

June 29, 2009

Pakistan Market**5M2009 Fertilizer offtake & outlook****MORNING BRIEFING**

KSE100 Index: Closing 7163.04 ↑ (+34.21)

We maintain our 'Over-weight' stance on fertilizer sector on the back of improved fundamentals in agriculture sector and healthy purchasing power of the farmers. This can be reflected from the first 5 months fertilizer off take statistics recently released by NDFC. As per NDFC, DAP offtake continued to surprise upwards to 95k tons (+ 67%YoY) in May 2009, despite being an off peak season, excess supply & expected decline in domestic prices.

Moreover, despite low inventory levels and limited supply urea offtake remained rather steady as it was recorded at 466k tons up 10%MoM in May. As a result, overall urea offtake for the 5M2009 remained strong at 2.4mn tons (up 7%YoY), while DAP offtake over the same period was up a massive 114%YoY at 334k tons.

Given the cyclical nature of the fertilizer utilization, Apr – June generally remain a lull period as procurement activity for the Rabi seasons kicks off around July while procurement for Kharif is generally completed during the first quarter.

DAP: May 2009 offtake up 67%YoY

Despite May being an off peak period, provision of excess supply and expected decline in domestic prices (amid sharp fall in international prices), DAP offtake remained strong at 95k tons up a massive 94%MoM and 67%YoY. Though, international DAP prices hovered at US\$280-320/ton (Rs1,100 -1,300 per bag), major domestic players such as FFBL and Engro kept prices unchanged i.e. around Rs1,900 per bag. FFBL and Engro managed to sell 54k tons and 7k tons, respectively in May amid alleged reports of distributors taking advantage of urea shortage and forcing buyers to buy one bag of DAP for every 4 bags of urea.

Encouragingly, FFBL has sold 192k tons of DAP in 5M2009 which makes us confident that our full year expectation of 500k tons offtake would be achieved. Resultantly industry offtake in 5M2009 reached 334k tons (up 114%YoY). With DAP inventories now on the lower side (102k tons as of May 2009), there would be a natural shift towards imports

particularly from major player such as Engro. Hence we expect prices to fall by around 20% in the coming months and average Rs1,500-1,600/bag in 2H2009. On the back of declining DAP price outlook, we expect a robust DAP consumption, which entails better fertilizer mix and would help sustain bumper crop for next year - a welcome boost to both agriculture and overall economy.

Urea offtake up 10% MoM in May

A combination of improved production particularly by Engro and anticipated delays in urea imports resulted in improved demand from buyers reflected by 10%MoM increase in urea offtake which stood at 466k tons in May 2009. As a result, the total offtake in the 5M2009 stood at 2.4mn tons up 7%YoY. Amid better production statistics, Engro offtake for May was recorded at 75k tons up 77%MoM, while FFC's offtake remained steady at 213k tons. On the flip side, urea offtake was down a marginal 2%YoY. We are however not discouraged by the 2%YoY decline, as high DAP price last year had resulted in major substitution towards urea. Moreover, historically urea off take remains slow in 2QCY09 due to wheat harvesting and is expected to reverse from July onwards once the Rabi season purchases kicks in.

Outlook: 'Over-weight' maintained

Continued focus on agri growth coupled with anticipated decline in DAP prices during Rabi encourages us to believe that offtake would remain strong in the 2H2009. After analyzing May 2009 statistics, we maintain our full year urea offtake forecast of 5.9mn tons up 8%YoY, while DAP offtake is expected at 1.1mn tons – an increase of 40%. Moreover, continued urea supply gap of 800-900k tons makes offtake more or less guaranteed and given high prices (up 23%YoY) predominately urea play FFC is likely to witness a handsome earning growth of 21% in 2009. We therefore maintain our 'Over-weight' stance on the sector which trades at 2009E PE and dividend yield of 8.8x and 11.1%, respectively, with FFC and Engro our top picks at current levels.

Table: Fertilizer Offtake (Jan-May) 2009

'000 tons	5M2009	5M2008	Δ%	May-09	May-08	Δ%
All fertilizer	3,134	2,742	14%	668	610	10%
UREA	2,427	2,267	7%	466	474	-2%
DAP	334	156	114%	95	57	67%

Source: NDFC

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Also in focus**16% FED not applicable on interest, mark-up**

According to a newspaper report citing a budget document, the 16% Federal Excise Duty (FED) applicable on fund services provided by banking and non banking financial companies would not apply on interest and mark-up. The 16% FED on fund services of banks and non banks financial companies was imposed in budget FY10, with a view to boost revenue collection from the sector. However, given that credit to private sector is - Rs3bn in FY09 to date, an incremental FED charge would have been detrimental to already depressed credit offtake situation.

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