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Fauji Fertilizer Bin Qasim

Initiating Coverage

Notified Research Entity
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Call

Buy	Hold	Sell

Within our DSL's Fertilizer Universe, we have a "Positive" stance on FFBL. With improved urea capacity utilization coupled with additional revenue from the sale of electricity to KEL, followed by diversified business portfolio could bode well for Fauji Fertilizer Bin Qasim (FFBL)

Quick Financials

Current Price (PKR/sh)	33.85
Year High - Low (PKR/sh)	44.81 – 31.03
Market Capital (PKR mn)	38,569
Market Capital (USD mn)	311
P/E (TTM)	33.7
Free Float (%)	35%
Free Float Market Capital (PKR mn)	13,499
Outstanding Shares (mn)	934.11
Targer Price (PKR/sh)	45
Upside	32%

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Information & Data Sources:
PSX, NFDC, Company Accounts, SBP, PBS and DSL Research

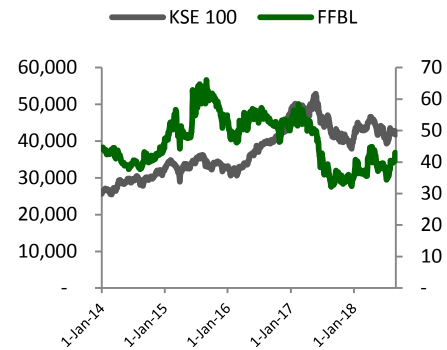
Making its way through tough times…

Investment Thesis

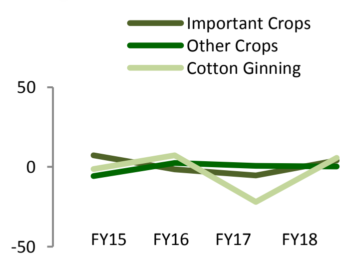
We initiate our coverage on Fauji Fertilizer Bin Qasim (FFBL) with a Target Price of PKR 45/share, with an upside of 32% on last closing price.

Within our DSL's Fertilizer Universe, we have a "Positive" stance on FFBL. With improved urea capacity utilization coupled with additional revenue from the sale of electricity to KEL, followed by diversified business portfolio could bode well for Fauji Fertilizer Bin Qasim (FFBL). While recent developments on the back of ECC's meetings which would have a negative impact on fertilizer sector, could also hit-hard FFBL, as government is planning to make fertilizer companies to return PKR 10bn as a windfall to the economy which they earned by exporting excess fertilizer.

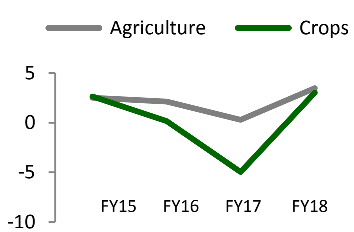
Relative Performance



Crops Growth in %



Agricultural Growth in %



Base year 2005-06
Source: PBS & DSL Research

The important triggers which would influence FFBL's earnings include:

- Being a sole producer of DAP, FFBL enjoys a unique position with a capacity of 650Kt.
- FFBL's 118MW coal based power plant which would provide 66MW to FFBL and the remaining 52MW will be sold to KEL.
- FFBL's diversified portfolio also makes it look more promising in the long term, especially in consumer sector which includes Fauji Meat and Fauji Food, can be an upright source of income for the company.
- Unlike FATIMA and EFERT, which is still our top picks within our DSL's Fertilizer Universe, FFBL is getting feed gas at normal rate (USD 4.2mmbtu/ton) and not on concessionary rates (USD 0.7mmbtu/ton), which increases cost of producing urea as compared to FATIMA and EFERT. While recently feed gas and fuel gas prices have increased by 50% and 30% respectively.

FFBL's ownership consists of

In Subsidiaries:
1. Fauji Meat Limited – 75%
2. Fauji Power Company Limited – 75%
3. FFBL Foods Limited – 100%
4. Fauji Foods Limited – 50%

In Associate Companies:
1. Pakistan Maroc Phosphore S.A (JV) – 25%
2. Foundation Wind Energy I & II – 35%
3. Fauji Cement Limited – 1.3%
4. Askari Bank Limited - 22%

Industry Overview

Within in past couple of years, Pakistan's economy witnessed improvement, though at the moment facing multiple challenges but with better policies and strategies in the pipeline would positively influence the economy. Despite an increase in macroeconomic imbalances, WB and IMF project 4.8% GDP growth rate for Pakistan in FY19. Energy crisis improved slightly and will show progress in coming future with the completing of new power projects, nevertheless, gas shortages still a threat to the fertilizer industry. Our local market was negatively influenced by the on-going political uncertainties prior to GE'18, which also seemed to ease down now. Country's growing population, increased market liquidity and stabilizing economic indicators with new government taking reasonable steps to overcome short-term and long term issues, could turn out to be good for the agriculture sector and eventually for the local fertilizer industry.

Pakistan's population has been on the immense rise from many years and the population growth is roughly gauged at 2% with current population of around 200mn. As the population is growing at a remarkable rate, the demand for food is also developing parallel with the population.

The economy of Pakistan is largely depending on its agricultural products. Its share of GDP mainly comes from different products of agriculture. Therefore the importance of water is more for Pakistan, as the agriculture sector of Pakistan is mainly depending upon the water and different resources of water that are available in Pakistan but recent water shortages have a negative impact on the agriculture sector as a whole.

Much of the Pakistan's agriculture output is utilized by the country's growing processed-food industry. Moreover, out of the total area of 79.6mn hectares, 22mn hectares are being cultivated and the rest of the territory is rangelands. Cropped area constitutes 23mn hectares and forests consist of 4.2mn hectares. Almost 80% of the cultivated area is irrigated.

Agriculture sector of Pakistan accounts for:

- 21% of the country's GDP
- 60% of the employed labor force in rural areas
- 65% of the country's total export earnings
- The agriculture sector has a growth rate of around 3% per annum
- Provides raw material for industries like textile and sugar

Associated problems with agriculture sector of Pakistan:

- Water logging & salinity related problems
- Unequal distribution of landholdings
- Traditional & old methods of production
- Conversion of arable land into non-agricultural uses
- Disguised unemployment and land erosion related issues

Did you know?
The Indus Basin Irrigation System of Pakistan has emerged as the largest contiguous irrigation system in the world which has three large dams, eight five small dams, nineteen barrages, twelve inter-river link canals, forty-five canal commands and 0.7 million tube wells.

Economical Upfront

Even with Pakistan GDP growth rate portraying swelling corresponding to last period GDP growth but on the cost of rising fiscal and trade deficits, and rising current account deficit. Moreover, breaking its record since 2014, the inflation has increased to 5.8% as of Aug 2018 along with the PKR/USD parity clocking at PKR 133/USD till Oct 2018. Overall, Pakistan has a stringent economic condition at this moment and straight-forward policy is the need of the hour.

Fertilizer Sector's Critique

In Pakistan, demand of fertilizer products is met through local production and foreign imports, while the demand of fertilizer products is largely driven by factors including availability of water, prices of fertilizer products, availability of cultivable land, population growth and government policies such as subsidies offered to farmers.

Pakistan has been a urea deficit country for many years; however the industry turned into a urea surplus into 2016. Recent decline in commodity prices and inventory glut has resulted in favor of the fertilizer market; nevertheless the manufacturers in Pakistan are still facing cost related issues.

Did you know?
In December 2017, The World Bank approved USD 300mn to modernize agriculture in Punjab province of Pakistan to raise farmers' incomes, give consumers better quality and safer food at lower prices, create jobs on farms and agribusinesses, and improve the use of irrigation water.

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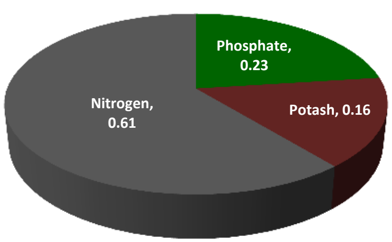
On the other hand, pricing power of the manufacturers is considered to be on the lower side due supply-related issues and fierce competition in the fertilizer industry but previous government capped the urea price at PKR 1,400/bag, however, as the subsidies faded away, manufacturers have increased fertilizer prices accordingly to pass on the impact to end-consumer. As a result of these dynamics, margins of industry are expected to remain under pressure in the coming future. Recent hike of PKR 130/bag by urea manufacturers have brought the total price to 1,700/bag.

Fertilizer sector may also become fruitful in future and could create multiple opportunities but this is only possible if the new government avoids any imprudent decisions which can become extremely difficult for farmers to take any practical choices and to optimize their harvest.

Avg. % used annually in fertilizer



In Pakistan, farmers' income and purchasing power are mainly influenced by variables like input costs which include fertilizer prices, fuel and electricity costs combined with lower output prices. These problems are also largely the result of farm policies that have hardly changed in the last 50 years. These include extensive subsidies that are inefficient and ineffective, and government spending that does not provide widespread benefits and results in wasteful water use.

While gas unavailability and irregular supply became more apparent, fertilizer plants feared urea production shortages which might lead them to increase prices, however, it is important to note that, the new government has decided to supply gas to AGL and FATIMA closed plants to cater the growing demand of urea for the "Rabi Season", while also the PTI-led government is importing 100Kt of urea to meet the Rabi Season demand which will cost them at around PKR 2,575/bag while local urea is priced at around PKR 1,700/bag to as high as 1,750/bag. The new government would subsidies PKR 875/bag to keep imported urea prices at low levels for farmers.

The plants which are now being provided with gas are FATIMA's plant, which has a capacity of 44Kt per month and has a gas requirement of 44mmcfd, whereas, AGL's plant, which has a capacity of 35Kt per month and has a gas requirement of 28.5mmcfd.

Company-wise

UREA	CY'13		CY'14		CY'15		CY'16		CY'17		8MCY'18	
Kt	Prod.	Off-Tk	Prod.	Off-Tk	Prod.	Off-Tk	Prod.	Off-Tk	Prod.	Off-Tk	Prod.	Off-Tk
EFERT	1,562	1,560	1,823	1,820	1,967	1,879	1,873	1,653	1,854	1,802	1,004	1,166
FFC	2,408	2,409	2,402	2,370	2,469	2,408	2,523	2,428	2,513	2,474	1,458	1,439
FFBL	224	226	213	214	302	290	434	443	543	546	308	306
FATIMA	355	346	367	371	394	373	500	356	474	417	281	305

DAP	CY'15			CY'16			CY'17			8MCY'18		
Kt	Prod.	Import	Off-Tk	Prod.	Import	Off-Tk	Prod.	Import	Off-Tk	Prod.	Import	Off-Tk
EFERT	-	430	391	-	521	528	-	506	536	-	248	229
FFC	-	204	165	-	164	202	-	513	513	-	432	264
FFBL	768	-	748	791	-	791	809	-	831	404	-	329
FATIMA	-	-	-	-	-	24	-	17	45	-	-	10

Region-wise

Urea Kt	CY'13	CY'14	CY'15	CY'16	CY'17	8MCY'18
Punjab	4,038	3,775	3,721	3,573	3,909	727.8
Sindh	1,241	1,327	1,472	1,487	1,529	196.3
KPK	388	321	273	303	247	36.8
Baluchistan	228	209	150	133	176	23.1
TOTAL	5,895	5,631	5,616	5,495	5,861	983.9

DAP Kt	CY'13	CY'14	CY'15	CY'16	CY'17	8MCY'18
Punjab	1,159.3	1,202.4	1,301.8	1,588.1	1,709.2	727.761
Sindh	317.4	329.3	373.3	469.3	501.2	196.33
KPK	91.3	81.9	74.2	81.3	85.2	36.763
Baluchistan	57.6	41.6	43.7	55.6	82.7	23.068
TOTAL	1,626	1,655	1,793	2,194	2,378	984

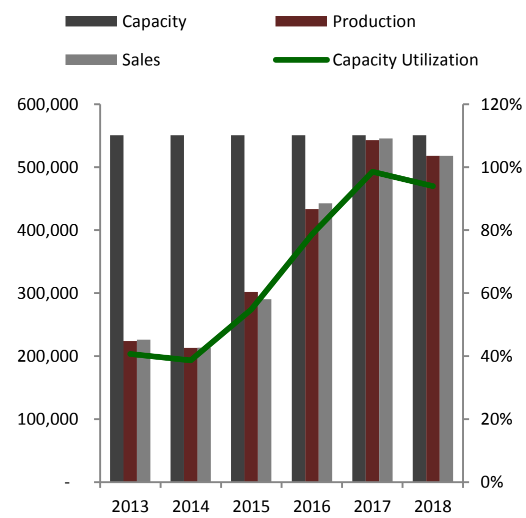
Source: NFDC

We believe that any increase in crop prices while fertilizer prices remaining at constant level could also benefit farmers as well as the fertilizer sector, as farmers tend to increase crop yields in such scenarios by utilizing more fertilizer products. We believe that the government needs to support fertilizer industry to ensure inexpensive local urea to farmers so that this industry could become more cost effective.

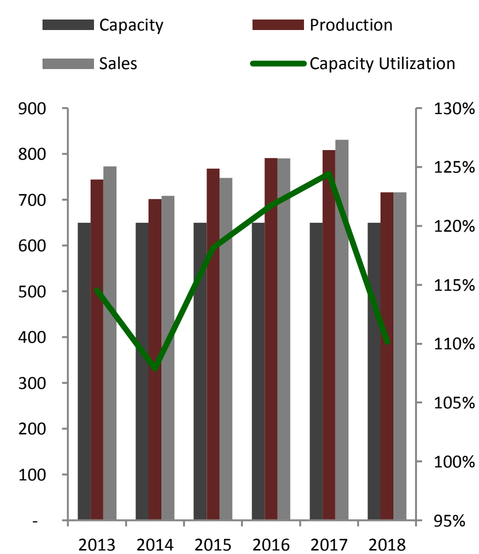
As for the Finance Act 2017-18, due to previous GoP reduced the cash subsidy on Urea from PKR 156/bag to PKR 100/bag which is not being totally abolished, the financial burden on Urea manufacturer rose.. Moreover, GoP also withdraw subsidy on DAP (PKR 300/bag) and adjusted GST to 100/bag, which later also abolished and a uniform tax subsidy is provided at a uniform rate of 5%.

Did you know?
In Pakistan, the most important crops are wheat, sugarcane, cotton, and rice, which together account for more than 75% of the value of total crop output.

FFBL's Urea



FFBL's DAP

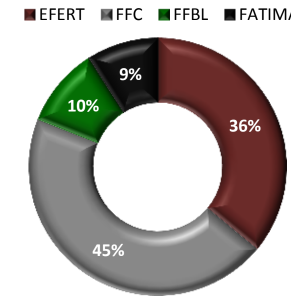


Analytical Growth

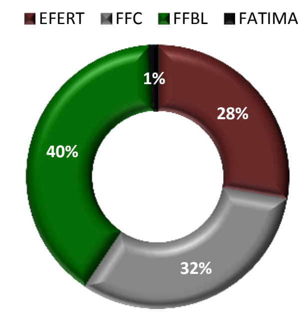
Although, demand showed impressive recovery because of significant reduction in urea prices, followed by the subsidy announced by the previous government which also turned out to be better for weak agro-economics and farmers' conditions.

Lower urea imports with constant supply of gas also give an edge to the local urea manufacturers, who are currently distressed in terms of both increased competition and a loss of purchasing power and we expect that higher international prices may force the Government of Pakistan to reduce urea imports due to limitations on foreign exchange reserves which will eventually provide breathing space to local fertilizer manufacturers.

UREA Market Share in 8MCY18



DAP Market Share in 8MCY18



Subsidy on fertilizer

Pakistani government provides subsidies and incentives to farmers to amplify productivity. The uplift of fertilizer industry by Pakistani government is actually meant to pass on the benefit of domestic manufacturing to the farmer.

The previous governments have strengthened the agricultural and fertilizer sectors by giving subsidies, allocating particular gas supplier to fertilizer companies/plants and also by guaranteeing uninterrupted gas supply. The previous governments also gave immense cushion to this sector after giving small loans to the farmers, supporting farmers to expand their purchasing power and also by reducing sales tax on urea from 17% to 5%, a GST based subsidy. However, cash subsidy on urea had been revised from PKR 156 per bag to PKR 100 per bag for FY18 from former Finance Ministry of Pakistan but it had been assured from the Ministry to make the disbursement process smooth. However, currently, all cash subsidies have been abolished and tax subsidies have been given to all fertilizer products at a uniform rate of 5%. But a cash subsidy can be expected from this government in the near future.

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Global Scenario

Global Fertilizer's Market

Along with the International Monetary Fund (IMF) predicted global growth reaching 3.9% in both 2018 and 2019, the Organization for Economic Co-operation and Development (OECD) and the Food and Agriculture Organization of the United Nations (FAO) predicted the global food demand to grow more slowly in the coming decade driven by population growth and slight increase in consumption per capita concentrated in the least developed countries which may damper fertilizer demand.

As far as the global fertilizer markets are concerned, Chinese export sets the price for the global markets as China has been the world's largest urea producer. China, together with India and the Middle East, accounts for around two-thirds of the world's production of urea. China holds 35% share in the world urea production and almost 30% in global urea exports.

On average Global fertilizer demand is expected to expand by 1.3% per annum between FY19. Moreover, subsequent to the mid-term trend, world demand is forecasted to grow faster for Potassium, followed by Phosphorus and Nitrogen by 1.8%, 0.9% and 0.5% respectively.

World Urea production in 2017, dropped for the second consecutive year by 2%, reached 170Mt, with almost 90% decrease coming from China.

With Large capacity expansions seen in USA, Latin America and EECA; the global Urea capacity will reach to around 230Mt in FY19. The global Urea supply is estimated at around 200Mt in FY19.

Did you know?
Pakistan ranks eighth worldwide in farm output, according to the List of countries by GDP sector composition.

FFBL

Company's Dynamics & Competitive Landscape

Fauji Fertilizer Bin Qasim (FFBL) was incorporated in 1993 as Fauji Jordan Fertilizer Company, a joint venture of Fauji Foundation, Fauji Fertilizer and Jordan Phosphate Mines Company. After getting publically listed in PSX, it started it commercial production from January 1, 2000. In 2003, after JPMC sold its shares, it was renamed as Fauji Fertilizer Bin Qasim Limited (FFBL) with the major shareholders being FFC (51%) and Fauji Foundation (17%). It is a listed company with authorized and paid up capital of PKR 9,341 million.

FFBL plant site is a modern Granular Urea and Di-Ammonia Phosphate (DAP) fertilizer manufacturing complex, built at a cost of USD 468 million and located on 350 acres in the Eastern Zone of Bin Qasim, Karachi.

Being the producer of 1,670 metric tons per day of Granulated Urea and sole producer of 1,350 metric tons per day of Di-Ammonia phosphate (DAP), it is making a significant contribution towards agricultural growth in the country, by meeting around 50% on average of the demand of DAP and about 10% on average of Urea in the domestic market.

Moreover, under the extensive upgradation program with an estimated cost of USD 82 million, the company enhanced its production capacity of

Ammonia, from 1270 metric tons to 1570 metric tons per day
DAP, from 1350 metric tons to 2230 metric tons per day
Urea, from 1670 metric tons to 1950 metric tons per day

Furthermore, since 2008, 100% of the main raw material for DAP, phosphoric acid, is being supplied by Pakistan Maroc Phosphore S.A. (PMP), in which FFBL shareholding is 25%.

DAP Plant brought to suspension in 2001 due to accumulated loss of PKR 6.5 Billion. It resumed production in Sep 2003, after a lapse of 2 years.

Gas Networks

Company	Network
FATIMA	Mari
EFERT	SNGP, Mari
FFC	Mari
FFBL	SSGC
AGL	SNGP
FatimaFert	SNGP

Source: NFDC, DSL Research

The gas supply improved considerably and better management, reduced the FFBL gas curtailment to 7% in 2017 from 18% in 2016, thus resulting in higher production of Ammonia, Urea and DAP by 16%, 25%, and 2% respectively in CY17. Moreover, another reason for remarkable production was due to the close coordination with Office Cherifien des Phosphates (OCP) Group of Morocco that enabled the smooth supply of Phosphoric Acid by Pakistan Maroc Phosphore (PMP), a joint venture of FFBL and OCP.

FFBL's plants

1. Ammonia Plant
2. Urea Plant
3. Di-ammonium Phosphate Plant

Operational and Financial Performance

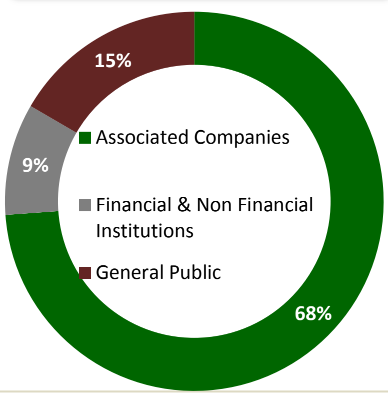
Owing to gas curtailment and subsidy elusiveness prevailing in the fertilizer industry FFBL's urea off-takes remained volatile. Moving towards the FFBL's production mix, urea contributed 35% and DAP 65% of the total production of the industry, we gauged this by using 5-Year CAGR i.e. (2013-2017).

In CY17, upsurge was witnessed in the topline by +17%YoY to PKR 52,733mn as compared to corresponding period last year which was PKR 45,011mn on the back higher volumetric sales; furthermore, we expect sales to continue to increase and will benefit in the long run because higher DAP price and higher demand for DAP will benefit FFBL since it's only the sole producer of DAP. As far as DAP market share is concerned, FFBL is the market leader with a market share of 38% in 8MCY18 followed by FFC 30%, EFERRT 30% and Fatima with only 1%. On the other hand FFC remained the market leader in urea segment with a market share of 45% followed by EFERT 37%, FATIMA 9% and FFBL 9%.

CoGS inched up by +7%YoY in CY17 versus PKR 43,792mn in CY16 owing to increase in power and phosphoric acid price, but we expect it to increase till this year end, after then it will start decline as the company has the capacity to keep the overall cost control, while finance cost inclined sharply and we expect it to continue to increase in future due to incline in interest rates. Moreover, other income declined on a sequential basis for shorter period of time, because of elimination of subsidies but not from associated company's income and nonetheless, due to portfolio diversification it will benefit the company on a longer term.

FFBL recorded lowest NPAT in CY17 which was PKR 1,004mn (EPS 1.08), down -25%YoY. We expect this to recede in the future because of higher volumes and higher prices with other income growing at a stable pace.

Major Shareholdings

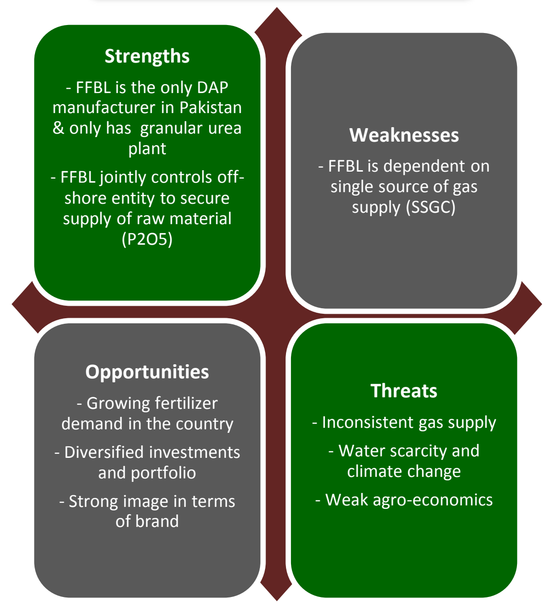


Shareholding Pattern in CY17

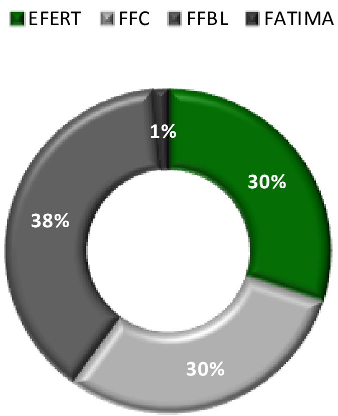
Categories of shareholders		Shares held	Percentage
Directors		6,009	0.0%
Associated Companies			
	Fauji Fertilizer Company Ltd	465,891,896	50%
	Fauji Foundation	170,842,386	18%
NIT and ICP		1,896,124	0.2%
Financial & Non Financial Institutions		82,150,749	9%
Insurance Companies		10,235,445	1%
Modarabas and Mutual Funds		4,602,385	0.5%
General Public			
	Local	143,256,781	15%
	Foreign	44,000	0.005%
Others		55,190,234	6%
Total		934,116,009	100%

Source: Company Accounts & DSL Research

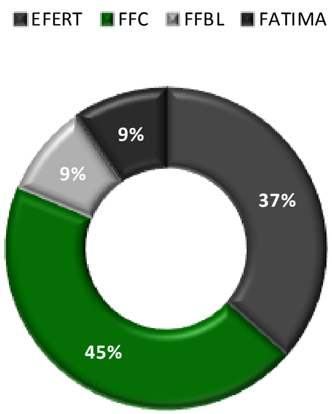
FFBL's SWOT Analysis



DAP Industry's Market Share – 8MCY18



Urea Industry's Market Share – 8MCY18



FFBL's Urea

Volumes in Kt	CY13	CY14	CY15	CY16	CY17	CY18 E
Capacity	551	551	551	551	551	551
Production	224	213	301	433	543	518
Sales	226	213	290	443	546	518
Capacity Utilization	41%	39%	55%	79%	99%	94%

FFBL's DAP

Volumes in Kt	CY13	CY14	CY15	CY16	CY17	CY18 E
Capacity	650	650	650	650	650	650
Production	744	701	768	791	809	716
Sales	773	709	748	791	831	717
Capacity Utilization	115%	108%	118%	122%	124%	110%

Source: NFDC & DSL Research

FFBL's Investments

FFBL has a diversified portfolio of investments which includes investment in Pakistan Maroc Phosphore S.A. Morocco (PMP), Fauji Cement Company Limited, Askari Bank Limited, Foundation Wind Energy I, Foundation Wind Energy II, Fauji Meat Limited, FFBL Foods Limited and FFBL Power Company Limited.

Did you know?

Fertilizer industry in Pakistan is the second largest consumer of Pakistan's total gas availability which is consumed at an estimation of 25% for fertilizer companies and 35% for the energy usage.

Recent Developments

In the first meeting of the ECC, it appeared that the committee is setting the stage for some serious business to make fertilizer companies return PKR 10bn windfalls to the economy.

In Sep, urea manufacturers have raised prices by around PKR 130 per bag in an attempt to pass the impact of gas price hike on to consumers despite government assurances that the state will pay subsidy to them.

The fertilizer industry has also been demanding that the Ministry of Finance clear long overdue subsidy claims of approximately PKR 19bn.

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FFBL's Performance

PKR MN	CY15 A	CY16 A	CY17 A	CY18 E	CY19 E
Net sales	52,182	45,011	52,733	58,215	53,550
COGS	44,968	43,792	46,705	51,647	46,049
Gross Profit	7,214	1,219	6,028	6,568	7,500
Finance cost	1,868	2,156	1,941	1,468	1,231
Profit/Loss before tax	5,385	1,601	1,441	1,307	2,518
Profit/Loss after tax	4,062	1,338	1,004	1,174	2,151
EPS/LPS - basic	4.35	1.43	1.08	1.26	2.30
DPS	3.80	0.50	0.85	0.85	2.00

*Unconsolidated accounts

Margins

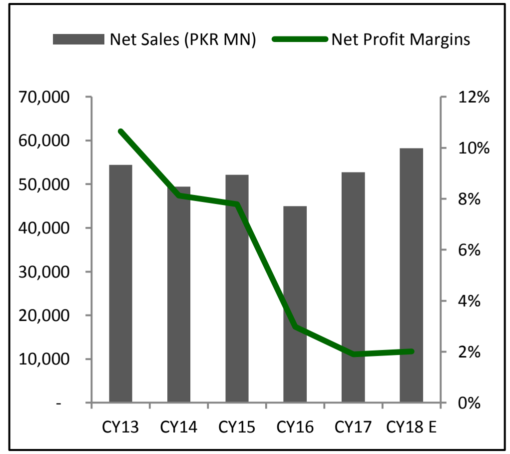
Margins	CY15 A	CY16 A	CY17 A	CY18 E	CY19 E
Gross Profit Margin	14%	3%	11%	11%	14%
Operating Profit Margin	4%	-11%	-1%	0%	2%
Net Profit Margin	8%	3%	2%	2%	4%

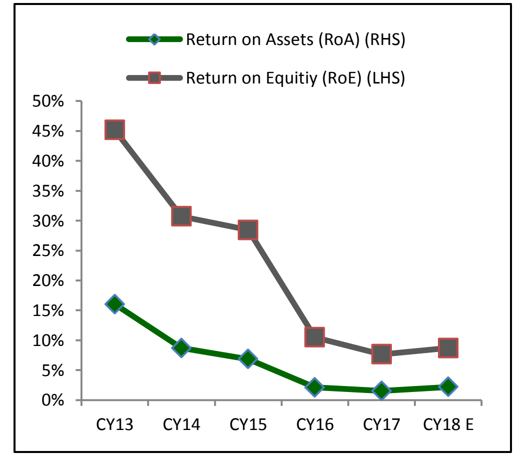
Ratios

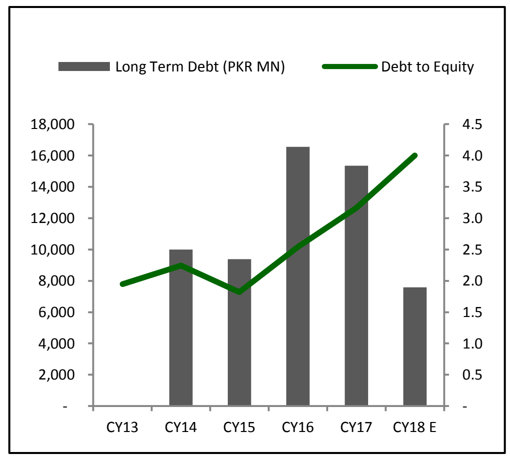
	2015 A	2016 A	2017 A	2018 E	2019 E
Investment valutation ratios					
Operating profit per share	2.1	(5.1)	(0.6)	0.2	1.3
Net profit per share	4.3	1.4	1.1	1.3	2.3
Profitibility Ratios					
Return on equity	28%	10%	8%	9%	14%
Liquidity and solvency ratios					
Current ratio	1.1	1.1	0.6	0.5	0.5
Quick ratio	0.9	0.9	0.7	0.4	0.2
Debt to equity ratio	3.2	4.0	4.0	3.0	2.4
Management efficiency ratios					
Inventory turnover ratios	9.9	18.0	25.2	25.2	25.2
Fixed asset turnover ratio	1.8	1.4	1.7	2.9	3.2
Total assets turnover ratio	0.9	0.7	0.8	1.1	1.1
Price to earning	7.8	23.6	31.5	26.9	14.7
Book value per share	15.3	13.7	14.1	14.5	15.9

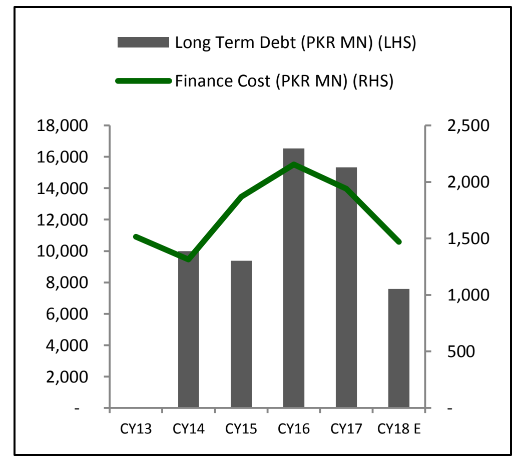
Source: Company Accounts, DSL Research

Financial Trends









Source: Company Accounts, DSL Research

Future stance

Valuation methodology

Within the DSL's Fertilizer Universe, we have a positive stance of FFBL with an upside of 32% given the company's diversified investment product portfolio and being a sole DAP's producer.

We indicate fertilizer manufacturers which have a secure supply of natural gas with concessionary gas to be the likely beneficiary of higher fertilizer demand, which includes EFERT and FATIMA. Furthermore, considering on-going government's mixed strategies and an unclear roadmap and its outcome, we can also expect that the fertilizer sector may become a victim of negligence coupled with higher fuel prices which would also influence this sector unfavorably.

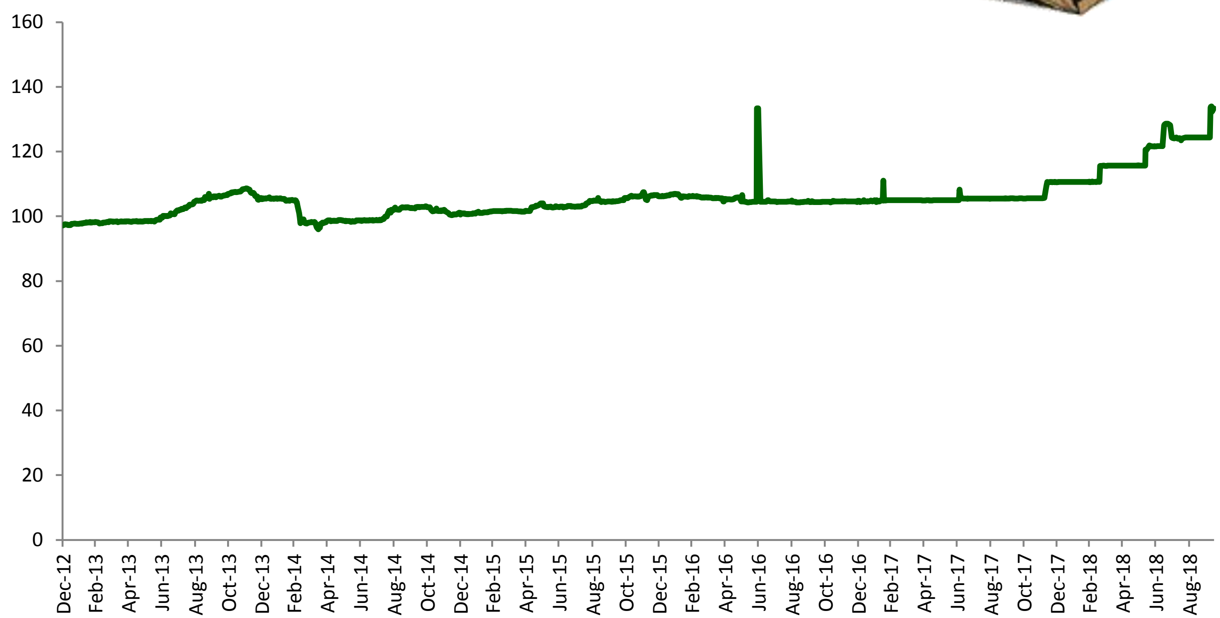
Incorporating the discussed changes, our CY18 December target price for FFBL based on SOTP valuation is PKR 45/sh resulting in a BUY call.

Risk Associated with Target Price

The risks which are linked with our valuation are:

- Urea price regulations
- Decline in international fertilizer prices
- Hike in gas prices
- Increased competition
- Continued unhelpful government policies
- Increase in Phosphoric Acid prices

USD/PKR Movement



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Risk Associated with Target Price:
Any inability to compete successfully in their markets may harm the business. This could be a result of many factors which may include geographic mix and introduction of improved products or service offerings by competitors. The results of operations may be materially affected by global economic conditions generally, including conditions in financial markets. The company is exposed to market risks, such as changes in interest rates, foreign exchange rates and input prices.

Rating System:
If;

- **Expected return >15%** - Buy Call
- **Expected Return is in between 0% to 15%** - Neutral/Hold Call
- **Expected Return <0%** - Sell Call

Valuation Methodology
To arrive at our period end target prices, DSL uses different valuation methodologies including:

- Discounted cash flow (DCF, DDM)
- Justified price to book (JPB)
- Relative Valuation (P/E, P/B, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)

SECP JamaPunji Portal link: www.JamaPunji.pk

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