

PAKISTAN FERTILIZER

MARKET VISTA

Leniency in GIDC payment

- The fertilizer players have reportedly approached the government, requesting recovery of outstanding GIDC dues (Pkr109bn on non-concessionary gas) in 10 years instead of 2 years, as per the recent Supreme Court decision, indicating urea price hike (Pkr500/bag) in case of dismissal of request.
- To recall, the recent Supreme Court decision should result in an outflow in the range of Pkr6-60bn from the Fertilizer players, where netting off the GIDC payables by available cash and short term investments imply a net cashflow burden of Pkr3-20bn for Fertilizer players.
- Amid the aforementioned background, our numbers suggest a 48 months extension for GIDC payment should be sufficient for the players worst hit by the GIDC decision (FFBL's per annum CFO is Pkr3bn vs. per annum GIDC payment of approx. Pkr9bn). A potential outcome of the ongoing discussions could be a 12 to 24 months extension along with a Pkr100-200/bag urea price hike.
- Amid, this scenario, we highlight FFC as our top pick due to: (i) best liquidity situation with short term investments and cash sufficient to meet 70% of GIDC payables, and (ii) healthy EBITDA generation, which will enable the company to sustain its D/Y north of 10% in CY20/21F (TP: Pkr127/sh; total return 26%).

Extension in GIDC payment timeline: The fertilizer players have reportedly approached the government, requesting recovery of outstanding GIDC dues (Pkr109bn on non-concessionary gas) in 10 years instead of 2 years, as per the recent Supreme Court decision. The fertilizer players have cited their worsening liquidity situation as the reason, where in case of dismissal of request, the players may resort to increase urea prices by Pkr500/bag to Pkr2,100/bag. However, this move would defeat the purpose of the agreement reached in early CY20, where Fertilizer players reduced urea price by Pkr400/bag on prospective elimination of GIDC. The GoP and fertilizer players may chalk out a more amicable solution with respect to recovery of outstanding GIDC dues, in our view. To recall, the recent Supreme Court decision should result in an outflow in the range of Pkr6-60bn from the Fertilizer players, where netting off the GIDC payables by available cash and short term investments imply a net cashflow burden of Pkr3-20bn for Fertilizer players (refer to table).

A much needed relief for FFBL: Amid the aforementioned background, our numbers suggest a 48 months extension for GIDC should be sufficient for the players worst hit by the GIDC decision. To emphasize, in line with Supreme Court's GIDC verdict, we foresee FFBL to witness a shortfall of Pkr6bn per annum for meeting net cash burden based on expected cashflow from operations in CY21 (per annum CFO is Pkr3bn vs. per annum GIDC payment of approx. Pkr9bn). Precarious core earnings situation (1HCY20 NLAT: Pkr4.2bn, up 2.2x YoY) as well as loss-making FML and FFL have resulted in FFBL's debt to equity ratio rising to 15.2x, which may hinder FFBL's ability to further leverage its books. Potential saviors for FFBL in the aforementioned situation could be: (i) right issue which could generate Pkr4-6bn, (ii) continued improvement on core earnings, along with (iii) an extension in GIDC payment timeline by a minimum of 24 months.

Investment Perspective: Assessing Fertilizer player's indication to increase prices, we believe that could be a possibility, given urea inventory at 334K tons (lower than last 12 month's average of approx. 590K tons). Furthermore local prices are currently at a steep 50% discount to international prices. An increase in urea price by Pkr500/bag would be more than sufficient for FFC, EFERT and FATIMA to meet the net cash burden resulting from GIDC outflow. However, we see limited possibility for such a price hike. A more likely situation could be a 12 to 24 months extension along with a Pkr100-200/bag urea price hike. Amid, this scenario, we highlight FFC as the top pick in Fertilizer sector due to: (i) best liquidity situation with short term investments and cash sufficient to meet 70% of GIDC payables, and (ii) healthy EBITDA generation, which will enable the company to sustain its D/Y north of 10% in CY20/21F (TP: Pkr127/sh; total return 26%). Meanwhile, EFERT and FATIMA have obtained a stay order on GIDC levy on concessionary gas until next hearing dated at 29th Sep'20

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Snapshot of Fertilizer players' liquidity situation

	GIDC Payable (PkrMn)	Short Term Investment (PkrMn)	Cash (PkrMn)	Net Cash burden (PkrMn)	Incr. in urea price impact (PkrMn)*
FFC	62,629	42,820	5,665	14,145	24,000
EFERT	18,943	12,707	2,959	3,277	19,000
FFBL	22,201	0	5,012	17,188	5,000
FATIMA	5,822	1,473	1,259	3,089	3,700

*Impact of Pkr500/bag urea price hike for 12 months Source: Co Reports & AKD Research

Valuation Stats

	TP (Pkr)	Stance	EPS 20F	EPS 21F	DY 20F	DY 21F
EFERT	55.5	Sell	8.75	8.31	12.9%	12.9%
FFBL	30.0	Buy	0.14	1.55	-	-
FFC	127.0	Buy	15.17	16.07	11.0%	11.0%
FATIMA	34.4	Buy	5.98	4.67	7.5%	5.9%

Source: Company Reports & AKD Research



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