

PAKISTAN FERTILIZER

MARKET VISTA

The curious case of price hikes

- As per our channel checks EFERT has increased its urea price by another PKR50/bag to PKR1,675/bag w.e.f 11th Jan'21, taking cumulative price hike to PKR75/bag post GIDC elimination. Every PKR25/bag increase is expected to elevate our CY21F EPS estimates by PKR0.68/0.51/0.23/0.08 for FFC/EFERT/FFBL/FATIMA.
- Tax regulations implemented in income tax laws in Budget FY21 disallowed 10% expense deduction w.e.f from Oct'20 for sale to unregistered dealers, implying a PKR45-50/bag increase in urea prices by industry leaders (EFERT & FFC). While the measure is still under negotiations, its implementation could somewhat negate the impact of recent price hikes (not incorporated). We therefore maintain our urea price assumption at PKR1,600/bag.
- Meanwhile, shortage of DAP on global scale has led to intl. prices to continue their uptrend in Dec'20 (up by 3%MoM; up 27% FYTD), where EFERT has increased DAP prices by PKR400/bag recently as a result. Every PKR100/bag higher DAP price than our base case assumption translates into an EPS impact of PKR1.22/0.56/0.53 for FFBL/FFC/EFERT on an annualized basis.
- While EFERT and FFBL are likely to witness a strong start to CY21F, we highlight the potential upcoming gas price hike. An increase in feed/fuel gas prices by 25/15% (PKR120/bag impact for FFC) may be positive for EFERT. On the flipside, potential gas price hike may trim some of the gains for FFBL from commodity pricing momentum.

EFERT increases urea price - yet again: Fertilizer prices seem to be on an uptrend, with our channel checks suggesting another PKR50/bag hike w.e.f 11th Jan'21 in urea prices announced by EFERT. To recall, GIDC rates on feed and fuel gas were eliminated on prospective basis in Jan'20, bringing down the urea prices by PKR400/bag to PKR1,600/bag over 1QCY20. The GIDC removal completely negated the impact of gas price hike (feed/fuel gas witnessed 136/31% increase in Sep'19) passed on to consumers. However, in face of LNG shortage in recent months amidst peak season, the Fertilizer players seem to be reversing the benefit of GIDC elimination. The recent urea price increase takes the cumulative hike to PKR75/30 per bag for EFERT/FFC since Aug'20. Tax regulations implemented in income tax laws in Budget FY21 disallowed 10% expense deduction w.e.f from Oct'20 for sale to unregistered dealers, implying a PKR45-50/bag increase in urea prices by industry leaders (EFERT & FFC). While the measure is still under negotiations, its implementation could somewhat negate the impact of recent price hikes. We therefore maintain our urea price assumptions at PKR1,600/bag.

DAP prices continue to gather steam: In addition to urea, EFERT also announced PKR400/bag increase in DAP prices to ~PKR4,400/bag in Jan'21, citing DAP shortage in international markets as a reason. With DAP imports accounting for ~60% of country-wide offtake, the local DAP prices had already witnessed an uptick of c. PKR500/bag over Aug-Sep'20. Meanwhile, international DAP prices continue to edge up, increasing 3% MoM in Dec'20 (27% increase FYTD to US\$390/MT), translating into local DAP price of ~PKR4,100/bag (also our base case assumption for CY21). With plants undergoing maintenance during Jan-Feb'21, the global supply shock is likely to continue through 1QCY21. FFBL, the sole DAP manufacturer is likely to benefit the most (see table on right). ECC approved a subsidy of PKR900/bag on DAP based on scratch card mechanism which continues to face a delay. GoP's attempt to keep fertilizer prices at a manageable level may result in providing subsidy as per earlier mechanism, which could have negative implications for FFBL's cashflows.

Investment Perspective: While EFERT and FFBL are expected to stay in the limelight amidst the aforementioned backdrop, we also bring attention to potential gas price hikes expected in CY21. A backlog of PKR175bn of circular debt stands unresolved as per latest estimated revenue requirement notice of SNGP, indicating towards further gas price, especially as COVID-19 related leniencies end for the economy, along with revival of IMF program. An increase in feed/fuel gas prices by 25/15% would translate into impact of PKR120/bag for FFC. In case of complete pass-on, EFERT being concessionary based player is expected to benefit the most. On the flipside, potential gas price hike may trim some of the gains for FFBL from pricing momentum.

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Valuation Stats

	TP (Pkr)	Stance	EPS 20F	EPS 21F	DY 20F	DY 21F
EFERT	59.0	Sell	11.4	8.9	16.5%	12.0%
FFBL	25.7	Neutral	2.3	3.3	-	-
FFC	131.0	Buy	15.2	16.1	10.7%	10.7%
FATIMA	39.0	Buy	6.0	6.0	8.2%	6.4%

Source: Company Reports & AKD Research

Sensitivity Analysis*

	EFERT	FFC	FFBL	FATIMA
CY21F EPS (Pkr)	8.90	16.10	3.30	6.00
	EPS impact (Pkr)			
Urea	0.51	0.68	0.23	0.08
DAP	0.53	0.56	1.22	0.00
	Impact as % of EPS			
Urea	6%	4%	7%	1%
DAP	6%	3%	37%	0%

*PKR25/100 per bag increase in urea/DAP prices Source: AKD Research



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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.)

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Neutral	> 8.5% to < 14.5% expected total return
Sell	< 8.5% expected total return (Rf: 8.5%)



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