

January 20, 2012

Pakistan Market

FFC: 2011 EPS expected at Rs24.1 / 'Buy' maintained

KSE100 Index: Closing 11,515.59 ↓ (32.13)

Fauji Fertilizer Company (FFC) is expected to report earnings of Rs20.5bn (EPS: Rs24.1) in 2011 up 85%YoY. Higher urea price is the primary reason behind this growth. We also expect a dividend payout of Rs4.75 per share taking the cumulative full year dividend to Rs19.50 per share. In addition, a bonus issue of 25% can not be ruled out. At current levels, the stock is trading at a 2012F PE of 6.5x and offers a dividend yield of 12.4% and we maintain our 'Buy' call on it. The increase in gas tariff and the consequent hike in urea prices has somewhat reduced the ambiguity surrounding the fertilizer sector. However, lower urea margins pose a key risk to our investment thesis.

FFC: Financial highlights

(Rs mn)	2011E	2010A	%Δ
Sales	55,170	44,874	23%
Cost of sales	22,894	25,310	-10%
Gross profit	32,276	19,564	65%
Gross margin (%)	59%	44%	
Distribution cost	4,441	3,944	13%
Other expenses	2,460	1,376	79%
Other income	5,574	3,153	77%
Operating Profit	30,949	17,397	78%
Operating margin (%)	56%	39%	
Finance cost	976	1,087	-10%
Profit before taxation	29,973	16,310	84%
Taxation	9,518	5,281	80%
Profit after taxation	20,455	11,029	85%
Net margin (%)	37%	25%	
EPS	24.12	13.00	85%

Source: Company accounts & JS Research

EPS of Rs24.1 in 2011E

The company's PAT is anticipated to jump by 85%YoY to Rs20.5bn (EPS: Rs24.1) compared to Rs11.0bn (EPS: Rs13.0) in 2010. The growth is primarily attributable to higher

urea margins. Consequently, we expect gross margins to improve significantly to 59% from 44% last year. To recall, urea manufacturers have increased urea prices by Rs560/bag (including GST) during 2011. Furthermore, healthy dividend income from FFBL of Rs4.8bn is expected to propel FFC's bottom-line. In 4Q alone, company's earnings are projected to clock in at Rs7.8 per share.

Incremental gas cost pass-through

The increase in gas tariff and the consequent hike in urea prices has somewhat reduced the ambiguity surrounding the fertilizer sector. However, FFC even after raising urea price to Rs1,795/bag has been unable to pass through its full incremental cost and therefore has to take brunt on its margins from 2012 onwards. Despite, given the current scenario FFC will still be able to post a decent growth of 5.6%YoY in its 2012F EPS, in our view.

Urea pricing remains the key

The urea pricing remains the key risk to our investment thesis that can play on both sides. The resumption of gas supply to ENGRO (Enven) after the winter season and consequent reduction in urea prices due to regulatory pressure may dampen urea margins. Additionally, imposition of equalization tax is likely to result in depressed margins going forward. On the other hand, given the bleak gas supply outlook any further hike in urea prices poses an upside risk to our investment case.

Recommendation: Buy

Considering the present fertilizer industry scenario, we continue to maintain a 'Buy' stance on FFC that is currently trading at a 2012F PE of 6.5x and offers a dividend yield of 12.4%.

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Fauji Fertilizer Company	
Market Price: Rs165.95	Kats Code: FFC
Market Cap: Rs140.7bn (US\$1.6bn)	Bloomberg Code: FFC PA
1-yrs Avg. Daily Volume: 2.1mn shares, Rs331.9mn (US\$3.7mn)	Reuters Code: FAUF.KA
1-year High/Low: Rs198.35/109.82	

Also in focus

Textile exports down 20%YoY in Dec 2011

The Federal Bureau of Statistics (FBS) released the textile export numbers for December, which stood at US\$944mn, down 20%YoY and 15%MoM. Dip in exports of raw cotton, cotton yarn and garments along with lower cotton prices are likely to be the reason for the decline. Cumulative exports in 1HFY12 came in at US\$5.96bn, a decline of only 4.7%YoY.

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