

Fertilizer Sector: 2QCY21 Earnings Preview

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Prices as of 23th July 2021



Universe earnings to rise by 65% YoY

- With the onset of 2Q results season, we expect our fertilizer universe to post earnings jump of 65% YoY in 2Q, mainly led by high DAP margins.
- Fertilizer companies in our universe are expected to post 1.2pps jump in Gross Margins, primarily due to increased DAP prices. DAP prices were up 50% YoY during 2QCY21, whereas Urea prices grew by 3.4% YoY in 2Q.
- In 2QCY21, Urea offtake is expected to remain lower, down 20% YoY to 1.3mn tons, compared to 1.6mn tons in 2QCY20. However, 49% YoY jump in DAP offtake to 0.4mn tons along with ~50% YoY jump in DAP prices will likely improve profitability.
- Company wise, EFERT is likely to report profitability growth of 29% YoY during 2Q whereas FFC's earnings are to decline by 23% YoY. For FFBL, the bottom-line will turn green during 2Q compared to the net loss in 2QCY20.
- Topline of our fertilizer universe is expected to grow by 12% YoY due to FFBL's hefty DAP sales coupled with 50% YoY jump in DAP prices during 2Q.
- EFERT is likely to announce PKR 3 dividend along with the results, and FFC likely to pay PKR 2.4 dividend for 2Q. For FFBL, we do not expect any payout this time.
- We have a HOLD call on both EFERT and FFBL with PTs of PKR 68/share and 26/share respectively. For FFC, we recommend a BUY with PT of PKR 124/share.

Sector Key Data	
Market Cap (PKR bn)	513.42
Current Traded Value (PKR bn)	0.24
Current Turnover (mn share)	5.23

Script	Current Price	Target Price	Div/ Yld	Total Return
EFERT	72.6	68	17.9%	11%
FFC	107.8	124	12.3%	27%
FFBL	27.3	26	-	-4%

EPS	2QCY20	2QCY21	YoY	1HCY20	1HCY20E	YoY
EFERT	2.91	3.76	29%	3.34	8.05	141%
FFC	3.83	2.94	-23%	7.18	7.51	5%
FFBL	-1.24	1.55	225%	-4.5	2.53	156%

Source: Company Accounts., Akseer Research

Engro Fertilizers Limited - Earnings to surge by 29% YoY

- Engro Fertilizers (EFERT) earnings are expected to grow by 29% YoY to PKR 3.76/ share in 2QCY21 compared to PKR 2.91 in the same quarter last year, driven by hefty decline in finance and other charges during the quarter.
- For 1HCY21, EPS is expected to come at PKR 8.05, up 141% compared to PKR 3.34 in the same period last year.
- The company is expected to pay an interim cash dividend of PKR 3/share along with the results, which will take its 1HCY21 payout to PKR 7/ share.
- We estimate Gross Margins for 2QCY21 to clock in at 36.4%, up 1.7 pps YoY, due to higher decline of 10% YoY in COGS versus 8% YoY decrease in sales.
- Finance cost is likely to reduce by 32% YoY on the back of debt pay off as well as loan repricing at lower interest rates.
- Other charges expected to decline 55% YoY due to absence of provisions of around PKR 600mn related to sales to unregistered dealers.
- We have a 'HOLD' call on EFERT with Dec-21 PT of PKR 68 per share. The target return of the scrip is 11%, which incorporates dividend yield of 18%.

Financial Estimates (PKR mn)						
	2QCY20	2QCY21E	YoY	1HCY20	1HCY21E	YoY
Net Sales	29,911	27,488	-8%	40,703	56,931	40%
Cost of Sales	19,522	17,477	-10%	26,678	35,363	33%
Gross Profit	10,390	10,010	-4%	14,025	21,568	54%
Distri. & Admin. Exp.	2,733	2,231	-18%	4,148	4,470	8%
Other Income	244	442	82%	505	921	83%
Other Charges	1,222	554	-55%	1,371	1,227	-11%
Finance cost	896	605	-32%	2,108	874	-59%
Other gains / (losses)/GIDC Payments	-	-	-	-	(196)	
Profit Before Tax	5,782	7,062	22%	6,903	15,723	128%
Taxation	1,896	2,048	8%	2,447	4,967	103%
Net Income	3,886	5,014	29%	4,457	10,756	141%
EPS	2.91	3.76	29%	3.34	8.05	141%
DPS	4.00	3.00		4.00	7.00	

Source: Company Accounts., Akseer Research

Engro Fertilizers Limited

EFERT - Valuation Basis

The target price of EFERT has been computed by using the free cash flow to firm method FCFF. Terminal growth is taken at 4.0%, Risk free rate is 11%, Market risk premium at 6%, and thus our cost of equity is 17%..

Investment Thesis

Our recommendation for EFERT is "HOLD" on the stock-based with a target price of PKR 68 on December 21. The total return is expected to be 11%, while the dividend yield is anticipated to be 18%. Our investment case on EFERT is based on 1) higher fertilizer prices, 2) volumes sustainability and 3) attractive dividend yield.

Risks

Key downside risks to our investments thesis are: 1) below expected gas supply, 2) lower than anticipated fertilizer demand, and 3) lower than expected fertilizer prices.

Company Description

Marketing of fertilizers. Engro Fertilizers Limited is a wholly owned subsidiary of Engro Corporation Limited.

Balance Sheet							
	CY17A	CY18A	CY19A	CY20A	CY21F	CY22F	CY23F
PPE	68,204	65,924	65,646	63,020	60,499	58,079	68,204
Other LT assets	4,630	5,235	5,247	5,129	5,030	4,947	4,630
Non-Current Assets	72,834	71,159	70,892	68,149	65,529	63,026	72,834
Current assets	44,887	55,888	60,821	53,023	48,745	44,716	44,887
Total Assets	117,721	127,047	131,713	121,172	114,274	107,742	117,721
Non-Current liabilities	33,069	34,632	35,975	27,714	21,107	13,738	33,069
Current liabilities	39,129	49,135	49,007	40,842	35,912	32,438	39,129
Total Liabilities	72,198	83,767	84,983	68,556	57,020	46,176	72,198
Equity	45,523	43,279	46,731	52,616	57,254	61,566	45,523
Total Equity & liabilities	117,721	127,047	131,713	121,172	114,274	107,742	117,721

Source: Company Accounts, Akseer Research

Income Statement							
	CY17A	CY18A	CY19A	CY20A	CY21F	CY22F	CY23F
Net sales	109,197	121,355	105,846	99,451	106,197	112,315	109,197
Cost of sales	73,880	81,815	71,591	63,607	70,069	74,021	73,880
Gross Profit	35,316	39,540	34,255	35,844	36,128	38,294	35,316
SG & A	9,593	9,985	10,365	10,877	11,580	12,348	9,593
Operating Profit	25,723	29,555	23,890	24,968	24,548	25,946	25,723
Other income	2,062	4,352	2,549	2,002	1,641	1,116	2,062
Other charges	1,432	2,623	1,905	1,977	1,960	2,084	1,432
Finance cost	2,071	3,887	3,236	2,598	2,651	1,980	2,071
Profit before tax	24,282	27,398	21,298	22,395	21,578	22,999	24,282
Taxation	6,869	10,526	3,165	6,494	6,258	6,670	6,869
Profit after tax	17,414	16,871	18,133	15,900	15,321	16,329	17,414

Source: Company Accounts, Akseer Research

Cashflow							
	CY17A	CY18A	CY19A	CY20A	CY21F	CY22F	CY23F
Net Income	17,414	16,871	18,133	15,900	15,321	16,329	17,414
Non cash Charges	5,195	5,677	5,343	5,414	5,179	4,957	5,195
Operating Cash flows	21,650	21,786	32,954	10,251	18,966	19,228	21,650
FCFF	18,660	20,782	30,645	9,308	18,189	18,096	18,660
Net borrowings	-4,330	1,182	8,242	-5,816	-11,247	-9,491	-4,330
FCFE	12,845	19,571	36,131	1,648	5,060	7,199	12,845
Net change in cash	-1,066	2,684	198	-338	935	52	-1,066
Closing cash	730	3,413	3,611	3,273	4,208	4,261	730

Source: Company Accounts, Akseer Research

Fauji Fertilizer Co. Limited – Bottomline to decline 23% YoY in 2Q

- Fauji Fertilizer Co. (FFC) net earnings are expected to decline by 23% YoY to PKR 2.94/share during 2QCY21 compared to PKR 3.83/share posted in the same period last year on the back of sluggish Urea sales despite Urea prices being on the upside(+4% YoY).
- On half yearly basis, nevertheless, net earnings will likely see positive growth of 5% YoY to PKR 7.51/ share compared to 1HCY20 EPS of PKR 7.18.
- The company is expected to pay an interim cash dividend of PKR 2.4/share along with the results, taking cumulative payout for 1HCY21 to PKR 5.90 per share.
- Uptrend in Urea prices (+4% YoY to PKR 1,775 per bag) during 2Q will likely lead to 8% YoY jump in net sales given FFC's Urea offtake is expected to decline by 12% YoY.
- 2Q Gross margins are anticipated to clock in 32.7%, up by a 0.7 pps YoY due to containment of COGS, which were up by mere 6% YoY.
- Higher distribution cost will be a drag on FFC's profitability as they are expected to rise by 35% YoY to PKR 2.5bn, due to increased logistics costs.
- We have a BUY call on the scrip with Dec-21 PT of PKR 124, providing an upside potential of 15% and a lucrative dividend yield of 12.3%.

Financial Estimates (PKR mn)						
	2QCY20	2QCY21E	YoY	1HCY20	1HCY21E	YoY
Net Sales	23,156	24,931	8%	43,782	46,519	6%
Cost of Sales	15,757	16,771	6%	28,893	29,925	4%
Gross Profit	7,398	8,160	10%	14,889	16,595	11%
Distribution cost	1,855	2,495	35%	3,930	4,503	15%
Other Income	2,287	653	-71%	1,135	3,373	197%
Other Charges	628	476	-24%	1,191	1,199	1%
Finance Cost	462	572	24%	1,135	992	-13%
Profit Before Taxation	6,740	5,270	-22%	12,640	9,557	-24%
Taxation	1,866	1,528	-18%	3,504	8,772	150%
Net Income	4,874	3,742	-23%	9,136	13,274	45%
EPS	3.83	2.94	-23%	7.18	7.51	5%
DPS	2.75	2.40		5.25	5.90	

Source: Company Accounts., Akseer Research

Fauji Fertilizer Company Limited

FFC - Valuation Basis

Our PT for Fauji Fertilizer Company Limited (FFC) has been computed using Free cash flow to equity (FCFE) method. We have used a risk free rate of 11.0%, beta of 1.0 & market risk premium of 6% to arrive at cost of equity of 16.0%.

Investment Thesis

We have a 'BUY' recommendation on the stock based on our PT of 124/share. Our price target offers an upside of 15% along with a dividend yield of 12.3%. Our investment case on FFC is based on 1) stable margins and 2) attractive dividend yield.

Risks

Key downside risks to our investments thesis are: 1) lower than expected fertilizer prices and 2) below estimated fertilizer demand.

Company Description

The principal activity of the Company is manufacturing, purchasing and marketing of fertilizers and chemicals, including investment in other fertilizers, chemical, other manufacturing, energy generation, food processing and banking operations.

Balance Sheet							
	CY17A	CY18A	CY19A	CY20A	CY21F	CY22F	CY23F
PPE	21,534	22,212	22,841	23,069	23,300	23,533	21,534
Other LT assets	29,601	33,877	38,206	36,990	36,400	35,848	29,601
Non-Current Assets	51,135	56,089	61,047	60,059	59,700	59,381	51,135
Current assets	95,355	97,301	111,902	84,112	71,063	65,593	95,355
Total Assets	146,490	153,390	172,949	144,171	130,762	124,974	146,490
Non-Current liabilities	13,162	10,947	48,742	28,622	9,337	6,997	13,162
Current liabilities	99,945	106,876	81,671	68,947	70,486	62,640	99,945
Total Liabilities	113,107	117,823	130,413	97,569	79,824	69,637	113,107
Equity	33,383	35,567	42,536	46,602	50,939	55,337	33,383
Total Equity & liabilities	146,490	153,390	172,949	144,171	130,762	124,974	146,490

Source: Company Accounts, Akseer Research

Income Statement							
	CY17A	CY18A	CY19A	CY20A	CY21F	CY22F	CY23F
Net sales	105,964	105,783	97,655	102,316	107,160	112,168	105,964
Cost of sales	77,986	75,046	66,071	65,587	69,620	73,749	77,986
Gross Profit	27,979	30,737	31,583	36,729	37,539	38,419	27,979
SG & A	8,833	8,288	7,848	8,479	8,900	9,342	8,833
Operating Profit	19,145	22,449	23,735	28,250	28,639	29,077	19,145
Other income	6,283	7,191	6,429	6,656	6,996	7,938	6,283
Other charges	2,109	3,409	2,639	2,924	2,989	3,134	2,109
Finance cost	1,637	2,477	1,874	2,525	2,796	2,600	1,637
Profit before tax	21,683	23,753	29,591	29,457	29,850	31,281	21,683
Taxation	7,244	6,643	8,772	8,542	8,657	9,072	7,244
Profit after tax	14,439	17,110	20,819	20,914	21,194	22,210	14,439

Source: Company Accounts, Akseer Research

Cashflow							
	CY17A	CY18A	CY19A	CY20A	CY21F	CY22F	CY23F
Net Income	14,439	17,110	20,819	20,914	21,194	22,210	14,439
Non cash Charges	2,162	2,286	2,310	2,286	2,309	2,332	2,162
Operating Cash flows	26,214	28,670	9,621	14,359	29,731	24,442	26,214
FCFF	3,198	29,844	(29,443)	43,325	37,578	26,380	3,198
Net borrowings	10,406	(11,256)	40,070	(24,433)	(18,785)	(6,302)	10,406
FCFE	12,513	16,804	9,309	17,100	16,808	18,233	12,513
Net change in cash	1,713	3,818	5,695	1,153	1,406	1,356	1,713
Closing cash	3,818	5,695	1,153	1,406	1,356	1,777	3,818

Source: Company Accounts, Akseer Research

Fauji Fertilizer Bin Qasim Limited – 2Q EPS to come at PKR 1.55

- Fauji Fertilizer Bin Qasim Limited (FFBL) EPS post of PKR 1.55 during 2QCY21 versus the net loss of PKR 1.24/share posed during 2QCY20. Hefty surge in the DAP prices will likely to contribute to the positive earnings growth.
- For 1HCY21, EPS is expected to come at PKR 2.53 as compared to a net loss of PKR 4.50 posted during 1HCY20.
- Gross margins are likely to increase to 20.3%, +7.6 pps compared to 12.7% in the comparable period last year.
- Other income, though, likely to recede 21% YoY during 2Q, but is expected grow by 57% YoY to PKR 2.6bn in 1HCY21 due to higher dividends from associates.
- We do not expected any dividend to be announced by the company along with the results.
- We have a HOLD call on FFBL with Dec-21 PT of PKR 26, providing a downside potential of 4%.

Financial Estimates (PKR mn)						
	2QCY20	2QCY21E	YoY	1HCY20	1HCY21E	YoY
Net Sales	15,224	24,287	60%	24,782	37,292	50%
Cost of Sales	13,293	19,368	46%	23,410	29,896	28%
Gross Profit	1,930	4,919	155%	1,372	7,396	439%
Distri. & Admin. Exp.	1,549	2,064	33%	2,549	3,265	28%
Other Income	1,372	1,079	-21%	1,688	2,645	57%
Other Charges	1,391	139	-90%	1,584	284	-82%
Finance Cost	1,208	964	-20%	2,726	1,960	-28%
Profit Before Tax	(846)	2,825	-	(3,800)	4,531	-
Taxation	314	819	161%	408	1,259	209%
Net Income	(1,160)	2,005	-	(4,208)	3,272	-
EPS	(1.24)	1.55	225%	(4.50)	2.53	

Source: Company Accounts., Akseer Research

Fauji Fertilizer Bin Qasim Limited

FFBL - Valuation Basis

Our PT for Fauji Fertilizer Bin Qasim Company Limited (FFBL) has been computed using Free cash flow to firm (FCFF) method. We have used a risk free rate of 11.0%, beta of 1.0 & market risk premium of 6%.

Investment Thesis

We have a 'HOLD' recommendation on the stock based on our PT of 26/share. Our price target offers a downside of 4%. FFBL earnings are increasing YoY basis, and internationally, DAP prices are rising. Therefore, it helps in increasing the revenues. Our investment case on FFBL is based on 1) strong fertilizer demand during CY21 and 2) Constant margin.

Risks

Key downside risks to our investment thesis are: 1) lower than expected fertilizer prices and 2) below estimated fertilizer demand.

Company Description

The principal activity of the Company is manufacturing, purchasing and marketing of fertilizers and chemicals, including investment in other fertilizers, chemical, other manufacturing, energy generation, food processing and banking operations.

Balance Sheet							
	CY17A	CY18A	CY19A	CY20A	CY21F	CY22F	CY23F
PPE	10,405	9,748	10,428	10,193	9,581	9,006	8,466
Other LT assets	24,487	27,145	29,407	31,619	34,478	34,478	34,478
Non-Current Assets	34,892	36,893	39,835	41,811	44,060	43,485	42,944
Current assets	30,760	43,471	51,332	49,157	36,617	37,392	37,466
Total Assets	65,652	80,364	91,167	90,968	80,676	80,876	80,411
Non-Current liabilities	15,858	17,032	15,370	29,955	27,729	15,866	4,284
Current liabilities	36,644	49,434	68,962	47,054	34,967	43,891	52,161
Total Liabilities	15,858	17,032	15,370	29,955	27,729	15,866	4,284
Equity	13,151	13,897	6,834	13,959	17,981	21,119	23,966
Total Equity & liabilities	65,652	80,364	91,167	90,968	80,676	80,876	80,411

Source: Company Accounts, Akseer Research

Income Statement							
	CY17A	CY18A	CY19A	CY20A	CY21F	CY22F	CY23F
Net sales	52,733	61,511	66,839	83,234	83,021	84,335	87,542
Cost of sales	46,705	53,327	60,955	70,655	66,286	69,293	72,299
Gross Profit	6,028	8,183	5,885	12,579	16,735	15,041	15,244
SG & A	6,599	6,074	6,767	6,773	7,563	8,418	9,033
Operating Profit	(571)	2,109	(883)	5,806	9,171	6,623	6,211
Other income	4,377	3,182	4,370	5,184	4,666	4,297	4,440
Other charges	423	1,259	2,158	312	571	419	396
Finance cost	1,941	2,223	5,199	4,444	3,510	3,353	3,518
Profit before tax	1,441	1,809	(3,869)	4,893	9,756	7,148	6,737
Taxation	437	373	2,052	2,700	2,829	2,073	1,954
Profit after tax	1,004	1,437	(5,921)	2,192	6,927	5,075	4,784

Source: Company Accounts, Akseer Research

Cashflow							
	CY17A	CY18A	CY19A	CY20A	CY21F	CY22F	CY23F
Net Income	1,004	1,437	(5,921)	2,192	6,927	5,075	4,784
Non cash Charges	1,600	1,634	1,667	1,667	1,427	1,341	1,261
Operating Cash flows	10,558	(8,096)	(16,295)	23,766	(10,160)	987	2,375
FCFF	6,958	(4,049)	(760)	25,334	(9,492)	1,996	3,183
Net borrowings	(7,271)	6,646	11,464	(8,522)	(6,730)	3,244	418
FCFE	(1,665)	832	2,748	14,821	(18,715)	2,860	1,103
Net change in cash	(2,276)	142	1,605	19,754	(21,620)	923	(833)
Closing cash	3,547	3,690	5,294	25,048	3,429	4,351	3,518

Source: Company Accounts, Akseer Research

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To arrive at our 12-months Price Target, the JV uses different valuation methods which include: 1). DCF methodology, 2). Relative valuation methodology, and 3). Asset-based valuation methodology.

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