hence we recommend '**HOLD**' stance on the stock.

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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)
Sell	If target price on aforementioned security(ies) is more than -10%, from its last closing price(s)

Time Horizon: Jun - 2017

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

DCF (Discounted Cash Flow)

Risk: Investment in securities are subject to economic risk, market risk, interest rate risks, currency risks, credit risks, political and geopolitical risks. The performance of company(ies) covered herein might unfavorably be affected by multiple factors including, business, economic, and political conditions. Hence, there is no assurance or guarantee that estimates, recommendation, opinion, etc. given about the security(ies)/company(ies) in the report will be achieved.

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