Day Break

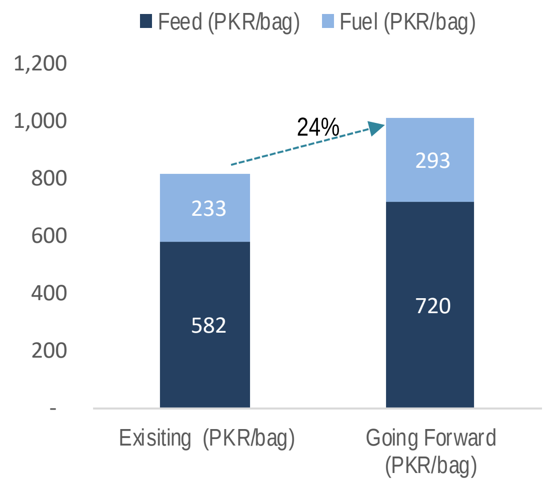
Thursday, 27 June 2019

Sector Update

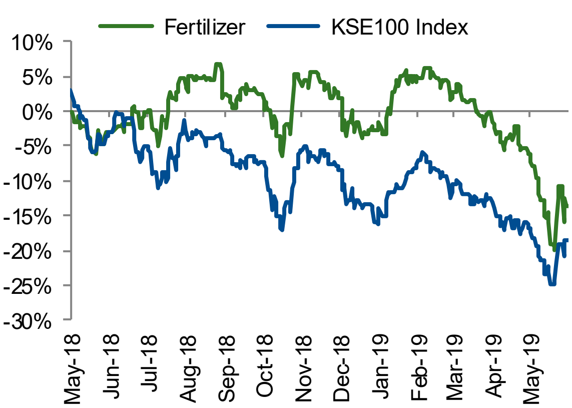
Exhibit: Product wise impact (PKR/bag)

	Feed	Fuel	Total	Change
Urea	138.0	62.0	200.0	47%
DAP	60.0	-	60.0	24%
CAN	-	42.0	42.0	31%
NP	-	36.0	36.0	31%

Exhibit: Increase in input costs for urea (inl.GIDC)



Relative Performance to KSE 100



Source: Bloomberg, PSX & IGI Research

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Fertilizer

ECC approves gas rate hike; price pass-on a likely scenario

- As per the latest news, ECC has approved 31% and 20% increase in gas prices to curb revenue shortfall of gas utility companies, SSGC and SNGPL. For fertilizer the gas rate on feed and fuel is increased from 62%/31% to PKR 300/1,021 MMbtu/ton
- The resulting gas price hike has a major bearing on sectors profitability with the impact hitting significantly on FFCs earnings, while EFERT and FATIMA receiving relatively minor brunt.
- We have determine the said impact for fertilizer companies, with the input cost rising to over PKR ~200/bag for urea manufacturers while PKR ~80/bag for combined CAN and NP production
- With local prices of urea crossing PKR1,850/bag this leaves sufficient room for manufactures to pass-on the impact. Hence, absorbing the impact of gas. We see, that a price pass-over of PKR 200/bag turns out beneficial for EFERT and FATIMA, leaving FFC and FFBL with minimal chunk of negative impact

ECC approves gas price increase across the board

As per the latest news, ECC has approved 31% and 20% increase in gas prices to curb revenue shortfall of gas utility companies, SSGC and SNGPL. The percentage increase in gas prices is applicable for industrial sector, while different rates have been put forward for domestic sectors falling under different slabs.

For fertilizer the gas rate on feed and fuel is increased from 62%/31% to PKR 300/1,021 MMbtu/ton. Inclusive of GIDC the total rate comes at PKR 600/1,171MMbtu/ton on feed and fuel.

…raising input costs to over PKR 200/bag for urea producers

We have determine the said impact for fertilizer companies, with the input cost rising to over PKR ~200/bag for urea manufacturers while PKR ~80/bag for combined CAN and NP production. For FFBL, in particular the increase pertains to feed gas only for DAP and urea production, since fuel requirement is met by Fauji Power. Likewise, for EFERT and FATIMA the proposed rate is relevant on fuel gas only as concessionary feed gas rate (USD 0.70/MMbtu) is applicable.

EFERT and FATIMA to suffer relatively minimal impact

The resulting gas price hike has a major bearing on sectors profitability with the impact hitting significantly on FFCs earnings (PKR 5.04/share), while EFERT (PKR 1.91/share) and FATIMA (PKR 0.28/share) receiving relatively minor brunt. To recall, as has been the case earlier as well where back in Oct-18 the increase in gas price (PKR 120/bag) was passed on, chances are highly probable for the situation to reoccur as well.

Urea selling at a significant discount from international prices; price pass-on expected

As per our findings international urea prices are currently hovering close to USD 360/ton, translating into landed price of PKR~2,400-2,500/bag. With local prices of urea crossing PKR1,850/bag this leaves sufficient room for manufactures to pass–on the impact. Hence, absorbing the impact of gas price hike. We see, that a price pass-over of PKR 200/bag turns out beneficial for EFERT and FATIMA, leaving FFC and FFBL with minimal chunk of negative impact. For FFBL in particular, the increase of PKR 200/bag won't be sufficient to absorb full cost owing to DAP production (further rise of PKR ~30/bag would offset the impact), putting company at disadvantageous position.

Exhibit: Company wise cost pass-on to offset the impact

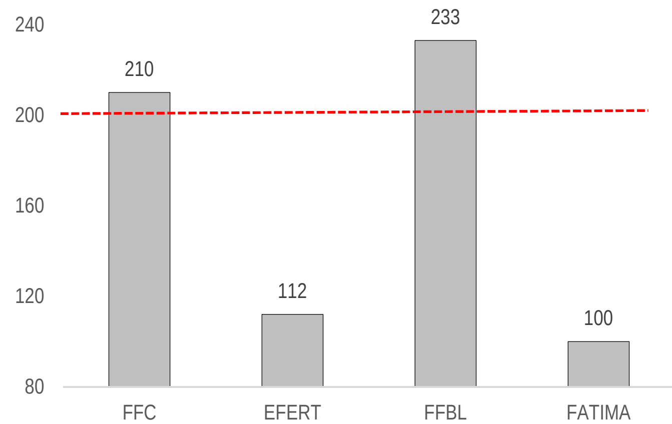

Exhibit: Impact on earnings with gradual price increase

	FFC	EFERT	FFBL	FATIMA
-	(5.04)	(1.91)	(1.80)	(0.28)
40.0	(4.08)	(1.23)	(1.49)	(0.16)
80.0	(3.12)	(0.55)	(1.18)	(0.05)
120.0	(2.17)	0.13	(0.88)	0.06
160.0	(1.21)	0.81	(0.57)	0.18
200.0	(0.25)	1.49	(0.26)	0.29

Source: IGI Research, Company Accounts

Recommendation

We have a **"HOLD"** call on EFERT, based on our Dec-19 target price of PKR 71.6/share, offering +9% upside from its last closing. The company is currently trading at CY19E P/E of 6.50x and offers a dividend yield of 16.8%.

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Time Horizon: Dec – 2019
Valuation Methodology: The analyst(s) has used following valuation methodology to arrive at the target price of the said security (ies):
(Reserve Based DCF Valuation)

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