Alfalah CLSA

Pakistan Fertilizers

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Pakistan
Fertilizer

Fertile grounds offering unmatched yields

Earnings/dividend of fertilizer universe to increase by 58%/39% in CY24

AFS fertilizer universe will see significant increase in earnings on back of multiple output price hikes and likely absence of negative deferred taxation impact. Core business dynamics remain enticing on back of robust demand and pricing discount from international markets. Companies are trying to overcome hazy outlook on gas provisions with timely capital expenditure on that front. Lastly, current discount of trading multiples to their near-term historic levels further adds to the comfort in an environment of improving economic outlook.

Company wise, EFERT/FFC/FFBL will see their EPS jumping by 41%/55%/218% YoY to PKR 27.5/36.1/10.9 respectively in CY24. Higher earnings will help the sector maintain high dividend yield which it is historically known for. Keeping in view higher capital expenditure requirements for gas pressure enhancement facilities, CY24E dividend pay-out for EFERT/FFC/FFBL is expected at PKR 26.0/21.5/4.0 per share translating into yields higher than those on PIBs. Thus, the sector provides good upside to investors seeking relatively safe avenues for their funds.

Demand to remain robust

Urea demand has remained robust in yesteryears on the back of better farm economics and the concerns of it being smuggled out of country due to disparity with landed prices. Industry sales have consistently remained above 6 MTPA for the past 5 years with last 2 years sales figure crossing 6.6 MTPA. This sales trend is likely to persist as increase of wheat support price to PKR3,900/maund has compelled farmers to use fertilizer in pursuit of higher yields.

In discussion with farmers, we've noted that applying optimal quantity of fertilizer pushes wheat yield to beyond 40 maunds per acre while it falls by a quarter to near 30 maunds per acre in absence of fertilizer application. Given potential loss in revenue of around PKR39,000 per acre in absence of fertilizer application, farmers tend to apply fertilizers to crops as potential loss in revenue is greater than savings from skipping fertilizer.

With high support prices, urea demand is likely to persist. This can also be corroborated by looking at nutrient needs of different crops and availability of those nutrients in the country.

Figure 1

Nutrient Demand

Nutrient requirement Kg/Acre	N	P2O5	Urea bags per acre (46% N)	Area under cultivation (Million acres)
Wheat	53	30	2.3	22.3
Rice	69	37	3	7.4
Cotton	90	31	3.9	5.3
Maize	92	51	4	4.2
Sugarcane	133	50	5.8	3.4
Gram	14	30	0.6	2.1
Rapeseed & Mustard	32	26	1.4	1.3
Bajra	35	26	1.5	0.6
Total nutrient requirement (8 crops only)	3.1 MTPA	1.6 MTPA	6.7 MTPA	

Source: Soil Fertility Research Institute, NFDC, Alfalah CLSA Research

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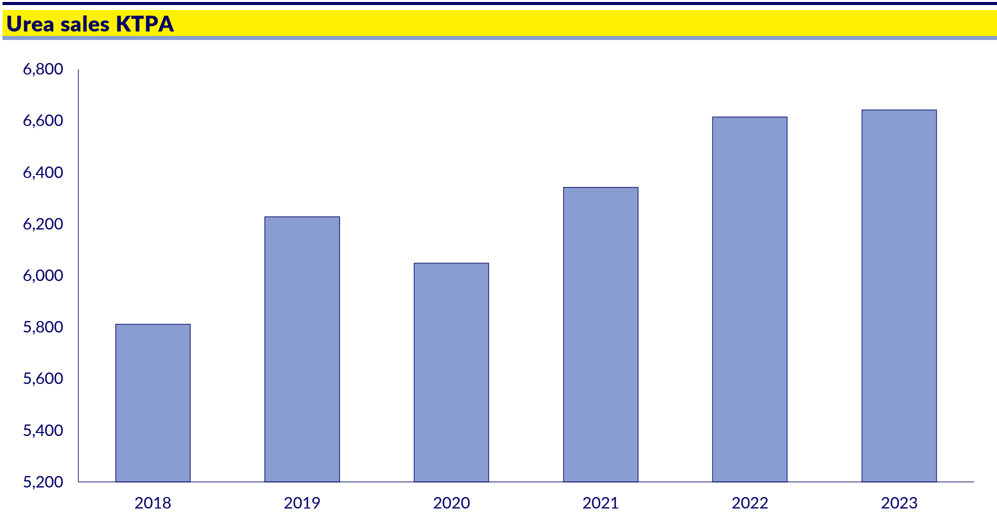
In the table above, we have shown required nitrogen for 1 acre of different types of crops as per Soil Fertility Research Institute, Punjab. Based on these calculations, total nitrogen requirement for just 8 main crops stand at 3.1MTPA which translates into 6.7MTPA of Urea. P_2O_5 requirement also stand at 1.6MTPA.

Historic offtake levels suggest that farmers tend to replace P_2O_5 with N due to pricing discount. Hence, average nitrogen demand remained at 3.8MTPA for the past 2 years, while average P_2O_5 demand remained at 1.4MTPA as per NFDC. Excess 0.7MTPA of nitrogen demand is met by other fertilizers having low nitrogen content i.e. CAN, AS or through phosphatic fertilizers with minor nitrogen presence e.g. DAP, NP.

In this backdrop, we are of the opinion that urea demand will hover around current levels even with higher fertilizer prices as fertilizer accounts for less than quarter of total expense of a farmer. So, any increment in prices will hike overall cost in single digits which can be compensated by higher crop prices.

Figure 2

Urea sales KTPA



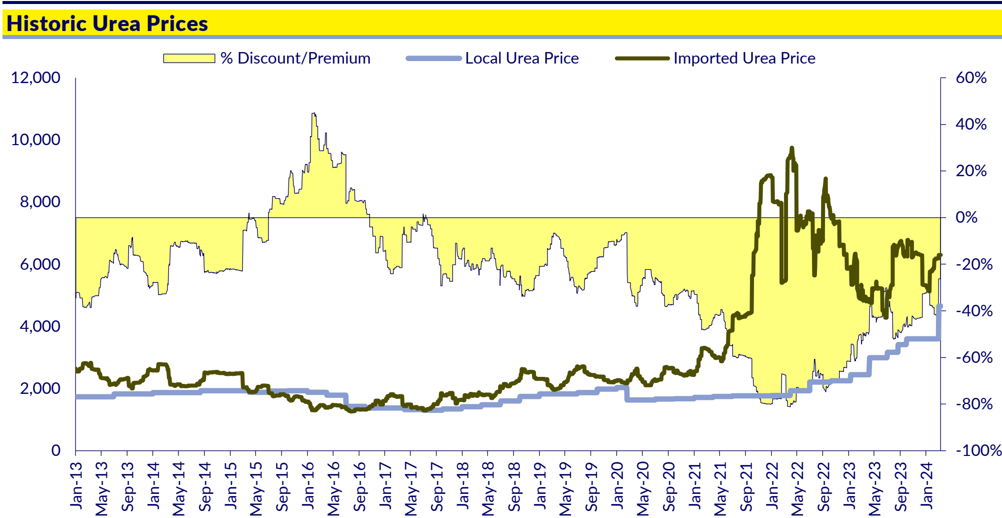
Source: NFDC, Alfalah CLSA Research

Concerns on cross-border smuggling not eliminated yet

Although imported urea prices have fallen of late, however, local (EFERT) urea is still trading at 26% discount to imported parity even without incorporating importer margin. Hence, the commodity still remains prone to cross border smuggling albeit of lower magnitude. However, if international urea prices fall to USD300/Ton, then this smuggling becomes infeasible at current local urea prices.

Figure 3

Historic Urea Prices



Source: PBS, Bloomberg, Alfalah CLSA Research

Pricing distortion in urea market

Over the past 2 years, there has been significant differences in gas pricing of fertilizer manufacturers. Fatima Fertilizer's base plant and 3 plants of FFC are entitled to fertilizer policy gas pricing which are notified separately for Mari network, hence their gas prices remained unchanged for first three quarters of CY23 when other manufacturers saw hike in their gas cost.

Previously FFBL was provided gas at system gas rate, EFERT's ENVEN at concessionary rate of USD 0.7/MMBTU and RLNG based plants at PKR1,239/MMBTU. In February'24, government has equalized the rates of gas supplied to erstwhile RLNG based plants, FFBL and EFERT's ENVEN. However, other 6 plants are supplied directly from Mari without using gas infrastructure of Sui network and their gas prices remains unchanged. Gas supply agreements of those plants are expiring in June 2024.

ECC formed a committee in CY23 with representation of ministries of industries, finance, commerce, planning, energy, power, and food security to deliberate upon the pricing and allocation of gas to the fertilizer industry. Resultantly, ministry of petroleum's view of raising tariff may thus get implemented as new contracts are signed by June 2024.

Figure 4

FEED / FUEL GAS RATE			
(PKR/MMBTU)	Old Rate	New Rate	System
FFC			
Feed Gas	580	580	MARI
Fuel Gas	1,580	1,580	MARI
EFERT			
ENVEN feed gas	USD 0.7 was charged while PKR 580 was being accrued	PKR 1597	MARI through SNGPL
Fuel gas	1,580	1,597	MARI through SNGPL
Base plant gas (Current)	USD 5.8	USD 5.8	MARI
FFBL			
Feed Gas	580	1,597	SSGC
Fuel Gas	1,580	1,597	SSGC
AGL			
Feed and Fuel Gas	1,239	1,597	SNGP
FATIMA			
Sadiqabad Plant Feed Gas	580	580	MARI
Sadiqabad Fuel Gas	1,580	1,580	MARI
Multan Plant Feed and Fuel	USD 5.8	USD 5.8	MARI
Sheikhupura Plant Feed and Fuel	1,239	1,597	SNGP

Source: Alfalah CLSA Research

Due to this difference in gas pricing, current variation in urea prices of different manufacturers has surged to PKR1,720/bag. Before CY22, this range has historically hovered around PKR100/bag due to differences in granular and prilled urea. Variation in urea prices has been detrimental to farmers as they procure urea at close to the highest specified MRP in the industry. Our informal discussion with different dealers suggest that market price of prilled urea for farmers currently hovers between PKR4,900/bag to 5,300/bag for different regions while that of granular urea is between PKR5,500/bag and PKR5,700/bag.

Figure 5

Urea MRP	
	PKR/Bag
Sona Urea Prilled (FFC)	3,767
Neem Coated Urea (FFC)	4,017
Sona Urea Granular (FFBL)	5,489
Engro Urea (EFERT)	4,649
Zabardash Urea (EFERT)	5,799
Sarsabz Urea (Fatima)	3,839
Babbarsher Urea (Fatima)	4,095
Tara Urea (AGL)	4,807

Source: Alfalah CLSA Research

Government will want to eliminate the pricing differential as excess margin is pocketed by dealers at the cost of end user. Hence, our view is that post June'24, gas prices of 6 plants on Mari network will be brought at par with prevailing tariff of those on Sui network. Since current petroleum policy gas prices of USD5.8/MMBTU is very close to PKR1,597/MMBTU; so, whether new agreements are signed at petroleum policy prices or current Sui notified tariff, output price gap is likely to converge from July 2024 onwards. We have considered this to be our base case in forecasting earnings.

Pressure enhancement facility to ensure food security of the country

FFC/EFERT/FATIMA are undertaking a project that involves construction of compressors to maintain the gas pressure of Mari HRL. Capital expenditure for the

said project is estimated to range between USD250-USD300mn with share of FFC/EFERT/FATIMA being 47.7%/33.9%/18.4%. Phase 1 is slated to be completed by end of CY24 while phase 2 has also commenced with procurement of compressors and will get completed during CY25. Dispatches from MARI field were expected to plateau during ongoing year after completion of HRL phase X development project. However, with this capital outlay, robust gas pressure is likely to persist for longer and will thus help ensure food security of the country.

Sector trading at attractive future earnings

The ability of the sector to pass-on any increase in costing to end users by the virtue of it selling at steep discount to landed parity has enabled it to maintain a robust future earnings profile. For the ongoing quarter, companies will have to book higher gas cost since start of February, however, this slight hit on earnings due to retrospective gas tariff hike is one-off in nature. Note that FFC's gas pricing remained unchanged. Moreover, it will book higher other income in 1QCY24 due to dividend flow from power subsidiaries and associates (AKBL, FFBL).

Future earnings and dividend yield remain robust as shown below.

Figure 6

Earnings and dividend estimates

	CY24	CY25
EPS		
FFC	36.1	38.0
EFERT	27.5	34.2
FFBL	10.9	7.3
DPS		
FFC	21.5	26.5
EFERT	26.0	32.5
FFBL	4.0	2.5
P/E		
FFC	3.4	3.2
EFERT	5.3	4.2
FFBL	2.3	3.4
Dividend Yield		
FFC	17.7%	21.8%
EFERT	18.0%	22.4%
FFBL	16.0%	10.0%

Source: Alfalah CLSA Research

FFC - BUY

FFC is expected to see a rise in its profitability on the back of hike in urea prices at the start of CY24 resulting in higher margins coupled with robust demand emanating from healthy farm economics. Expected dividend flow of PKR1.5bn from Thar Energy Limited will also augment earnings starting CY25 and increasing thereon. In this backdrop, company offers one of the highest dividend yield of 17.7% among KSE-100 companies. With our Dec-24 price target of PKR152.3/sh, company provides potential upside of 25.1%. Dividend yield takes total return potential to 42.8%. Moreover, the company is currently trading at 52% discount to its last 10 year forward P/E multiple of 7.1x, even partial rerating is likely to provide significant price appreciation.

Pricing power to overshadow any cost pressure: FFC is market leader in urea sales and has significant pricing power. Currently FFC is being charged feed/fuel gas at PKR580/1580 exclusive of sales tax as last gas price hike notification omitted those manufacturers who draw gas directly from MARI network. Resultantly, FFC did not increase urea price like competitors and is selling urea at a discount of PKR882/bag to EFERT.

Recently, news flow suggests that IMF has recommended ending all subsidies provided to fertilizers. In lieu of that, we have considered hike in input cost in proportion to industry peers from July'24 onwards as gas supply agreement gets renewed on new terms. We have further assumed that FFC will increase retention by PKR1190/bag with higher dealer margin and FED to take MRP at PKR 5130/bag. Profitability will remain largely unchanged as output price hike just offsets the negative impact of increase in gas cost.

GIDC payment to marginally strain payout capability: FFC had PKR64bn GIDC payable as of CY19 end. Subsequently, Supreme Court in August 2020 ordered payment in 24 monthly instalments and later in review petition in November 2020 asked the same to be paid in 48 monthly instalments. Matter is still under adjudication currently and the company has not made any payment in this regard. We, however, have assumed full payment in CY25 as we believe government of Pakistan will vigorously pursue the matter given fiscal constraints.

Company has the financial muscle to payoff this liability without any significant headwind as Dec'23 cash and short-term investments stood at PKR96bn. This repayment will dent income coming from financial assets from CY25 onwards. Our estimated income from this stream is PKR 19.5/13.6/4.5 bn in CY24/25/26 which translates into after tax income per share of PKR 9.3/6.5/2.2 respectively.

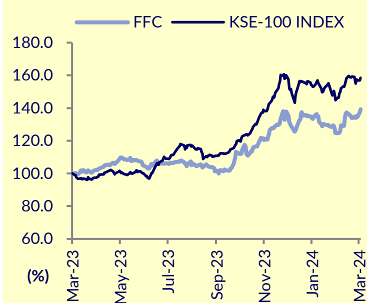
This payment will likely put marginal pressure on company's willingness for dividend payout. We have assumed payout ratio of 80% after deducting financial outlay required for capital expenditure relating to pressure enhancement facility. Our estimated dividend yield stands at attractive 17.7%. Hence, FFC offers one of the highest dividend yield among KSE-100 index companies.

Moreover, whenever the capital currently deployed in fixed income instruments is used for payment of GIDC, the company will become more attractive for sharia compliant investors.

Subsidiaries and associates to add to profitability: Other income flowing from associates/subsidiaries will cushion profitability. We have assumed dividend flow

Symbol	**FFC**
Price PKR	121.8
Bloomberg	FFC PA
Reuters	FAUF.PSX
Price Target	152.3
Up/downside	25.1%
Mkt. cap USD mn	556.0
No. of Shares mn	1,272.2
3M ADV USD mn	0.5

FFC vs KSE100 performance



Source: PSX, Bloomberg

of PKR1.1bn from Thar Energy limited from CY25 onwards. Furthermore, we have assumed AKBL to maintain the annual dividend payout of PKR2.5/sh going forward. These inflows will likely lead to dividend income of PKR 4.1/6.5 bn in CY 24/25 respectively.

Further, Foundation Wind Energy 1 & 2 will cumulatively expand consolidated earnings by around PKR 4.1/2.2 per share for CY24/CY25 as debt repayments complete in ongoing calendar year.

Other expenses may remain high for CY24: Company booked PKR2.9bn loss allowance on subsidy receivable in CY23 which muted its net profitability by PKR1.4/sh. Continuing with this trend, we have assumed PKR1.24bn loss allowance on subsidy receivable in CY24 to provide for 100 percent of subsidy receivable from Government of Pakistan.

Moreover, management may deem to impair equity investment in Fauji Fresh N Freeze (FFF). Current carrying value of investment on FFC's book is PKR4.23bn, however, our estimates suggest the net book value of FFF to be around PKR1.1bn. Hence, we have assumed that company may book an impairment charge of PKR3.1bn in CY24. Hence, these two charges will diminish CY24 earnings by PKR2.1/sh. However, these charges should not continue in CY25 unless FFC decides to convert lines of credit of PKR1.8bn recently extended to Fauji Fresh and Freeze into equity and impair them further.

Trading at discount to historic multiple: FFC has traded at an average forward price to earnings multiple of 7.1 since last 10 years. It is currently trading at a multiple of 3.4, implying 52% discount to its historic average. Company can provide a significant upside even if partial rerating happens.

We have used discounted free cash flows to value the company with cost of equity of 23%. We have a buy call on the company as at our Dec-24 target price of PKR152.3/sh, price appreciation potential is 25.1% from the last close. Potential dividend yield of 17.7% makes total upside of 42.8%.

Financial Projection

Figure 7

Income Statement (PKR Mn)	CY23A	CY24E	CY25E	CY26E	CY27E
Net Sales	159,472	238,536	289,069	314,148	340,702
Cost of Sales	95,220	157,145	200,738	217,585	235,984
Gross Profit	64,252	81,392	88,331	96,563	104,718
Operating Profit	51,570	64,605	70,102	77,470	84,720
EBIT	59,171	79,258	79,240	77,934	86,966
PBT	53,547	73,120	76,498	76,396	86,314
PAT	29,674	45,910	48,736	48,872	55,238
EPS	23.32	36.09	38.01	38.31	43.42

Source: Company Accounts, Alfalah CLSA Research

Figure 8

Balance Sheet (PKR Mn)	CY23A	CY24E	CY25E	CY26E	CY27E
PPE	40,223	63,257	62,452	61,658	60,874
Total Non-Current Assets	93,157	116,191	115,386	114,592	113,808
Stores and Spares	7,784	11,586	11,513	11,366	11,222
Stock In Trade	2,068	14,751	18,786	20,363	22,086
Cash & Short Term Investments	95,595	89,289	28,587	44,478	62,404
Total Current Assets	130,123	148,026	92,909	111,047	131,415
Total Assets	223,280	264,217	208,296	225,639	245,223
Long Term Financing	18,200	12,816	8,512	5,653	3,755
Total Non-Current Liabilities	22,212	16,828	12,524	9,665	7,767
Trade and Other Payables	106,867	151,077	82,539	89,470	97,039
Total Current Liabilities	139,217	167,880	97,897	103,868	110,800
Equity	61,851	79,509	97,874	112,105	126,656
Total Liabilities and Equity	223,280	264,217	208,296	225,639	245,223

Source: Company Accounts, Alfalah CLSA Research

Upside Risks

Further Delay in GIDC dues payment

Better operating performance of Fauji Fresh n Freeze leading to no impairment

Higher than expected decline in interest rate

Resolution of power sector circular debt issues

Downside Risks

Restraint on urea price hike under pressure from government

Higher than assumed increase in KIBOR

Further sharp decline in international urea price

EFERT - BUY

EFERT is expected to see jump in its earnings after July'24 when gas supply contracts of FFC, FATIMA are renegotiated. Higher urea price by competitors following surge in gas cost is likely to benefit EFERT as it tries to match its competitors in output pricing. With the potential jump in earnings, we reiterate our buy call for EFERT with Dec-24 target price of PKR181.9/sh. Coupled with dividend yield of 18.0%, the company provides total return of 43.6% from the last close.

Urea price still at discount to import parity: EFERT increased urea price by PKR882/bag to PKR 4,649/bag effective March 1st, 2024. This price hike has no impact on profitability as it equates surge in input costs. One probable reason for lower than expected urea price hike can be availability of urea by competitors on lower prices. However, once gas rate of manufacturers drawing directly from MARI (FFC, FATIMA) is increased, EFERT is expected to follow its peers in urea price hike, which bodes well for its profitability. Moreover, this temporary differential in pricing from peers won't impact volumetric offtake since the company is currently selling urea at a discount of ~26% from import parity level and of ~16% from FFBL.

Cost benchmarking strategy can also increase earnings: Although less probable but even if gas pricing of FFC and FATIMA isn't increased post July'2024, EFERT can increase its profitability if it benchmarks its urea price to that of FFC and charge a premium based on differential in cost structure. Currently, cost of gas per bag of urea for FFC and EFERT is PKR1,136 and PKR2,329 leading to differential in cost per bag of PKR1,193. However, difference in output price is PKR883/bag. So, if EFERT increases its urea prices by remaining differential of PKR310/bag, it will see its earnings increase by PKR6.3/sh. Company won't face pressure on volumes in such a scenario due to discount to international parity and more than PKR500/bag discount from FFBL prices. However, we see low probability of such change in strategy. Higher MARI pricing post renegotiation of gas supply contracts remains our base case.

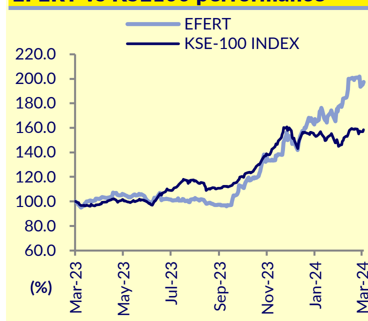
Plant BMR will likely improve efficiency: EFERT is planning to undertake major turnaround of its ENVEN facility during April & May 2024. Major components have already been procured thus incremental outlay is relatively small. Company plans to replace current waste heat boilers with more efficient ones. Any potential increase in fuel efficiency post BMR provides a potential upside from our base case estimates.

Dividend yield like none other: Company has maintained average pay-out ratio of 101% for the last 5 years, with the ratio surging to 113%/105% in CY22/CY23. Going forward, even if we assume pay-out to be at more sustainable level of 95%, the dividend yield of company will remain at elevated levels of 18.0%/22.4% for CY24/25 respectively. Thus, the company provides dividend yield close to yields on fixed income securities and unlike fixed income instruments expected yield is likely to increase going forward. Thus, the company can also be considered for relatively risk averse investors purely from yield perspective.

Outlook: Company's earnings will remain stressed for Q1CY24 due to delayed urea price hike amid escalated costs. Earning for outgoing quarter is likely to remain at PKR6.3/sh. Second quarter will also remained stressed due to ENVEN shutdown. However, quarterly run rate of earnings is likely to improve significantly to an

Symbol	EFERT
Price PKR	144.8
Bloomberg	EFERT PA
Reuters	ENGR.PSX
Price Target	181.9
Up/downside	25.6%
Mkt. cap USD mn	694.1
No. of Shares mn	1,335.3
3M ADV USD mn	1.3

EFERT vs KSE100 performance



Source: PSX, Bloomberg

average of above PKR8/sh after July 2024. Thus the company trades at attractive CY24/25 PE of 5.3x/4.2x respectively.

We have used discounted free cash flows to value the company with cost of equity of 23%. We have a buy call on the company as at our Dec-24 target price of PKR181.9/sh, price appreciation potential is 25.6% from the last close. Potential dividend yield of 18.0% makes total upside of 43.6%.

Financial Projections

Figure 9

Income Statement (PKR Mn)	CY23A	CY24E	CY25E	CY26E	CY27E
Net Sales	223,704	302,187	340,702	367,043	395,075
Cost of Sales	151,407	214,195	232,088	249,771	268,664
Gross Profit	72,297	87,992	108,615	117,272	126,411
Operating Profit	55,237	67,741	89,238	96,926	105,051
EBIT	51,604	63,690	84,272	92,185	99,467
PBT	49,693	60,283	72,987	82,522	91,064
PAT	26,191	36,773	45,682	51,755	56,977
EPS	19.61	27.54	34.21	38.76	42.67

Source: Company Accounts, Alfalah CLSA Research

Figure 10

Balance Sheet (PKR Mn)	CY23A	CY24E	CY25E	CY26E	CY27E
PPE	79,965	86,557	91,657	91,730	91,804
Total Non-Current Assets	85,561	92,153	97,253	97,326	97,400
Stores and Spares	8,730	8,355	10,006	10,014	10,022
Stock In Trade	15,356	31,799	23,539	25,332	27,248
Cash	28,117	27,438	25,779	26,094	26,751
Total Current Assets	75,282	95,358	107,494	111,775	116,661
Total Assets	160,843	187,511	204,747	209,101	214,061
Total Non-Current Liabilities	14,627	12,647	11,360	11,240	11,120
Trade and Other Payables	74,096	78,869	92,580	101,234	110,480
Total Current Liabilities	98,313	124,191	130,441	127,885	125,131
Equity	47,903	50,673	62,946	69,977	77,810
Total Liabilities and Equity	160,843	187,511	204,747	209,101	214,061

Source: Company Accounts, Alfalah CLSA Research

Upside Risks

Favourable court decision on extension in provision of subsidized gas

Further delay in GIDC dues payment

Decrease in interest rate

Downside Risks

Some reversal in urea price under pressure from government

Sharp decline in international urea price

Adverse court decision on payment of GIDC on subsidized ENVEN's gas

FFBL - BUY

FFBL's profitability is expected to increase threefold in the ongoing year on the back of high income from financial assets and healthy profitability from DAP post settlement of GST issue in Finance Act 2023. Company's production figures will improve with probable allocation of gas from Jhim East X-1. Further, any negative currency movement will result in relatively lower magnitude of exchange losses as payables to foreign suppliers have reduced by 52% YoY in CY23. Moreover, unlike yesteryears, capital injection requirement in subsidiaries has receded, opening room for dividend payouts. With Dec-24 price target of PKR32.7/sh, company provides potential upside of 31.2%. CY24E dividend yield of 16.0% takes total return potential to 47.2%.

Lower coal prices to the rescue: Company makes use of its coal fired power plant for its power requirement replacing fuel gas usage. FFBL draws around 0.5 MMCFD fuel gas from SSGC network i.e. ~4% of its fuel gas requirement. This signifies that company is relying almost entirely on its subsidiary FPCL for its power needs. With recent drop in coal prices, fuel cost of company is likely to wane in stark contrast to other manufacturers whose fuel cost has been hiked in recent times. As per our estimates, fuel and power cost is expected to fall 15% YoY to PKR18.6bn in CY24 despite higher production level. This reduction in cost has an EPS impact of PKR1.4/sh.

New product in offing: Company has announced launching of Sona Boran DAP with 0.1% Boron, translating into 50 grams of Boron per 50kg bag. FFC is also currently selling Boron at dealer transfer price (DTP) of PKR2281 per 3kg. Hence, additional cost, even assuming no margin is PKR38 for 50 grams. DTP of Boran DAP is PKR13,616/bag compared to Sona DAP of PKR13,168/bag. Thus, net excess margin, after accounting for cost and FED, is PKR370/bag. If company is able to increase share of Boran DAP to 10% of overall DAP sales, then this value addition provides upside potential of PKR0.24/sh to our base EPS estimates.

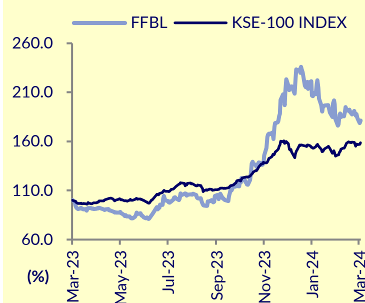
Production profile to get better: FFBL has faced gas supply constraints in recent years as provision of gas supply to the company fell from 19,119 MMCF in CY22 to 13,714 MMCF in CY23 in stark contrast to government approved allocation level of 23,800 MMCF. This gas curtailment resulted in 36%/22% YoY reduction in Urea/DAP production to 336/660 KT in CY23.

Pakistan Petroleum Limited has asked government to allow 100% allocation of gas from its new discovery Jhim East X-1. Later, on March 7th 2024, Ministry of Finance asked petroleum division to allocate the said gas to FFBL. This gas provision is to be in accordance with caretaker government's move of allowing E&P firms to bypass gas utilities and sell higher proportion of resources directly to third parties to avoid circular debt buildup. Production is expected to plateau at 15 MMCFD from this gas field. Hence, this field alone can supply 21% of approved gas quantum of 23,800 MMCF to FFBL. This gas allocation is sufficient for 180KTPA of urea production helping company to recover lost production volumes.

Moreover, after approval of SIFC, ECC has recently changed merit order of gas supply whereby fertilizer sector is placed on second priority compared to third priority level which it previously enjoyed. This, in conjunction with recent steep gas price hike of fertilizer sector, is expected to improve the gas flow to company and hence it is expected to resume operating at better capacity utilization.

Symbol	FFBL
Price PKR	24.9
Bloomberg	FFBL PA
Reuters	JORD.PSX
Price Target	32.7
Up/downside	31.2
Mkt. cap USD mn	115.5
No. of Shares mn	1,291.3
3M ADV USD mn	0.5

FFBL vs KSE100 performance

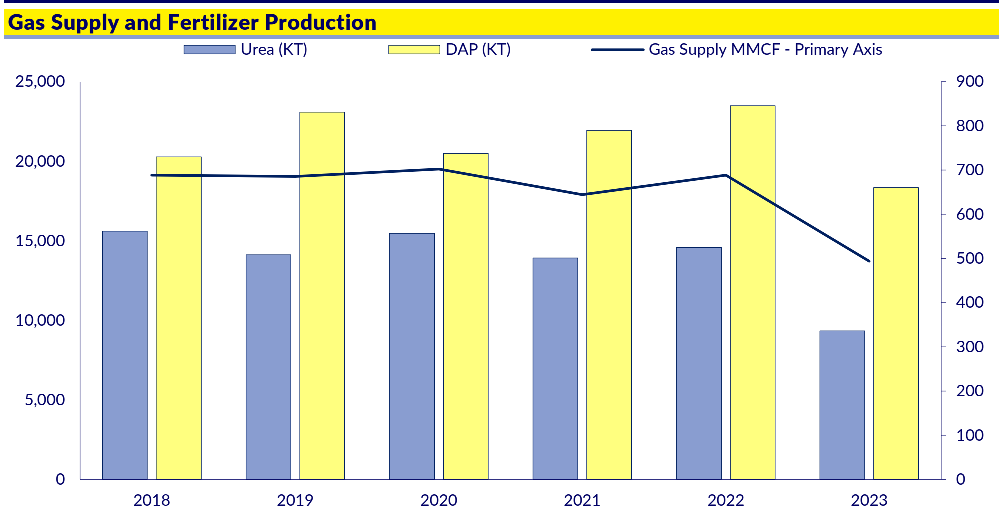


Source: PSX, Bloomberg

Production profile of company is likely to get better due to these regulatory changes. Going forward, we have assumed production of 0.5/0.7 MTPA of Urea/DAP respectively.

Figure 11

Gas Supply and Fertilizer Production



Source: Company Accounts, Alfalah CLSA Research

Interest income to remain high in CY24: Company's advances from customers has swelled past PKR25.2bn in Dec'23, up 45% QoQ. This liquidity influx has led to company being net cash positive and will thus earn huge return from financial assets. As this huge advances position was in anticipation of impending higher fertilizer prices, so we have lowered days payable going forward. We have assumed interest income to be PKR7.1bn in CY24, up 23% YoY. However, company may get lower dividend from power subsidiary if it decides to inject capital directly from FPCL into Fauji Foods for acquisition of Fauji Infravest and Fauji Cereal to avoid dividend tax.

Exchange losses to diminish in CY24: Company has rationalized its payables to foreign suppliers to PKR14.1bn in CY23 from PKR29.3b in CY22. Primary reason for this fall in payable level is fall in prices of Phosphoric acid. Prices dropped from highs of USD1715/Ton in Sept'22 to USD985/Ton in Dec'23. Prices are now close to 5/10 year average prices of USD 960/830 per Ton. With commodity super cycle waning, we see low probability of USD denominated payables swelling to previous highs and witnessing corresponding exchange losses in event of negative currency adjustment. Hence, this strain on profitability will be limited as we have assumed PKR1.6bn exchange loss in CY24, down 64% YoY.

Excessive urea price pose risk to earnings if revised down: Company has increased its urea price to PKR 5,489/bag, i.e. PKR 907/bag higher than average of peer group. This differential used to hover around PKR100/bag couple of years ago due to difference between prilled and granular urea. Prevalence of this steep pricing differential shows that company expects urea demand to remain robust and inventory is not expected to build up as product is priced at discount to imported parity. However, company may face pressure from government to rationalize its output prices. Moreover, its Feb'24 urea offtake also fell to 11KT, down 64%/57% MoM/YoY. Hence, company may also deliberate upon pricing on its own accord as well. Any downward revision in urea price poses risk to company's profitability as every PKR100/bag reduction in urea price will erode EPS by PKR0.45/sh.

Dividend yield to improve amid low capital injection in food ventures: Capital injection requirement in Fauji Meat Limited has stopped after its divestment. For loan/equity injection in Fauji Foods for acquisition of Fauji Infavest/Cereal, we have assumed that company will flow capital directly from its power subsidiary FPCL like it did in recent debt conversion. Hence, being conservative, we have not assumed any dividend flow from FPCL to FFBL in CY24.

Company has resumed dividend payout in CY23 after a hiatus of 5 years. Company paid PKR1/sh final dividend, translating into payout ratio of 29%. We expect payout ratio to increase going forward. Company's payout rate remained at 96%/92% in 5/10 years preceding CY19 when it stopped paying dividends. Going forward, we have remained conservative and assumed payout ratio of 35%. Even at 35% payout ratio, dividend yield of CY24 clocks in at 16%.

Outlook: Company's earnings will likely decline from CY25 on back of hike in gas pricing and its perceived inability to pass-on cost pressures on DAP business when urea prices are close to landed parity. Currently, bundling of fertilizer saves the company from those pressures as demand for urea is robust due to steep discount from imported parity. Moreover, rationalized customer advances and repayment of GIDC payables – assumed in CY25 - will dent other income. Hence, company's profitability is expected to dip in CY25 before rebounding.

We have used discounted free cash flows to value the company with cost of equity of 23%. We have a buy call on the company as at our Dec-24 target price of PKR 32.7/sh, price appreciation potential is 31.2% from the last close. Potential dividend yield of 16% makes total upside of 47.2%.

Financial Projections

Figure 12

Income Statement (PKR Mn)	CY23A	CY24E	CY25E	CY26E	CY27E
Net Sales	193,064	200,584	208,183	223,883	240,809
Cost of Sales	159,954	157,874	172,367	185,557	200,439
Gross Profit	33,110	42,710	35,816	38,325	40,370
Operating Profit	21,901	26,847	19,351	21,046	22,235
EBIT	22,973	30,168	19,197	21,211	22,413
PBT	14,145	24,472	16,623	19,247	20,991
PAT	4,403	14,023	9,478	11,003	11,983
EPS	3.41	10.86	7.34	8.52	9.28

Source: Company Accounts, Alfalah CLSA Research

Figure 13

Balance Sheet (PKR Mn)	CY23A	CY24E	CY25E	CY26E	CY27E
PPE	9,616	9,383	9,239	9,078	8,945
Total Non-Current Assets	35,167	34,934	34,790	34,629	34,496
Stores and Spares	2,442	2,383	2,346	2,305	2,272
Stock In Trade	13,787	18,179	22,209	26,450	31,317
Cash and Short Term Investment	73,649	71,565	56,739	59,663	63,796
Total Current Assets	110,705	113,017	102,201	109,360	118,363
Total Assets	145,872	147,950	136,990	143,989	152,860
Total Non-Current Liabilities	15,699	11,353	7,968	5,840	4,503
Trade and Other Payables	55,384	73,026	55,069	58,447	62,178
Short Term Borrowing	13,385	1,230	12,730	10,184	7,638
Total Current Liabilities	103,080	100,013	87,789	89,140	91,238
Equity	27,093	36,584	41,233	49,009	57,119
Total Liabilities and Equity	145,872	147,950	136,990	143,989	152,860

Source: Company Accounts, Alfalah CLSA Research

Upside Risks

Further hike in DAP margin

Larger than anticipated fall in coal prices

Further delay in GIDC dues payment

Decrease in interest rate after customer advances normalize

Downside Risks

Rationalization of urea price under pressure from government

Higher than anticipated hike in feed gas price in future

Negative exchange rate movement

Further injection and impairment of equity in subsidiaries

Sharp decline in international DAP prices

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