

Agritech Limited

ANL's fertilizer offering

IPO subscription: **NO RATING**

Fertilizer

March 2010



JS Global Capital Limited

After the successful listing of Fatima Fertilizer Company Limited, Agritech Limited (Agritech), formerly known as Pak-American Fertilizer Limited is due for listing at the KSE, with Initial Public Offering (IPO) on March 11-13, 2010. With Rs1.87bn already been raised through Pre-IPO placement to institutional investors and high networth individuals, Azgard Nine Limited (ANL), the parent company of Agritech, intends to raise a further Rs500mn through an offer to the general public of 16.67mn ordinary shares with a Green Shoe Option (GSO) of 16.67mn ordinary shares at a fixed price of Rs30 per share. Agritech has a name plate capacity of 346k tons per annum (BMR to increase the capacity to 483k tons of urea) and an additional 90k tons of Single Super Phosphate (SSP) which comes from Hazara Phosphate Fertilizer (Pvt) Limited (HPFL), a 100% subsidiary of Agritech. Agritech is also involved in importing and selling of DAP, making it one of the traditional fertilizer players in the market.

Though we do not have a research recommendation on the company, we believe 1) the first mover advantage of the incremental urea capacity 2) marketing SSP (available at cheaper rates than DAP) as a substitute to other phosphatic fertilizers due to its lower price advantage and 3) government's focus on pro agriculture policies to be major triggers for the company. However, we do not rule out tough conditions in marketing SSP to the conventional farmer.

The offer

ANL intends to raise a total of Rs2.37bn through a combination of Pre-IPO Placement to individual investors & high networth individual and IPO of 16.67mn ordinary shares to the general public (on March 11-13, 2010) with an additional GSO of 16.67mn ordinary share. This cumulatively add upto tp 24.3% of Azgard Nine's total holding in the company. To date, 62.3mn ordinary shares have already been subscribed through Pre-IPO while another 16.7mn shares will be issued to the general public at a fixed price of Rs30 per share. The projected receipts from this offering will be Rs2.87bn if the GSO is subscribed.

Agritech Limited

Agritech Company Limited (formerly known as Pak-American Fertilizer Limited), is a 100% owned subsidiary of ANL (one of the leading denim manufacturers in Pakistan) which is backed by reputable sponsors, namely, JS Group and the Sheikh family. Agritech has a nameplate capacity of 346k tons of urea which is expected to increase to 483k tons after the ongoing BMR. Moreover, Agritech is also involved in importing and trading of DAP which makes it similar to the conventional urea & DAP manufacturers (the Fauji group & Engro) in the country.

However, what makes Agritech a different player in the market is its Single Super Phosphate (SSP) product, which is manufactured by its 100% owned subsidiary, Hazara Phosphate Fertilizer Limited. HPFL has a current nameplate capacity of 90k tons which is projected to be enhanced to 162k tons by end of 1H2010. SSP is argued to be a close substitute of DAP due to its phosphate component and is expected to act as a potential growth driver for the company.

Offer Price:

Rs30

Offer size:

General Public: 16.67mn shares

Dates:

General Public: 11-13th Mar 2010

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Urea: a utility in constant demand

Agritech will be adding a further 136k tons on top of name plate capacity (by the end of this month) to the industry's total installed capacity of 4.6mn tons. As urea demand is expected to grow at 3-4% annually, this addition of 136k tons will help the company in stemming its top line further, as urea is considered a utility of sorts for the farmers. Interestingly, we expect industry's total urea capacity to reach 6.7mn tons in 2011 (1.3mn tons from Engro's new plant while 500k will be added from Fatima Fertilizers new plant) versus total demand of 6.5mn tons. We believe the surplus to be exported at the discretion of the government. Therefore, demand for urea is there to be catered to, and hence the product can be considered as a utility of sorts, generating a consistent revenue stream for the company.

Despite high average prices of urea in 2009, offtake reached record levels of 6.47mn tons (up 18%YoY) while total production stood at 5.04mn (up only a mere 1%YoY) tons. Agritech's market share in 2009 stood at 7% primarily due to successful marketing of its urea brand 'Tara', which is currently sold at par with other leading fertilizer brands in the country. To recall, prior to the privatization of PAFL an unnamed urea brand was sold at a discount to the established brands and remained a concern for lower earnings in early years for the new management.

With an annual growth of 3%, we project urea demand to reach 6.9mn tons by 2013 while the excess supply situation will cease to exist beyond 2012.

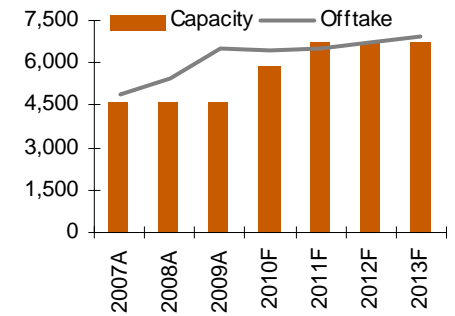
Single Super Phosphate: an alternative to DAP?

The Haripur plant (HPFL) which produces SSP, has a name plate capacity of 90k tons and 110 ton per day to produce 89.5% Sulphuric Acid. SSP is produced through a blend of indigenous local & imported phosphate rock with Sulphuric acid. SSP is argued as a cheaper alternate of DAP as it has 18% phosphate, 21% Calcium and 12% Sulphur compared to DAP's 46% phosphate content. Similarly, SSP also provides cheaper P2O5 nutrient than the other already available P2O5 nutrient fertilizers in the market. Sulphur and Calcium content in SSP bring down the pH value of the fertilizer making it more acidic and henceforth, suitable for agriculture with 90% water solubility. Given its acid qualities and better water solubility, SSP targets all the major crops like wheat, cotton and rice.

The lesser content of phosphate in SSP makes it cheaper to manufacture and hence is available at lower rates than DAP. Currently, SSP is available at Rs800 per bag as compared to Rs2,550 per bag for DAP. However, given our customary farmers (fairly acquainted with the more conventional urea and DAP fertilizer), we believe, it will be a tough challenge to market SSP in the local market as a substitute for DAP.

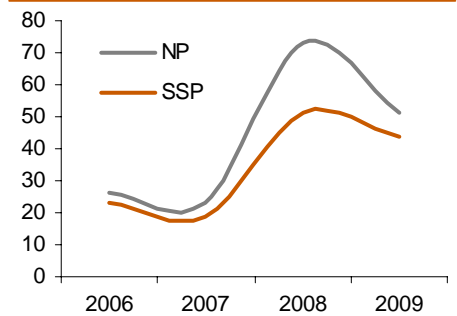
Looking at the historic trend of phosphate fertilizer use in Pakistan, phosphate fertilizers have remained in high demand, with DAP leading the market share (89%) and SSP & MAP following at 4% each. In contrast SSP contributes about 25% to the total production in the international phosphate fertilizer market. If marketed properly, the management believes there is a latent demand for SSP in the local market. We believe SSP's probability to capture DAP demand is higher due to 1) the aforementioned benefits of SSP and 2) one producer (FFBL) scenario for DAP and 3) high price elasticity of DAP.

Urea demand & supply ('000 tons)



Source: JS Research, NFDC Reports

Rupees per P2O5



Source: Investor presentation

Trading Business – DAP

Agritech is also involved in importing and selling of DAP, which provides an additional strength to the top line of the company. Within just 3 years of trading, Agritech has been able to attain a market share of 11% by selling 89k tons of DAP in FY09. With a growing distribution network, Agritech is finally pacing up with already established players in the market. As mentioned earlier, our customary farmers are more acquainted with DAP rather than any other phosphate fertilizers hence, we can see Agritech's offtake growing from here on, provided that DAP prices stay at reasonable rates.

2009 witnessed a remarkable DAP offtake, which rose by 118%YoY to 1.69mn tons. However, due to rise in input costs, DAP prices in the international market have risen considerably by 30% since the start of the year. Hence, we believe DAP offtake to reduce a bit during the current year due to its high price elasticity.

Leadership through cost efficiency

Apart from Fatima Fertilizer's new plant, Agritech operate one of the newest and the most cost efficient plants in Pakistan. In addition, the company has successfully developed an extensive distribution network of over 500 dealers in less than 3 years, and that to, just within close proximity of the consumption area allowing Agritech to keep the distribution costs down.

Govt's agri-focused policies providing support to the industry

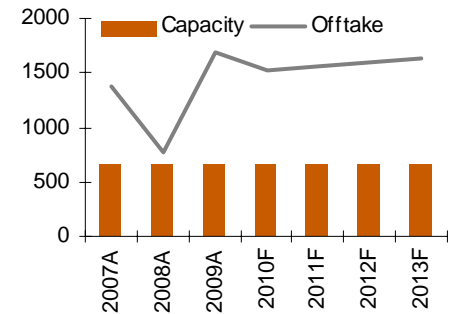
The fertilizer sector is an indirect beneficiary of the incentives being offered by the government to the agriculture sector. Bumper wheat crop this year along with higher support prices for farmers have enhanced fertilizer consumption this year. Resultantly, both urea and DAP offtake were reported at record levels. The agriculture sector has grown by 4.7% last year and our projection of 3.7% for agriculture growth in 2010 further supports our thesis of high offtake this season as well.

Risks

Although, Agritech is expected to perform commendably, we do not rule certain risks attached to the business.

- **Delays in expansion process** – Any hold ups in the BMR and the expansion project for the SSP plant can add uncertainty to the revenues.
- **Changes to demand supply scenario for SSP** – SSP is a relatively complex and new product compared to urea and DAP, hence to forecast a demand estimate for the product can be a little optimistic. Lower than anticipated demand for the product is likely to hurt earnings going forward and hence the valuation.
- **Disruption in gas supply** – As like any other fertilizer business, the risk of disruption in gas supply will add to the costs of the company and hence will hurt earnings in the future.
- **High leverage and interest rate hike** – Due to companies high leverage ratio, any hikes in the interest rate can dent the earnings going forward.

DAP demand & supply ('000 tons)



Source: JS Research, NFDC Reports

About the company

Agritech, formerly known as Pak-American Fertilizer Limited, was incorporated in 1959 as a subsidiary of National Fertilizer Corporation. The company was subsequently acquired by ANL with a 100% shareholding for Rs16.1bn (US\$269mn) in July 2006. With long term objectives of diversifying its product portfolio, Agritech acquired 100% of HPFL (producer of SSP) for Rs1.3bn (UD\$17mn) in November 2008. The combined capacity of the two plants currently stand at 436k tons (346k tons of urea & 90k tons of SSP). Under the Gas Supply Agreement with SNGPL, the company is allocated 28.5 mmcf/d gas.

JS Group

JS Group currently holds 36% of the total shareholding of ANL. JS Group is one of the most diversified financial services group in the country. The flagship company, JSCL, is one of Pakistan's largest listed investment companies. JS Group also has strategic investment in ports telecom, media, transportation, natural resources and real estate businesses.

Sheikh Family

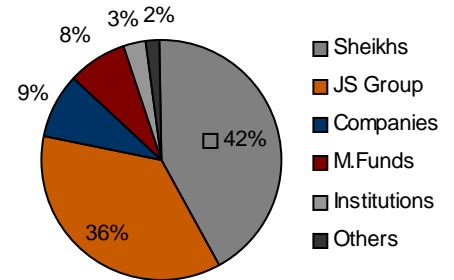
Sheikh Family is one of the oldest families in South Asia with over hundred years of experience. They are the founders of the Colony Group here in Pakistan and as of today their business portfolio comprises of textile and fertilizer businesses.

Key personnel:

Ahmed Juadat Bilal (CEO)

Mr Ahmed Juadat has an MBA from Western International University, UK and currently holds the key position of a Chief Executive Officer at Agritech. With previous experience at ICI Pakistan and Becton Dickson, he has extensive experience in developing new chemicals and agri chemical businesses in Pakistan.

Shareholding



Source: JS Research, NFDC Reports
*As of Dec 2008

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ANALYST CERTIFICATION

I, Bilal Qamar, the author of this report, hereby certify that all of the views expressed in this research report accurately reflect my personal views about any and all of the subject issuer(s) or securities. I also certify that no part of my compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

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