

PAKISTAN FERTILIZER

MARKET VISTA

FFBL: Risks to the turnaround story

- We revise our estimates for Fauji Fertilizer Bin Qasim Ltd (FFBL), incorporating the recent right issue (post right TP: PkR25.7/sh). FFBL witnessed a turnaround in terms of 3QCY20 NPAT (PkR3.3bn; EPS: PkR3.54) vs NLAT of PkR1.2bn (LPS: PkR1.24) in 2QCY20. A mix of uptrend in DAP price as well as volumetric offtake, lower finance cost, GIDC elimination and dividend income, led to the bottomline in green.
- Positive developments namely, (i) extension in GIDC payment timeline and (ii) potential sell-off of its stake in wind power project (PkR8.6bn), could result in improved liquidity (GIDC payment net of cash is PkR14bn, vs. right issue + sell off of wind projects PkR13.6bn).
- However, downside risks including: (i) further loans to loss making food ventures and, (ii) budgetary measure of 10% expense disallowance w.e.f Oct'20, may keep price performance in check. To emphasize, the latter has the potential to erode 40% of our CY21F NPAT, even if EFERT and FFC decide to pass-on the impact to end consumers in terms of a PkR45-50/bag urea price hike (see table below).
- While we have not incorporated the aforementioned risk in our estimates, this could be a potential dampener for an otherwise turnaround story. The recent correction has opened valuation upside, however, we advise investors to maintain a cautious stance based on potential sector developments.

Result Review: We revise our estimates for Fauji Fertilizer Bin Qasim Ltd (FFBL), incorporating the recent right issue. FFBL witnessed a turnaround in 3QCY20, with NPAT of PkR3.3bn (EPS: PkR3.54), as opposed to a loss of PkR1.2bn (LPS: PkR1.24) in 2QCY20. This takes 9MCY20 NLAT to PkR901mn (LPS: PkR0.97), vs PkR2.4bn (LPS: PkR2.59) in the same period last year. Barring the impact of other income, core earnings were at PkR1.22/sh vs. core loss of PkR2.49/2.37 per share in 2QCY20/3QCY19. The turnaround in core earnings is on the back of (i) 14/65% YoY/QoQ increase in topline, courtesy 22/115% YoY/QoQ uptick in DAP offtake, (ii) 5.4/3.0 ppt YoY/QoQ increase in GMs to 15.7%, courtesy DAP price hike and GIDC elimination in Jan'20 and (iii) 43/33% YoY/QoQ decline in finance cost, amid decline in interest rates. In 9MCY20, 2.4xYoY higher other expenses (impairment charges of PkR1.1bn on FML) overshadowed improvement in core business dynamics, keeping the bottomline in red for the period.

Extension in GIDC payment timeline provides a breather: The extension of 3 years for GIDC payments with 60 installments to be paid over 5 years vs. 24 installments over 2 years as per initial SC decision, shall be favorable for FFBL which has cash to cover ~40% of GIDC payment as per latest financials (PkR8bn vs. GIDC payment of PkR22bn). As per our initial working, FFBL would have witnessed a shortfall of PkR4bn per annum for meeting net cash burden based on expected CFO in CY21 (per annum CFO is PkR3bn on average vs. per annum GIDC payment of approx. PkR7bn). The company has recently issued 38.3% right to raise PkR5.0bn. To add, MARI has also expressed interest in acquisition of majority shares in wind power projects. FFBL has 35% stake in Foundation Wind Energy I & II each, where we value the FFBL's stake in the projects at PkR8.7bn (PV of ROE). If the transaction goes through, FFBL may be in a comfortable position in terms of liquidity (right issue of PkR5bn + FEW transaction of PkR8bn) despite GIDC payment (PkR14bn, net of existing cash balance). The FEW I & II sell-off may also result in one-time positive EPS impact of PkR1.27.

Downside risks may negate recent tailwinds: FFBL is considering to extend a loan of PkR3.5bn to FFL which may be converted to fully paid-up ordinary shares of corresponding value, issued by FFL to FFBL (PkR2.6bn loan extended to FFL was converted to paid-up ordinary shares in 3QCY20). To recall, FFL and FML cumulatively contributed a loss of PkR2.6bn to FFBL's consolidated bottomline in 9MCY20. The loss making food ventures may continue to be a drain on FFBL's cashflows, negating the excitement of turnaround on core earnings basis. Furthermore, GoP's announced budgetary measure of 10% expense disallowance on sale to unregistered deal-

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



BUY

TARGET PRICE (PkR)	SHARE PRICE (PkR)
*25.70	21.67
UPSIDE/DOWNSIDE	DIV. YIELD
18.61%	-

*Post right TP

FFBL: Valuation Glance

Key metrics	CY19	CY20F	CY21F	CY22F
EPS (PkR)	(4.59)	0.57	2.40	1.76
EPS Growth	-512.2%	n.a	429.5%	-26.7%
PER(x)	(4.73)	47.74	9.02	12.30
BVS (PkR)	5.29	9.62	12.02	13.78
P/BVS(x)	4.09	2.25	1.80	1.57
ROE	-57.1%	6.1%	22.2%	13.7%
ROA	-6.9%	0.7%	3.5%	2.6%

Source: Company reports & AKD Research



AKD Securities Limited

ers may also potentially result in a negative EPS impact of Pkr1.86 (assuming 100% sales to unregistered dealers) for FFBL. The per bag impact of the aforementioned budgetary measure is Pkr45-50/bag for both EFERT and FFC, but much higher for FFBL. FFBL may have to witness a negative NPAT impact of Pkr1.1bn (~40% of CY21F NPAT), as per our back of the envelop calculations (refer to the table below) if budgetary impact is partially passed on.

FFBL may struggle to pass-on the impact of 10% expense disallowance

(Pkrmn)	EFERT	FFC	FFBL	FATIMA
CY20F COGS	68,000	75,000	60,000	23,000
% of sale to unregistered persons	100%	100%	100%	100%
COGS - unregistered sale	68,000	75,000	60,000	23,000
Expense deduction disallowed (Pkrmn)	6,800	7,500	6,000	2,300
Tax Rate	29%	29%	29%	29%
Impact on NPAT	1,972	2,175	1,740	667
EPS impact	1.48	1.71	1.86	0.32
Urea offtake (MT)	1,900,000	2,450,000	600,000	500,000
Per bag impact	52	44	145	67

Source: AKD Research

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 with total returns (capital upside + dividend yield) benchmarked against the expected one year forward floating (variable) risk free rate (10Yr PIB) plus risk premium.

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.

Furthermore, all copyrights, patents, intellectual and other property in the information contained in this report are held by AKDS. No rights of any kind are licensed or assigned or shall otherwise pass to persons accessing this information. You may print copies of the report or information contained within herein for your own private non-commercial use only, provided that you do not change any copyright, trade mark or other proprietary notices. All other copying, reproducing, transmitting, distributing or displaying of material in this report (by any means and in whole or in part) is prohibited.

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.

New Rating Definitions

Buy	> 14.5% expected total return (Rf: 8.5% + Rp: 6%)
Neutral	> 8.5% to < 14.5% expected total return
Sell	< 8.5% expected total return (Rf: 8.5%)



AKD Securities Limited
602, Continental Trade Centre,
Clifton Block 8, Karachi, Pakistan.
research@akdsecurities.net