

PAKISTAN FERTILIZER

MARKET VISTA

REP-019

Cautious optimism on price hike

- As per our channel checks, Fauji Fertilizer Company Ltd (FFC) has increased Urea prices by PKR80/bag to PKR1,820/bag. The price increase comes on the back of expected demand pick up in the up-coming Kharif season, amid low inventory levels, in our view (Urea inventory Jan'19: 70K tons).
- The recent price hike is still short of justified Urea price as per Fertilizer players, who claim to have been absorbing approximately 90% of the GIDC imposition impact. The deadlock situation on GIDC settlement, meanwhile, is likely to continue as GoP demands Urea price reduction accompanying 50% GIDC waiver.
- In this regard, the GoP may collect approximately PkR30bn from the Fertilizer sector in the form of GIDC. In comparison, creating Urea surplus situation through imports or LNG based production may require PkR9-10bn out of national kitty, which seems unlikely, considering the dismal fiscal situation.
- While this price hike bodes well for AKD Fertilizer Universe (will lift CY19 earnings estimates by 15/9/34% for FFC/EFERT/FFBL – assuming prices are increased sector-wide, which is usually the case), we remain skeptical over the price increase and await further clarification on GIDC before incorporating it in our estimates.
- Amid this background, we highlight that FFC is better positioned with regards to the GIDC (complete pass-on of GIDC impact to be neutral), and, is expected to be the prime beneficiary if the recent Urea price hike sustains. FFC trades at CY19/20 P/E of 7.9/7.7x and offers a D/Y of 10.5%.

Tight supply results in Urea price hike: CY19 seems to be yet another year for Fertilizer players with the demand supply situation in favor of Fertilizer players despite Urea imports and LNG supply to hitherto closed fertilizer plants (FatimaFert and Dawood Hercules – 75K tons capacity per month). As per our channel checks, Fauji Fertilizer Company Ltd (FFC) has increased Urea prices by PKR80/bag to PKR1,820/bag. The price increase comes on the back of expected demand pick up in the up-coming Kharif season, amid low inventory levels, in our view. To recall, the Urea inventory closed at 70K tons in Jan'19, down 72% YoY, which is also a multi-year low. That said, the recent price hike is still short of justified Urea price of PKR2,080/bag as per Fertilizer players, who claim to have been absorbing approximately 90% of the GIDC imposition impact (refer to table at right).

Overhang on GIDC to continue: While this price hike bodes well for AKD Fertilizer Universe (will lift CY19 earnings estimates by 15/9/34% for FFC/EFERT/FFBL – assuming prices are increased sector-wide, which is usually the case), we remain skeptical over the price increase in the backdrop of ongoing discussions over the GIDC settlement. A 50% waiver to outstanding GIDC payments for Fertilizer players is conditional on Urea price reduction of PkR200/bag which will result in a negative earnings impact for concessionary based Fertilizer players (EFERT and FATIMA) on recurring basis, while being neutral for FFC. While Urea players maintain their stance that Urea prices are still at a discount, we believe the GIDC overhang situation to continue. Note that, the GoP may collect approximately PkR30bn from the Fertilizer sector in the form of GIDC. In comparison, creating Urea surplus situation through imports or LNG based production may require PkR9-10bn out of national kitty, which seems unlikely, considering the dismal fiscal situation.

Investment Perspective: Amid this background, we highlight that FFC is better positioned with regards to the GIDC (complete pass-on of GIDC impact to be neutral), and, is expected to be the prime beneficiary if the recent Urea price hike sustains. FFC trades at CY19/20 P/E of 7.9/7.7x and offers a D/Y of 10.5%. We await for further clarification before incorporating the recent price hike in our estimates. Downside risks for the sector include increase in GST from the current uniform rates of 2% across all fertilizers, where every 5% increase in GST results in per bag impact of PKR90/bag of Urea.

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GIDC pass-through impact

GIDC Impact	PkR/bag
Feed GIDC	342
Fuel GIDC	43

Total GIDC impact **385**

Urea price in Dec'11	1580
GIDC impact per bag with GST	385
Price decrease due to reduction in GST	-191
Price increase due to non-gas costs	148
Price increase due to gas costs other than GIDC	162
Urea price if all cost are passed on to farmers	2084
Current Urea price	1,820
Difference	-264
Percentage of GIDC impact absorbed by Urea players	69%

Landed cost of International Urea	2200
Difference	-380

Source: Company Presentation & NFDC



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Neutral	> 13% to < 19% expected total return
Sell	< 13% expected total return (Rf: 13%)

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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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