# Fatima Fertilizers Limited

## Improved price dynamics lift earnings outlook; reiterate Buy

**Friday, November 02, 2018**

## FATIMA – BUY

**Target Price: PKR 43.7**

**Current Price: PKR 35.9**

**FATIMA Performance**

| | 3M | 6M | 12M |
|---|---|---|---|
| Absolute % | 3% | 12% | -58% |
| Relative to KSE % | 5% | 20% | -61% |

| | |
|---|---|
| Bloomberg | FATIMA PA |
| Reuters | FATF.KA |
| MCAP (USD mn) | 577 |
| 12M ADT (USD mn) | 0.4 |
| Shares Outstanding (mn) | 2,100 |

Source: BMA Research

**FATIMA: Valuation snapshot**

| | CY17A | CY18F | CY19F |
|---|---|---|---|
| Net Sales | 45,371 | 51,801 | 65,823 |
| Growth | 7% | 14% | 27% |
| PAT | 9,268 | 13,566 | 12,398 |
| Growth | -1% | 46% | -9% |
| EPS (PKR) | 4.41 | 6.46 | 5.90 |
| P/E (x) | 8.15 | 5.56 | 6.09 |
| DPS (PKR) | 2.25 | 3.25 | 3.25 |
| D/Y (%) | 6% | 9% | 9% |
| EBITDA | 14,933 | 24,342 | 22,625 |
| EV/EBITDA | 6.54 | 4.09 | 3.84 |

Source: BMA Research


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- **We have revised up our earnings estimates of FATIMA incorporating (i) recent increase in urea prices, (ii) acquisition of PFL, (iii) incremental production of Fatimafert, and (iv) actual 9M18 results. We now project FATIMA to post EPS of PKR6.5/5.9/7.1 in CY18/19/20E.**
- **In a recent filing to the exchange, FATIMA provided additional details regarding acquisition of PFL assets. Consideration for acquisition would be staggered over three years and should put to rest the fears of possible dip in cash payout, in our view.**
- **With gas supply from Mari expected to commence by the end of the year, acquisition of PFL is likely to be value accretive for FATIMA as contribution margin per bag of urea/CAN/NP should register at PKR120/503/1,563, respectively.**
- **FATIMA's low cost structure, diversified product mix and dedicated supply from Mari network are some of the company's key strengths. We reiterate our Buy rating on FATIMA with DCF-based TP of PKR43.7, which reflects a total return of 31% along with a dividend yield of 9%.**
- **Key risks to our thesis include, (i) higher than expected delay in commencement of gas flows from Mari, (ii) non realization of synergy benefits, (iii) weakness in fertilizer prices, (iv) higher than expected gas tariff hike and/or currency depreciation.**

**Multiple developments supporting earnings outlook:** We revise up our earnings estimates of Fatima Fertilizers Limited (FATIMA) incorporating (i) recent increase in urea prices, (ii) acquisition of PFL, (iii) incremental production of Fatimafert for the months of Oct'18 and Nov'18, and (iv) actual 9M18 results. We now project FATIMA to post EPS of PKR6.5/5.9/7.1 in CY18/19/20E, up 21%/11%/23% from previous estimates. Resultantly, we arrive at our new DCF based TP on FATIMA of PKR44, offering 31% upside from current levels.

**Staggered payment of acquisition of PFL should alleviate dividend cut fears:** In a recent filing to the exchange, FATIMA provided additional details regarding its proposed acquisition of Pak Arab Fertilizer Limited's (PFL) six production assets (ammonia, nitric acid, urea, CAN, NP and clean development mechanism plants). The transaction would be spread out over a period of three years and payment of PKR9bn would be divided into seven equal semi-annual tranches with mark up payable at KIBOR +1.5%. Staggered payment of consideration should put to rest any fears of possible dip in dividend payout ratio, in our view. Furthermore, FATIMA would pay PFL a rent of PKR144mn per annum for use of land, buildings and utilities at PFL plant (transaction only encompasses production plants) along with compensation for actual man power costs incurred in production inclusive of all taxes and an 8% commission to PFL. Post completion of this transaction, FATIMA would emerge as the largest fertilizer manufacturer in the country (on the basis of capacity) with a total installed capacity of 2.6mn tons vs. current capacity of 1.7mn tons. Furthermore, this acquisition would also make FATIMA the sole manufacturer of CAN and the largest manufacturer of NP in the country (the second being Engro Fertilizers Limited).

**Operation on PP12 gas price likely to be value accretive:** Historically, PFL's plant has faced operational issues due to suspension of gas supplies, however, this is set to change as the company has signed gas sale agreement (GSA) with Mari Petroleum Company (MARI) for supply of 75mmcfd of gas, that is expected to commence by the end of Dec'18. Erring on caution, we have assumed a delay of three months in commencement of gas flows and assumed a capacity utilization level of 50% in first year of operations. This gas would be priced based on Petroleum Policy 2012 (PP12) and the company is likely to accrue GIDC on it. We estimate that operations of PFL's plant on PP12 gas would be value accretive for FATIMA as contribution margin per bag of Urea/CAN/NP should register at PKR120/503/1,563 per bag of urea/CAN/NP. CAN and NP are likely to be more profitable

Capacities (000' tons)

| | Existing | New |
|---|---|---|
| Urea* | 946 | 1,038 |
| CAN | 420 | 870 |
| NP | 360 | 665 |
| Total | 1,726 | 2,572 |

Source: BMA Research, PSX

products for FATIMA due to lower energy intensity of these fertilizers. To note, CAN and NP, currently contribute 71% of FATIMA's total net sales which is projected to rise to 74% of FATIMA's net sales in the next five years. Higher than expected sales of CAN and NP from newly acquired PFL assets represents a potential upside risk to our estimates.

**Investment perspective; reiterate Buy:** FATIMA's low cost structure, diversified product mix and dedicated supply from Mari network are some of the company's key strengths. Moreover, acquisition of PFL would further increase market share of FATIMA in the CAN and NP segments. We reiterate our Buy rating on the scrip with DCF based TP of PKR44, which reflects a total return of 31% along with a dividend yield of 9%.

**Key risks:** Key risks to our thesis include, (i) higher than expected delay in commencement of gas flows from Mari, (ii) non realization of synergy benefits, (iii) weakness in fertilizer prices, (iv) higher than expected gas tariff hike and/or currency depreciation.

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| | |
|---|---|
| Buy | >20% expected total return |
| Neutral | 0%-20% expected total return |
| Underperform | <0% expected total return |

*Total stock return = capital gain + dividend yield

### Old rating system

| | |
|---|---|
| Overweight | Total stock return > expected market return + 2% |
| Marketweight | Expected market return ± 2% |
| Underweight | Total stock return < expected market return - 2% |

## Valuation Methodology

To arrive at our period end target prices, BMA Capital uses different valuation methodologies including

- Discounted cash flow (DCF, DDM)
- Relative Valuation (P/E, P/B, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)