Pakistan Fertilizer

FFBL PA: Making efforts to turn it around

Fertilizer companies in domestic listed space are generally considered as stable due to their mature urea business segment and decent pass on ability. However, FFBL's profitability has remained volatile in yester years due to import parity based DAP pricing which was further dented by higher financial charges and loss making entities. Core operation has performed relatively well but higher leverage due to continued cash injections in loss making entities and impairment charges has negatively impacted the bottom-line. However, company is making strides to get rid of loss making entities via necessary alteration in capital structure of FFL and disposing its investment in FML.

We have a BUY stance on FFBL with SOTP of PKR25.8/sh. Our liking for the stock emanates from i) Stable DAP margins, ii) Improved balance sheet position, iii) Improvement in FFL's business operations, iv) sale of FML to Fauji Foundation and v) Possible inclusion in shariah compliant stocks list.

Key risks to our investment case include i) Slowdown in DAP consumption due to higher prices, ii) Volatility in exchange rate, iii) Increase in gas cost to hurt DAP margins, iv) Higher than expected increase in interest rate & v) increase in phos acid prices.

Core operations remains resilient

We expect FFBL to post EPS of PKR0.70 in CY23 with gross margins to clock in at 14.7% attributable to lower DAP margins and higher taxation charges amid imposition of super tax. Looking at the bigger picture, FFBL gross profit has grown at a 5-year CAGR of ~34%, primarily driven by higher DAP prices and margins. Assuming a margin of ~US$70/ton, it is expected that FFBL's EPS for CY24 is likely to clock in at PKR7.10/sh. This improvement is mainly attributable to absence of abrupt exchange losses, lower taxation charges and strong core operations.

The industry expects DAP offtakes to reach 1.3-1.4 million tons, as DAP demand has taken significant hit due to higher prices. As a sole DAP manufacturer, we expect FFBL's DAP plant to operate at optimal levels. Furthermore, the recent imposition of GST on DAP has allowed FFBL to pass on the already imposed GST on its input materials. Consequently, after incorporating imposed FED & GST, DAP prices have increased to PKR10,307/ bag.

On the other hand, urea offtakes for CY23 are expected to remain subdued at 6.5 million tons. Where, FFBL is likely to maintain 8% market share due to limited supply and strong demand dynamics. Urea prices have consistently followed an upward trajectory, leading to improved profit margins. Incorporating the recent imposition of FED, Sona urea-G prices have surged to PKR 3,212. However, a discrepancy in urea prices exists among industry players due to the recent upward revision of gas prices, impacting those

Fauji Fertilizer Bin Qasim

BUY | HOLD | SELL

We recommend BUY with Jun'24 SOTP of PKR26/sh, providing 77% Capital Upside

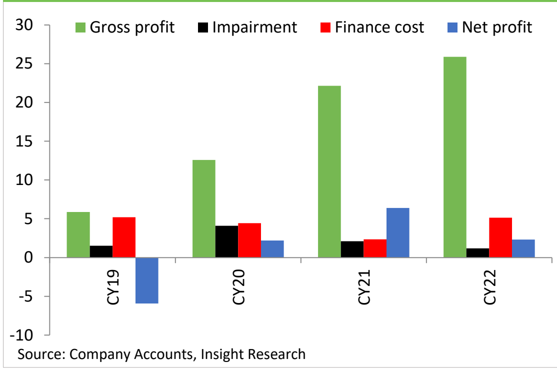
Current Price		14.6
Market cap	PKR b	18.9
Market cap	US$ m	65.7
Free Float Market cap	US$ m	23.0
30-day Avg. turnover	m Shares	2.1
30-day Avg. turnover	PKR m	29.3
52 week range	PKR/sh	10.8-21.3
Shares Outstanding	m	1,291.3
Free float	%	35%
Major Sponsors		Fauji Foundation
Bloomberg Ticker		FFBL PA

Financials (PKR m)	CY23E	CY24E	CY25E
Sales	170,573	162,373	179,573
Cost of sales	145,433	135,169	147,609
Gross Profit	25,139	27,204	31,964
Operating Profit	16,550	18,173	21,813
Profit Before Tax	6,508	15,038	18,895
Profit after Tax	898	9,173	11,526

Key Ratios	CY23E	CY24E	CY25E
EPS	0.7	7.1	8.9
DPS	-	2.5	3.6
Div. Yield	-	17%	24%
P/E	20.99	2.06	1.64
P/B	0.92	0.83	0.80
ROE	4%	40%	49%

Source: Company Accounts, Insight Research

FFBL: Core performace remains resiliant



Source: Company Accounts, Insight Research

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reliant SSGC system. Meanwhile, other players on the Mari system continue to receive gas at the previously prescribed rates. Currently, FFBL sources gas at PKR510/mmbtu for feed and PKR1500/mmbtu for fuel. To note, company's power and steam requirements are fulfilled through the FPCL plant, which employs coal for power generation. However, the supply of power from FPCL to FFBL has been halted due to technical issues at FPCL plant. From May'2023, FFBL has turned to RLNG to meet its power requirement, consequently leading to increased operational costs.

To note, any increase in gas cost or implementation of WACOG will negatively impact FFBL's DAP margins due to its import parity based pricing mechanism. As per our estimates, every 10% increase in cost of gas for DAP production result in decline of PKR0.20/sh on annualized basis.

Loss making entities: The real thorn in the flesh

Despite improvement in core operations, FFBL profitability has remained lackluster in recent years due to impairment charges relating to its food subsidiaries namely Fauji Foods Limited (FFL) and Fauji Meat Limited (FML). The poor performance of these subsidiaries has adversely affected FFBL's overall profitability, despite the fact that International DAP margins reached new historic highs in the CY21-CY22. To highlight, company has booked impairment of ~PKR2bn and ~PKR6.88bn on FFL & FML.

However, FFBL's profitability is expected to improve as FFL has started to show signs of a turnaround and is moving towards profitability. This positive trajectory in FFL's performance is expected to have a favorable impact on FFBL's overall financial performance. FFL has demonstrated a remarkable increase in its topline which increased by 105% YoY in 1HCY23. Gross margins of the company clocked in at 12.5% in 1HCY23 vs 3.4% in 1HCY22. To further enhance its cost efficiency, FFL has planned to narrow down its sales centers to major cities. This strategic move is expected to reduce operational costs and streamline the distribution process, ultimately contributing to improved profitability. In addition, company has drastically changed its capital structure in recent quarters, which will reduce its financial charges. Company's debt to asset stands at ~17% at the end of 1QCY23, as compared to 55% in 4QCY22. To highlight, FFL booked finance cost of PKR1.2bn against gross profit PKR970mn in CY22.

Whereas in case of FML, company has received an offer from Fauji foundation to purchase 100% shareholding of FML for PKR4.3bn against net investment of PKR4.0bn as of 1QCY23. If this transaction materializes, it will have a positive impact on FFBL as there will be no impairment charges in future. In addition, inflow of PKR4.3bn will provide much needed liquidity to FFBL and help in deleveraging its debt.

Improving cash generation to pave way for dividends

FFBL has not announced any dividends since CY19 amid its underperforming subsidiaries and high financial charges. However, prior CY18, the company's 5-year average payout ratio stands at ~75%. We believe that recently announced transaction of FML will result in cash inflow of PKR4.3bn which will improve company's overall cash position and would help FFBL in deleveraging.

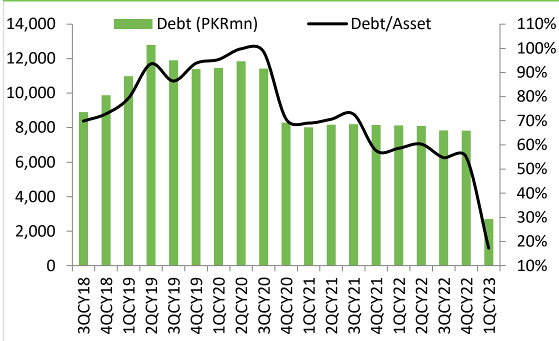
SOTP breakup	
Core value	13.98
AKBL	3.41
PMP	9.49
FFL	5.92
FPCL	4.99
Discounted portolio value	11.90
SOTP	**25.88**

Company Accounts, Insight research

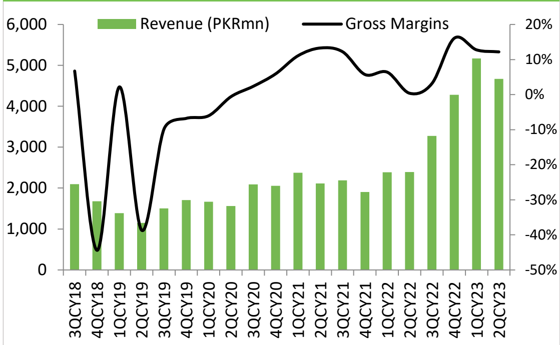
FFL P/S vs. Peers	TTM P/S	5-Year avg
NESTLE	1.75	2.41
FCEPL*	0.64	1.35
FFL	0.97	1.39
PREMA (incl. gain)*	0.38	0.95
PREMA (ex. gain)*	0.83	1.70

Company Accounts, Insight research
*As per 1QCY23

FFL: Debt vs. Debt/Asset

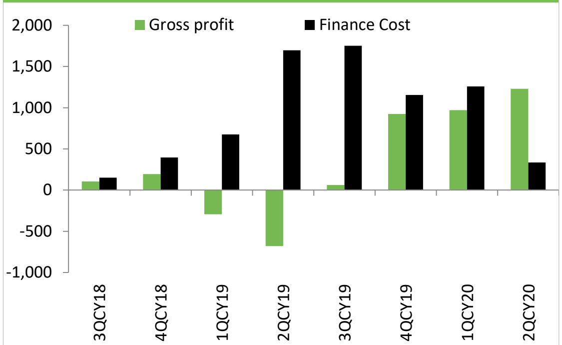


FFL: Revenue vs. gross margins



Source: Company Accounts, Insight Research

FFL: Gross profit vs. finance cost (PKRmn)



Source: Company Accounts, Insight Research

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- 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

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