

Pakistan Fertilizers

FFC PA: Quality earnings and hefty cash on book warrants buy stance

Performance of FFC's stock remained persistent and has provided total upside of ~103% in last 5-years, whereas, KSE-100 index has remained flattish during the same period. Furthermore, company has offered stable payout of ~77% in CY22 (5-year Avg 78%). We continue our liking for the stock and have revised our earnings amid urea price hike at the start of CY23. We have 'BUY' stance on Fauji Fertilizer Limited with Dec'23 DDM based TP of PKR125/sh, offering a capital upside of 21% along with dividend yield of 22%.

Our investment thesis is based on the following facts i) better earning quality, ii) stable demand dynamics, iii) diversified portfolio of investments, iv) attractive payout ratio, v) reasonable ability to pass on cost side pressure, and vi) improving farmers income.

Key risks to our valuation include i) administrative control on urea price, ii) abrupt increase in gas price, iii) weak agronomics & natural calamities, iv) unfavorable decision on matters related to gas pricing and GIDC payable, v) PKR rupee devaluation against green back and vi) challenges on local urea supply/demand front.

Strong profitability on the back of decent pricing power

In CY22, FFC recorded a revenue of PKR109bn, growing at a CAGR of 4% over the past five years. Whereas, PBT stood at PKR33.6bn, up by 11 YoY. However, company's PAT decreased by 8% YoY due to the imposition of retrospective super tax, leading to ETR of 40% (compared to 28% in CY21). FFC's urea offtakes stood at 2.4mn tons during the year, however, on YoY basis, the company witnessed a slight decline in urea offtakes of 2% attributable to lower production. FFC being the market leader in urea (Market share: 38% CY22) enjoys strong pricing power. The company is capable of passing on cost burden to end consumer since urea is available at a significant discount as compared to international parity. Moreover, price inelasticity of urea amid food security concerns provides an immunity to urea demand. On the flip side, DAP offtakes declined substantially by 66% YoY due to higher prices and floods in the country.

Gas prices; uncertainty prevails

In Jan'23, fertilizer industry increased urea prices by PKR190/bag to PKR2440/bag. The increase was due to mounting inflationary pressure and impact of PKR devaluation on PP-12 gas. In our opinion, FFC stands to benefit from this price increase since all of its procured gas is charged at industry tariff. Thus, urea price hike with steady gas tariff is expected to improve company's margins. Moreover, as per the latest notification by OGRA, government has raised gas prices for the SSGC and SNGPL network. However, major fertilizer players source gas from Mari network, for which notification has not been issued yet. We believe that any hike on gas prices

Fauji Fertilizer Company

BUY

HOLD

SELL

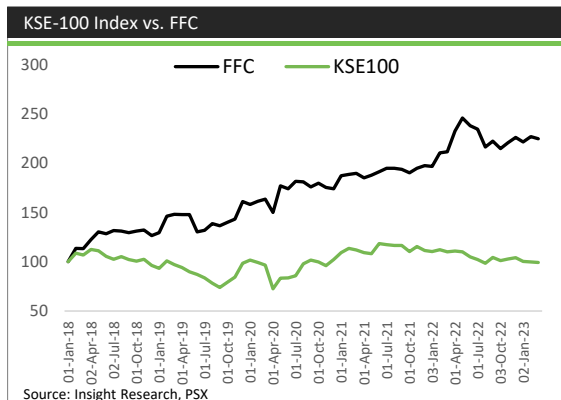
We recommend BUY with Dec'23 DDM target price of PKR125/sh, providing 43% Total Upside

Current Price		103.6
Market cap	PKR b	131.8
Market cap	US\$ m	467.2
Free Float Market cap	US\$ m	257.0
30-day Avg. turnover	m Shares	0.6
30-day Avg. turnover	PKR m	56.12
52 week range	PKR/sh	98-129
Shares Outstanding	m	1,272.2
Free float	%	55%
Major Sponsors	Fauji Foundation	
Bloomberg Ticker	FFC PA	

Financials (PKR mn)	CY22A	CY23E	CY24E
Sales	109,364	156,896	152,436
Cost of sales	69,317	96,030	91,283
Gross Profit	40,046	60,866	61,153
Operating Profit	29,939	49,949	49,363
Profit Before Tax	33,687	53,451	53,789
Profit after Tax	20,050	36,379	36,605

Key Ratios	CY22A	CY23E	CY24E
EPS	15.8	28.6	28.8
DPS	12.1	22.8	23.0
Div. Yield	12%	22%	22%
P/E	6.57	3.62	3.60
P/B	2.59	2.26	2.01
ROE	39%	62%	56%

Source: Company Accounts, Insight Research



for Mari network can result in further cost escalation for urea manufacturers and cause simultaneous increase in urea prices as sector enjoys sufficient pricing power, evident from FFBL's decision of increasing urea prices by PKR440/bag after gas prices hiked by 69% & 47% for feed and fuel, respectively for SSGCL network.

Diversified portfolio and hefty short-term investments of PKR80/sh:

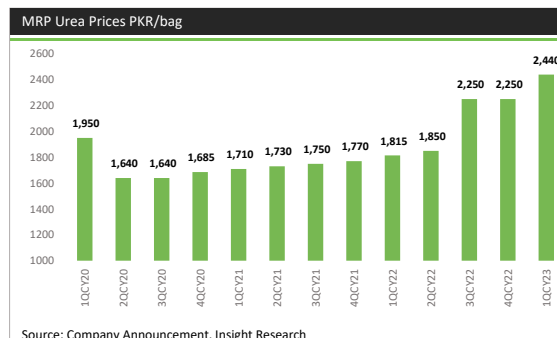
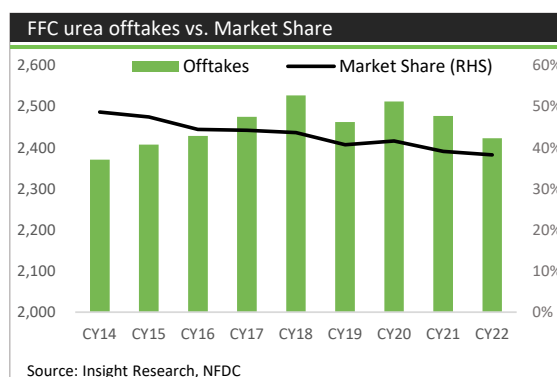
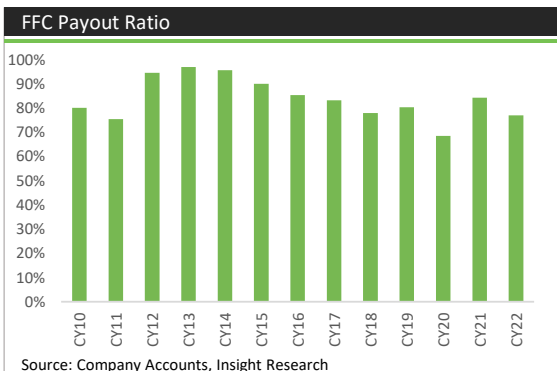
FFC holds a diversified portfolio of investments in the energy, banking, and food sectors. Moreover, it holds liquid assets worth ~PKR102bn (PKR:80/sh). These investments enable the company to generate substantial other income to support its bottom line. During CY22, the company recorded other income of PKR14.4bn, out of which approximately PKR4.5bn was received as dividends from its JV (PMP) and subsidiary companies (FWEL I & II). We believe that higher interest rate will improve FFC's other income, amid sizeable short-term investment on the book.

Smooth operations and investments for stability

Company has entered into an agreement with SNGPL for laying a dedicated line of RLNG for back-up supply to its Plant-3 (urea capacity: 718kt). The estimated CAPEX for the project is ~PKR2bn with an expected life of 14 years. In addition, FFC has also signed an agreement with other fertilizer players and Mari Petroleum Company Limited (MPCL) for the construction of pipeline infrastructure and compressors within the Mari field. This initiative aims to improve the life of the field by increasing its delivery pressure to the required levels. The project is estimated to cost around US\$150 million, which is to be shared among all parties of an agreement.

GIDC issue remained unresolved

GIDC has been a long due issue, and a court ruling mandated the fertilizer sector to settle the unpaid balance in 24 equal monthly installments. However, following a review petition, the court ordered to extend the payment period to 48 installments. Unfortunately, this matter has become entangled in further legal proceedings, and as a result, the court has granted a stay on the collection of GIDC. For FFC, the total payable amount for GIDC stands at PKR62.5 billion, and in the current fiscal environment where fiscal space is squeezed, the government aims to recover these arrears. Any unfavorable decision in this regard could result in a cash outflow of PKR49.16 per share for FFC, which would have a negative impact on their earnings i.e PKR6.59/sh.



FFC: CY23E-EPS: Gas price vs. urea Prices							
Urea Prices PKR/bag	317	Feed Gas Price PKR/mmbtu					
		10% ↑	20% ↑	30% ↑	40% ↑	50% ↑	60% ↑
2,440	28.59	27.65	26.71	25.76	24.82	23.88	22.93
2,684	34.41	33.46	32.52	31.57	30.63	29.69	28.74
2,928	40.22	39.27	38.33	37.38	36.44	35.50	34.55
3,172	46.03	45.08	44.14	43.20	42.25	41.31	40.36
3,416	51.84	50.89	49.95	49.01	48.06	47.12	46.17
3,660	57.65	56.70	55.76	54.82	53.87	52.93	51.98
3,904	63.46	62.51	61.57	60.63	59.68	58.74	57.80

* Source: Insight Research

FFC (PKR mn)	CY22	CY23E	CY24E	CY25E	CY26E	CY27E	CY28E
Net Sales	109,364	156,896	152,436	155,386	157,293	162,419	168,125
Cost of Sales	(69,317)	(96,030)	(91,283)	(93,388)	(94,531)	(98,504)	(103,109)
Gross Profit	40,046	60,866	61,153	61,998	62,762	63,915	65,015
GM %	37%	39%	40%	40%	40%	39%	39%
Selling & Dist Exp.	(10,108)	(10,916)	(11,790)	(12,733)	(13,751)	(14,852)	(16,040)
Other Income	14,442	21,992	17,732	15,011	15,226	15,444	15,666
Other Charges	(3,037)	(3,996)	(3,949)	(3,941)	(3,921)	(3,925)	(3,918)
Financial Charges	(4,868)	(13,594)	(9,207)	(7,252)	(6,992)	(6,844)	(6,638)
Profit before Taxation	33,687	53,451	53,789	53,084	53,323	53,738	54,086
Taxation	(13,637)	(17,072)	(17,183)	(16,951)	(17,029)	(17,167)	(17,281)
Profit after taxation	20,050	36,379	36,605	36,133	36,293	36,571	36,804
EPS	15.8	28.59	28.8	28.4	28.5	28.7	28.9
Effective tax rate	40%	32%	32%	32%	32%	32%	32%

Source: Company accounts, Insight research

Balance Sheet (PKR mn)	CY22	CY23E	CY24E	CY25E	CY26E	CY27E	CY28E
Non-current assets							
Property, plant & equipment	27,631	28,185	28,750	29,327	29,915	30,515	31,127
Long term Investment	50,525	50,525	50,525	50,525	50,525	50,525	50,525
Others	6,141	6,713	7,356	8,081	8,896	9,813	10,846
Total Non-current assets	84,297	85,423	86,632	87,933	89,336	90,854	92,498
Current assets							
Stores, spares and loose tools	6,301	9,044	8,839	9,042	9,160	9,547	9,975
Stock in trade	19,488	9,541	11,026	11,328	11,485	12,099	12,703
Trade debts	372	2,512	2,455	2,512	2,545	2,652	2,771
Short term Investments	100,270	102,164	104,094	106,060	108,063	110,104	112,184
Cash & Bank Balances	1,520	2,803	2,567	2,454	2,283	2,732	2,705
Others	27,874	30,104	32,516	35,125	37,946	40,998	44,300
Total Current assets	155,825	156,169	161,497	166,520	171,482	178,133	184,637
Total Assets	240,122	241,592	248,129	254,453	260,818	268,987	277,136
Non-current liabilities							
LT Debt	16,295	10,200	5,300	1,250	-	-	-
Others	11,230	11,463	11,694	11,929	12,169	12,413	12,663
Total Non-current liabilities	27,525	21,663	16,994	13,179	12,169	12,413	12,663
Current liabilities							
Trade and Other payables	89,836	99,433	100,399	101,398	102,432	103,503	104,613
Short-Term Borrowing	57,994	47,336	51,110	53,580	55,028	55,146	54,341
Current Portion of LT Debt	5,445	6,095	4,900	4,050	1,250	-	-
Others	8,486	8,792	9,110	9,440	9,783	10,140	10,510
Total Current liabilities	161,762	161,656	165,519	168,468	168,494	168,789	169,463
Equity							
Paid-up Capital	12,722	12,722	12,722	12,722	12,722	12,722	12,722
Capital reserves	160	160	160	160	160	160	160
Retained Earnings	38,067	45,504	52,848	60,037	67,387	75,015	82,240
Total equity	50,835	58,271	65,615	72,805	80,155	87,783	95,008
Total Equity & Liabilities	240,122	241,592	248,129	254,453	260,818	268,987	277,136

IMPORTANT DISCLAIMER AND DISCLOSURES

Disclaimer: This report has been prepared by **Insight Securities (Private) Ltd**, hereinafter referred as 'ISL' and is provided for information purposes only. Under no circumstances is to be used or considered as an offer to sell or solicitation of any offer to buy. While all reasonable care has been taken to ensure that the information contained therein is not untrue or misleading at the time of publication, we make no representation as to its accuracy or completeness and it should not be relied upon as such. This report is provided solely for the information of professional advisers who are expected to make their own investment decisions without undue reliance on this report. Statements regarding future prospects may not be realized while all such information and opinions are subject to change without notice. ISL recommends investors to independently evaluate particular investments and strategies and it encourages investors to seek the advice of a financial advisor.

Investments in capital markets are subject to market risk and ISL accepts no responsibility whatsoever for any direct or indirect consequential loss arising from any use of this report or its contents. In particular, the report takes no account of the investment objectives, financial situation and particular need of individuals, who should seek further advice before making any investment or rely upon their own judgment and acumen before making any investment. The views expressed in this document are those of the ISL Research Department and do not necessarily reflect those of ISL or its directors.

ISL may, to the extent permissible by applicable law or regulation, use the above material, conclusions, research or analysis in which they are based before the material is disseminated to their clients. ISL, as a full-service firm, has/intends to have business relationships, including investment-banking relationships, with the companies in this report. Investors should be aware of that the ISL may have a conflict of interest that could affect the objectivity of the report. Investors should consider this report as only a single factor in making their investment decision. This report may not be reproduced, distributed or published by any recipient for any purpose whatsoever without prior written approval by ISL. Action may be taken for unauthorized reproduction, distribution or publication.

ISL Stock Rating System: ISL employs a 3-tier rating mechanism i.e 'BUY', 'HOLD' and 'SELL', which is based upon the level of expected annualized return for a specific stock. When total annualized return (capital gain + dividends) exceeds 22%, a 'BUY' rating is assigned. A 'SELL' rating is issued whenever total annualized return is less than negative 5% and for return in between the 2 ranges, 'HOLD' rating is meted out. An 'Under Review' stance is given if ISL research stance depends upon the outcome of an uncertain event having significant impact on the valuations. Different securities firms use a variety of rating terms/systems to describe their recommendations. Similar rating terms used by other securities companies may not be equivalent to ISL rating system.

Time horizon is usually the annual financial reporting period of the company (unless otherwise mentioned in the report). Ratings are updated daily and can therefore change daily. They can change because of a move in the stock's price, a change in the analyst's estimate of the stock's fair value, a change in the analyst's assessment of a company's business risk, or a combination of any of these factors. In addition, research reports contain information carrying the analyst's views 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 (such as the investors existing holdings or investment objectives) and other considerations.

Target price risk disclosures: Any inability to compete successfully in the markets may harm the business. This could be a result of many factors which may include (but not limited to) 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. From time to time, the company may enter into transactions, including transactions in derivative instruments, to manage/offset certain of these exposures.

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

- Discounted cash flow (DCF)
- Relative Valuation (P/E, P/Bv, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)

Frequently Used Acronyms

TP	Target Price	DCF	Discounted Cash Flows	FCF	Free Cash Flows
FCFE	Free Cash Flows to Equity	FCFF	Free Cash Flows to Firm	DDM	Dividend Discount Model
SOTP	Sum of the Parts	P/E	Price to Earnings ratio	P/Bv	Price to Book ratio
P/S	Price to Sales	EVA	Economic Valued Added	BVPS	Book Value per Share
EPS	Earnings per Share	DPS	Dividend per Share	DY	Dividend Yield
ROE	Return on Equity	ROA	Return on Assets	CAGR	Compounded Annual Growth Rate

ANALYST CERTIFICATION AND IMPORTANT DISCLOSURES

Analyst Certification: The research analyst(s), if any, denoted by AC on the cover of this report, who exclusively reports to the research department head, primarily involved in the preparation, writing and publication of this report, certifies that (1) the views expressed in this report are unbiased and independent opinions of the Research Analyst(s) which accurately reflect his/her personal views about all of the subject companies/securities and (2) no part of his/her compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

The research analyst or any of its close relatives do not have a financial interest in the securities of the subject company aggregating more than 1% of the value of the company and the research analyst or its close relative have neither served as a director/officer in the past 3 years nor received any compensation from the subject company in the past 12 months. The Research analyst or its close relatives have not traded in the subject security in the past 7 days and will not trade in next 5 days.

Disclosure of Financial Interest: ISL or any of its officers and directors does not have a significant financial interest (above 1% of the value of the securities of the subject company) in the securities of the subject company. Under normal course of business, ISL, their respective directors, officers, representatives, employees and/or related persons may have a long or short position in any of the securities or other financial instruments mentioned or issues described herein at any time and may make a purchase and/or sale, or offer to make a purchase and/or sale of any such securities or other financial instruments from time to time in the open market or otherwise. ISL or its employees may trade contrary to the recommendation given by ISL Research through this report or any other. ISL may be providing, or have provided within the previous twelve months, significant advice or brokerage services to the subject company. ISL may have, within the past twelve months, 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, the entities mentioned in this report or received compensation for corporate advisory services, brokerage services or underwriting services from the subject company. Apart from this, ISL or any other of its officers and directors have neither served as a director/officer in any company under ISL research coverage in the past 3 years nor received any compensation from the subject company in the past 12 months.

ISL Research Dissemination Policy: ISL endeavors to make all reasonable efforts to disseminate research to all eligible clients in a timely manner through either physical or electronic distribution such as mail, fax and/or email. Nevertheless, not all clients may receive the material at the same time.

Insight Securities (Pvt.) Limited

Suite 509, Business and Finance Centre,

I. I. Chundrigar Road , Karachi, Pakistan

+92-21-32462541-44