

June, 2018

| Company Name: | Fauji Fertilizer Company Limited |
|--------------------------|----------------------------------|
| Symbol | FFC |
| Target Price | PKR 105.16 |
| Upside | 8% |
| Key Statistics | |
| Current Price* | PKR 97.80 |
| Outstanding Shares | 1272.24 mn |
| 52 Week High | PKR 102.02 |
| 52 Week Low | PKR 70.07 |
| Market Capitalization* | PKR 124,425.72 mn |
| 1 year Avg. Daily Volume | 1.3 mn |
| Valuation Methodology | DCF |
| Free Float | 700 mn |

Source: PSX & WE Research

* Prices as of June 14, 2018

| | Key Numbers | | | |
|-----------------|-------------|-------|-------|-------|
| | CY17A | CY18E | CY19F | CY20F |
| EPS | 8.42 | 8.90 | 9.18 | 9.74 |
| DPS | 7.00 | 7.89 | 8.14 | 8.64 |
| BVPS | 23.07 | 24.08 | 25.11 | 26.21 |
| P/E (x)* | 11.62 | 10.99 | 10.04 | 9.90 |
| P/BV (x)* | 4.24 | 4.06 | 3.89 | 3.73 |
| Dividend Yield* | 7.2% | 8.1% | 8.3% | 8.8% |
| ROE % | 37% | 38% | 37% | 38% |

* Prices as of June 14, 2018

Source: Company Accounts & WE Research

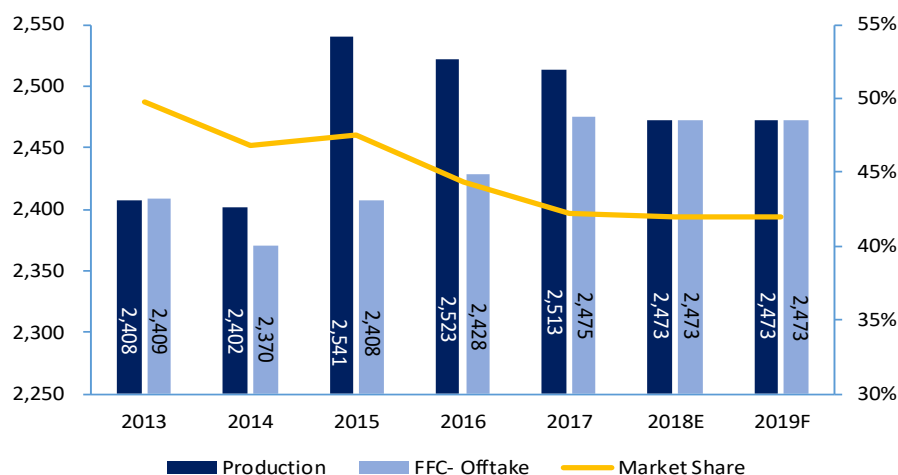
We initiate our coverage on Fauji Fertilizer Company Limited (FFC) by incorporating the CY17 financial results and current industry dynamics of Urea and DAP. Our Discounted Cash Flow (DCF) target price is PKR 105.16 for December 2018 which offers upside potential of 8% from current price with expected earning of PKR 8.90 per share and dividend yield of 8.1% in CY2018E which is key attraction for investors. The stock depicts a surge of 23% CY18TD outperforming the benchmark KSE -100 index by 16%. Hence, we initiate "HOLD" rating on FFC.

Fauji Fertilizer – The Market Leader in Urea Segment:

The Fertilizer giant continuously enjoys a leading position by holding 42% market share in urea segment. Currently the company is operating at 123% of production capacity to meet the on-going demand of urea. By keeping in mind the gas curtailment and scheduled plant maintenance we believe FFC will continue to operate at 121% of total capacity to produce 2,473 KT of urea and will manage to sell it in CY2018E. We have incorporated latest dynamics of industry such as lower inventory held, commencement of exports and cheaper loan facility to farmers, thus, we expect prices to follow upward trajectory and will remain above PKR 1,450 per bag with elimination of discounts. We believe change in the dynamics will be beneficial to FFC since it holds larger market share. The industry's inventory declined to 0.336KT in CY 17 to an optimum level and we expect it to remain at lower side which gives some room to manufacturers to eliminate discounts and have negotiation power and resultantly prices will increase further.

Urea Trend—Figures in KT

Source: NFDC, WE Research



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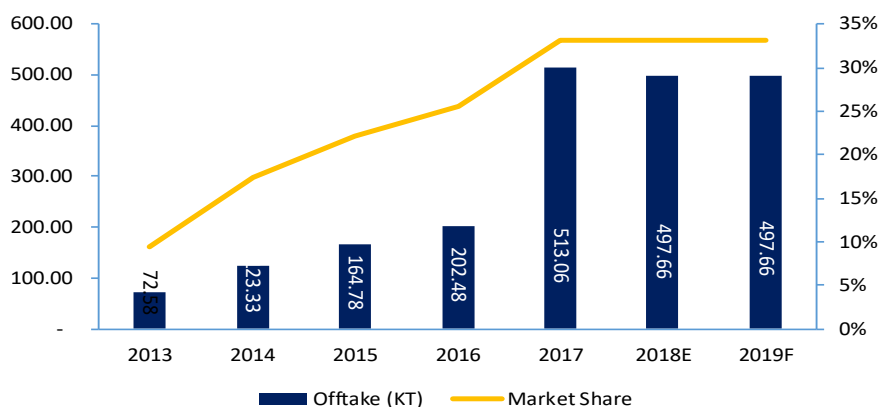
FFC has 33% market share in imported DAP segment .

DAP Dynamics:

On other hand, we have witnessed an increasing trend in DAP offtake over the past few years on back of improved crops. In CY17 DAP offtake increased by 153% YoY to 513KT. We have taken a conservative approach and reduced DAP offtake by 3% at 498KT in CY2018E on possibility of lower crop in upcoming season (kharif). The increasing demand of DAP and higher DAP prices in long run will benefit FFBL since it is the sole producer of DAP but it would also benefit those players who are Bulk importers of DAP, wherein FFC has around 33% of market share in imported DAP segment. Further, we have incorporated the latest prices of PKR 3,100/bag in our valuation.

DAP Trend— Figures in KT

Source: NFDC and WE Research



In CY17 urea and DAP offtakes recorded at 2,474KT and 513KT respectively.

CY17 Performance and Improving Margins ahead:

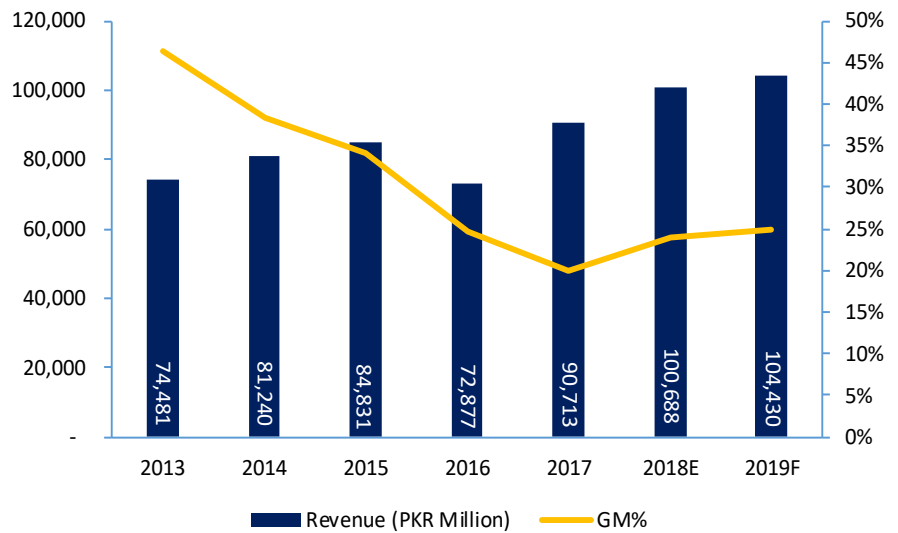
In CY17 the gross margins shrank as low as 19.9% from 24.8% in CY16 despite impressive urea and DAP offtakes of 2,474 KT and 513 KT respectively, resultantly PAT witnessed a decline of 9% to clock in at PKR 10.71 billion (EPS: PKR 8.42/Share) as opposed to PKR 11.78 billion (EPS: PKR 9.26). The decline in earnings was attributed to lower retention price as FFC offered significant discounts to dealers in order to off-load piled up inventories and resultantly the price went down to approx. PKR 1,320 per bag during 3rd Quarter of CY17. However, after approval from government to export the surplus inventory, the figures of total inventory came down drastically to 0.336 KT in CY17 from 1,038 KT in CY16. Owing to opening up of exports, discounts were further curtailed and flagship Sona Urea was traded at PKR 1,470/bag.

Gross margin and net profit margin to grow at 24% and 11.24% in CY18E

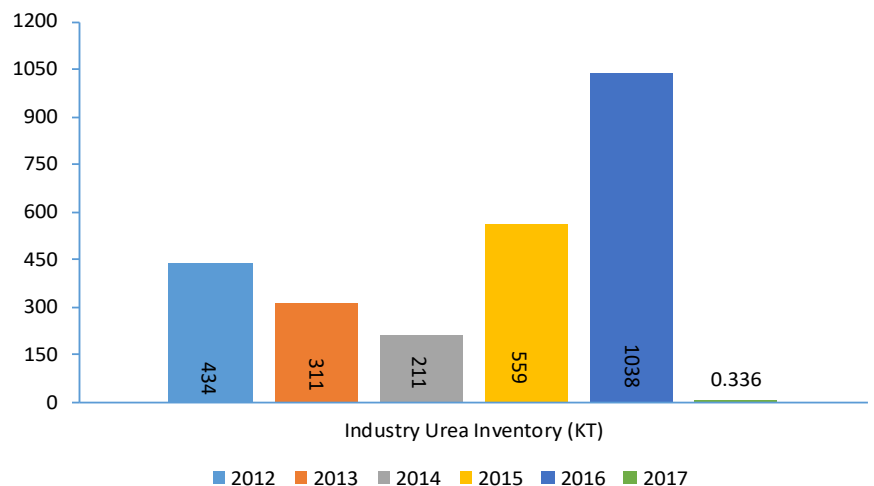
A first time dividend in 4QCY17 amounting to PKR 500 million from FFC’s subsidiary, FFC Energy, supported the bottom line.

Hence, we expect the gross margin and net profit margin to grow at 24 % and 11.24% in CY18E to clock in at PKR 24,163 million and PKR 11,320 million respectively, primarily due to lower inventory levels, pre-buying by dealers and farmers on anticipation of increase in urea prices, increasing trend in urea prices, better crop prices and cheaper loans available to farmers since the agricultural credit allocations are enhanced by 10% to Rs. 1,100 billion from Rs. 1,000 billion in the Budget 2018-19.

Revenue (PKR Mn) & GPM % Source: Company Accounts & WE Research



Industry Closing Inventory Source: NFDC, WE Research



Industry Inventory drastically came down to 0.336 KT in CY17

We believe dividends from subsidiary FFCEL likely to continue.

Imports may resume to fill up the demand and supply gap.

Investment Diversification:

Fauji Fertilizer Company limited is well diversified through investments in associated companies; Fauji Cement Company Limited with 6.79% of its share capital, Fauji Fertilizer Bin Qasim with 49.88% of FFBL's share capital and Askari Bank Limited with 43.15% of AKBL's share capital. Additionally, FFC has investment in joint venture (Pakistan Maroc Phosphore S.A., Morocco (PMP)) with 12.50% equity participation. Further, investment is diversified through 100% own subsidiaries FFC Energy Limited and Fauji Fresh n Freez Limited which adds value to business entity. FFC has also recently entered into an investment agreement to invest USD 121 million in Thar Energy Limited, a subsidiary of Hub Power Company Ltd. FFC management hints at further planned strategic diversification.

In 4QCY17, fully owned subsidiary FFC energy Limited had paid its first dividend of PKR 500 million which supported the bottom line. Going forward, we believe dividend flows from subsidiary FFCEL to continue which are incorporated in our valuation forecast.

Industry Outlook:

In CY17 the urea demand was 5,861 KT while annual production was recorded at 5,653 KT. We expect the annual demand for urea in CY18 to fall in the range of between 5.8 to 6 million tonnes. During 1QCY 18 urea production declined by 4% YoY primarily due to FFC and FFBL plant maintenance and absence of production from LNG based players due to higher LNG prices. If absence of production from LNG based players prevails throughout the year, then we expect approx. 10% reduction in annual production of CY2018E at 5.4 million tonnes, wherein, imports may resume to fill the demand and supply gap and local manufacturers will likely be in a position to raise prices further.

Assumptions

| | |
|---------------------|------------|
| Risk Free Rate | 9% |
| Market Risk Premium | 6% |
| Adjusted Beta | 0.94 |
| Cost of Debt | 7% |
| Cost of Debt (1-T) | 5% |
| Weight of Equity* | 79% |
| Weight of Debt | 21% |
| WACC | 12.55% |
| Target Price | PKR 105.16 |

Valuation:

We have valued Fauji Fertilizer Company Limited using Discounted Cash flow methodology to arrive at Dec'18 target price of Rs. 105/-share on the basis of projected free cash flow to the firm (FCFF) and discounted at WACC 12.55%, with 3% sustainable growth rate, 14.7% cost of equity and 7% cost of debt.

We estimated cost of Equity of 14.7% by using Capital Assets Pricing Model (CAPM) approach using a risk free rate of 9%, equity risk premium of 6% and adjusted beta of 0.94 based on FFC's last 3 year trading history.

Key Risks to Valuation:

The risks to our valuation are 1) Water shortage problem deteriorating current scenario 2) Gas curtailment 3) prevailing subsidy ambiguity 4) higher gas prices.

Source: Company Accounts & WE Research

** Prices as of June 14, 2018*

KEY FINANCIAL HIGHLIGHTS:

Figures in PKR million

| PROFIT & LOSS ITEMS | CY14 A | CY15 A | CY16 A | CY17 A | CY18 E | CY19 F | CY20 F | CY21 F |
|---------------------|--------|--------|--------|--------|---------|---------|---------|---------|
| NET SALES | 81,240 | 84,831 | 72,877 | 90,713 | 100,688 | 104,430 | 107,478 | 109,745 |
| COST OF SALES | 50,137 | 55,949 | 54,827 | 72,620 | 76,525 | 78,514 | 80,518 | 82,530 |
| GROSS PROFIT | 31,103 | 28,882 | 18,050 | 18,093 | 24,163 | 25,915 | 26,960 | 27,215 |
| OPERATING PROFIT | 24,672 | 22,068 | 10,896 | 9,519 | 14,279 | 15,664 | 16,409 | 16,441 |
| FINANCE COST | 849 | 1,475 | 2,405 | 2,471 | 1,706 | 2,058 | 1,989 | 2,034 |
| POST-TAX PROFITS | 18,171 | 16,766 | 11,783 | 10,710 | 11,320 | 11,674 | 12,393 | 12,566 |

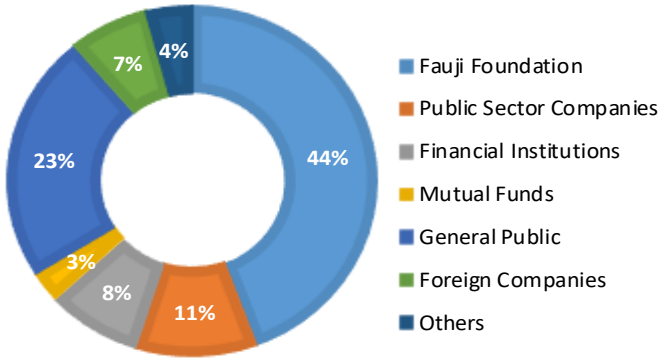
| BALANCE SHEET ITEMS | CY14 A | CY15 A | CY16 A | CY17 A | CY18 F | CY19 F | CY20 F | CY21 F |
|-----------------------------|--------|--------|--------|---------|--------|--------|--------|---------|
| PROPERTY PLANT & EQUIP: | 20,094 | 21,382 | 21,232 | 22,311 | 23,441 | 24,625 | 25,864 | 27,162 |
| LONG TERM INVESTMENTS | 28,135 | 29,129 | 29,656 | 27,868 | 27,868 | 27,868 | 27,868 | 27,868 |
| INVENTORY | 982 | 5,100 | 4,237 | 395 | 2,198 | 2,255 | 2,312 | 2,370 |
| TRADE DEBTS | 822 | 1,774 | 4,306 | 3,722 | 2,316 | 2,402 | 1,767 | 1,804 |
| SHORT TERM INVESTMENT | 27,433 | 10,335 | 14,143 | 30,883 | 20,084 | 20,306 | 20,531 | 19,380 |
| TOTAL ASSETS | 86,562 | 80,130 | 90,766 | 108,630 | 96,413 | 97,948 | 99,526 | 103,163 |
| LONG TERM BORROWINGS | 2,500 | 15,893 | 16,653 | 15,571 | 8,334 | 3,843 | 1,250 | - |
| PAYABLES | 37,904 | 8,114 | 10,912 | 39,218 | 33,304 | 34,170 | 35,042 | 35,918 |
| SHORT TERM BORROWINGS | 11,602 | 18,021 | 22,177 | 11,539 | 10,789 | 18,027 | 22,518 | 25,110 |
| TOTAL LIABILITIES | 60,892 | 52,818 | 62,558 | 79,278 | 65,782 | 65,999 | 66,178 | 68,396 |
| SHARE CAPITAL | 12,722 | 12,722 | 12,722 | 12,722 | 12,722 | 12,722 | 12,722 | 12,722 |
| REVENUE RESERVES | 12,484 | 13,895 | 14,842 | 16,176 | 17,454 | 18,772 | 20,172 | 21,591 |
| TOTAL EQUITY | 25,670 | 27,311 | 28,211 | 29,352 | 30,631 | 31,949 | 33,348 | 34,767 |
| TOTAL LIABILITIES AND S H E | 86,562 | 80,130 | 90,769 | 108,630 | 96,413 | 97,948 | 99,526 | 103,163 |

| KEY RATIOS | CY14 A | CY15 A | CY16 A | CY17 A | CY18 F | CY19 F | CY20 F | CY21 F |
|--------------------------|--------|--------|--------|--------|--------|--------|--------|--------|
| EPS (PKR) | 14.28 | 13.18 | 9.26 | 8.42 | 8.90 | 9.18 | 9.74 | 9.88 |
| DPS (PKR) | 13.65 | 11.86 | 7.90 | 7.00 | 7.89 | 8.14 | 8.64 | 8.76 |
| BVPS (PKR) | 20.18 | 21.47 | 22.17 | 23.07 | 24.08 | 25.11 | 26.21 | 27.33 |
| Current Ratio (x) | 0.67 | 0.84 | 0.91 | 0.95 | 0.81 | 0.75 | 0.72 | 0.72 |
| Quick Ratio (x) | 0.59 | 0.30 | 0.46 | 0.88 | 0.60 | 0.59 | 0.59 | 0.62 |
| Gross Margin | 38.29% | 34.05% | 24.77% | 19.95% | 24.00% | 24.82% | 25.08% | 24.80% |
| Operating Profit Margin | 30.37% | 26.01% | 14.95% | 10.49% | 14.18% | 15.00% | 15.27% | 14.98% |
| Net Margin | 22.37% | 19.76% | 16.17% | 11.81% | 11.24% | 11.18% | 11.53% | 11.45% |
| Time Interest Earned (x) | 31.91 | 17.61 | 8.23 | 7.37 | 10.48 | 8.99 | 9.66 | 9.46 |
| ROA | 23.54% | 20.12% | 13.79% | 10.74% | 11.04% | 12.01% | 12.55% | 12.40% |
| ROE | 71.51% | 63.29% | 42.44% | 37.21% | 37.74% | 37.31% | 37.96% | 36.90% |
| Debt/Equity | 38.22% | 58.45% | 61.60% | 53.63% | 46.25% | 44.59% | 42.86% | 43.12% |
| P/E (x) | 6.85 | 7.42 | 10.56 | 11.62 | 10.99 | 10.66 | 10.04 | 9.90 |
| P/B (x) | 4.85 | 4.56 | 4.41 | 4.24 | 4.06 | 3.89 | 3.73 | 3.58 |
| Dividend Yield | 13.96% | 12.13% | 8.08% | 7.16% | 8.07% | 8.32% | 8.84% | 8.96% |
| EV/EBITDA (x) | 3.86 | 5.35 | 6.98 | 6.16 | 6.46 | 6.20 | 5.90 | 5.82 |

Source: Company Accounts & WE Research

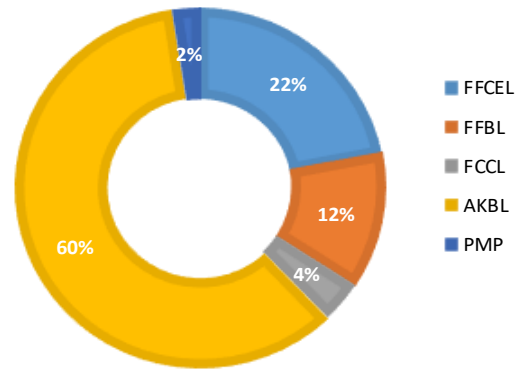
Shareholder Pattern

Source: Company Accounts & WE Research



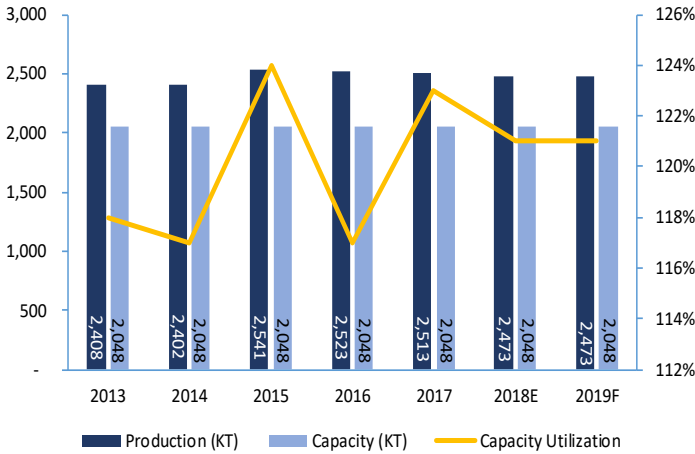
Earning Contribution

Source: Company Accounts & WE Research



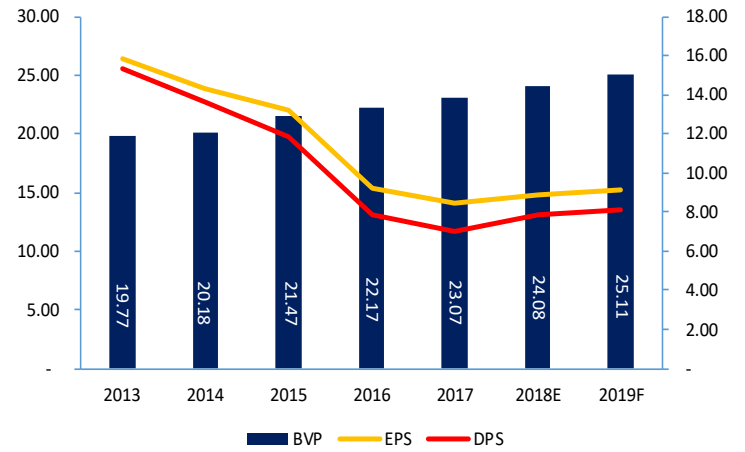
Production and Capacity Utilization

Source: Company Accounts & WE Research



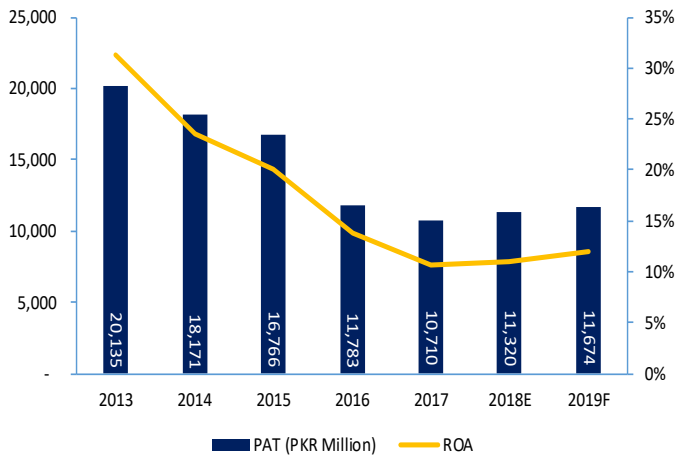
EPS DPS BVPS Trend

Source: Company Accounts & WE Research



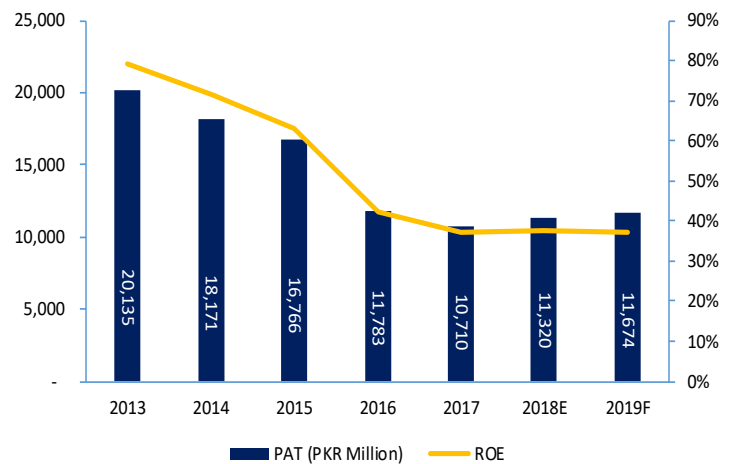
Net Income & ROA

Source: Company Accounts & WE Research



Net Income & ROE

Source: Company Accounts & WE Research



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Stock Ratings

WE Financial Services Ltd. uses three rating categories, depending upon return form current market price, with Target period as June 2018 for Target Price. In addition, return excludes all type of taxes. For more details kindly refer the following table;

| Potential to target price | |
|---------------------------|--|
| Buy Upside | More than +10% from last closing price |
| HOLD | In between -10% and +10% from last closing price |
| SELL | Less than -10% from last closing price |

Equity Valuation Methodology

WE Research uses the following valuation technique(s) to arrive at the period end target prices;

- Discounted Cash Flow (DCF)
- Dividend Discount Model (DDM)
- Relative valuation (P/E, P/B, P/S)
- Equity & Asset return based (EVA, Residual income)

Risks

The following risks may potentially impact our valuations of subject security(ies);

- Market Risk
- Interest Rate Risk
- Exchange rate risk

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