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WE Detailed Report

November 2015

Fatima Fertilizer Company Limited

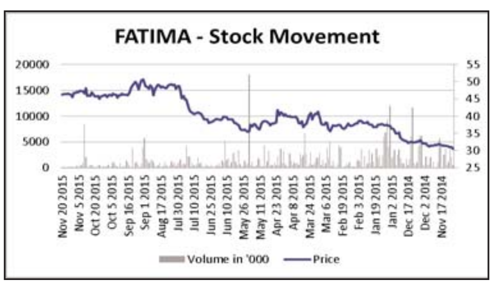
FATIMA: Future sustainability looks promising

We initiate coverage on Fatima Fertilizer Company Limited (FATIMA) with DCF based June'16 target price of Rs 54/share, offering a striking upside potential of 27% from closing price of Rs 42.41/share. Our bullish stance is backed by expected increase in urea off-take due to government subsidy in the form of farmers package; international lower prices of DAP, better returns from CAN off-take and NP off-take, Shifting of Annual Turnaround Activity (ATA) cycle from 12 months to 18 months; De-bottlenecking project in final stages; and acquisition of Dawood Hercules (DHFL). The key risks linked to our report are gas shortage issue; GDIC imposed on concessionary gas, corporate guarantee issued against DHFL, and cases under appellate tribunal inland revenue. The company is currently trading at PE multiple of 7.7x and 7.5x for CY16 and CY17 respectively.

KEY DATA

KATS Code	FATIMA
Reuters Code	FATF.KA
Current Price (Rs)	42.41
Year High, Low (Rs)	51.25, 31.00
Market Cap (Rs' bn)	89.06
Market Cap (US$ mn)	848
Shares Outstanding (mn)	2,100

Source: KSE, Reuters & WE Research



Source: KSE & WE Research

FATIMA Financial Snapshot

	CY14A	**CY15E**	**CY16E**	**CY17E**
Net Sales (Rs mn)	36,169	33,290	39,997	41,128
Gross Profit (Rs mn)	21,461	21,054	22,321	23,883
Profit after Taxation (Rs mn)	9,258	11,489	11,822	12,093
EPS (Rs)	4.41	5.47	5.63	5.76
DPS (Rs)	2.75	3.00	3.25	3.50
P/E (x)	9.62	7.75	7.53	7.36
P/BV (x)	2.4	2.1	1.9	1.7
Dividend Yield (%)	6.5%	7.1%	7.7%	8.3%
ROE (%)	27%	29%	27%	25%
ROA (%)	14%	17%	17%	16%

Source: Company Reports & WE Research

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Our June'16 Target Price for FATIMA is Rs 54/share; offering an upside scope of 27%-Buy!

Valuation: BUY with a Target Price of Rs 54

We have used Discounted Cash Flow (DCF) methodology with an assumption of 14.5% cost of equity (9.5% Risk free rate and 5% Risk premium) and 4% growth rate, thus our June'16 Target Price for FATIMA is Rs 54/share; offering an upside scope of 27%-Buy!

DCF based value of FATIMA

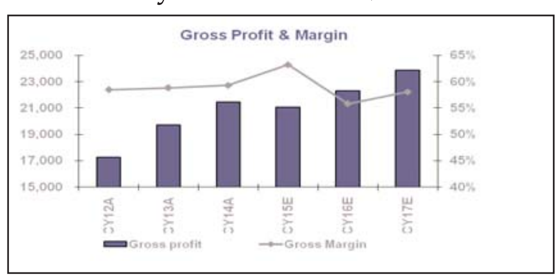
Rs in million	CY15E	CY16F	CY17F
Net Income	11,489	11,822	12,093
Non-Cash Expense	1,598	1,772	1,884
Interest Exp	1,554	2,179	2,326
Change in Working Capital	227	(528)	(89)
Capex	(2,395)	(4,992)	(5,078)
Free Cash Flow to Equity	12,473	10,254	11,137
Discounted Free Cash Flow	12,473	9,661	9291
PV of Terminal Value	101,143		
Equity Value (EV)	132,568		
(-) Debt	(18,587)		
Shares Outstanding	2,100		
Target Price June'16 (Rs)	**54**		

Source: Company Reports and WE Research

Gross margins of the company are expected to clock in at 56% during the year 2016; owing to concessionary gas available, slightly higher fertilizer prices and better offtake. We expect gross profit to increase by 6% to Rs 22,321 million versus Rs 21,054 million in CY15.

Higher margin - Lower curtailment

Gross margins of the company are expected to clock in at 56% during the year 2016; owing to concessionary gas available, slightly higher fertilizer prices and better offtake. We expect gross profit to increase by 6% to Rs 22,321 million versus Rs 21,054 million in CY15. Other administrative expenses are also predicted to be moved within pre-established limits during current year 2016.



Source: WE Research,

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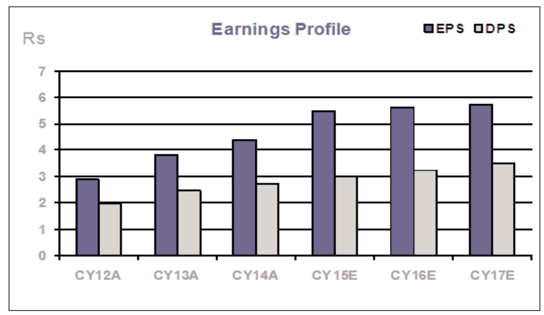
Growth in bottom line to continue

On the back of expected higher take-off, reduction in financing cost and concessionary gas available, we expect the earnings of Fatima Fertilizer Company Limited to continue moving upwards in the coming years. The company is likely to earn a profit after taxation of Rs 11,822 million (EPS: Rs 5.63) in CY16. In addition to the strong profitability, the company is expected to continue its track record of distributing cash dividends to its shareholders, where we expect the company to announce a cash dividend of Rs 3.25/share and Rs 3.50/share in CY16 and CY17 respectively.



Source: WE Research

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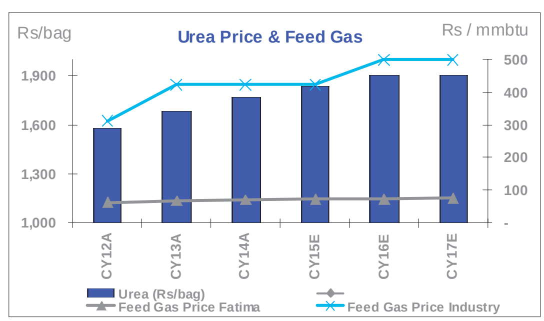
Impact of gas prices on the revenues

From September 1, 2015 the gas prices have been revised by Oil and Gas Regulatory Authority (OGRA) where Feed gas was increased from Rs 423/mmbtu to Rs 500/mmbtu for old manufactures (not for Fatima) and Fuel gas took a hike up to Rs 750/mmbtu as against Rs 638/mmbtu. The increase was however passed on to farmers by the manufacturers who uplift urea prices by Rs 160/bag bringing the per bag price to Rs 2,020 (MRP). The uncertainty remained hovered over the price fluctuation that affected sales. Going forward, the possibility may arise that government reverse its decision over feed gas price, whereas fuel price increase is absorbed by urea manufacturers to maintain equilibrium. Currently we have assume urea price of Rs 1900/bag.



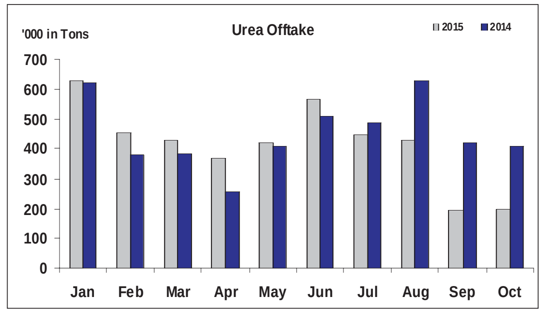
Source: WE Research

Rabi 2015-2016 urea off-take is predicted to be 3.1 million tons vis-à-vis expected availability of 3.4 million tons including current inventories and local production. The Government's announcement of the farmer support package will generate demand and sales are thus expected to enhance, but in the meantime the uncertainty over prices may impact this demands.

FATIMA has closed its urea plant for the month of November 2015 in order to work on plant turnaround and to complete Phase-I of ammonia revamp project.

Urea off-take - Government subsidy may increase sale

Rabi 2015-2016 urea off-take is predicted to be 3.1 million tons vis-à-vis expected availability of 3.4 million tons including current inventories and local production. The Government's announcement of the farmer support package will generate demand and sales are thus expected to enhance, but in the meantime the uncertainty over prices may impact this demand.



Source: WE Research

CAN off-take and NP off-take status

As per the data released by National Fertilizer Development Centre (NFDC), Calcium ammonium nitrate (CAN) off-take was pushed up by 8.1% to 339k tons during January to August 2015, while Single Super Phosphate (SSP) sales spiked by 6.2% to 35k tons during the same time period. Nitrogen Phosphorus (NP) volumes witnessed modest rise of 3.4% to 313k tons though FATIMA's Sarsabz NP sales shrank by 11.8% to 195k tons.

De-Bottlenecking Project

FATIMA has closed its urea plant for the month of November 2015 in order to work on plant turnaround and to complete Phase-I of ammonia revamp project. As per company resources, the Capacity and Operational Efficiency Building Project - DBN Phase-1 is progressing as per schedule. All the major equipment including the Cold Box, the Refrigeration and Waste Gas Compressor, various Heat Exchangers etc. have already been placed on the foundations. The new Cooling Tower construction and other Mechanical Construction work are rolling out adequately. Commissioning of DBN Phase-I is started in November 2015, while Waste Gas Boiler installation, fabrication and commissioning will be completed, as per schedule, afterwards.

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With total capital expenditure of US$ 100 million, de-bottlenecking project aims to increase ammonia production by 100-120tpd (7% of installed capacity) by improving the gas consumption in the plant. As the company is already producing CAN and NP at optimal capacity, we expect debottlenecking project to increase company's urea production by 9-12%. Commissioning of Phase-II of the project depends on the success of Phase-I and availability of sufficient gas among other factors.

FATIMA reduced urea prices to Rs 1,823/bag temporarily in October 2015, before increasing them back to match the prices of bigger market players. We anticipate this fertilizer company will be protected from urea price reversal, due to availability of concessionary feed gas at US$0.70/mmbtu till 2021.

Urea sales expected to boost

FATIMA reduced urea prices to Rs 1,823/bag temporarily in October 2015, before increasing them back to match the prices of bigger market players. We anticipate this fertilizer company will be protected from urea price reversal, due to availability of concessionary feed gas at US$0.70/mmbtu till 2021. Any such scenario will likely prove to have a positive impact on the bottom-line as the company currently has more than 100k tons of urea, which includes 20k tons stock held at DHFL and 50k tons of CAN in inventory. The company also maintained a considerable inventory of NP at the end of third quarter, which is expected to be utilized in upcoming quarters since the subsidy has been implemented.

Annual Turnaround Activity Cycle shifted

Ever since the plant is commissioned, it is the first time when Annual Turnaround Activity (ATA) has been shifted from the cycle of 12 months to 18 months. TA-2015 will be carried out as per schedule in Q4-2015. In order to have maximum possible production in 2015, timing of TA-2015 has been aligned with commissioning time of Ammonia Plant Revamp and De-Bottlenecking Project (DBN Phase-1).

Dawood acquisition - A Historical Decision

Acquisition of Dawood Hercules Fertilizer Limited (DHFL) would be surprising decision as the plant is not receiving stable gas supply from SNGP network. During 3QCY15, DHFL has produced 25k tons. Following implementation of gas load management by SNGP, Dawood fertilizer became more relied over imported LNG. Uncertainty on imported LNG price is still under question and is company's key challenge going forward.

Key Risks

GIDC levied across the sector
Government has lifted the exemption of GIDC on new fertilizer plants i.e. Enven and Fatima, they will also be charged with Rs 300/mmbtu on feed stock which is against the 10 year contract of the both the companies with GoP, but companies have taken stay on implementation of bill. If GIDC is implemented, FATIMA's margins are going to hurt badly by 38% on annualized basis.

Corporate guarantee issued to syndicate
The Company has issued a corporate guarantee to a syndicate of financial institutions through Meezan Bank Limited to guarantee payment of any amount due under or in connection with the Diminishing Musharaka Finance Facility of Rs 4.5 billion availed by Dawood Hercules Fertilizers Limited up to a maximum amount of Rs 6 billion. This corporate guarantee will remain in force until a receipt of notice is received from Meezan Bank that amounts payable under the facility have been paid and guarantee stands discharged.

Company Introduction
The Fatima Fertilizer Company Limited was incorporated on December 24, 2003, as a joint venture between two major business groups in Pakistan namely, Fatima Group and Arif Habib Group. The fertilizer complex is a fully integrated production facility, capable of producing two intermediate products, i.e., Ammonia and Nitric Acid and four final products which are Urea, Calcium Ammonium Nitrate (CAN), Nitro Phosphate (NP) and Nitrogen Phosphorous Potassium (NPK) at Sadiqabad, Rahim Yar Khan. The Complex has a 56MW captive power plant in addition to off-sites and utilities. The Complex has been allocated 110 MMCFD of gas from the dedicated Mari Gas fields.

FATIMA - Financial Highlights

Valuation

	CY14A	CY15E	CY16E	CY17E
EPS (Rs)	4.41	5.47	5.63	5.76
Book Value (Rs/share)	17.50	19.97	22.35	24.61
DPS (Rs)	2.75	3.00	3.25	3.50
P/E (x)	9.62	7.75	7.53	7.36
P/BV(x)	2.4	2.1	1.9	1.7
Dividend Yield (%)	6.5	7.1	7.7	8.3

Source: Company Reports & WE Research

Key Ratio Analysis

	CY14A	CY15E	CY16E	CY17E
Current Ratio (x)	0.97	0.93	0.85	0.74
ROE (%)	27	29	27%	25
ROA (%)	14	17	17	16
Gross Margin (%)	59	63	56	58
Net Margin (%)	26	35	30	29
Sales Growth (%)	8	-8	20	3
PAT Growth (%)	15	24	3	2

Source: Company Reports & WE Research

Income Statement

Rs in million	CY14A	CY15E	CY16E	CY17E
Sales	36,169	33,290	39,997	41,128
Cost of Goods Sold	14,708	12,236	17,676	17,245
Gross Profit	21,461	21,054	22,321	23,883
Administrative Expense	1,449	1,601	1,430	1,508
Distribution Cost	1,346	1,492	1,613	1,695
Other Income	624	581	269	434
Other Expenses	1,374	1,290	1,216	1,240
Finance Cost	3,767	2,303	2,853	3,206
Profit before Taxation	14,149	14,949	15,479	16,669
Taxation	4,891	3,460	3,657	4,576
Profit after Taxation	9,258	11,489	11,822	12,093

Source: Company Reports & WE Research

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Balance Sheet

Rs in million	**CY14A**	**CY15E**	**CY16E**	**CY17E**
Share Capital	21,000	21,000	21,000	21,000
Shareholder Equity	36,757	41,946	46,943	51,686
Non-Current Liabilities	31,756	26,661	22,126	17,919
Current Liabilities	14,608	17,352	25,754	25,624
Total Liabilities	46,364	44,013	47,880	43,543
Non-Current Assets	68,952	69,749	72,969	76,163
Current Assets	14,169	16,210	21,854	19,067
Total Assets	83,121	85,959	94,824	95,230

Source: Company Reports & WE Research

Cash Flow Statement

Rs in million	**CY14A**	**CY15E**	**CY16E**	**CY17E**
Cash from Operations	10,441	13,313	13,066	13,889
Cash from Investing activities	(2,799)	(2,395)	(4,992)	(5,078)
Cash from Financing	(6,932)	(8,064)	(4,325)	(11,917)
Net change in Cash	711	2,854	3,750	(3,107)
Beginning Cash balance	238	949	3,803	7,553
Ending Cash balance	949	3,803	7,553	4,446

Source: Company Reports & WE Research

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