April 9, 2019

PAKISTAN FERTILIZER

REP-019

MARKET VISTA

FFC: The safest bet

- **The GIDC settlement news-flow has lost steam, putting a lid on the price performance of the non-concessionary gas based Fertilizer players. However, the recent price correction has opened up valuation upside for one of the safest bets in the Fertilizer space, FFC.**
- **FFC is expected to record a one-off reversal of PkR21bn (EPS impact: PkR11.58 vs. FFC's CY18 earnings: PkR11.35) in case of GIDC settlement. On a recurring basis, the reduction in Urea prices following the relief in form of 50% GIDC removal is expected to be Neutral for FFC, but positive for its 49.9% owned subsidiary, FFBL.**
- **Meanwhile, GoP plans to increase gas prices by 18-20% w.e.f Jun'19 - the increase in 20% of feed/fuel gas price translate into a PkR80/bag impact for FFC. We believe the Fertilizer players will likely pass-on the cost impact, given favorable supply demand dynamics. FFC has increased Urea prices by PkR80/bag effective Mar'19; however, we have not incorporated the same in our estimates.**
- **Within the Fertilizer space, FFC is the best sheltered against macro headwinds, in our view. The scrip trades at a CY19F P/E of 8.06x and offers a D/Y of 9.8%. Our TP of PkR116/sh implies total return of 23% on last close – Buy.**

To be or not to be: The GIDC settlement news-flow has lost steam, putting a lid on the price performance of the non-concessionary gas based Fertilizer players. By way of background, the government had proposed a 50% waiver on GIDC payable accrued and prospective application. However, the GoP is likely to demand Fertilizer players to pass on atleast a partial impact in form of lower Urea prices (up PkR410/bag since Dec'17). Meanwhile, the Fertilizer players, especially EFERT and FFC, which account for cumulative 80% of total Urea market share, contend that the current Urea prices do not completely reflect the impact of inflationary pressures over the last few years, resulting in a deadlock situation.

GIDC settlement could be a turnaround: Out of the cumulative GIDC arrears of PkR70bn as of Dec'18, FFC, being the largest Urea player in terms of market share, accounts for the highest amount of GIDC – PkR42bn. In case of its materialization, FFC is expected to record a one-off reversal of PkR21bn (EPS impact: PkR11.58 vs. FFC's CY18 earnings: PkR11.35). On a recurring basis, the reduction in Urea prices along with the relief in form of 50% GIDC removal is expected to be Neutral for FFC, but positive for its 49.9% owned subsidiary, FFBL.

To note, FFBL has a 45/55% of Urea/DAP in its product mix – while GIDC of PkR300/150/mmbtu is expected to reduce for the entire feed/fuel gas used by FFBL, only Urea prices are likely to come down, resulting in positive earnings impact for FFBL. The recurring benefit in form of lower GIDC could result in better payouts from FFBL, subject to conclusion of FFL transaction. The dividend income from subsidiaries, associates and joint ventures have contributed 15% on average to FFC's bottomline over CY17-18.

Gas prices up for another hike: The GoP is considering another gas price hike (w.e.f Jul'19) by 18-20% by Jun'19 to meet revenue shortfall of SNGP/SSGC. The increase in 20% of feed/fuel gas price translate into a PkR80/bag impact for FFC. In the event of gas price hike, the Fertilizer players are likely to increase Urea price similar to Oct'18 episode, given the supply demand dynamics remain in favor. To note the ECC has recently approved 100K tons of Urea import, which is insufficient to create an oversupply situation in the market, in our view. On the contrary, FFC (followed by other Urea players) has increased Urea price by PkR80/bag in Mar'19 (EPS impact of 17% for CY19) –however, we have not incorporated the same in our estimates.

Investment Perspective: Within the Fertilizer space, FFC is the best sheltered against macro headwinds (gas price hike, potential pressure on Urea prices). While its concessionary gas based competitors (EFERT and FATIMA), are expected to pocket in higher profits in case of a gas price hike and its complete pass-on, these players also remain under the risk of comparatively higher earnings erosion in case of proposed GIDC settlement. The scrip trades at a CY19F P/E of 8.06x and offers a D/Y of 9.8%. Our TP of PkR116/sh implies total return of 23% on last close – Buy.

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

BUY

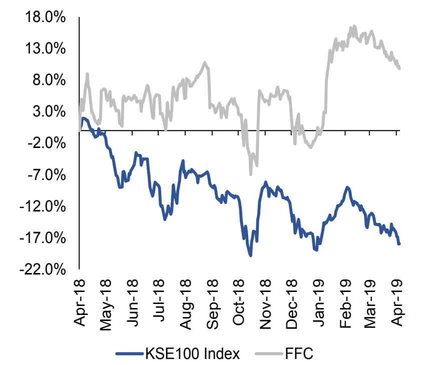
TARGET PRICE (PkR)	SHARE PRICE (PkR)
115.78	**102.0**
UPSIDE/DOWNSIDE	DIV. YIELD
13.50	**9.80**

FFC: Key ratios

	CY18	CY19F	CY20F
EPS (PkR)	11.35	12.66	13.60
EPS Growth (%)	34.81	11.52	7.49
PER (x)	8.99	8.06	7.50
P/BVS(x)	3.89	3.53	3.24
DPS (PkR)	8.85	10.00	11.00
Dividend yield (%)	8.68	9.80	10.78
Gross Margin (%)	28.03	24.41	27.03

Source: Company Report & AKD Research

FFC vs. KSE100 Index



Source: PBS & AKD Research

AKD Securities Limited

Disclosure Section

Neither the information nor any opinion expressed herein constitutes an offer or a solicitation of an offer to transact in any securities or other financial instrument and is for the personal information of the recipient containing general information only. AKD Securities Limited (hereinafter referred as AKDS) is not soliciting any action based upon it. This report is not intended to provide personal investment advice nor does it provide individually tailored investment advice. This report does not take into account the specific investment objectives, financial situation/financial circumstances and the particular needs of any specific person. Investors should seek financial advice regarding the appropriateness of investing in financial instruments and implementing investment strategies discussed or recommended in this report and should understand that statements regarding future prospects may not be realized. AKDS recommends that investors independently evaluate particular investments and strategies and it encourages investors to seek the advice of a financial advisor.

The appropriateness of a particular investment or strategy will depend on an investor's individual circumstances and objectives. The securities or strategies discussed in this report may not be suitable for all investors, and certain investors may not be eligible to purchase or participate in some or all of them.

Reports prepared by AKDS research personnel are based on public information. AKDS makes every effort to use reliable, comprehensive information, but we make no representation that it is accurate or complete. Facts and views presented in this report have not been reviewed by and may not reflect information known to professionals in other business areas of AKDS including investment banking personnel. AKDS has established information barriers between certain business groups maintaining complete independence of this research report.

This report has been prepared independently of any issuer of securities mentioned herein and not in connection with any proposed offering of securities or as agent of any issuer of any securities. Neither AKDS, nor any of its affiliates or their research analysts have any authority whatsoever to make any representation or warranty on behalf of the issuer(s). AKDS Research Policy prohibits research personnel from disclosing a recommendation, investment rating, or investment thesis for review by an issuer prior to the publication of a research report containing such rating, recommendation or investment thesis.

We have taken all reasonable care to ensure that the information contained herein is accurate, up to date, and complies with all prevailing Pakistani legislations. However, no liability can be accepted for any errors or omissions, or for any loss resulting from the use of the information provided as any data and research material provided ahead of an investment decision are for information purposes only. We shall not be liable for any errors in the provision of this information, or for any actions taken in reliance thereon. We reserve the right to amend, alter, or withdraw any of the information contained in these pages at any time and without notice. No liability is accepted for such changes.

Stock Ratings

Investors should carefully read the definitions of all ratings used in each research report. In addition, research reports contain information carrying the analyst's view and investors should carefully read the entire research report and not infer its contents from the rating ascribed by the analyst. In any case, ratings or research should not be used or relied upon as investment advice. An investor's decision to buy, sell or hold a stock should depend on individual circumstances and other considerations. AKDS uses a three tier rating system: i) Buy, ii) Neutral and iii) Sell (new rating system effective Sep 10'18) with total returns (capital upside + dividend yield) benchmarked against the expected one year forward floating (variable) risk free rate (10yr PIB) plus risk premium.

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

Valuation Methodology

To arrive at our period end target prices, AKDS uses different valuation techniques including:

- Discounted Cash Flow (DCF, DDM)
- Relative Valuation (P/E, P/B, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)

Analyst Certification of Independence

The analysts hereby certify that their views about the companies and their securities discussed in this report are accurately expressed and that they have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

The research analysts, strategists or research associates principally having received compensation responsible for the preparation of this AKDS research report based upon various factors including quality of research, investor client feedback, stock picking, competitive factors and firm revenues.

Disclosure of Interest Area

AKDS and the authoring analyst do not have any interest in any companies recommended in this research report irrespective of the fact that AKD Securities Limited may have, within the last three years, served as manager or co-manager of a public offering of securities for, or currently may make a primary market in issues of, any or all of the entities mentioned in this report or may be providing, or have provided within the previous 12 months, significant advice or investment services in relation to the investment concerned or a related investment.

Regional Disclosures (Outside Pakistan)

The information provided in this report and the report itself is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation or which would subject AKDS or its affiliates to any registration or licensing requirements within such jurisdiction or country.

For the United States

Compliance Notice.

This research report prepared by AKD Securities Limited is distributed in the United States to Major US Institutional Investors (as defined in Rule 15a-6 under the Securities Exchange Act of 1934, as amended) only by Decker & Co, LLC, a broker-dealer registered in the US (registered under Section 15 of Securities Exchange Act of 1934, as amended). All responsibility for the distribution of this report by Decker & Co, LLC in the US shall be borne by Decker & Co, LLC. All resulting transactions by a US person or entity should be effected through a registered broker-dealer in the US. This report is not directed at you if AKD Securities Limited or Decker & Co, LLC is prohibited or restricted by any legislation or regulation in any jurisdiction from making it available to you. You should satisfy yourself before reading it that Decker & Co, LLC and AKD Securities Limited are permitted to provide research material concerning investment to you under relevant applicable legislations and regulations.