Pakistan Fertilizers

Supply glut not seen emerging in near future; maintain OW

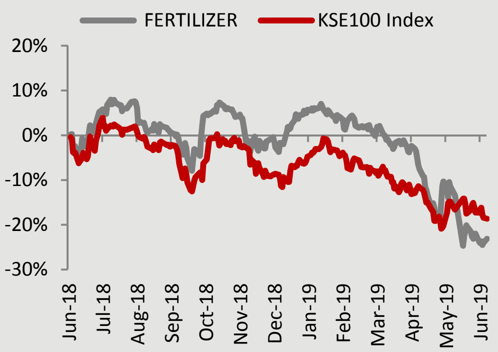
Tuesday, July 02, 2019

Fertilizer Performance

	3M	6M	12M
Absolute %	-23%	-22%	-23%
Relative to KSE %	-12%	-11%	-4%

Source: PSX, BMA Research

Fertilizers vs. KSE100 relative chart



Source: BMA Research

Urea Demand Supply Balance (000's)	
CY19A Opening Inventory	174
5MCY19A production	2,347
Production in remaining 7MCY19E	3,689
CY19E production	6,036
CY19 availability	6,210
CY19E offtake	5,869
CY19E closing inventory	341

Source: NFDC, BMA Research

- **Our channel checks indicate that urea offtake during Jun'19 is likely to clock in at 625k tons (+3% YoY) taking FY19 urea offtake to 5.95mn tons (+1% YoY).**
- **Growth in urea offtake has been led by FATIMA (+17% YoY) and RLNG based players such as AGL & FF.**
- **DAP offtake for the month of Jun'19 is expected at 150k tons (-21% YoY) translating into cumulative sales of 2.19mn tons in FY19 (-11% YoY). All major players are expected to record dip in DAP offtake during FY19 with the exception of FATIMA & Pak Arab.**
- **Assuming that the two RLNG based urea plants remain in operation till Dec'19, we project urea closing inventory for CY19 at 341k tons (0.7 months of consumption) and flag that any supply glut is highly unlikely.**
- **We maintain Overweight stance on the Fertilizer sector and highlight EFERT (TP: PKR94/sh) as our top pick amongst fertilizer manufacturers. Our conviction on the scrip is premised on its (i) low cost structure, (ii) attractive valuations (CY19F P/E: 5.2x), and (iii) high dividend yield (17%).**

Urea inventory likely to drop to 168k tons in Jun'19: Our channel checks indicate that urea offtake for the month of June'19 may clock in at ~625k tons, up 3% YoY (+5% MoM). The increase in offtake would mainly be led by the two Fauji group companies; Fauji Fertilizer Company Limited (FFC) and Fauji Fertilizer Bin Qasim Limited (FFBL) that would witness 22% and 47% YoY expansion in their urea sales to 263k tons and 83k tons, respectively. On the other hand, Engro Fertilizers Limited (EFERT) and Fatima Fertilizers Limited (FATIMA) are likely to post 29% and 15% YoY dip in their urea sales to 173k tons and 77k tons, respectively. Consequently, market shares of FFC and FFBL may clock in at 42% and 13%, respectively (35% and 9% in Jun'18), whereas, market share of EFERT and FATIMA might slip to 28% and 12%, respectively from 40% and 15% in Jun'18. Domestic urea production is likely to remain stable at ~527k tons during the month and as a result, closing inventory of urea is projected to drop to 168k tons in Jun'19 (0.34 months of consumption) from 266k tons in the previous month.

On a cumulative basis, urea offtake during FY19 was recorded at 5.95mn tons, up 1% YoY. Most major players (barring FATIMA) witnessed 4 – 14% dip in their urea offtake. Buckling the trend, FATIMA managed to post 17% YoY expansion in its urea sales as its higher opening inventory (117k tons, 70% of industry opening inventory) allowed for elevated sales. Furthermore, Agritech Limited (AGL) and FF gained at the expense of the major players recording urea sales growth of 2.4x and 6.9x YoY, respectively. Sales of imported urea witnessed 34% YoY drop to 105k tons on the back of lower avails by the state owned National Fertilizer Marketing Limited (NFML).

Jun'19 DAP offtake; FFBL to get a breather: During the month of Jun'19, DAP offtake is expected to clock in at 150k tons, down 21% YoY (down 30% MoM). Major Importers such as FFC and EFERT are likely to post 65% and 53% YoY reduction in their DAP sales that is expected to be partially offset by 58% YoY expansion in FFBL's DAP sales. Similarly, FATIMA is expected to outperform the rest of the industry to record a massive 10.6x YoY increase in its DAP offtake to 23k tons. Consequently, FFBL and FATIMA's market shares are projected to rise to 41% and 15% from 20% and 1% in same period of last year, respectively. On the other hand, EFERT and FFC's market shares may fall to 15% and 20% from 35% and 34%, respectively.

DAP offtake during FY19 are expected to come in at 2.19mn tons, down 11% YoY. The two Fauji Foundation companies, FFBL and FFC, are expected to fare worse as compared to rest of the industry recording 12% and 38% YoY contraction in their DAP offtake to 680k tons and 379k tons, respectively. FFBL's market share may remain intact at 31%, however, market

Syed Khurram Mohiuddin
Khurram.mohiuddin@bmacapital.com
+9221-111-262-111 Ext: 2053

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share of its parent company FFC is likely to contract to 17% from 25% in same period of last year. EFERT is expected to record modest 1% YoY drop in its DAP sales during FY19 causing its market share to increase to 28% from 25% in same period of last year due to larger contraction in the overall size of the market(down 11% YoY). On the other hand, periphery players such as FATIMA and Pak Arab may post DAP offtake of 53k tons and 184k tons, reflecting robust growth of 1.8x and 2.25x YoY, respectively. Market share of FATIMA and Pak Arab is likely to rise to 2% and 8% from 1% and 2% in same period of last year.

CY19 likely to close with urea closing inventory of 341k tons: In the past few months, concerns have emerged amongst market participants over potential build up of surplus urea inventory due to operation of two RLNG based urea manufacturing plant (AGL & FF). To recall, both these plants have been in operation since last week of Sep’18 and have been producing a cumulative 65k tons per month on average. Although urea closing inventory levels have risen to 266k tons in May’19 from just 115k tons in Sep’18 (when RLNG based plants became operational), absolute inventory levels are still below levels that may trigger stiff price competition. For CY19, we forecast urea sales of 5.87mn tons (+1% YoY) and production of 6.0mn tons (+8% YoY), taking CY19E closing urea inventory to 341k tons. In our production estimates, we have assumed that both AGL and FF plants would operate till Dec’18 although the govt. has only committed to providing gas until Oct’19. We are comfortable on this inventory level as it represents just 0.7 months of consumption.

Investment perspective; maintain Overweight stance on Fertilizer sector: We maintain Overweight stance on the Fertilizer sector and highlight EFERT (TP: PKR94/sh) as our top pick amongst fertilizer manufacturers. Our conviction on the scrip is premised on its (i) low cost structure due to access to concessionary gas, (ii) attractive valuations (P/E 5.2x), (iii) enticing dividend yield (17%), and (iv) growing market share In phosphate segment.

Key risks: Key risks to our thesis include (i) steep drop in int’l fertilizer prices, (ii) slow down in domestic agricultural sector, and (iii) punitive regulatory action on urea prices.

Provisional Fertilizer offtake (000's)

	Jun-18	May-19	Jun-19	YoY	MoM	FY18	FY19	YoY
Urea								
FFC	215	271	263	22%	-3%	2,615	2,483	-5%
FFBL	56	79	83	47%	5%	603	521	-14%
EFERT	245	141	173	-29%	23%	1,978	1,894	-4%
FATIMA	91	36	77	-15%	116%	432	505	17%
Others	0	65	29	N.M	-56%	260	551	N.M.
Urea	**608**	**593**	**625**	**3%**	**5%**	**5,889**	**5,953**	**1%**
DAP								
FFBL	39	77	61	58%	-21%	776	680	-12%
FFC	66	34	23	-65%	-32%	611	379	-38%
EFERT	64	60	30	-53%	-50%	615	609	-1%
FATIMA*	6	22	23	271%	2%	76	237	214%
Others	15	20	13	-12%	-33%	394	287	-27%
DAP	**190**	**213**	**150**	**-21%**	**-30%**	**2,471**	**2,193**	**-11%**

** Includes Pak Arab & FF*

Source: NFDC, BMA Research

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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.)