

Day Break

Thursday, 26 May 2016

Company Update

Fauji Fertilizer Co. Ltd.

Fertilizer

Recommendation	HOLD
Target Price	109.0
Last Closing	117.1
Upside	-7%

Market Data

Bloomberg Tkr.	FFC PA
Shares (mn)	1,272.2
Market Cap (PKRbn USDmn)	149.0 1,423.2
Exchange	KSE 100

Price Info.	90D	180D	365D
Abs. Return	9.3	(4.1)	(16.6)
Low	105.6	104.8	104.8
High	117.2	121.6	158.9

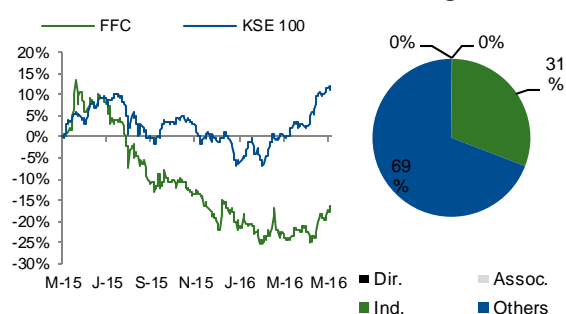
Key Company Financials

PKRbn	CY15A	CY16E	CY17F	CY18F
Total Revenue	84.8	66.4	79.2	81.7
Net Income	16.8	11.6	13.4	13.7
EPS (PKR)	13.2	9.2	10.6	10.8
DPS (PKR)	11.9	7.9	10.1	10.1
Total Assets	80.1	74.0	73.0	74.0
Total Equity	27.3	28.9	29.6	30.3

Key Financial Ratios

ROE (%)	61%	40%	45%	45%
P/E (x)	8.9	12.8	11.1	10.9
P/B (x)	5.5	5.2	5.0	4.9
DY (%)	10.1	6.7	8.6	8.6

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

Analyst

Rashmina Lalani

rashmina.lalani@igi.com.pk

Tel: (+92-21) 111-234-234 Ext.: 826

Fauji Fertilizer Limited

Price Rally Owing to Probable MSCI EM inclusion

- Fauji Fertilizer Company's (FFC) scrip has gained +9% in MTD from PKR 107/share on 30th Apr-16 to PKR 117/share on 25th May-16. We believe, this rally is likely on the back of a) possible inclusion of the company into MSCI Emerging Market Index mid-cap category and b) probable removal of GST on fertilizer products and abolishment of GIDC in upcoming budget.
- Company posted 54%YoY decline in earnings to PKR 2.7bn (EPS PKR 2.14) in 1QCY16, as compared to PKR 5.9bn (EPS PKR 4.64) in same period last year. FFC also declared cash dividend of PKR 1.85/share along with the result.
- Our Dec-16 target price of PKR 109/share, we recommend hold stance on the company. The scrip is currently trading at CY16E P/E 12.8x and divided yield of 6.7%.

Rally led by MSCI EM Inclusion

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Earnings clocked in at PKR 2.14/share in 1QCY16, 54%YoY

Company posted 54%YoY decline in earnings to PKR 2.7bn (EPS PKR 2.14) in 1QCY16, as compared to PKR 5.9bn (EPS PKR 4.64) in same period last year. FFC also declared cash dividend of PKR 1.85/share along with the result. Despite steady urea production to the tune of 610k ton in 1QCY16, offtake declined by 43%YoY to 357k ton largely due to poor farm economics and demand contraction. This along with 3%YoY urea price drop, led to 43%YoY fall in revenue. Gross margin witnessed a significant contraction to 26% in 1QCY16 from 41% in same period last year, largely due to absorption of increased gas tariff in Sep-15. However, other income showed a +12%YoY growth to PKR 2.7bn (PKR 2.15/share) due to higher dividends from long term investments as well as DAP subsidy of PKR 500/bag by government. Company's finance cost also escalated by +187%YoY, largely on the back of bloated short term borrowing as

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a consequence of tight cash cycle post GIDC payments, increase in cost and decline in urea prices.

Exhibit: Financial Highlights

PKR mn	1QCY16	1QCY15	YoY	4QCY15	QoQ
Net Sales	11,646	20,409	-43%	30,537	-62%
Cost	8,594	12,105	-29%	22,290	-61%
Gross Profit	3,052	8,304	-63%	8,248	-63%
Opt. income	2,738	2,445	12%	1,826	50%
Other Expenses	373	734	-49%	643	-42%
EBIT	3,900	8,434	-54%	7,595	-49%
Interest Expense	561	196	187%	512	10%
PBT	3,339	8,238	-59%	7,083	-53%
Tax	611	2,331	-74%	2,263	-73%
PAT	2,728	5,907	-54%	4,820	-43%
EPS	2.14	4.64		3.79	
DPS	1.85	3.94		3.42	
<i>Key Ratios</i>					
Gross Margin	26%	41%		27%	
Net Margin	23%	29%		16%	
Effective Tax Rate	18%	28%		32%	

Source: IGI Research, Company Financials

International Urea Prices; Downward Momentum Continues

Urea prices remained under the grind as manufacturers had to offload inventory at discounts in the range of PKR 50-100/bag throughout 1QCY16. However, in order to support fertilizer sector, government reverted back feed gas prices to PKR 123/mmbtu on 29th Apr-16 from PKR 200/mmbtu, which resulted in domestic urea prices drop by PKR 60/bag to PKR 1,790/bag in Apr-16. Going forward, we foresee local urea prices to remain under pressure in CY16 on the back of a) poor farm economics, b) decline in international urea prices, where middle east urea (FOB) declined by 1% to USD 218/ton in MTD translating into PKR 1,717/bag, a discount of 4% to domestic urea prices.

All Eyes on Incentives

With budget announcement expected on 3rd Jun-16, any incentives announced for agriculture sector could bring some good news for fertilizer manufacturers. As per media reports, government is considering removal of GST and GIDC on urea sales in upcoming FY17 budget. Sales tax abolishment, if realized can increase offtake going forward, keeping the realized price for fertilizer manufacturers at same levels. With every 1% increase in offtake from our base case of 2.1mn tons sales in CY16, FFC's earning increase by PKR 0.08/share (1% of CY16 earnings). Whereas elimination of GIDC (Feed: PKR 300/mmbtu, Fuel: PKR 150/mmbtu) can improve margins and earning of urea producers. Our preliminary estimates suggest that GIDC abolishment can open room for local urea price reduction in the range of PKR 710/bag to PKR 790/bag. However, we think manufacturers are unlikely to pass on the full impact of cost cut to farmers.

Recommendation

Our Dec-16 target price of PKR 109/share, we recommend hold stance on the company. The scrip is currently trading at CY16E P/E 12.8x and dividend yield of 6.7%.

Analyst Certification

The analyst[^] hereby certify that the views about the company/companies and the security/securities discussed in this report are accurately expressed and that he/she has not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report. The analyst is principally responsible for the preparation of this research report and that he/she or his/her close family/relative does not own 1% or more of a class of common equity securities of the following company/companies covered in this report.

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Buy	If return on aforementioned security(ies) is more than 10%, from its last closing price(s)
Hold	If return on aforementioned security(ies) is in between -10% and 10%, from its last closing price(s)
Sell	If return on aforementioned security(ies) is more than -10%, from its last closing price(s)

Valuation Methodology

The analyst[^] has used following valuation methodology to arrive at the target price of the said security (ies):

- DCF (Discounted Cash Flow)

Time Horizon

- Dec - 2016

Risk

- Changes in State Bank of Pakistan Policy Rate
- Changes in country (Pakistan) macro-economic environment
- Changes in Company(ies) operating structure
- Change in Exchange Rate (USDPKR)

Contact Details

Research Team

Saad Khan	Deputy Head of Research	Tel: (+92-21) 111-234-234 Ext.: 810	saad.khan@igi.com.pk
Rashmina Lalani	Senior Research Analyst	Tel: (+92-21) 111-234-234 Ext.: 826	rashmina.lalani@igi.com.pk
Abdullah Farhan	Research Analyst	Tel: (+92-21) 111-234-234 Ext.: 912	abdullah.farhan@igi.com.pk
Yawar Saeed	Research Analyst	Tel: (+92-21) 111-234-234 Ext.: 973	yawar.saeed@igi.com.pk
Abdul Sajid	Database	Tel: (+92-21) 111-234-234 Ext.: 974	abdul.sajid@igi.com.pk
Umesh Solanki	Database Assistant	Tel: (+92-21) 111-234-234 Ext.: 966	umesh.solanki@igi.com.pk

Equity Sales

Faisal Jawed Khan	Head of Equities	Tel: (+92-21) 35301779	faisal.jawed@igi.com.pk
Zaeem Haider Khan	Regional Head (North)	Tel: (+92-42) 35777863-70	zaeem.haider@igi.com.pk
Muhammad Naveed	Branch Manager (Islamabad)	Tel: (+92-51) 2604861-2	muhammad.naveed@igi.com.pk
Gul Hussain	Branch Manager (Faisalabad)	Tel: (+92-41) 2540843-45	gul.hussain@igi.com.pk
Laiq-Ur-Rehman	Branch Manager (RY Khan)	Tel: (+92-68) 5871653-6	Laiq.queeshi@igi.com.pk

IGI Finex Securities Limited

Trading Rights Entitlement Certificate (TREC) Holder of Karachi Stock Exchange Limited and Lahore Stock Exchange Limited | Corporate member of Pakistan Mercantile Exchange Limited

Head Office

Suite No 701-713, 7th Floor, The Forum, G-20,
 Khayaban-e-Jami Block-09, Clifton, Karachi-75600
 UAN: (+92-21) 111-444-001 | (+92-21) 111-234-234
 Fax: (+92-21) 35309169, 35301780
 Website: www.igisecurities.com.pk

Stock Exchange Office

Room # 719, 7th Floor, KSE Building, Stock Exchange Road, Karachi.
 Tel: (+92-21) 32429613-4, 32462651-2, Fax: (+92-21) 32429607

Lahore Office

5-F.C.C. Ground Floor, Syed Maratib Ali Road,
 Gulberg II, Lahore
 Tel: (+92-42) 35777863-70, 35876075-76
 Fax: (+92-42) 35763542

Faisalabad Office

Room #: 515-516, 5th Floor, State Life
 Building, 2- Liaquat Road, Faisalabad
 Tel: (+92-41) 2540843-45
 Fax: (+92-41) 2540815

Islamabad Office

Mezzanine Floor, Office 5, 6 & 7, Kashmir Plaza,
 Block- B, Jinnah Avenue, Blue Area, Islamabad
 Tel: (+92-51) 2604861-2, 2604864, 2273439
 Fax: (+92-51) 2273861

Rahim Yar Khan Office

Plot # 12, Basement of Khalid Market,
 Model Town, Town Hall Road, Rahim Yar Khan
 Tel: (+92-68) 5871653-6, 5871652
 Fax: (+92-68) 5871651