

May 05, 2010

**Pakistan Market****FFC & FFBL: downward revision in earnings estimate** KSE100 Index: Closing 10467.76 ↑ (+78.30)**MORNING BRIEFING**

Despite decent results during 1Q2010, performance of the fertilizer stocks has been marred by the ongoing gas curtailment issue. In light of the same, we have tweaked our full year (2010) earning estimates for the two Fauji group companies as well. We have adjusted down, Fauji Fertilizer Company's (FFC) earnings a little, due to lower margins on urea during 1Q2010, which came in at 42% (our initial estimate was 46%). A 20% gas curtailment followed by a price hike of Rs75 per bag coupled with revision in primary margins are the main reasons for adjustments in FFBL's (Fauji Fertilizer Bin Qasim Limited) earnings. We now expect the FFC to post profits of Rs9.35bn (EPS: Rs13.8) vs. Rs9.51bn (EPS: Rs14.0) and FFBL of Rs3.23bn (EPS: Rs3.46) vs. Rs3.87bn (EPS: Rs4.15) earlier and maintain a 'Hold' on both the scrips.

**FFC: lower margins to dent earnings**

Our revision in FFC's full year (2010) earnings estimate has come not because of the gas cut back issue, but owing to the lower margins during 1Q2010 which we initially estimated to be around 46%. Higher cost of goods sold mainly driven by increased repair & maintenance expense (up 119%YoY) and salaries & wages (up 64%YoY), led to margins being squeezed to 42% during the quarter under review. Moreover, in light of the gas curtailment issue (FFC currently being supplied 7% less gas) we have revised our production efficiencies and product pricing (urea prices up Rs75 per bag) which technically offset any cost imbalances. Furthermore, with FFC already receiving Rs2.75 per share as dividends from its investment in FFBL, we do not foresee any major change and maintain our full year dividend expectation of Rs3.75 per share from the company.

Our full year (2010) earnings estimate has been revised to Rs9.35bn (EPS: Rs13.78) compared to Rs9.51bn (EPS: Rs14.0) earlier. The scrip currently trades at a 2011F PE and dividend yield of 8.2x and 11.9% and maintain our 'Hold' stance on the scrip.

**FFBL: gas curtailment to dampen 2010 earnings**

FFBL is the one of the three major fertilizer companies which has been hit most by this gas load management program. Due to its gas supply coming from the Sui networks, the quantum of gas reduction being curtailed for FFBL currently stands at 20%, which even with the recent raise in urea prices will not offset resulting production cuts and inefficiencies of the plant. Consequently, the company is likely to take a hit of Rs0.36 per share. Moreover, given the recent surge in phosacid prices to US\$775 per ton, up 29%YTD, we have also revised our primary margin estimates for the current year to US\$260 per ton from US\$278 per ton earlier. Hence, we expect the company to post earnings of Rs3.23bn (EPS: Rs3.46) compared to profits of Rs3.87bn (EPS: Rs4.15) earlier.

The scrip currently trades at a 2011F PE and dividend yield of 8.7x and 10.6x% respectively and we main our 'Hold' stance on the scrip.

|                                   | New   | Old   | Δ%   |
|-----------------------------------|-------|-------|------|
| <b>Fauji Fertilizer Company</b>   |       |       |      |
| PAT (Rs mn)                       | 9,350 | 9,517 | -2%  |
| EPS (Rs)                          | 13.78 | 14.03 |      |
| Target Price                      | 132   | 135   |      |
| <b>Fauji Fertilizer Bin Qasim</b> |       |       |      |
| PAT (Rs mn)                       | 3,235 | 3,873 | -16% |
| EPS (Rs)                          | 3.46  | 4.15  |      |
| Target Price                      | 32    | 35    |      |

Source: JS Research

**Outlook: 'Market-weight' maintained**

The stark price differential between domestic and international urea prices (US\$157 per ton) remains a major comforting factor for fertilizer manufacturers, because it enables them to raise prices further if need be. Further, the companies long term objectives of investing in the highly attractive power sector, remains a major trigger going forward. Hence, we maintain our 'Market-weight' stance on

the sector with a 'Buy' call on Engro while recommending 'Hold' for FFC and FFBL.

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**Also in focus****Final cotton arrivals stand at 12.7mn bales**

According to the latest numbers released by Pakistan Cotton Ginners Association (PCGA), as of 1 May 2010, this season's cotton arrivals stood at 12.7mn bales with a fortnightly flow of 1.2k bales, an increase of 12%YoY. We believe this to be the final round of inflows for the current season and now look forward to the next season's cotton arrivals. The GoP has set a target of around 13.6mn bales for the said period.

**Receipt of another US\$468mn confirmed by SBP**

After releasing US\$188mn on Apr 30 as part of the payment promised under the Coalition Support Fund (CSF), the SBP confirmed receipt of a further US\$468mn on May 4. This will thus cumulatively add US\$656mn to the reserves which stand at US\$15.24bn currently. A total of US\$1.69bn had been billed by the GoP under the same head, for the current fiscal year.

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