Fauji Fertilizer-laying golden egg

FFC 1HCY16 output remained robust i.e. 1.25mn tons depicting 5% y-o-y growth wherein capacity utilization reached 122%. As at June 30, 2016, FFC was holding inventory amounting to Rs10.7bn. we expect this to be released in present quarter since application of fertilizer especially rice & cotton usually falls in 3Q.

We have already mentioned in one of our earlier reports that consumption of the locally produced Urea may increase in the country given growers appetite to utilize more fertilizers in the backdrop of relatively weaker off-take in 1HCY16.

We see case for FFC...

-given history of great marketing efforts as against peers (combined FFC & FFBL market share is nearly 60% during this year) to continue despite slight competitive environment wherein we do not see any decrease in FFC market share
-we expect better results for FFC wherein FFBL Urea off-take could also improve after nearly half a decade (FFC owns nearly 50% stakes in FFBL); FFBL is a sole producer of DAP wherein we expect higher off-take (given FFC's typical distribution mechanism). Government has also ended subsidy on imported DAP which would favour FFBL.

FFC P&L Rs 000'	1HCY16	1HCY15
Sales	28,321,912	39,186,304
COGS	19,994,620	24,503,875
GP	8,327,292	14,682,429
EBIT	5,223,092	11,513,247
Finance Cost	1,178,376	443,210
Other income	4,299,364	2,933,213
PBT	7,529,804	12,821,810
PAT	4,892,804	8,265,810
EPS	3.85	6.50
DPS	3.40	5.7

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Margins & payout	1HCY16	1HCY15
GP Margin	29%	37%
EBIT Margin	18%	29%
Net Margin	17%	21%
Payout	88%	88%

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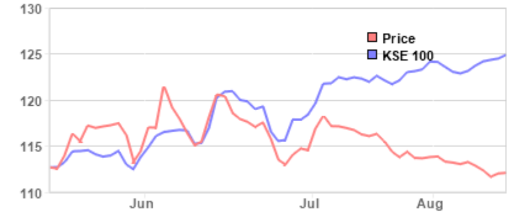
FFC	@ Rs 112
52 Week Low	104.21
52 Week High	146.20
Beta	0.94
EV/sh	128.44 – 130

Relative index



Investments in associates include

Fauji Cements	6.79%
Fauji Bin Qasim	49.88%
Askari Bank	43.15%

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Clarity in the sector...

At the moment, we now see some clarity in the sector given
-government passing on per bag subsidy to producers, which in our view, would invariably help in sales build up for companies;
-clarity on Gas Infrastructure Development Cess (GIDC) wherein it decreased via a notification by Rs77/mmbtu on feedstock from Rs200/mmbtu to Rs123/mmbtu;
-Growers appetite to consume fertilizers would increase after prime minister advised incumbent finance minister to reduce rates in a televised message
-the only aspect which may keep investors on tenterhooks would be probable increase in feedstock rates, however, we do not see any eventuality on this count given government's own concern about lower crop yield in the outdoing FY16; any increase in feedstock rates could be counter-productive and in our view would hurt their political support in rural constituencies in Punjab.

Valuations skewed towards 3Q & 4Q probable earnings & performance of main associate FFBL...

Our premise of improved fertilizer off-take plus hefty other income (dividend expectation from FFBL, Askari Bank & Fauji Cement) could actually translate into CY16 net earnings range of Rs12.6bn – Rs13bn (EPS: Rs 9.93 – Rs10.21). These spate of earnings is inclusive of levy of super tax. FFC has paid interim cash dividend of Rs3.4/sh wherein taking payout ratio of 90% we expect another Rs6.2 to Rs6.4/sh during the course of this year translating into cumulative dividend of around Rs9.8/sh. In CY15, FFC paid Rs11.86/sh cash dividend.

FFC yield CY16 PE of 10.9x & we remain positive though EFERT deciphers slightly lower PE (multiple of 8.6x at the pretext of Rs8/sh EPS estimations).

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