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PAKISTAN
FERTILIZER

REP-019
MARKET
VISTA

FFBL: Event triggers make (or break) value

- **Despite potential upside triggers on the horizon, core profitability outlook in the near-term seems to be weak for FFBL. The gas price hike, higher leverage amid rising interest rates scenario and inability to completely pass-on the impact of cost inflation will likely eat into FFBL's profitability.**
- **We incorporate better than current DAP margins in our estimates due to expected improvement in 2H and higher dividend income (35% owned FEW-I and FEW-II) for CY19. Nonetheless, the CY19 profits are likely to take a dip, considering leveraged B/S (D/A: 44%) and inability to pass-on gas price hike across product categories.**
- **Meanwhile, potential triggers in the form of (i) conclusion of FFL transaction and (ii) GIDC settlement are likely to balance the slack in core profitability. The 50.6% owned FFL has been a strain on FFBL's consolidated profits and cashflows, which could ease up if the FFL sale transaction materializes. Furthermore, a one-time cash inflow could also assist FFBL to deleverage (current D/A ratio: 44%).**
- **FFBL, being a non-concessionary gas player, also stands to benefit the most in case of GIDC resolution. If the GIDC settlement transpires as per proposal, that is removal of 50% of GIDC on fertilizer feed/fuel followed by a PkR180/bag reduction in Urea prices, it will result in recurring positive earnings impact of PkR0.98/sh for FFBL (60% of standalone CY18 EPS).**
- **The upcoming result could put a lid on the scrip's price performance in our view, unless either of the trigger, that is FFL transaction or GIDC settlement materializes. Our TP of PkR36/sh, implies an upside of 13.8% on last close - Neutral.**

Dividend income elevated 4QCY18 profits: We revisit our investment case of Fauji Fertilizer Bin Qasim Ltd (FFBL) post release of detailed financial accounts. FFBL posted 28% YoY higher NPAT of PkR1.6bn (EPS: PkR1.76) in 4QCY18 on stand-alone basis, taking the CY18 NPAT to PkR1.43bn (EPS: PkR1.54). The increase in 4Q NPAT was led by 2.2x YoY higher 'other income' (first dividend from its power subsidiary FPCL), which outweighed hefty exchange losses and 2 ppt YoY decline in GMs to 13%. Note that FFBL's product mix is 45/55% Urea/DAP – while Urea price increased to pass on the higher gas price, lower margins on its DAP business subdued gross margins.

Core earnings to remain under pressure: The company's profitability is expected to remain under pressure in CY19, due to (i) 50/30% higher feed/fuel gas prices in Oct'18, (ii) high leverage amid rising interest rate scenario and (iii) limited pass-on ability of expensive raw material imports (phosphoric acid). The phosphoric acid prices increased 23% YoY in CY18, further worsened by 14% YoY weaker PkR. Downward trend in phosphoric acid prices CYTD however, is an encouraging sign. While DAP players are likely to pocket comparatively better margins in Rabi season, 1HCY19 results are likely to remain dismal. To note, DAP players are currently offering discounts for better offtake amid high inventory levels (Dec'18 DAP inventory: 588Ktons, up 3.4x YoY). We expect full year standalone CY19F profits to take a dip, despite incorporating (i) higher than current DAP price, and (ii) first dividend income from its 35% held wind power subsidiaries (FWE-I and FWE-II).

Upside triggers balance negatives: The downside risks are neutralized by potential upside triggers: (i) FFL transaction and/or (ii) GIDC settlement, which if materialize could be value accretive for the scrip. Inner Mongolia Yili Industrial Group Company, a China based Dairy company, has expressed interest in buying 51% stake in Fauji Foods Ltd (FFL) from FFBL and other stakeholders, a joint venture which has been a drain on FFBL's cashflows since CY15. If the transaction goes through (expected timeline 2QCY19), the same could result in improving FFBL's consolidated earnings. A cash inflow from the transaction could also assist FFBL in deleveraging, bringing down D/A level from 44% in CY18. In addition to this, FFBL, being a non-concessionary gas player, stands to benefit the most in case of GIDC resolution. If the GIDC settlement transpires as per proposal, that is removal of 50% of GIDC on fertilizer feed/fuel followed by a PkR180/bag reduction in Urea prices, it will also be earnings positive for the company. Our TP of PkR36/sh, implies an upside of 13.8% on last close - Neutral.

Ailia Naeem
ailia.naeem@akdsecurities.net
111-253-111 Ext: 603

NEUTRAL

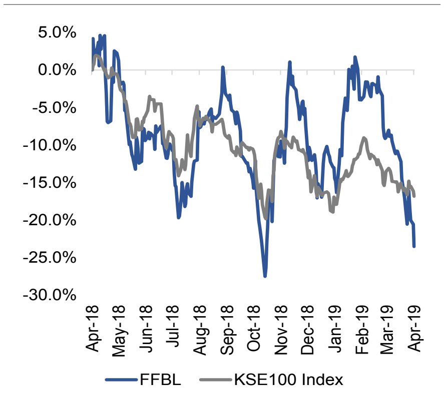
TARGET PRICE (PkR)	SHARE PRICE (PkR)
36.14	31.76
UPSIDE/DOWNSIDE	DIV. YIELD
13.8	-

FFBL: Key ratios

	CY18	CY19F	CY20F
EPS* (PkR)	1.54	0.72	2.04
EPS Growth (%)	43.0	-53.0	182.6
PER (x)	20.65	43.92	15.54
P/BVS(x)	2.13	2.04	1.95
DPS (PkR)	1.0	-	1.32
Dividend yield (%)	3.1	-	4.2
Gross Margin (%)	13.3	11.1	12.2

*Standalone Source: Co Report & AKD Research

FFBL vs. KSE100 Index



Source: PSX & AKD Research

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New Rating Definitions	
Buy	**> 19% expected total return (Rf: 13% + Rp: 6%)**
Neutral	**> 13% to < 19% expected total return**
Sell	**< 13% expected total return (Rf: 13%)**

Old Rating Definitions (Discontinued)	
Buy	**> 20% upside potential**
Accumulate	**> 5% to < 20% upside potential**
Neutral	**< 5% to > -5% potential**
Reduce	**< -5% to > -20% downside potential**
Sell	**< -20% downside potential**
Not Rated	**No investment opinion or recommendation**

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- Equity & Asset return based methodologies (EVA, Residual Income etc.)

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