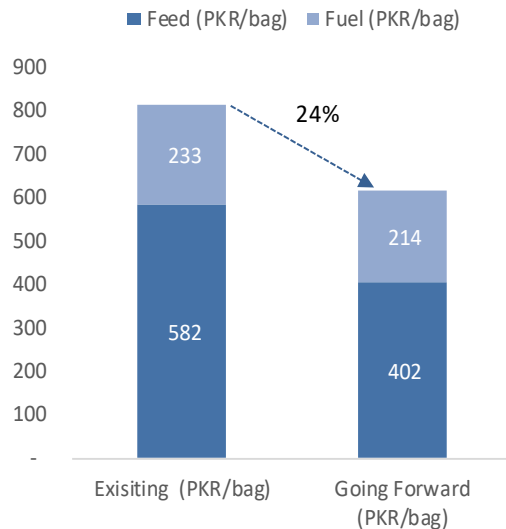


Day Break

Wednesday, 06 February 2019

Sector Update

Exhibit : Reduction in total cost (PKR/bag) of urea



Fertiliser

GIDC resolution; Not exactly a win-win game

- Later in January 2019, along with the 'Economic Reform Package 2019' the Finance Minister put forward before the cabinet of allowing 50% reduction in Gas Infrastructure Development Cess (GIDC) rate, with a condition of paying half of accrued amount of GIDC for the period 2012-18
- For fertilizer players the proposal brings in a benefit of reduced rate (50%) on GIDC if manufactures are willing to pay 50% of the accrued amount and sell urea at a discounted price of PKR 200/bag. The resolution is yet to be implemented based on the consent of the Parliament and fertilizer manufactures
- With respect to GIDC amount, companies will see a positive on-off effect on income statement while on cash flow basis FFC turns out to be major beneficiary, followed by EFERT. In case of price reduction, FFBL stands as a major beneficiary, followed by FFC, leaving EFERT and FATIMA in disadvantageous position with a negative impact

Proposal of 50% reduction in GIDC rate and payment of accrued amount

Later in January 2019, along with the 'Economic Reform Package 2019' the Finance Minister Asad Umar put forward before the cabinet of allowing 50% reduction in Gas Infrastructure Development Cess (GIDC) rate, with a condition of paying half of accrued amount of GIDC for the period 2012-18. In addition to above, the government has further proposed for fertilizer sector to reduce urea bag price by PKR 200/bag which is currently selling at PKR 1,830/bag.

To recall, the GIDC was first enacted in 2011 on industrial users with the purpose of utilizing the collected amount for infrastructure development of Iran-Pakistan Pipeline Project, (TAPI). With its imposition industrial users filed litigation against the bills passed (GIDC ACT 2011, 2014 & 2015) and after subsequent hearings (Islamabad High Court and Peshawar High Court) the levy was declared unconstitutional and unlawful. On government fiscal side, total GIDC amount payable by the industry players including fertilizer, captive power plants and CNG filling station is estimated to be PKR ~420bn. If realized this will increase government non-tax revenue by roughly PKR ~100bn or reduce country fiscal deficit by approximately 4-5%.

Exhibit:

GIDC budgeted and realized amount

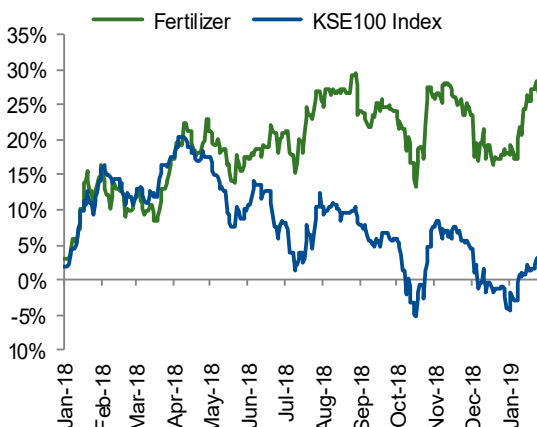
(in PKRbn)	2012	2013	2014	2015	2016	2017	2018	2019B	2012-18
Budgeted	25	30	30	38	145	145	110	100	623
Revised	24	35	35	88	145	80	15		422
Actual collection	23	32	32	57	80	42	15		281
(Shortfall)/Excess	(1)	(3)	(3)	(31)	(65)	(38)	-		(141)

Source: IGI Research, Company accounts, MoF

Proposal sets in mixed implications for the fertilizer sector; FFC and FFBL turning out beneficiaries

For fertilizer alone we estimate total accrued amount for the period is PKR ~180bn (both on feed and fuel gas), of which roughly PKR 98bn has already been paid, leaving net receivable of PKR 11bn. We have also included subsidy receivables in our analysis to determine net impact on cash flows. With respect to 50% accrued amount of GIDC payable to government, companies will see a positive on-off positive impact on income

Relative Performance to KSE 100



Source: Bloomberg, PSX & IGI Research

Analyst

Suleman Ashraf

suleman.ashraf@igi.com.pk

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

statement, with FFC being the major beneficiary while for a price reduction, FFBL stands as a major beneficiary (0.70/share impact on earnings), followed by FFC, leaving EFERT and FATIMA in disadvantageous position with a negative impact.

Total GIDC amount during the period calculated at PKR 180bn; PKR 100bn already paid

The total amount payable by the company from 2012-18 is estimated to be PKR 109.2bn on the basis of GIDC rates levied for feed and fuel in the respective years. Our calculation suggests, the company has already paid an estimated amount of PKR 66bn as of CY17. With reference to the recent proposed GIDC settlement of granting 50% waiver on the total amount, a reversal of PKR 54bn (50% of the 109.2) or PKR 30/share (after tax basis) will be a one-off effect in the income. However, on cash flow basis the impact comes at PKR 11.7bn (PKR 9.2/share) after slashing the amount already paid. Hence, total receivables from the government is estimated to be PKR 19.0bn (PKR 14.0/share) after taking into account outstanding amount of subsidy.

FFC: Earnings to witness one-off impact of PKR 30/share

The total amount payable by the company from 2012-18 is estimated to be PKR 109.2bn on the basis of GIDC rates levied for feed and fuel in the respective years. Our calculation suggests, the company has already paid an estimated amount of PKR 66bn as of CY17. With reference to the recent proposed GIDC settlement of granting 50% waiver on the total amount, a reversal of PKR 54bn (50% of the 109.2) or PKR 30/share (after tax basis) will be a one-off effect in the income. However, on cash flow basis the impact comes at PKR 11.7bn (PKR 9.2/share) after slashing the amount already paid. Hence, total receivables from the government is estimated to be PKR 19.0bn (PKR 14.0/share) after taking into account outstanding amount of subsidy.

Exhibit:

Impact on cash flows and income

Accrued Amount	109.4
50% GIDC Reversal	54.7
GIDC amt. already Paid	66.3
Net Receivable am. from Govt.	11.6
Outstanding Subsidy Amount	7.3
Total Receivable from Govt. (2018)	18.9
P&L: Other Income	54.6
Number of Shares	1.3
Per Share Before Tax	42.9
P&L: PKR / Share (after tax)	30.0
Cash flows: PKR / Share	9.2

Estimated GIDC amount 2012-18

(in PKRbn)	CY12	CY13	CY14	CY15	CY16	CY17	CY18*
Opening	-	9.2	2.6	24.7	0.8	4.1	22.9
GIDC Payable	12	12	12	13.3	20.1	20	20
GIDC Paid	2.8	18.6	-10.2	37.2	16.8	1.1	-
Ending	9.2	2.6	24.7	0.8	4.1	22.9	42.9
GIDC Rate on Feed Gas	197	197	197	197	300	300	300
GIDC Rate on Fuel Gas	50	50	50	100	150	150	150

Source: Company accounts and IGI Research, Estimated*

EFERT: Benefit of concessionary feed rate to minimize the accrued burden; PKR 7.6/share impact on income

For EFERT, the impact is relatively on the lower-side (given the quantum of total urea production, second to that of FFC) as much of the gas cost comprises of concessionary rate (no GIDC charged on feed gas). However, company accrues GIDC cost for the gas supplied to its base plant. As per our calculation, total amount during the years sums up at PKR 29bn, of which we estimate company has already paid PKR 17.6bn. On net basis, the impact on cash flow comes positive at PKR 3.1bn (PKR 2.3/share) recouping from 50% waiver on the total amount. Similarly, a reversal of PKR 7.6/share (after-tax basis) in other income will be a one-off effect in the income.

Exhibit:

Impact on cash flows and income

Accrued Amount	29.0
50% GIDC Reversal	14.5
GIDC amt. already Paid	17.6
Net Receivable am. from Govt.	3.1
Outstanding Subsidy Amount	6.5
Total Receivable from Govt. (2018)	9.6
P&L: Other Income	14.5
Number of Shares	1.3
Per Share Before Tax	10.9
P&L: PKR / Share (after tax)	7.6
Cash flows: PKR / Share	2.3

Estimated GIDC amount 2012-18

(in PKRbn)	CY12	CY13	CY14	CY15	CY16	CY17	CY18*
Opening	-	-	4.3	12.6	0.8	1.8	7
GIDC Payable	5.1	1.6	2.9	4.1	5.6	5	4.7
GIDC Paid	-	2.7	-5.4	15.9	4.6	-0.2	
Ending	-	4.3	12.6	0.8	1.8	7	7
GIDC Rate on Feed Gas	197	197	197	197	300	300	300
GIDC Rate on Fuel Gas	50	50	50	100	150	150	150

Source: Company accounts and IGI Research, Estimated

FFBL: GIDC settlement to result in PKR 11.9/share impact on income

Taking into consideration urea and DAP production the GIDC amount payable is estimated at PKR 32bn. However, for CY18 the cost accrued will be lower compared to that in preceding years as company has its own facility to supply steam for fuel purposes; hence, we assume no GIDC charges on fuel for the outgoing year. With PKR 13.8bn estimated to be paid off by the company, the net impact turns out to be a cash outflow of PKR 2.0bn (PKR 2.2/share). For income purpose, the per share after tax impact is PKR 11.9, derived from 50% reduction on total estimated amount.

Exhibit:

Impact on cash flows and income

Accrued Amount	31.8
50% GIDC Reversal	15.9
GIDC amt. already Paid	13.8
Net Receivable am. from Govt.	(2.1)
Outstanding Subsidy Amount	2.6
Total Receivable from Govt. (2018)	0.5
P&L: Other Income	15.9
Number of Shares	0.9
Per Share Before Tax	17.0
P&L: PKR / Share (after tax)	11.9
Cash flows: PKR / Share	(2.2)

Estimated GIDC amount 2012-18

(in PKRbn)	CY12	CY13	CY14	CY15	CY16	CY17	CY18*
Opening	-	-	-	2.3	7.9	5.6	11.6
GIDC Payable	2.8	2.8	2.7	3.4	6.3	7.5	6.3
GIDC Paid	2.8	2.8	0.3	-2.2	8.6	1.5	
Ending	-	-	2.3	7.9	5.6	11.6	11.6
GIDC Rate on Feed Gas	197	197	197	197	300	300	300
GIDC Rate on Fuel Gas	50	50	50	100	150	150	-

Source: Company accounts and IGI Research, Estimated

FATIMA: GIDC payable amount relatively on the lower-side; impact estimated at PKR 0.9/share on income with an outflow of PKR 0.8/share

For FATIMA the impact on cash flows and income will be minimal at PKR 0.8/share and PKR 0.9/share respectively. The company receives gas at concessionary rate and hence we have incorporated GIDC cost on fuel only in our calculations. Our cost estimates for GIDC takes into account production of urea, CAN and NP. The total accrued amount accumulates at PKR 5.3bn, signifying per share impact of PKR 0.9 on income. However, on cash flow basis, the impact is negative with an outflow of PKR 1.6bn (PKR 0.8/share).

Exhibit:

Impact on cash flows and income

Accrued Amount	5.3
50% GIDC Reversal	2.7
GIDC amt. already Paid	1.0
Net Receivable am. from Govt.	(1.7)
Outstanding Subsidy Amount	2.6
Total Receivable from Govt. (2018)	1.0
P&L: Other Income	2.7
Number of Shares	2.1
Per Share Before Tax	1.3
P&L: PKR / Share (after tax)	0.9
Cash flows: PKR / Share	(0.8)

Estimated GIDC amount 2012-18

(in PKRbn)	CY12	CY13	CY14	CY15	CY16	CY17	CY18*
Opening	-	-	-	0.6	1.5	2.2	2.8
GIDC Payable	0.2	0.3	0.4	0.7	1.1	1.4	1.2
GIDC Paid	-	-	-	-0.2	0.3	0.9	
Ending	-	-	0.6	1.5	2.2	2.8	2.8
GIDC Rate on Feed Gas	-	-	-	-	-	-	-
GIDC Rate on Fuel Gas	50	50	50	100	150	150	150

Source: Company accounts and IGI Research, Estimated

GIDC proposal seeks reduction in urea price (PKR 200/bag)

On a net basis, a) 50% reduction in GIDC rate for both feed and fuel on non-concessionary and b) price reduction of PKR 200/bag, we estimate FFBL to benefit the most.

Exhibit:

Net impact of Price reduction and GIDC rate

(In PKRbn)	FFC	EFERT	FFBL	FATIMA
CY19 Estimates	11.1	11.3	1.2	6.7
Urea production (kTons)	2,481.0	1,726.0	521.0	516.0
GIDC Cost (PKR/bag)	397.5	157.1	260.8	87.9
50% reduction	198.8	78.5	130.4	44.0
Per Share:				
Impact of 50% reduction GIDC rate	5.2	1.2	2.1	0.1
Impact of price reduction (PKR 200/bag)	0.4	(2.0)	0.7	(0.5)
Total Impact	5.6	(0.9)	2.8	(0.4)
<i>as %age of est. 2019 EPS</i>	50%	-8%	228%	-6%

Source: IGI Research, Company accounts, PSX

GIDC resolution; Not exactly a win-win game

We are of the opinion that if resolution gets materialized this could benefit government in terms of revenue shortfall, albeit slightly. However, even still this might not come as straightforward as some sort of settlement may be needed, such as manufacturers demanding outstanding subsidy receivable from the government and tax refundable. More so, price reduction may seem infeasible as manufactures have already absorbed 90% of the GIDC cost (in the form of sales tax and other operational costs).

Recommendation

So far the sector's price performance has been lucid as the news flow regarding GIDC started pouring in during the start of January. The sector return stands at +9% as of CY19TD with FFC leading the growth, marking a return of +18%. We believe the market has already priced in the impact of the proposal. Our stance on the sector remains neutral, with strong preference for EFERT at Dec-19 target price of PKR 80.2/share. The company is currently trading at CY19E P/E of 6.84x and offers a dividend yield of 13%.

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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) 38303559-68	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

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 # 134, 3rd Floor, Stock Exchange Building,
Stock Exchange Road, Karachi.
Tel: (+92-21) 32429613-4, 32462651-2
Fax: (+92-21) 32429607

Lahore Office

Shop # G-009, Ground Floor,
Packages Mall
Tel: (+92-42) 38303560-69
Fax: (+92-42) 38303559

Faisalabad Office

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

Multan Office

Mezzanine Floor, Abdali Tower,
Abdali Road
Tel: (92-61) 4512003, 4571183

Peshawar Office

2nd Floor, The Mall Tower,
35 The Mall Saddar Cantt.
Tel: (92-91) 5273035, 5223882

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

Rahim Yar Khan Office

Plot # 12, Basement of Khalid Market,
Model Town, Town Hall Road
Tel: (+92-68) 5871652-3
Fax: (+92-68) 5871651

Abbottabad Office

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

Sialkot Office

Suite No. 10 & 11, 1st Floor, Soni Square,
Mubarik Pura
Tel: (+92-52) 3258028

IGI Finex Securities Limited

Research Analyst(s)

Research Identity Number: BRP009

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