

November 18, 2009

Pakistan Market**FFC: Attractive dividend yield of 13%/‘Buy’****MORNING BRIEFING**

KSE100 Index: Closing 9204.98 ↓ (-99.33)

Rising urea demand (up 15% in 9M2009) amid better crop economics and high dividend yield at 12.7% (one of the highest in the JS Universe) for 2010, Fauji Fertilizer Company (FFC) continues to remain one of our preferred plays in the Fertilizer sector. The company has been a major beneficiary of higher urea offtake which has been achieved, despite a 23%YoY increase in urea prices. Moreover, concerns at the beginning of the year with regards to the dividend flows from its subsidiary, Fauji Fertilizer Bin Qasim (FFBL) has also proved to be unfounded as FFC would recognize dividends worth Rs1.7bn (EPS impact Rs2.52 per share) in 2009. Further, risk of an over supply situation beyond 2010 is expected to be countered via exports as local urea is sold at a deep discount compared with international variants.

Urea offtake to remain robust

Urea demand remained robust throughout 2009 rising by 15%YoY amid better wheat support prices and sowing of BT cotton which requires higher urea per acreage compared to traditional cotton seed. FFC being the largest urea player benefited from these changing dynamics as it posted a 3% growth in urea offtake to 1.86mn tons during 9M2009. Due to strong demand in the Rabi sowing season, particularly for wheat, we estimate FFC's urea offtake for 2009 to stand at 2.4mn tons, an increase of 4%YoY. Our estimate is based on an expected offtake of 560ktons in 4Q2009. The growth in urea offtake coupled with higher urea prices (currently Rs730/bag, up 12%YoY), will help FFC post revenues of Rs34.9bn in 2009 - an increase of 14%YoY. Moreover, higher prices will help gross margins improve by 391bps to 44% in the current calendar year.

Other income continues to beat expectations

While profits of FFBL are expected to witness a 9% decline in 2009, risk of dividend inflows at the beginning of the year have been proved wrong, as DAP offtake has exceeded expectations. Interestingly, sharp decline in phos acid prices has ensured significant improvement in the primary margins

on DAP. In addition, to the final dividend of Rs2.25/share announced in January, FFBL declared a cumulative interim dividend of Rs1.75/share in 9M2009, taking the full year dividend for 2009 to Rs4/share (after tax per share impact of Rs2.52). Given the current pricing and margin situation on DAP, FFBL is expected to continue with a steady stream of dividends beyond 2009 as well.

Recommendation: ‘Buy’ maintained

Given guaranteed urea offtake amid government's agri focus and limited exposure to other fertilizers except urea, FFC is a safe play for risk-averse investors. We expect the bottomline of the company to grow by 37% to Rs8.9bn (EPS of Rs13.2) in 2009 versus Rs6.5bn (EPS of Rs9.6) in 2008. Currently the scrip is trading at a 2009E and 2010F PE of 7.9x and 7.8x respectively. Further, it offers an attractive 2009E and 2010F dividend yield of 12.7% and 12.8% respectively. We reiterate our ‘Buy’ call on the scrip at current levels.

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Also in focus**MCB Bank files petition in SC regarding RBS deal**

According to a news report, representatives of MCB Bank have filed a petition in Supreme Court against the State Bank of Pakistan for not providing regulatory approval to acquire the local operations of RBS. The issue has stalled over the sponsor shares, required to be deposited in a blocked account with the CDC. The transaction is reported to have a deadline of December 31, 2009. To recall, MCB Bank in August agreed to take over a 99.4% stake in RBS for US\$87mn.

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