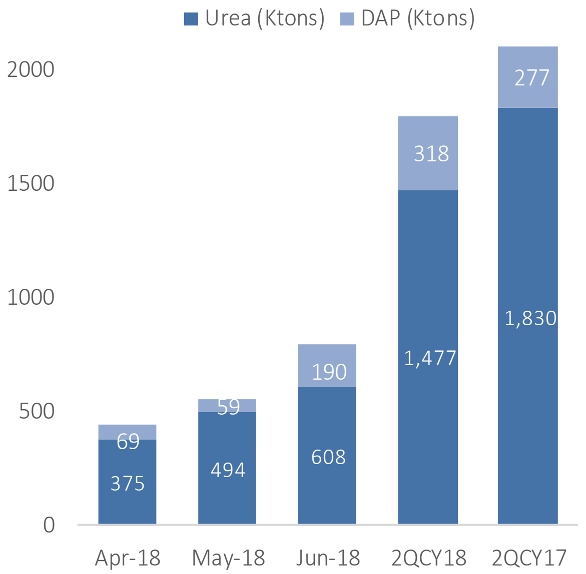
Day Break

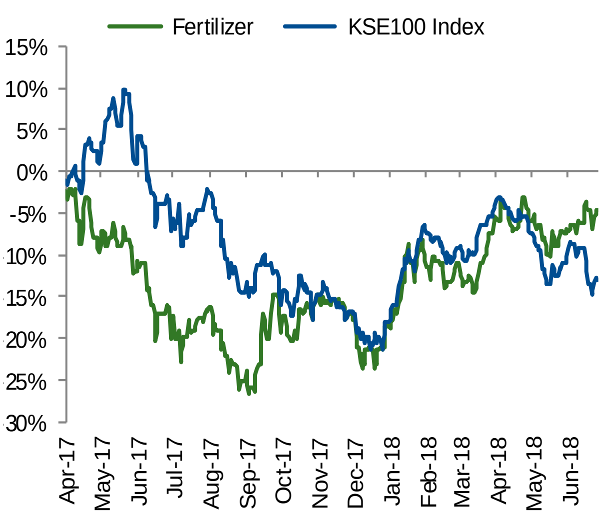
Monday, 30 July 2018

Sector Update

Industry Offtake: Urea (ktons) and DAP (ktons)



Relative Performance to KSE 100



Source: Bloomberg, PSX & IGI Research

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Fertilizer

Improved pricing dynamics to drive sector's profitability up by +31%YoY for 2QCY18

- We preview earnings for the fertilizer companies under IGI coverage (FFC, FFBL, EFERT & FATIMA) wherein we expect the profitability to surge by +31%YoY to PKR 7.67bn on the back of improved fundamentals driven by high pricing power despite a drop of 20%YoY in urea offtake.
- With respect to stock performance, the sector has over performed by 16% CY18TD against the benchmark index, spurred by sustained offtakes and high pricing power stemming from low inventory levels.
- Company wise, FATIMA is expected to lead the sector's profitability with earnings attaining at PKR 2.97bn (EPS: PKR 1.42). Similarly, FFC and EFERT will follow the trail witnessing double digit growth in their earnings at PKR 2.45bn (EPS: PKR 1.93) and PKR 2.72bn (EPS: PKR 2.04) respectively. FFBL, however will impede sector earnings a bit with a loss of PKR 0.47bn (LPS: PKR 0.51.

We preview earnings for the fertilizer companies under IGI coverage (FFC, FFBL, EFERT & FATIMA) wherein we expect the profitability to surge by +31%YoY to PKR 7.67bn on the back of improved fundamentals driven by stable prices despite a drop of 20%YoY in urea offtake. Moreover, low finance cost and low handling costs (low inventory levels) will provide additional support to the earnings. However, inclusion of super tax charge will trim away overall sectors profitability. With respect to stock performance, the sector has over performed by 16% CY18TD against the benchmark index, spurred by sustained offtakes and high pricing power stemming from low inventory levels.

Series of price hikes post budget as urea inventory levels declined

On pricing front, to recall, fertilizer manufacturers increased urea prices by PKR 100/bag to account for subsidy amount and since then have been on pricing spree, surpassing the price cap of PKR 1,400/bag and crossing PKR 1,600/bag as of now. In addition, low inventory levels during the period have given added advantage for the urea manufacturers to increase prices. For DAP, external factors such as rapid PKR depreciation during the quarter coupled with rising raw material costs have led manufacturers and importers to pass over the price.

Exhibit:

Sector: 2QCY18 Result Highlights

Period End Dec- PKRmn	2QCY18E	2QCY17	YoY	1HCY18E	1HCY17	YoY
Net Sales	64,913	53,207	22%	126,095	90,788	39%
Gross Profit	19,696	13,743	43%	38,699	24,092	61%
Selling / Dist.	5,739	6,162	-7%	11,607	16,753	-31%
Other Op. Income	3,289	6,135	-46%	7,033	11,279	-38%
EBIT	14,734	11,768	25%	29,147	21,705	34%
Finance Cost	1,788	2,277	-21%	3,432	4,473	-23%
Pre-Tax Profits	12,947	9,491	36%	25,716	17,232	49%
Taxation	4,632	3,652	27%	8,809	6,122	44%
Post-Tax Profits	8,314	5,839	42%	16,906	11,111	52%

Source: IGI Research, Company Financials, PSX

FATIMA to drive sector's profitability followed by EFERT and FFC

Company wise, FATIMA is expected to lead the sector's profitability with earnings estimated at PKR 2.97bn (EPS: PKR 1.42). Similarly, FFC and EFERT will follow the trail witnessing double-digit growth in their earnings at PKR 2.45bn (EPS: PKR 1.93) and PKR 2.72bn (EPS: PKR 2.04) respectively. FFBL however will impede sector earnings a bit with a loss of PKR 0.47bn (LPS: PKR 0.51).

FFBL: Despite improved offtake, company to report a loss of PKR 0.48bn (LPS: PKR 0.51) for 2QCY18

Fauji Fertilizer Bin Qasim Limited (FFBL) is scheduled to announce its financial results for 2QCY18 on 30th Jul-18 wherein we expect the company to report a loss of PKR 0.48bn (LPS: 0.51) on unconsolidated basis taking total loss for the 1HCY18 to PKR 0.93bn (LPS: PKR 0.99) compared to PKR 0.38bn (LPS: PKR 0.41) in the same period last year. Major erosion to earnings stems from decrease in margins primarily owing to steam prices and subsequent capacity payments along with increase in phosphoric acid prices. With offtake in urea and DAP, tuning at 168k tons and 66k tons respectively, we expect net sales for the quarter to clock in at PKR 8.51bn, up by +13%YoY. However, major dent to earnings may come from decrease in other income owing to decrease in subsidy for urea and removal of DAP subsidy (corresponding reduction in tax rate). We have a **"HOLD"** call on the scrip based on our Dec-18 target price of PKR 40.9/share.

Exhibit:

FFBL: 2QCY18 Result Highlights

Period End Dec- PKRmn	2QCY18E	2QCY17	YoY	1HCY18E	1HCY17	YoY
Net Sales	8,511	7,556	13%	18,794	15,555	21%
Gross Profit	336	543	-38%	1,081	289	274%
Other Op. Income	474	1,201	-61%	834	2,946	-72%
EBIT	(268)	273	n.m	(499)	453	n.m
Finance Cost	460	445	4%	880	922	-5%
Pre-Tax Profits	(729)	(171)	325%	(1,379)	(469)	n.m
Taxation	(254)	78	n.m	(455)	(85)	n.m
Post-Tax Profits	(474)	(249)	90%	(924)	(384)	140%
EPS	(0.51)	(0.27)		(0.99)	(0.41)	
DPS	-	0.10		-	0.10	
Key Ratios						
Gross Profit Margins	3.9%	7.2%		5.8%	1.9%	
Ebit Margins	-3.2%	3.6%		-2.7%	2.9%	
Effective Tax Rate	34.9%	-45.6%		33.0%	18.1%	

Source: IGI Research, Company Financials, PSX *No. of shares :934mn*

FFC: Earnings to clock in at PKR 2.45bn (EPS: PKR 1.93), up by +51%YoY for 2QCY18

Fauji Fertilizer Company Limited (FFC) is scheduled to announce its financial result for 2QCY18 on 31th Jul-18 wherein we expect the company to post a profit of PKR 2.45bn (EPS: PKR 1.93) unconsolidated basis up by +51%YoY. Although, offtake for urea inched down by 8%YoY to 653k tons but increase in fertilizer price partially arrested the impact along with DAP offtake increasing by +79%YoY to 81k tons. Owing to price, hikes coupled with no discounts, retention prices for Sona urea improved by 12%YoY during the quarter. As a result, net sales are expected to increase by +20%YoY to PKR 22.7bn, taking total net sales for 1HCY18 to PKR 43.3bn, up by +43%YoY. In addition, decrease in finance cost owing to subsequent debt repayments may also lift earnings by +49%YoY. However, other income is expected to glide down by 62%YoY owing to decrease in subsidy amount (amount recorded till Apr-18). Lastly, we expect company to declare cash dividend of PKR 1.70/share. We have a **"HOLD"** call on the scrip based on our Dec-18 target price of PKR 100.0/share.

Exhibit:

FFC: 2QCY18 Result Highlights

Period End Dec- PKRmn	2QCY18E	2QCY17	YoY	1HCY18E	1HCY17	YoY
Net Sales	22,703	18,971	20%	43,261	30,161	43%
Gross Profit	5,675	3,637	56%	9,768	6,238	57%
Other Op. Income	1,058	2,788	-62%	3,144	5,567	-44%
EBIT	4,277	3,669	17%	8,149	7,065	15%
Finance Cost	337	666	-49%	715	1,202	-41%
Pre-Tax Profits	3,940	3,003	31%	7,434	5,863	27%
Taxation	1,487	1,378	8%	2,716	2,046	33%
Post-Tax Profits	2,453	1,625	51%	4,718	3,817	24%
EPS	1.93	1.28		3.71	3.00	
DPS	1.70	1.00		3.45	2.50	
Key Ratios						
Gross Profit Margins	25.0%	19.2%		22.6%	20.7%	
Ebit Margins	18.8%	19.3%		18.8%	23.4%	
Effective Tax Rate	37.7%	45.9%		36.5%	34.9%	

Source: IGI Research, Company Financials, PSX *No. of shares :1,272mn*

FATIMA: Low Finance cost and modest growth in offtake to drive earnings by +47%YoY to PKR 2.97bn (EPS: PKR 1.42) for 2QCY18

We expect the company to report a profit of PKR 2.97bn (EPS: PKR 1.42) on unconsolidated basis, up by +47%YoY taking total earnings for 1HCY18 to PKR 5.86bn (+37%YoY). Low finance cost (down by 59%YoY) and decent growth (+22%YoY) in offtake have catalyzed earnings for the quarter. Top line is expected to grow by +25%YoY to PKR 11.8bn led by increase in urea / NP offtake with CAN sales sliding down by 23%YoY. Gross margins are expected to hover around 60% as against 46% for the 2QCY17 owing to increase in retention prices covering up increased phosphate rock prices. However, handling costs may increase (+77%YoY) amid high urea inventory amongst other peers in the industry. We have a **"BUY"** call on the scrip based on our Dec-18 target price of PKR 41.3/share.

Exhibit:

FATIMA: 2QCY18 Result Highlights

Period End Dec- PKRmn	2QCY18E	2QCY17	YoY	1HCY18E	1HCY17	YoY
Net Sales	11,784	9,433	25%	23,172	17,692	31%
Gross Profit	7,201	4,348	66%	14,035	8,857	58%
Other Op. Income	166	85	96%	320	259	23%
EBIT	4,928	3,017	63%	9,590	6,421	49%
Finance Cost	228	552	-59%	552	1,049	-47%
Pre-Tax Profits	4,699	2,465	91%	9,038	5,372	68%
Taxation	1,727	448	286%	3,179	1,080	194%
Post-Tax Profits	2,972	2,017	47%	5,859	4,291	37%
EPS	1.42	0.96		2.79	2.04	
DPS	-	-		-	-	
Key Ratios						
Gross Profit Margins	61.1%	46.1%		60.6%	50.1%	
Ebit Margins	41.8%	32.0%		41.4%	36.3%	
Effective Tax Rate	36.8%	18.2%		35.2%	20.1%	

Source: IGI Research, Company Financials, PSX *No. of shares :2,100mn*

EFERT: Earnings for 2QCY18 to increase by +11%YoY to PKR 2.72bn (EPS: PKR 2.04/share)

As per our analysis, we expect earnings for 2QCY18 to increase by +11%YoY to PKR 2.72bn (EPS: PKR 2.04) taking total profitability for 1HCY18 to PKR 6.61bn (EPS: PKR 4.95), up by +66%YoY. Accretion to earning stems from increase in prices and low handling costs amid low inventory levels while inclusion of super tax charge will chip away earnings by PKR~ 0.3/share. Net sales will increase by +26%YoY to PKR 21.74bn despite witnessing a slight drop (10%YoY) in urea offtake to 497k tons. However, DAP sales have exhibited recovery, up by ~+2.0xYoY to 120k tons, thereby adding up the topline. Finance cost is expected to decrease by 17%YoY on the back of debt repayments. In addition, the company may declare a cash dividend of PKR 1.50/share for the quarter. We have a **"HOLD"** call on the scrip based on our Dec-18 target price of PKR 84.6/share.

Exhibit:

EFERT: 2QCY18 Result Highlights

Period End Dec- PKRmn	2QCY18E	2QCY17	YoY	1HCY18E	1HCY17	YoY
Net Sales	21,740	17,247	26%	39,959	27,311	46%
Gross Profit	6,856	5,215	31%	14,187	8,708	63%
Other Op. Income	317	2,061	-85%	1,462	3,275	-55%
EBIT	4,872	4,809	1%	10,983	7,767	41%
Finance Cost	509	615	-17%	1,033	1,300	-21%
Pre-Tax Profits	4,363	4,194	4%	9,950	6,467	54%
Taxation	1,644	1,748	-6%	3,341	2,364	41%
Post-Tax Profits	2,720	2,446	11%	6,609	4,102	61%
EPS	2.04	1.83		4.95	3.07	
DPS	1.50	1.00		1.50	2.50	
Key Ratios						
Gross Profit Margins	31.5%	30.2%		35.5%	31.9%	
Ebit Margins	22.4%	27.9%		27.5%	28.4%	
Effective Tax Rate	37.7%	41.7%		33.6%	36.6%	

Source: IGI Research, Company Financials, PSX *No. of shares :1,334mn*

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Time Horizon: Dec – 2018

Valuation Methodology: The analyst(s) has used following valuation methodology to arrive at the target price of the said security (ies):
(Discounted Cash Flow)

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