

Fertilizers

Overweight

Jul 22, 2022

Pakistan Equities
Fertilizers

Key Points

- Next fertilizer universe is likely to post 2QCY22 profitability of PKR4.3bn, compared to PKR10.9bn in the same period last year, depicting a decline of 61% YoY.
- Despite higher 5%/50% growth in urea/DAP offtakes on YoY basis, 11%/79% higher prices, and higher gross margins, the dent in profitability is due to imposition of super tax of 10% on CY21 income and 4% on CY22 income.
- With a relatively stable business model and cash flows, EFERT and FFC offer dividend yields in excess of 13% making them amongst the highest dividend yielding stocks. We have an overweight stance on the sector and prefer FFC and EFERT.

61% YoY decline expected in profitability

Next fertilizer universe is likely to post 2QCY22 profitability of PKR4.3bn compared to PKR10.9bn in the same period last year, depicting a decline of 61%YoY. This notable decline is mainly attributable to imposition of super tax in budget FY23. We have incorporated super tax of 4% for both 1st and 2nd quarters and 10% super tax charged on CY21 PBT, in 2QCY22 earnings estimates. Net sales of our coverage universe are expected to clock in at PKR106bn marking a growth of 63%YoY on account of 5%/50% increase in urea/DAP offtakes coupled with 11%/79% higher retention prices. Sequentially, profitability is expected to register 74% decline, in spite of higher offtakes and better gross margins. This sequential profitability decline will mainly be driven by FFBL amid exchange loss on account of currency devaluation in addition to super tax charge.

FFC: Earnings to clock in at PKR2.4bn (EPS PKR1.90), decreasing by 33%YoY

We estimate FFC to post unconsolidated profit of PKR2.4bn (EPS PKR1.90) for the outgoing quarter, posting a massive decline both on yearly and sequential basis. The imposition of super tax in FY23 budget will heavily weigh on FFC's bottom-line as we estimate effective tax rate for the outgoing quarter to clock in at 71%. In conjunction with the result, FFC is all set to declare second interim cash dividend of PKR1.50/share, which would take 1HCY22 DPS to PKR5.2/share. Net sales of the company for the outgoing quarter are anticipated to clock in at PKR28.8bn against PKR26.3bn of 1QCY22 and PKR22.4bn of 2QCY21. Furthermore, we anticipate FFC to post gross margin of 37% against 36% of 1QCY21 and 35% of the same period last year. The slight increase in gross margins is mainly attributable to higher fertilizer prices. Other income of the company is expected to provide some cushion and likely to clock in at PKR2.9bn. The significant jump in KIBOR rates throughout the quarter is also expected to weigh on profitability as financial charges are expected to surge by almost 4.5x yearly and 62% sequentially.

EFERT: Earnings are expected to decline by 70%/74% YoY/QoQ to PKR1.08/share

EFERT is expected to announce consolidated profitability of PKR1.4bn (EPS PKR1.08) for 2QCY22, declining by 70%YoY/74%QoQ. The drop in urea offtakes, discontinuation of concessionary gas after 2QCY21, and higher effective tax rates are major factors for the yearly drop in earnings. This is readily evident from gross margins, which are expected to clock in at 28%, a steep decline from 2QCY21 margins of 38%. On a sequential basis, margins are expected to decline relatively less (-1.0ppts). Finance costs is expected to burden profitability as well amid higher interest rate wherein, we anticipate finance cost for the 2QCY22 to clock in at PKR0.5bn. For 1HCY22 earnings of the company likely to clock in at PKR6.9bn (EPS: PKR5.21), marking an YoY decline of 34%YoY. In conjunction with the result, we expect EFERT to announce an interim cash dividend of PKR1.3/share given the practice by the company to announce higher dividend.

FFBL: Higher effective tax rate and other expense heavily weigh down on earnings

FFBL is expected to report unconsolidated earnings of PKR0.38bn (EPS PKR0.30), marking a decline of 85%YoY/76%QoQ. The massive decline is mainly attributable to higher taxation and exchange loss. Top-line of the company is expected to clock in at PKR40.95bn marking an improvement of 142%YoY/65%QoQ. The massive increase in net sales is mainly due to higher DAP offtakes and higher fertilizer prices. However, due to higher prices of coal and phosphoric acid, gross margins of the company for 2QCY22 will likely come down to 16% against 22% of 1QCY22 and 21% of 2QCY21. Furthermore, other expense of the company will post a massive increase to clock in at PKR1.2bn due to exchange losses. In spite of this other income will provide some cushion, increasing by 39%QoQ due to dividend from PMP amid strong profitability. Effective tax rate of the company is likely to clock in at 84% against 36% of 1QCY22 and 12% of the same period last year.

Key Data

Mkt. Cap. (USDmn)	2,201
Mkt. Cap. (PKRbn)	499.3
Index Weightage (KSE-100)	14.0%
Listed Companies	6.0

Source: PSX, Next Research

Cumulative Fertilizer Estimates

	1HCY22	1HCY21	YoY
FFC	6.85	7.42	-8%
EFERT*	5.21	7.87	-34%
FFBL	1.56	3.0	-48%

* Consolidated

Source: Company Accounts, Next Research

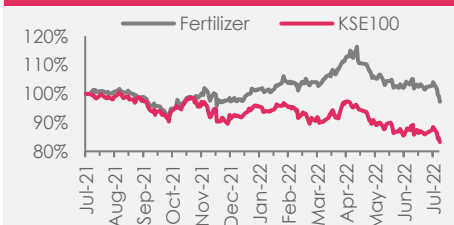
Jun'22 Estimates

	2QCY22	QoQ	YoY	DPS
FFC	1.94	-60%	-32%	1.50
EFERT*	1.08	-74%	-70%	1.25
FFBL	0.30	-76%	-85%	-

* Consolidated

Source: Company Accounts, Next Research

1 Year Relative Performance



Source: PSX, Next Research

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Rating	Sector's proposed weight in the portfolio
Over Weight	> Weight in KSE 100 index
Market Weight	= Weight in KSE 100 Index
Under Weight	< Weight in KSE 100 Index

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Rating	Expected Total Return
Buy	$R \geq 15\%$
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Where;

R = Expected Dividend Yield + Expected Capital Gain

R' is before tax

Investment horizon is between six months to twelve months

Ratings are updated regularly based on the latest developments in the economy/sector/company, changes in stock prices, and changes in analyst's assumptions.

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