ABBASI SECURITIES

REP-091
August 10, 2018

- ***FATIMA's share price has increased by 13% from CYTD as compared to KSE 100 Index which has increased by only 6%. The surge in stock price is backed by higher urea off take (up by 7%), increase in urea prices and increase in CAN prices which is a high margin product and considered as a close substitute to DAP***
- ***FATIMA's long term debt has significantly declined in last few years resulting in a decline in finance cost. We expect FATIMA will continue to deleverage its long term debt in coming years which could increase its dividend paying capacity by Rs1/share***
- ***Subsequent to the end of concessionary gas price period (July 2021) FATIMA's gross margins are expected to decline to 40% as compared to the current avg. of around 56%***
- ***Possible recommencement of Fatimafert plant (wholly own subsidiary) along with 2 other plants by the government in order to meet the short fall of around 0.5mn tons of urea in Rabi season with a mix of RLNG and local Gas will add around Rs0.5/share in the consolidated profit of the company***
- ***We have a HOLD stance on FATIMA with a DCF based Dec 18 target price of Rs38. Stock is currently trading at CY18E and CY19E P/E of around 5.74x and 5.89x and providing an upside potential of around 8% from LDCP***

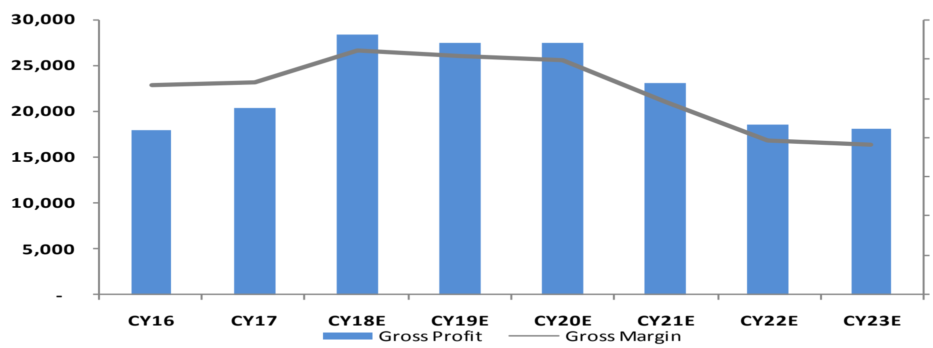
Volumetric sales to remain strong due to upcoming of Rabi Season

- We expect urea sales to remain strong due to upcoming season of Rabi along with possible announcement of farmer friendly policies by the upcoming government in order to support the agriculture sector
- As far as the prices are concerned, urea price has already increased by Rs200 to Rs250 per bag due to the decline in urea inventory, revocation of cash subsidy and increased inflation. Whereas the prices of CAN have also increased on the back of DAP prices in international market.

Gross margins to come under pressure after end of concessionary gas period

- FATIMA obtains gas at concessionary price of 0.70cent per MMBTU as per the fertilizer policy of 2001 for 10 years since the commencement of plant. Fatima's concessionary gas contract will expire in 3 years (July 2021) after that we expect the margins to decline to 40% as compared to current avg. of around 56% at current prices (as mentioned in Fig. 1). However we expect FATIMA can increase the CAN prices as it is the only producer of CAN in Pakistan right know as Pak Arab fertilizer's plant is closed due to non availability of gas.

Fig.1 Gross Profit and Gross Margins



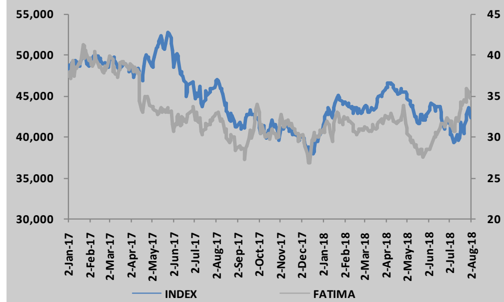
Source: Co Financials, AS Research

Decrease in finance cost will increase the dividend paying capacity of FATIMA

- FATIMA's debt to equity ratio has declined from 52% in CY12 to 23% in CY17 which has resulted in decline in overall finance cost. Currently FATIMA's total long term debt stands at Rs16.42bn with avg. annual repayment of around Rs5bn. We expect the decline in debt and finance cost will enhance dividend paying capacity by about Rs1/share.

KATS Symbol	**FATIMA**
Reuters Symbol	FATF.KA
Target Price	**Rs38**
LDCP	Rs35
Outstanding Shares (mn)	2,100
Free Float (mn)	315
Market Cap (mn Rs)	72,912

Price Performance vs KSE100 Index



Source: PSX

EPS Estimates

	CY17A	CY18E	CY19E
EPS (Rs)	4.41	6.10	5.95
DPS (Rs)	2.25	2.50	2.50
P/E (x)	7.93	5.74	5.89
Div. Yield	6.43%	7.14%	7.14%

Source: Co Financials, AS Research

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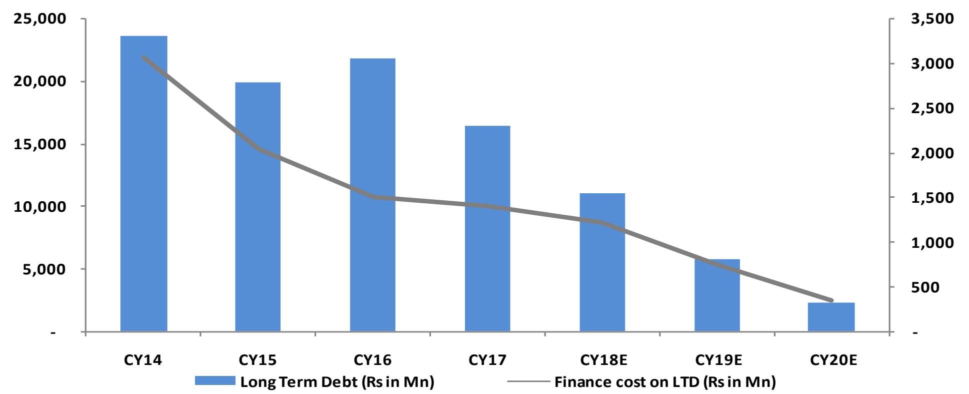
Fig.2 Long Term Debt and Finance Cost



Source: Co Financials, AS Research

Probable recommencement of Fatimafert plant

- As per media reports, government is planning to restart the bunged plants of urea (3 plants of around 1mn ton) which were closed due to the non availability of gas, in order to meet the robust demand in upcoming Rabi season. As a matter of fact, imported RLNG is much more expensive as compared to local gas. Therefore, the govt. has recently proposed formula mix of RLNG and local gas (72:28) which would be used in the production of fertilizers. Moreover, the govt. would also provide a subsidy of around Rs950/bag as compared to Rs1,100/bag previously given on imported fertilizer.
- Fatimafert (formerly Dawood Hercules), a wholly owned subsidiary of FATIMA with the capacity of 500,000 tons of urea was also affected due to the non availability of gas and is closed since May 2017. As per our calculation, gas with the newly proposed formula mix of RLNG and local gas (72:28) would cost around Rs1,190/MMBTU as compared to the local gas which costs around Rs429.58/MMBTU. However, the subsidy of Rs950/bag would help the local producers to meet this surged cost.
- On 100% utilization level we expect Fatimafert to contribute around Rs0.5/share in consolidated earnings of FATIMA and will add Rs.4 in our DCF based target price.

Valuation

- We have a HOLD stance on FATIMA with a DCF based Dec 18 target price of Rs38. The Stock is currently trading at CY18E and CY19E P/E of around 5.74x and 5.89x providing an upside potential of around 8% from LDCP.

Risks

- Lower off-take of fertilizer
- Lower than estimated increase in urea prices
- Gas Curtailment

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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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