May 08, 2009

Pakistan Market

MORNING BRIEFING

FFBL: DAP price outlook & sensitivity analysis

KSE100 Index: Closing 7125.66 ↓ (-73.21)

With steep fall in phosphoric acid prices, investors are eager to know the earnings and demand outlook for FFBL. We have been receiving queries regarding the potential benefits of lower phosphoric acid prices on DAP margins and the sustainability of local DAP prices in the wake of declining international prices to US$370/ton CFR.

The impact of low phosphoric prices

Recent revision in phosphoric acid contract price to US$633/ton from US$760/ton in 1Q2009 has improved FFBL's primary margins on DAP to US$184/ton on new production from US$120/ton earlier. At the same time, international DAP prices have fallen sharply from US$400/ton at the start of the year to US$330/ton, hence the cost of imported DAP now stands at Rs1,500/bag. This indeed poses a downside risk to domestic ex factory DAP prices which are currently hovering at Rs1,900/bag.

What does this mean to margins?

Improved primary margins on account of lower phosacid prices should provide room to FFBL to cut DAP price by Rs150-200 per bag to stay competitive against imports and to maintain historical average margins of US$150/ton on new production.

Table: Impact of DAP price on margins & EPS

	DAP price per bag (Rs)			
2009	**1,900**	**1,800**	**1,700**	**1,600**
Primary Margin (US$/ton)	165	145	120	95
EPS	2.5	2.2	1.8	1.2
2010	**1,900**	**1,800**	**1,700**	**1,600**
Primary Margin (US$/ton)	172	148	123	99
EPS	2.8	2.5	2.0	1.4

Source: JS Research

** Phosacid price assumed at US$650/ton (2009) & US$620/ton (2010)*

Moreover, lower DAP prices provides an opportunity for volumetric growth in the form of higher DAP offtake, which should mitigate the downside price effect. We estimate DAP offtake of around 1.0-1.1mn tons in 2009 with FFBL's share likely to range between 480-500k tons. We have resorted to sensitivity analysis (see table) to quantify the impact on change in primary margins on earnings of FFBL.

Recommendation: 'Hold' maintained

DAP price remains the key downside risk to FFBL's topline, given the company's heavy reliance of DAP sales. As local prices are tied with international DAP prices, we believe domestic DAP prices are unlikely to recover in the short to medium term, due to international recessionary woes. The global economic slowdown would result in subdued international oil prices hence relatively muted demand for bio-fuels. We expect DAP prices to average around Rs1,600-1,800 per bag over the next 2 years, premised on the assumption that phosacid prices stabilize around US$600/ton over the same period. Hence primary margins are likely to average around US$120-US$130 per ton over 2009-10.

On the basis of our base case assumption (phosacid prices US$660/ton, domestic prices Rs1,750/bag, and off-take levels of 500k tons), we expect FFBL to post earnings of Rs2.0 in 2009. Trading at a one year forward PE of 8.8x and offering a dividend yield of 11.2%, we maintain our 'Hold' stance on FFBL.

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Fauji Fertilizer Bin Qasim

Market Price: Rs17.92	**Kats Code:** FFBL
Market Cap: Rs16.7bn (US$208.0mn)	**Bloomberg Code:** FFBL PA
1-yrs Avg. Daily Volume: 3.8mn shares, Rs82.5mn (US$1.0mn)	**Reuters Code:** JORD.KA
1-year High/Low: Rs39.60/12.48	

Also in focus

CPI outlook for April

We expect CPI around 16-17% (down from 19.07%) for April 2009 purely on ground of base effect. However, we expect month-over-month inflation to inch up due to higher staple food prices that prevailed in the country. Looking forward, we expect food prices to ease on account of bumper wheat and minor crop.

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