EFERT– Price Hike and Rain Shortfall to Hamper Fertilizer off-take

ABBASI SECURITIES

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Result review

In 1HCY18, EFERT posted PAT of Rs7.1bn (EPS of Rs5.3) vs. PAT 4.1bn (EPS of 3.07) in SPLY, this earning was accompanied by DPS of Rs4. Increase in profitability emanated from improve selling prices and volumes. Price increase was due to elimination of subsidy and inflation pass on to end consumers. High sales volumes during 1HCH18 were due to anticipation of fertilizer price hike in 2HFCY18. Urea and DAP sales clocked in at 994KT and 174KT up by 25% and 83% YoY respectively. Finance cost came in at 0.886nn vs. 1.309bn in SPLY due to loan repayment and lower working capital requirement. One time tax credit of Rs1bn was booked in 2QCY18 due to reduction in tax rate in phases from 30% in FY17 to 25% in FY22. Going forward, water shortage and price increase may limit fertilizer sales to clock in at 5.6Mt and 1.8-1.9MT respectively

Rain shortfall to hamper sales going forward

- As per NFDC data rainfall during 7MFY18 was 3,171mm which is 9.61% YoY lower. Regions most affected by rain shortfall are Southern Punjab and Sindh. We foresee water shortage to curtail crop sowing in the upcoming Rabi season, which in turn result in reduced fertilizer off take. Cotton production is estimated to fall 25 percent short of its target of 14.37 million bales for the current season due to water shortage and pest attack.

Subsidy withdrawal—Price increase

- Subsidy withdrawal along with inflation impact has increased prices of urea and DAP to Rs1630/bag and Rs3300/bag respectively. In the recent past prices at similar level didn't bode well for the fertilizer off take and supply glut was created. This price increase will result in subdued demand and possible inventory pileup going forward. Accordingly we have reduced our urea off take assumption by 5% in CY19.

Possible Gas price hike is on the cards

- Economic Coordination Committee (ECC) has left the ball in prime minster`s court to approve increase in gas price hike given political sensitivity of the issue. Price hike being proposed is around 186% for domestic consumers but for fertilizer industries it comes to around 26.4%. We haven`t incorporated gas price hike in our valuation. If this increase in gas price is materialized it will weigh down on our valuations by 15% (if industry unable to pass on cost increase). However ECC has deferred the proposed gas price increase
- If gas price for industry is increased by 26.4% it will result in Rs61 and Rs83/bag increase in cost for EFERT and FFC respectively.

Propositions to arrest depleting urea Inventory

- New incumbent government has shown its intentions to reenergize three closed fertilizer plants namely Fatimafert, Pakarab and Agritech for short period of time to address depleting inventory stock of urea in the country. Details as to mechanism i.e. gas mix, subsidy and time frame (two or four months) are still ambiguous.
- Another proposed measures to counter depleting urea inventory is to import around 100,000 tons of urea for the Rabi season.

Valuation

- EFERT`s stock price is up by 13.56% YTD, whereas KSE 100 index is up by 1.43% YTD. This increase has priced in 1HFY18 result and increased fertilizer prices.
- Our earnings estimates for CY18/19/20E are Rs.10.08/9.19/9.70 per share respectively. Accordingly our DCF based Dec-19 TP comes to around Rs84/share which offers a limited upside of 9%. EFERT offers a lucrative dividend yield of 10.4%. However, we have a hold stance on the stock given limited upside on the stock and overall weak agro economics.

Key risks

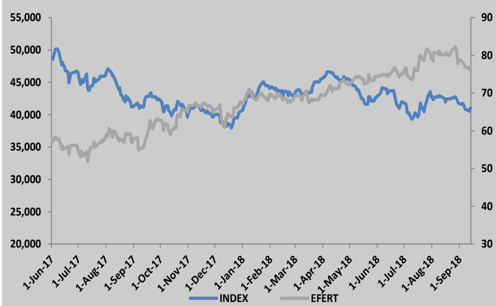
- Gas price hike for industry
- Negative outcome of pending GIDC legal proceedings
- Government netting subsidy claims with windfall gains on charging higher prices and export of urea.

On the flip side there are few positives as well:

- Further hike in urea prices with similar off takes
- Pesticide business making significant contributions to company`s bottom line going forward

KATS Symbol	**EFERT**
Reuters Symbol	EFERT.KA
Target Price	**Rs.84**
LDCP	Rs. 77.05
Outstanding Shares (mn)	1335.30
Free Float (mn)	600.88
Market Cap (mn Rs)	102,885

Price Performance vs KSE100 Index



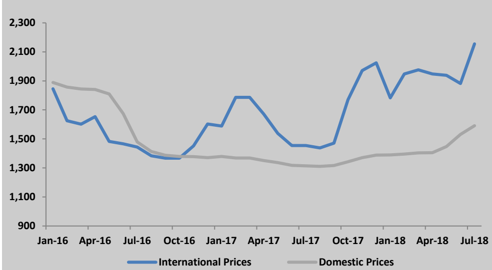
Source: PSX

EPS Estimates

	CY17A	CY18E	CY19E
EPS (Rs)	7.59	10.08	9.19
P/E (x)	10.15	7.64	8.38
DPS (Rs)	8.50	8.00	8.50
D/Y (%)	11.03%	10.38%	11.03%

Source: Co Financials, AS Research

Int vs. Domestic Urea Price



Source: NFDC, AS Research

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Valuation Methodology

To arrive at period end target price, Abbasi Securities uses different valuation methodologies:

- Comparable Method (P/E, P/B, Justified P/B & P/E etc.)
- Discounted Cash flow Method
- Equity and Asset based valuation

Rating

BUY	Total return more than 20% from last closing of market price
HOLD	Total return is in between 10% and 20% from last closing of market price
REDUCE	Total return is less than 10% from last closing market price

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