

June 04, 2009

Pakistan Market

Fertilizer: FY10 Budget Expectations & Outlook

MORNING BRIEFING



KSE100 Index: Closing 6989.94 ↓ (-135.17)

The fertilizer sector remained in the limelight last year due to volatility in product prices along with increased profitability of the companies (sector earnings grew by 24% in 2008). We believe upcoming Budget FY10 would once again be positive for the fertilizer sector as government maintains its focus on the agriculture sector.

While subsidy for urea is likely to remain intact, due to sharp fall in DAP prices government is unlikely to announce any subsidy on DAP. Moreover, to encourage balance fertilizer use, government may announce subsidy on SOP.

Urea subsidy to continue/ DAP subsidy unlikely

Due to a sharp fall in global fertilizer prices, particularly phosphates, government is likely to reduce subsidy to Rs10-15bn for the fertilizer sector in Budget FY10. Our subsidy estimate is premised on assumption that average International DAP prices would remain below US\$400 per ton (in other words no subsidy would be needed) and import of approx. 800k tons of urea. Moreover, to encourage balance fertilizer use government could announce subsidy on SOP. The potash fertilizer prices in the international market remain high, hovering around US\$1,110 per ton and has hence discouraged utilization by farmers. In the last Budget FY09, the government had announced a subsidy of Rs35bn.

Agri growth target of 3.8% in FY10

Agricultural growth in FY09 is expected at 3.3-3.5% as against a target of 3.3% set in Budget FY09. The expected increase will come about due to bumper wheat and rice crop while the other major crop cotton recorded flat production. Going forward in FY10, we expect the government to set a growth target of 3.8% amid greater agri focus and better fertilizer mix due to lower prices.

Agri credit target of Rs250–300bn likely for FY10

In 10-month (Jul-Apr) FY09, agri-credit disbursement stood at Rs175bn – an increase of 11%YoY. We expect the full year credit disbursement to arrive at Rs225bn, 10% lower than

target of Rs250bn. That said the government is likely to set FY10 agri credit target in the range of Rs250-300bn as focus on agri growth remains intact.

Impact: Neutral to Positive

A decent agriculture growth, supplemented by sufficient agri loans and low prices, will ultimately lead to more demand for fertilizers. Core earnings of local fertilizer producers are expected to benefit from likely increase in fertilizer offtake particularly DAP which has seen the price fall sharply to US\$280-300 per ton from peak of US\$1,200 per ton. Moreover, subsidy on potash would improve its offtake and thus support agri growth due to a balanced fertilizer mix.

Outlook: 'Over-Weight' maintained

We believe government will maintain its focus on the agriculture sector due to the fact that it contributes about 20% to the total GDP of Pakistan. We expect the demand-supply gap in urea to continue till the commissioning of Engro's new 1.3mn tons urea plant. The sector trades at 2009E PE and dividend yield of 9.3x and 9.8%, respectively with FFC our top pick for the sector at current levels.

farhan.rizvi@js.com

92 (21) 111-574-111 (ext. 3096)

Also in focus

US to increase IDP aid by US\$200m

Richard Holbrook, US special envoy for Pakistan and Afghanistan, yesterday announced that US government has requested the US Congress to approve an additional US\$200mn aid for internally displaced persons (IDPs). This likely aid is on top of the original commitment of US\$110mn announced a few weeks back.

JS Global Capital Limited

6th Floor, Faysal House, Main Shahrah-e-Faisal, Karachi

Research:

Tel: +92 (21) 2799005

Fax: +92 (21) 2800163

js.research@js.com

Fixed Income Sales:

Tel: +92 (21) 2799541-44

Fax: +92 (21) 2800165

tariq.usman@js.com

Equity Sales:

Tel: +92 (21) 2799513

Fax: +92 (21) 2800166

junaid.iqbal@js.com

Corporate Finance:

Tel: +92 (21) 2799005

Fax: +92 (21) 2800166

llyas.ahmed@js.com

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