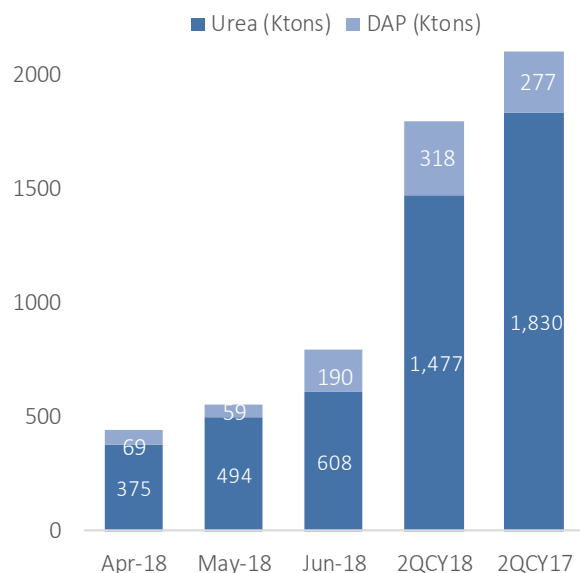


# Day Break

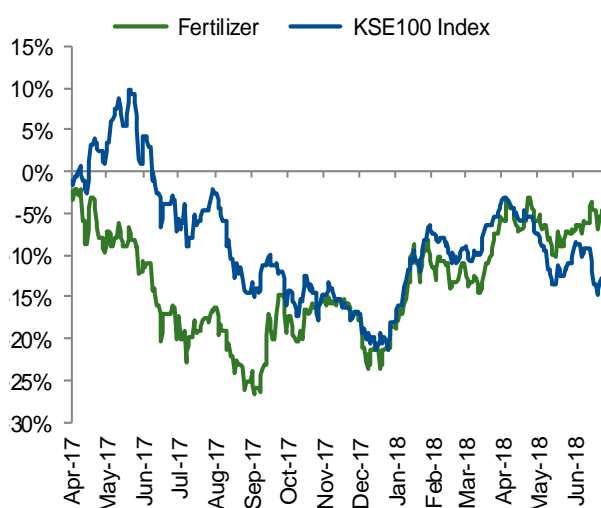
Monday, 30 July 2018

## Sector Update

Industry Offtake: Urea (ktons) and DAP (ktons)



Relative Performance to KSE 100



Source: Bloomberg, PSX & IGI Research

**Suleman Ashraf**

Research Analyst

[suleman.ashraf@igi.com.pk](mailto:suleman.ashraf@igi.com.pk)

Tel: (+92-21) 111-234-234 Ext.: 957

## Fertilizer

### Improved pricing dynamics to drive sector's profitability up by +31%YoY for 2QCY18

- We preview earnings for the fertilizer companies under IGI coverage (FFC, FFBL, EFERT & FATIMA) wherein we expect the profitability to surge by +31%YoY to PKR 7.67bn on the back of improved fundamentals driven by high pricing power despite a drop of 20%YoY in urea offtake.
- With respect to stock performance, the sector has over performed by 16% CY18TD against the benchmark index, spurred by sustained offtakes and high pricing power stemming from low inventory levels.
- Company wise, FATIMA is expected to lead the sector's profitability with earnings attaining at PKR 2.97bn (EPS: PKR 1.42). Similarly, FFC and EFERT will follow the trail witnessing double digit growth in their earnings at PKR 2.45bn (EPS: PKR 1.93) and PKR 2.72bn (EPS: PKR 2.04) respectively. FFBL, however will impede sector earnings a bit with a loss of PKR 0.47bn (LPS: PKR 0.51).

We preview earnings for the fertilizer companies under IGI coverage (FFC, FFBL, EFERT & FATIMA) wherein we expect the profitability to surge by +31%YoY to PKR 7.67bn on the back of improved fundamentals driven by stable prices despite a drop of 20%YoY in urea offtake. Moreover, low finance cost and low handling costs (low inventory levels) will provide additional support to the earnings. However, inclusion of super tax charge will trim away overall sectors profitability. With respect to stock performance, the sector has over performed by 16% CY18TD against the benchmark index, spurred by sustained offtakes and high pricing power stemming from low inventory levels.

### Series of price hikes post budget as urea inventory levels declined

On pricing front, to recall, fertilizer manufacturers increased urea prices by PKR 100/bag to account for subsidy amount and since then have been on pricing spree, surpassing the price cap of PKR 1,400/bag and crossing PKR 1,600/bag as of now. In addition, low inventory levels during the period have given added advantage for the urea manufacturers to increase prices. For DAP, external factors such as rapid PKR depreciation during the quarter coupled with rising raw material costs have led manufacturers and importers to pass over the price.

Exhibit:

#### Sector: 2QCY18 Result Highlights

| Period End       | Dec- PKRmn | 2QCY18E | 2QCY17 | YoY  | 1HCY18E | 1HCY17 | YoY  |
|------------------|------------|---------|--------|------|---------|--------|------|
| Net Sales        |            | 64,913  | 53,207 | 22%  | 126,095 | 90,788 | 39%  |
| Gross Profit     |            | 19,696  | 13,743 | 43%  | 38,699  | 24,092 | 61%  |
| Selling / Dist.  |            | 5,739   | 6,162  | -7%  | 11,607  | 16,753 | -31% |
| Other Op. Income |            | 3,289   | 6,135  | -46% | 7,033   | 11,279 | -38% |
| EBIT             |            | 14,734  | 11,768 | 25%  | 29,147  | 21,705 | 34%  |
| Finance Cost     |            | 1,788   | 2,277  | -21% | 3,432   | 4,473  | -23% |
| Pre-Tax Profits  |            | 12,947  | 9,491  | 36%  | 25,716  | 17,232 | 49%  |
| Taxation         |            | 4,632   | 3,652  | 27%  | 8,809   | 6,122  | 44%  |
| Post-Tax Profits |            | 8,314   | 5,839  | 42%  | 16,906  | 11,111 | 52%  |

Source: IGI Research, Company Financials, PSX

### FATIMA to drive sector's profitability followed by EFERT and FFC

Company wise, FATIMA is expected to lead the sector's profitability with earnings estimated at PKR 2.97bn (EPS: PKR 1.42). Similarly, FFC and EFERT will follow the trail witnessing double-digit growth in their earnings at PKR 2.45bn (EPS: PKR 1.93) and PKR 2.72bn (EPS: PKR 2.04) respectively. FFBL however will impede sector earnings a bit with a loss of PKR 0.47bn (LPS: PKR 0.51).

### FFBL: Despite improved offtake, company to report a loss of PKR 0.48bn (LPS: PKR 0.51) for 2QCY18

Fauji Fertilizer Bin Qasim Limited (FFBL) is scheduled to announce its financial results for 2QCY18 on 30<sup>th</sup>Jul-18 wherein we expect the company to report a loss of PKR 0.48bn (LPS: 0.51) on unconsolidated basis taking total loss for the 1HCY18 to PKR 0.93bn (LPS: PKR 0.99) compared to PKR 0.38bn (LPS: PKR 0.41) in the same period last year. Major erosion to earnings stems from decrease in margins primarily owing to steam prices and subsequent capacity payments along with increase in phosphoric acid prices. With offtake in urea and DAP, tuning at 168k tons and 66k tons respectively, we expect net sales for the quarter to clock in at PKR 8.51bn, up by +13%YoY. However, major dent to earnings may come from decrease in other income owing to decrease in subsidy for urea and removal of DAP subsidy (corresponding reduction in tax rate). We have a "HOLD" call on the scrip based on our Dec-18 target price of PKR 40.9/share.

Exhibit:

#### FFBL: 2QCY18 Result Highlights

| Period End Dec-      | PKRmn | 2QCY18E | 2QCY17 | YoY  | 1HCY18E | 1HCY17 | YoY  |
|----------------------|-------|---------|--------|------|---------|--------|------|
| Net Sales            |       | 8,511   | 7,556  | 13%  | 18,794  | 15,555 | 21%  |
| Gross Profit         |       | 336     | 543    | -38% | 1,081   | 289    | 274% |
| Other Op. Income     |       | 474     | 1,201  | -61% | 834     | 2,946  | -72% |
| EBIT                 |       | (268)   | 273    | n.m  | (499)   | 453    | n.m  |
| Finance Cost         |       | 460     | 445    | 4%   | 880     | 922    | -5%  |
| Pre-Tax Profits      |       | (729)   | (171)  | 325% | (1,379) | (469)  | n.m  |
| Taxation             |       | (254)   | 78     | n.m  | (455)   | (85)   | n.m  |
| Post-Tax Profits     |       | (474)   | (249)  | 90%  | (924)   | (384)  | 140% |
| EPS                  |       | (0.51)  | (0.27) |      | (0.99)  | (0.41) |      |
| DPS                  |       | -       | 0.10   |      | -       | 0.10   |      |
| <b>Key Ratios</b>    |       |         |        |      |         |        |      |
| Gross Profit Margins |       | 3.9%    | 7.2%   |      | 5.8%    | 1.9%   |      |
| Ebit Margins         |       | -3.2%   | 3.6%   |      | -2.7%   | 2.9%   |      |
| Effective Tax Rate   |       | 34.9%   | -45.6% |      | 33.0%   | 18.1%  |      |

Source: IGI Research, Company Financials, PSX

No. of shares :934mn

### FFC: Earnings to clock in at PKR 2.45bn (EPS: PKR 1.93), up by +51%YoY for 2QCY18

Fauji Fertilizer Company Limited (FFC) is scheduled to announce its financial result for 2QCY18 on 31<sup>th</sup> Jul-18 wherein we expect the company to post a profit of PKR 2.45bn (EPS: PKR 1.93) unconsolidated basis up by +51%YoY. Although, offtake for urea inched down by 8%YoY to 653k tons but increase in fertilizer price partially arrested the impact along with DAP offtake increasing by +79%YoY to 81k tons. Owing to price, hikes coupled with no discounts, retention prices for Sona urea improved by 12%YoY during the quarter. As a result, net sales are expected to increase by +20%YoY to PKR 22.7bn, taking total net sales for 1HCY18 to PKR 43.3bn, up by +43%YoY. In addition, decrease in finance cost owing to subsequent debt repayments may also lift earnings by +49%YoY. However, other income is expected to glide down by 62%YoY owing to decrease in subsidy amount (amount recorded till Apr-18). Lastly, we expect company

to declare cash dividend of PKR 1.70/share. We have a “HOLD” call on the scrip based on our Dec-18 target price of PKR 100.0/share.

Exhibit:

**FFC: 2QCY18 Result Highlights**

| Period End Dec- PKRmn | 2QCY18E | 2QCY17 | YoY  | 1HCY18E | 1HCY17 | YoY  |
|-----------------------|---------|--------|------|---------|--------|------|
| Net Sales             | 22,703  | 18,971 | 20%  | 43,261  | 30,161 | 43%  |
| Gross Profit          | 5,675   | 3,637  | 56%  | 9,768   | 6,238  | 57%  |
| Other Op. Income      | 1,058   | 2,788  | -62% | 3,144   | 5,567  | -44% |
| EBIT                  | 4,277   | 3,669  | 17%  | 8,149   | 7,065  | 15%  |
| Finance Cost          | 337     | 666    | -49% | 715     | 1,202  | -41% |
| Pre-Tax Profits       | 3,940   | 3,003  | 31%  | 7,434   | 5,863  | 27%  |
| Taxation              | 1,487   | 1,378  | 8%   | 2,716   | 2,046  | 33%  |
| Post-Tax Profits      | 2,453   | 1,625  | 51%  | 4,718   | 3,817  | 24%  |
| EPS                   | 1.93    | 1.28   |      | 3.71    | 3.00   |      |
| DPS                   | 1.70    | 1.00   |      | 3.45    | 2.50   |      |

**Key Ratios**

|                      |       |       |       |       |
|----------------------|-------|-------|-------|-------|
| Gross Profit Margins | 25.0% | 19.2% | 22.6% | 20.7% |
| Ebit Margins         | 18.8% | 19.3% | 18.8% | 23.4% |
| Effective Tax Rate   | 37.7% | 45.9% | 36.5% | 34.9% |

Source: IGI Research, Company Financials, PSX

No. of shares :1,272mn

**FATIMA: Low Finance cost and modest growth in offtake to drive earnings by +47%YoY to PKR 2.97bn (EPS: PKR 1.42) for 2QCY18**

We expect the company to report a profit of PKR 2.97bn (EPS: PKR 1.42) on unconsolidated basis, up by +47%YoY taking total earnings for 1HCY18 to PKR 5.86bn (+37%YoY). Low finance cost (down by 59%YoY) and decent growth (+22%YoY) in offtake have catalyzed earnings for the quarter. Top line is expected to grow by +25%YoY to PKR 11.8bn led by increase in urea / NP offtake with CAN sales sliding down by 23%YoY. Gross margins are expected to hover around 60% as against 46% for the 2QCY17 owing to increase in retention prices covering up increased phosphate rock prices. However, handling costs may increase (+77%YoY) amid high urea inventory amongst other peers in the industry. We have a “BUY” call on the scrip based on our Dec-18 target price of PKR 41.3/share.

Exhibit:

**FATIMA: 2QCY18 Result Highlights**

| Period End Dec- PKRmn | 2QCY18E | 2QCY17 | YoY   | 1HCY18E | 1HCY17 | YoY  |
|-----------------------|---------|--------|-------|---------|--------|------|
| Net Sales             | 11,784  | 9,433  | 25%   | 23,172  | 17,692 | 31%  |
| Gross Profit          | 7,201   | 4,348  | 66%   | 14,035  | 8,857  | 58%  |
| Other Op. Income      | 166     | 85     | 96%   | 320     | 259    | 23%  |
| EBIT                  | 4,928   | 3,017  | 63%   | 9,590   | 6,421  | 49%  |
| Finance Cost          | 228     | 552    | -59%  | 552     | 1,049  | -47% |
| Pre-Tax Profits       | 4,699   | 2,465  | 91%   | 9,038   | 5,372  | 68%  |
| Taxation              | 1,727   | 448    | 286%  | 3,179   | 1,080  | 194% |
| Post-Tax Profits      | 2,972   | 2,017  | 47%   | 5,859   | 4,291  | 37%  |
| EPS                   | 1.42    | 0.96   |       | 2.79    | 2.04   |      |
| DPS                   | -       | -      |       | -       | -      |      |
| Key Ratios            |         |        |       |         |        |      |
| Gross Profit Margins  | 61.1%   | 46.1%  | 60.6% | 50.1%   |        |      |
| Ebit Margins          | 41.8%   | 32.0%  | 41.4% | 36.3%   |        |      |
| Effective Tax Rate    | 36.8%   | 18.2%  | 35.2% | 20.1%   |        |      |

Source: IGI Research, Company Financials, PSX

No. of shares :2,100mn

**EFERT: Earnings for 2QCY18 to increase by +11%YoY to PKR 2.72bn (EPS: PKR 2.04/share)**

As per our analysis, we expect earnings for 2QCY18 to increase by +11%YoY to PKR 2.72bn (EPS: PKR 2.04) taking total profitability for 1HCY18 to PKR 6.61bn (EPS: PKR 4.95), up by +66%YoY. Accretion to earning stems from increase in prices and low handling costs amid low inventory levels while inclusion of super tax charge will chip away earnings by PKR~ 0.3/share. Net sales will increase by +26%YoY to PKR 21.74bn despite witnessing a slight drop (10%YoY) in urea offtake to 497k tons. However, DAP sales have exhibited recovery, up by ~+2.0xYoY to 120k tons, thereby adding up the topline. Finance cost is expected to decrease by 17%YoY on the back of debt repayments. In addition, the company may declare a cash dividend of PKR 1.50/share for the quarter. We have a **“HOLD”** call on the scrip based on our Dec-18 target price of PKR 84.6/share.

Exhibit:

**EFERT: 2QCY18 Result Highlights**

| Period End Dec- PKRmn | 2QCY18E | 2QCY17 | YoY  | 1HCY18E | 1HCY17 | YoY  |
|-----------------------|---------|--------|------|---------|--------|------|
| Net Sales             | 21,740  | 17,247 | 26%  | 39,959  | 27,311 | 46%  |
| Gross Profit          | 6,856   | 5,215  | 31%  | 14,187  | 8,708  | 63%  |
| Other Op. Income      | 317     | 2,061  | -85% | 1,462   | 3,275  | -55% |
| EBIT                  | 4,872   | 4,809  | 1%   | 10,983  | 7,767  | 41%  |
| Finance Cost          | 509     | 615    | -17% | 1,033   | 1,300  | -21% |
| Pre-Tax Profits       | 4,363   | 4,194  | 4%   | 9,950   | 6,467  | 54%  |
| Taxation              | 1,644   | 1,748  | -6%  | 3,341   | 2,364  | 41%  |
| Post-Tax Profits      | 2,720   | 2,446  | 11%  | 6,609   | 4,102  | 61%  |
| EPS                   | 2.04    | 1.83   |      | 4.95    | 3.07   |      |
| DPS                   | 1.50    | 1.00   |      | 1.50    | 2.50   |      |
| <b>Key Ratios</b>     |         |        |      |         |        |      |
| Gross Profit Margins  | 31.5%   | 30.2%  |      | 35.5%   | 31.9%  |      |
| Ebit Margins          | 22.4%   | 27.9%  |      | 27.5%   | 28.4%  |      |
| Effective Tax Rate    | 37.7%   | 41.7%  |      | 33.6%   | 36.6%  |      |

Source: IGI Research, Company Financials, PSX

No. of shares :1,334mn

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**Time Horizon:** Dec – 2018

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IGI Finex Securities Limited

**Research Analyst(s)**

Research Identity Number: BRP009

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## Contact Details

### Research Team

|                 |                  |                                    |                            |
|-----------------|------------------|------------------------------------|----------------------------|
| Saad Khan       | Head of Research | Tel: (+92-21) 111-234-234 Ext: 810 | saad.khan@igi.com.pk       |
| Abdullah Farhan | Senior Analyst   | Tel: (+92-21) 111-234-234 Ext: 912 | abdullah.farhan@igi.com.pk |
| Suleman Ashraf  | Research Analyst | Tel: (+92-21) 111-234-234 Ext: 957 | suleman.ashraf@igi.com.pk  |
| Muhammad Saad   | Research Analyst | Tel: (+92-21) 111-234-234 Ext: 816 | muhammad.saad@igi.com.pk   |
| Umesh Solanki   | Database Manager | Tel: (+92-21) 111-234-234 Ext: 974 | 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   | Regional Manager (Islamabad & Upper North) | Tel: (+92-51) 2604861-62  | muhammad.naveed@igi.com.pk |
| Irfan Ali         | Regional Manager (Faisalabad)              | Tel: (+92-41) 2540843-45  | irfan.ali@igi.com.pk       |
| Asif Saleem       | Branch Manager (RY Khan)                   | Tel: (+92-68) 5871652-56  | asif.saleem@igi.com.pk     |
| Mehtab Ali        | Branch Manager (Multan)                    | Tel: (+92-61) 4512003     | mahtab.ali@igi.com.pk      |
| Zeeshan Kayani    | Branch Manager (Abbottabad)                | Tel: (+92-992) 408243-44  | zeeshan.kayani@igi.com.pk  |
| Ihsan Mohammad    | Branch Manager (Peshawar)                  | Tel: (92-91) 5253035      | ihsan.mohammad@igi.com.pk  |

### IGI Finex Securities Limited

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

### Lahore Office

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

### Islamabad Office

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

### 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

### Faisalabad Office

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

### Rahim Yar Khan Office

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

### Multan Office

Mezzanine Floor, Abdali Tower,  
Abdali Road  
Tel: (92-992) 408243 - 44

### Abbottabad Office

Ground Floor, Al Fatah Shopping Center,  
Opp. Radio Station, Mansehra Road  
Tel: (+92-99) 2408243 - 44

### Stock Exchange Office

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

### Peshawar Office

2nd Floor, The Mall Tower,  
35 The Mall Peshawar Cantt.  
Tel: (92-91) 5253035, 5278448

### Sialkot Office

Suite No. 10 & 11, 1st Floor, Soni Square,  
Mubarik Pura  
Tel: (+92-52) 3258437, 3258762