January 11, 2010

Pakistan Market

MORNING BRIEFING

Fatima Fertilizer: 1st fertilizer offering since 1996

KSE100 Index: Closing 9776.21 ↑ (+38.74)

Recommendation: Buy @ Rs10-11

We initiate our coverage on Fatima Fertilizer Company Limited (FFCL) with a fair value of Rs14 per share and hence recommend investors to participate in the Book Building process as the scrip offers a 40% upside at the floor price of Rs10 per share. FFCL is a joint venture between Arif Habib Group (AHG) and Fatima Group (FG) with a nameplate capacity of 1.58mn tons diversifying in urea as well as other fertilizers (phosphatic, calcium blended and potassium based). This makes FFCL a different player considering the conventional urea and DAP producers. With urea and CAN expected to operate at near full capacity in 2010, the NP plant coming online in 2011 and high margins due to special 10 year subsidy on feedstock gas we expect a 4 year earnings CAGR (2011-15) of 20%. Trading at a post full commissioning 2012F EV/EBITDA of 4.0x and PBV of 0.7x, we recommend investors to bid in the Book building process in the range of Rs10-11 per share. The key risks to our thesis are: (1) delays and cost overruns (2) disruption in gas supply (3) lower demand for NP & CAN and (4) integration and regulatory issues. We however, rule out any concerns on excess supply of urea.

What's on offer?

FFCL is issuing additional 200mn ordinary shares at a floor price of Rs10 through a combination of 150mn shares (75%) in the Book Building Process (Jan 11-13) to the Institutional Investors and High Net Worth Individuals (HNWI), while 50mn shares (25%) will be issued subsequently to the general public (Jan 27-28) at or below the strike price determined via the Book Building process. Arif Habib Limited is the mandated Lead Manager & Book Runner for the issue.

Valuation: 40% upside at the floor price of Rs10

Using the FCFF methodology with a risk free rate of 11% and WACC of 12%, our fair value of Fatima arrives at Rs14, which implies a 40% upside at the book building floor price of Rs10. Our liking for FFCL is also backed by the company's attractive 2012F EV/EBITDA and PBV multiples of 4.0x & 0.7x respectively, which implies that FFCL is available at a discount of 67-74% to the fertilizer sector.

Profits to post a 4 year (2011-15) CAGR of 20%

We project the company's earnings to grow at a post full commissioning (2011-2015) CAGR of 20% driven by a combination of gradual production build up with NP plant coming online in 2011 and high margins due to special subsidy on feed stock. Moreover, lower tax expense owing to accelerated capital allowance on the heavy capital expenditure will contribute towards strong earnings.

Offer likely to witness a good response

We believe the offer has decent merit at the floor price of Rs10 per share given its attractive fundamental value of Rs14 and the strong goodwill of the AHG, the main sponsor of the company. Moreover, given AHG's IPO history with regards to previous five offerings (over subscribed in the range of 1.1x-6.2x) and the performance of the last fertilizer IPO, FFBL in 1996 (oversubscribed 2.3x), we expect a positive response for FFCL as well.

Table: Key numbers

	2010E	2011F	2012F	2013F	2014F
EPS (Rs)	0.1	1.1	1.3	1.2	1.6
PBV (x)	0.9	0.8	0.7	0.7	0.6
PE (x)	NM	9.5	7.5	8.3	6.1
EV/EBITDA (x)	7.1	4.8	4.0	3.6	2.8
EV/ton (US$)	403.9	369.1	323.6	278.4	225.8

Source: JS Research

For more details please refer to our detailed report titled "Fatima Fertilizer: 1st fertilizer offering since 1996".

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Also in focus

PSMC: Liana prices raised by Rs0.1mn

Pak Suzuki Motor Company (PSMC) has raised price of its product Liana by Rs0.1mn, primarily to position it at a premium to its newly launched Swift. This raise in the price is expected to have an annualized positive impact of Rs0.6 per share, keeping all else constant. The company has also raised prices of its imported products i.e. the APV Van and JIMNY Jeep, by Rs100,000 and Rs50,000, respectively.

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