Standard Capital
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Pakistan Research | Fertilizers

Fauji Fertilizer (FFC) : Time to go for fertilizer king |BUY @ 108.7 | TP Rs 137/sh

Transfer of coverage...

We re-initiate our coverage on Fauji Fertilizer Company (FFC). The FFC's EPS for the year is Rs16.38 which is lower than the previous year's EPS of Rs17.68 and we are forecasting an EPS of Rs17.72 for the coming year. We are forecasting an increase of around 8% assuming some semblance in urea prices. Though our earnings propensity could change with the variation in prices since we see little pressure of cost of feedstock gas on overall margins since FFC enjoys advantageous position in the chemical fertilizer industry as far as dedicated feedstock gas supply from Mari is concerned.

During the past few months EFERT was negotiating gas prices with the consortium of gas fields in which government was also mediating, they were asking to provide gas at US $ 70 cents/mmbtu but the ECC (reportedly) refused to do so and have stated that they will be providing gas for US $ 3.3/mmbtu. If ECC would have agreed to their terms than EFERT would have been able to reduce their prices and it could have some impact on earnings growth of FFC. Now it seems that the decision of outgoing ECC is favourable to FFC. From here we assign DCF value of Rs137/sh - Rs138/sh given terminal growth of 4%.

The FFC's model is a very price sensitive model and slight changes in price could affect the EPS of FFC.

Sensitivity of EPS in relation to price change				
Price /bag	1,600	1,650	1,700	1,750
CY13 EPS	17.04	17.72	18.39	19.07
CY14 EPS	16.70	17.39	18.70	18.76

Source: Standard Capital Research

We have assumed urea prices in the range of Rs 1650 – Rs 1700/ 50kg bag for CY13 on the conservative side. Even though, prices of urea are currently hovering 2% above our base case assumed price.

Profit & loss a/c mn	CY11A	CY12A	CY13E	Chg
Net Sales	55,221	74,323	87,357	18%
Cost of Sales	20,872	38,324	47,261	23%
Gross profit	34,349	35,998	40,096	11%
Distribution Cost	4,372	5,561	7,124	28%
Finance Cost	786	999	795	-20%
Other Expenses	2,655	2,685	2,716	1%
Other Income	6,629	4,268	4,090	-4%
Before tax earnings	33,166	31,021	33,552	8%
Tax	10,674	10,181	11,012	8%
NPAT	22,492	20,840	22,540	8%
EPS Diluted	17.68	16.38	17.72	8%
DPS	20.0	14.5	16.0	10%

Source : Standard Capital Research

FFC has also acquired 60% of Askari Bank. FFC acquired 104.122mn shares of AKBL which means that FFC could gain in shape of bank dividend of Rs 208mn (just in case if AKBL gives a customary dividend of Rs 2/sh in a given annual year). This accounts to only Re0.16/sh incremental impact on EPS, as per our estimation. Though we consider AKBL acquisition a good omen for Fauji Foundation Group since it would be kind of diversified investments

The Fauji Fertilizer Company holds 46% market share of Urea market, however combined with its subsidiary Fauji Fertilizer Bin Qasim Limited, its aggregate market share is around 51%. The company has annual production capacity of 2.0mn tons and the company has over utilized their capacity by producing 117% of their designed capacity. The company made investment in FFC Energy Limited (FFCEL) and the construction activity has been completed and it is now in the test phase, if the test phase is completed successfully then the company will formally start its operation and will start generating revenue which in turn is going to increase the profitability of the FFC.

FFC has 100% holding of FFCEL and the test phase has completed and they will start their operation from this year, we have also incorporated nominal dividend income from FFCEL in the earnings of FFC.

We assume FFC to report CY13 EPS of Rs 17.72/sh (spelling PE of 6.2x).

Cost escalation….

Cost push inflation remains key challenge for every industry in the economy and therefore FFC also faces the risk of rise in the prices of its raw material, particularly the rise in the prices of gas which forms major part of its production cost. Apart from that, in the CY12 the cost of sales has increased by 83.6% as compare to the sales increase of 34.6%. The distribution cost of the company has also risen by 27% in CY12.

The gas is a major production cost of the FFC products. The gas to the FFC is being provided by Mari Petroleum Company limited which itself owned by Fauji Foundation i.e. 40% holding, and Fauji Foundation owns 44.35% of FFC. As per the OGRA notified well head gas prices the gas is being provided at **Rs.48.30/mmbtu** since 2011 and in 2008 the gas was provided at **Rs.37.28/mmbtu,** in short an increase of 29.6% in two years time. FFC has an advantageous position as far as feedstock gas pricing is concerned.

FFC triggers: A 1QFY13 review…

During Rabi 2012-13, total availability of urea is estimated to be around 3.0mn tons. This includes 0.3mn tons of imported supplies, 2.0mn tons of domestic production and 0.7 mn tons of opening inventory. The estimated off take during Rabi 2012-13 is expected to be 2.83 mn tons leaving behind 0.196 mn tons of opening balance for coming Kharif 2013.

Urea supply/demand situation during Rabi 2012-13		mn Tons		
Description	Dec*	Jan*	Feb**	Mar**
Opening inventory	1.025	0.434	0.256	0.176
Imported supplies	0.004	-	-	0.1
Domestic production	0.362	0.339	0.320	0.320
Total availability	1.391	0.773	0.576	0.596
Offtake	0.953	0.517	0.400	0.400
Write off/on	(0.004)	-	-	-
Estimated inventory	0.434	0.256	0.176	0.196

Source:Fertilizer Review

Urea and DAP off take during jan 2013 as compare to jan 2012 and jan 2011 mn			
	Jan-11	Jan-13	Jan-14
Urea	0.394	0.610	0.517
DAP	0.059	0.020	0.053

Source: Fertilizer review

The prices of the urea products produced by FFC has increased in January 2013 but the prices of DAP has reduced. These urea prices are expected to rise if the demand for the urea goes up in the coming months. Apart from that during CY12 the prices of the urea were reduced by Rs.145/bag in order to compete with the highly subsidized imported urea so, if the demand for the urea goes up then this cut down in the price may be reverted back which will increase the revenue for FFC.

Product	Dec-12	Jan-13
Urea Sona	1,692	1,723
Urea Tara	1,673	1,700
DAP	3,969	3,955

Source: Fertilizer review

FFC outlook

In general the next six month should see some major activity in the country's economic and political climate something that is set to help Pakistan's industry. This will also be favourable for the FFC as any economic activity is surely going to have an impact on FFC.

The outgoing Economic Coordination Committee of the Cabinet has increased the wheat support price to Rs 1,200 per 40 Kg from Rs 1,052(The Nation).Also the support prices of rice has been increased to 1200 to 1250(Dawn).These increase in the support prices would enable the farmers to bear the increase in the prices of fertilizers so if FFC increases the fertilizers price then it could be transferred to the Farmers.

FFC has made an investment in FFCEL; the company started its operations in 2013 and if the FFCEL performs well and is able to generate profits then the profitability of the company will be increased and during the FY12 FFBL paid Rs.2.7326million as compare to dividend of Rs.4.75233million in FY11, so if the fertilizer sector performs good during the FY13 then the dividend from FFBL would increase which in turn will increase the profitability the company.

Valuation: Our DCF value arrives at Rs 137/sh – Rs 138/sh

FFC is yielding a P/E of 6.3x wherein we foresee cumulative dividend of Rs 16/sh delineating dividend yield of 15% for the connoisseurs of defensive investors. We have estimated the fair value of FFC at Rs137/sh-Rs138/sh. On this basis we recommend BUY.

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