Daybreak

Friday, 08 April 2022

Company Update

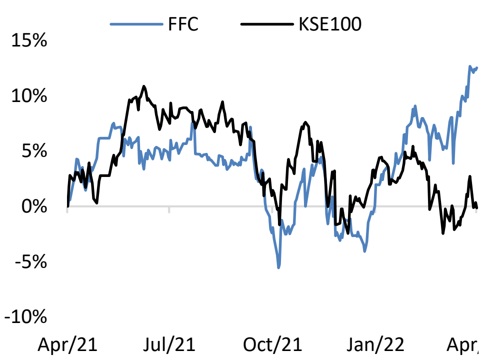
Fauji Fertilizer Company Limited (FFC)

Target Price: PKR 155/share;
Upside: 35.4%
2022: Dividend yld: 16%, P/E: 5.1x
Market Price: PKR 114.5
52 weeks: 111.4 — 114.6
Return: (3M) 0.4%, (6M) -0.1%, (12M) 2.3%
Outstanding Shares: 1.27bn (FF%: 55)
Market Capitalisation: PKR 141.7bn, US$ 0.75bn
Exchange: KSE100, KSEALL,MSCI FM,

Key Financial Highlights

PKR/ Share	2021a	2022e	2023f
EPS	17.2	22.4	19.3
DPS	14.5	18	15.5
BVPS	37.3	41.7	45.5
ROE%	46%	54%	42%
P/E	6.7x	5.1x	5.9x
DY	12.7%	15.7%	13.5%
P/B	3.1x	2.7x	2.5x

Relative Price performance



Source: Company Accounts, PSX

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Fertilizer

FFC: Attractive Valuations Amid Rising Urea Prices; Healthy Cash Position Ensuirng Stable Payout

- As per the market news urea manufacturers have increased prices per bag by PKR 150/bag. FFC has increased urea prices by PKR 150/bag. we expect this will increase our current EPS by 30% from PKR 17.2/share to PKR 22.4/share
- The company holds cash and cash equivalents of PKR 96.3 bn, which will help company to remain consistent with its dividend payouts Given FFC consistent payout history of average 85% next year projected DPS is expected to be PKR 18/share at the current prices dividend yield be 15.7%.
- FFC Script is currently trading at a price of 114.5, at CY22 P/E of 5.1x, with our Dec22 target price of 155/share, the script offers along with CY22E 15.7% dividend yield. Hence we recommend a "BUY" stance on the stock.

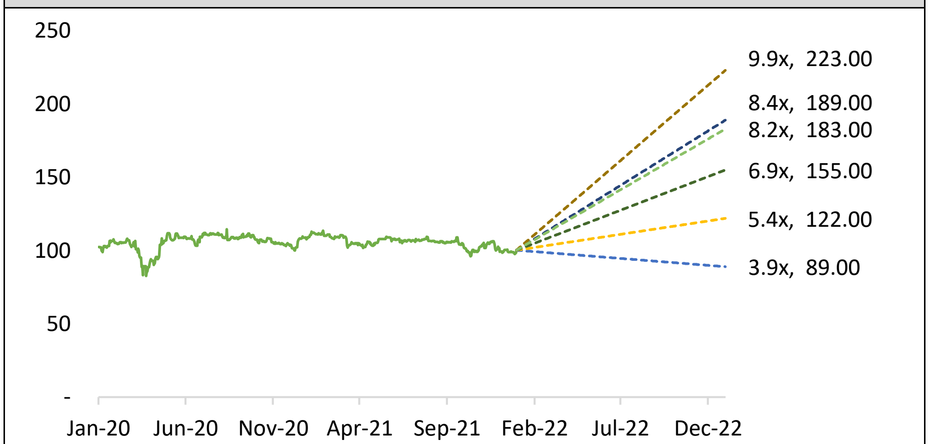
Earnings and target price revised on recent Urea price hike

We have revised up earnings estimates for Fauji Fertiliser Company Limited (FFC) incorporating recent Urea price of PKR 150/bag to PKR 2,011/bag. This is the second price increase in a row during the month of Mar-22, with the latest price hike of PKR 80/bag.

Trading at attractive multiples; P/E 5.1x and dividend yield of 16%

We have raised our earnings forecast by ~18% on average for Cy22-24, subsequently we have revised up our Dec-22 target price by 9% to PKR 155/share, using a ~18% discounting factor. We therefore maintain our '**Buy**' stance on the scrip offering +35% upside from last close and is trading at attractive price multiples, CY22/23 P/E of 5.1/5.9x and tall dividend yield of 16%.

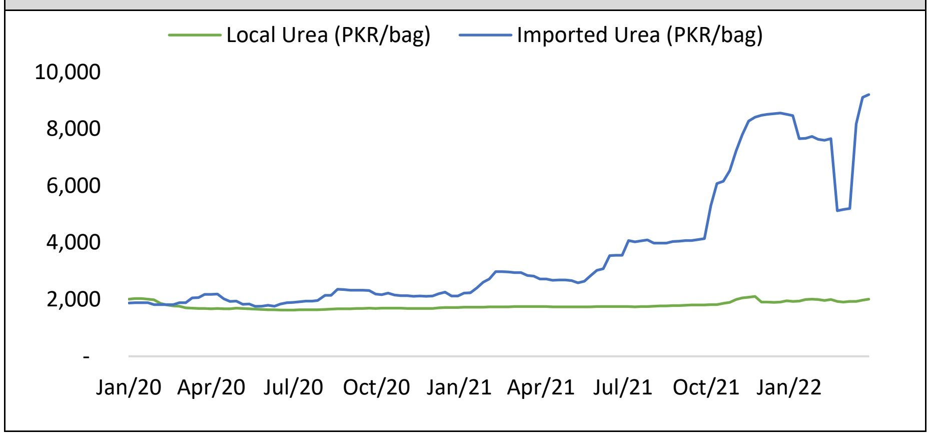
Exhibit: Target price sensitivity based on P/E multiples



Domestic prices at a steep discount to international urea prices…

Currently local urea prices are retailing at PKR 2,011/bag (up by 15%y), but remain at a deep discount of nearly ~80% when compared to international urea price of PKR 9,200/bag (up by 2.3xy). Strong demand led by both rise in agri-commodity prices and improved farm economics, combined with rising input costs (natural gas) have been key reason for rise in international urea prices. Looking forward, on the global front urea prices are unlikely to revert back to US$ 250-300/ton range anytime soon given strong demand and rising input costs.

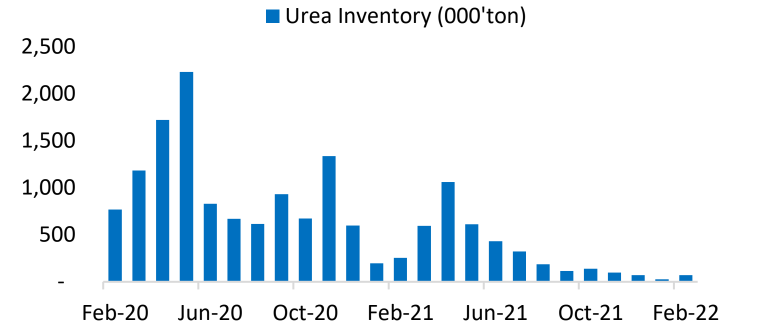
Exhibit: Discount between local and imported Urea Prices



…on home ground, high demand low inventory levels could potentially push prices further northwards

On home ground, upcoming Kharif season is expected to support urea demand whereas already low inventory levels are likely to keep supply side under pressure. Government's commitment to import Urea for May/Jun 2022 remains key to dwindling inventory levels. However, if supply side balance is not maintained through imports, this would propel local manufacturers to further hike Urea prices. For now, local Urea manufacturers remain in a strong position to further hike urea prices amid international supply disruptions due to ongoing Russia-Ukraine crises and lower inventory levels domestically.

Exhibit: Urea inventory levels



Source: NFDC, IGI Research

High dividend yield in offering

The Company holds cash and cash equivalents of PKR 96.3 bn, while total GIDC payments to be made are PKR 21bn. With free cash flow generation of PKR 18-20/share over the next 3 years, the Company's cash position remains strong to keep cash payout steady. FFC cash payout has averaged ~80% over the last 4 years, we project FFC cash payout of PKR 18/share during CY22 which at current price translates in to dividend yield of 16%.

Risks

Weighted Average Cost of Gas (WACOG) is expected to support gas prices in coming years, which might negatively impact FFC's bottom-line.
Considering changes in gas prices and GST rates if subsidized feed gas costs are increased in-line with fuel costs, it would require an in-line increase on the final product (urea) prices for FFC to completely pass-on incremental costs. Although WACOG has been approved but implementation is yet to come by. Considering current market conditions, wide international market discounts urea manufacturers most likely are in a sweet spot to pass-over the incremental impact of gas price hike if any.

Exhibit: Sensitivity of changes in Urea and gas prices on CY22 EPS

Gas Price (PKR/MMBtu) \ Urea Prices	1,700	1,800	1,900	1,990	2,100	2,200	2,300
744	18.0	20.2	22.4	24.3	26.8	28.9	31.1
827	17.4	19.6	21.8	23.8	26.2	28.4	30.5
919	16.7	18.9	21.1	23.1	25.5	27.7	29.9
1,021	16.0	18.2	20.4	**22.4**	24.8	27.0	29.2
1,123	15.3	17.5	19.7	21.6	24.0	26.2	28.4
1,235	14.5	16.7	18.9	20.8	23.2	25.4	27.6
1,359	13.6	15.8	18.0	19.9	22.4	24.5	26.7

Recommendation

We maintain our "**Buy**" stance on the scrip with Dec-22 target price of PKR 155/share, offering 35% upside from last close. The Company is currently trading at Cy22/23 P/E of 5.1/5.9x and offers a healthy dividend yield of 16%.

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Hold if target price on aforementioned security (ies) is in between -10% and 10%, from its last closing price(s)
Sell if target price on aforementioned security (ies) is less than -10%, from its last closing price(s)

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