

August 23, 2010

Pakistan Market

FFC: Possible acquisition of AGL

MORNING BRIEFING



KSE100 Index: Closing 9,860.36 ↑ (+12.75)

Fauji Fertilizer Company (FFC) in a notice issued at the Exchange has expressed its intention to acquire up to 79.85% shares of Agritech Limited (AGL). The proposed acquisition will put Fauji Group (FFC and FFBL) in a dominating position in the urea market taking its market share to 45% from the existing 39%.

The group will continue to maintain its 100% market share in DAP manufacturing. Moreover, with this acquisition, FFC will further diversify its product portfolio gaining access to Single Super Phosphate (SSP), a close substitute of DAP, through Hazara Phosphate - a 100% owned subsidiary of AGL. Though, it is difficult to comment on the potential transaction price at this stage, we anticipate the likely source of funding to be a combination of debt and equity. Currently, we have a 'Buy' call on FFC and it trades at a 2010E PE of 5.2x and offers a dividend yield of 12.9% for the same period.

Possible funding options and transaction price

One of the key questions that arises is what will the transaction price of this acquisition be. As AGL is recorded at Rs30 per share in Azgard Nine Limited's (ANL) books and is currently trading at Rs23.5, we anticipate the acquisition price to settle in the range of Rs20-30 per share. This translates to a transaction value of Rs6.3-9.4bn (US\$74-110mn).

As of Jun 30, 2010, FFC is carrying over Rs4bn in short term investments and cash along with a total debt of Rs9.2bn (Debt to Equity: 70%). In our view, the likely source of funding can either come from 1) internally generated funds (holding back its dividend payouts and using available cash on the balance sheet) 2) additional borrowings 3) announcing a rights issue or 4) a combination of the above.

Likely scenario – a mix

Given room for further borrowing, we believe the likely scenario for funding the acquisition would be a mix of additional borrowings and internally generated funds. We expect FFC take loan of Rs3.6-4bn and fund the rest of the transaction amount with its own funds. This will surely cause

FFC's finance cost to bulge to a range of Rs513-570mn (using an average rate of 14.25%), a negative EPS impact of Rs0.49-0.55 per share. This impact will however, be mitigated by incremental revenues from AGL.

FFC post acquisition

If the acquisition goes through, the total nameplate urea capacity of FFC would increase to 2.53mn tons per annum (current 2.04mn tons) taking its market share to 45% (current 39%). It will also obtain an exposure to the SSP. Moreover, Agritech operates one of the newest and the most cost efficient plants in Pakistan which could bring in cost efficiencies for FFC. In addition, AGL has successfully developed an extensive distribution network of over 500 dealers in less than 3 years, and that to, within close proximity of the consumption area, allowing Agritech to keep distribution costs down.

Urea market share

	Pre-acquisition	Post acquisition
Fauji Group	39%	45%
Engro & Dawood	35%	35%
Pak Arab & Fatima	20%	20%
Agritech	6%	0%

Source: NFDC & JS Research

We await further news flow on this matter and currently maintain our 'Buy' call on the scrip.

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Fauji Fertilizer Company Limited

Market Price: Rs109.01	Kats Code: FFC
Market Cap: Rs74.0bn (US\$863.4mn)	Bloomberg Code: FFC PA
1-yr Avg. Daily Volume: 1.2mn shares, Rs132.1mn (US\$1.5mn)	Reuters Code: FAUF.KA
1-year High/Low: Rs117.91/94.97	

Also in focus

IMF to discuss flood damage in meeting

IMF's head of its Middle East and Central Asia department, Masood Ahmed in a statement on Saturday acknowledged the scale of damage caused by flooding in Pakistan has posed a massive economic challenge for the country. He further stated that the institution intends to review budgetary and macro economic prospects post this tragedy, assess possible measures to address the challenge and discuss ways the IMF could offer assistance, with Pakistani officials in their upcoming meeting (Aug 23rd). News flow suggests a relaxation in targets set by the IMF is likely to be tabled.

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