



Pakistan Equity | Fertilizer | FFBL FFC Amalgamation

Jul 22, 2024

REP-057

FFBL and FFC amalgamation SWAP ratio estimation



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Topline Research
research@topline.com.pk
Tel: +9221-35303330 Ext:133
Topline Securities, Pakistan

FFBL board has granted in principle approval for amalgamation

- Fauji Fertilizer Bin Qasim (FFBL) board has granted in principle approval to evaluate and prepare a proposal for amalgamation of FFBL with and into Fauji Fertilizer Company (FFC) by way of Scheme of Arrangement (SoA).
- For the background, both fertilizer companies are part of Fauji Foundation group and FFC currently holds 49.9% stake in FFBL. With this merger activity, FFBL business operations will be merged into FFC and shareholders of the FFBL will get shares of FFC, in our view.
- To highlight, Fauji Group has been doing this activity of restructuring and consolidation for last few years wherein in the past, Askari Cement Limited (ACL) was merged into Fauji Cement (FCCL).
- According to SECP regulations, fair value of shares shall be determined by averaging the fair value arrived at through any three of the suggested 4 methods, (1) Net Worth Method (or break up value method), Market Value Method, Discounted Cash Flow, and Comparable Transaction Method.
- The valuation and subsequently swap ratio of the ACL and FCCL was determined by EY Ford Rhodes using average of the income approach (DCF), Cost Approach (Adjusted net asset value) and Market Approach. This resulted into 5 shares of FCCL against 1 share of ACL.
- The SWAP ratio of FCCL and ACL was determined within 22 days of the board announcement, as per the timeline of the notices shared with exchange. However, overall process took around 7 months as this transaction needed approval of competition commission and was required to be sanctioned by high court.
- In our view, FFBL and FFC amalgamation once approved by board and shareholders will be vetted by competition commission as this would be a horizontal merger (operating in same industry) like ACL and FCCL.
- **End Results of Surviving Entity:** If all approvals are accorded, the surviving entity post this amalgamation would be FFC with combined market share of 52% in Urea based on 6M2024 sales data and 71% in DAP. The capacity-based market share of Urea would be 41%.
- Furthermore, the merged entity, if okayed by regulator/board, will hold 65% market share in Askari Bank (AKBL), 37.5% in Pakistan Maroc Phosphore, S.A. (PMP), and 82% stake in Fauji Foods (FFL) amongst others.
- We have used 3 approaches (1) Market Approach (Forward P/E Multiples) and (2) Income approach (DCF), and (3) Breakup Value method (Book Value) to arrive at likely SWAP ratio of this transaction. The probable range based on our calculation is ~3.2-3.6 shares of FFBL against 1 share of FFC. The average of these methods comes around 3.39. This suggest long approach on FFBL to eliminate any arbitrage opportunity. However, the quantum of dividends announced by FFC may limit the arbitrage opportunity.
- Nonetheless, actual SWAP ratio will be determined by external/independent valuers and will simultaneously be approved by board.
- In the recent past, Dawood Hercules (DAWH) demerger into 2 legal entities “DH Corp” and “DH Partner” was a different case and shareholders of Engro will get shares 2.24 shares of DH Corp (against 1 share of Engro) to maintain proportionate shareholding in Engro Corp indirectly through DH Corp.

SWAP ratio below 4 is favorable for FFBL investors

| SWAP Ratio Sensitivity | | | | |
|------------------------|--------------------|--------------------|---------------------|-------------------|
| If FFBL moves | | | If FFC moves | |
| SWAP Ratio | FFC - Current Rate | FFBL - Target Rate | FFBL - Current Rate | FFC - Target Rate |
| 2.8 | 167.6 | 59.9 | 41 | 114.9 |
| 3 | 167.6 | 55.9 | 41 | 123.1 |
| 3.2 | 167.6 | 52.4 | 41 | 131.3 |
| 3.4 | 167.6 | 49.4 | 41 | 139.5 |
| 3.6 | 167.6 | 46.6 | 41 | 147.7 |
| 3.8 | 167.6 | 44.1 | 41 | 155.9 |
| 4.0 | 167.6 | 41.9 | 41 | 164.1 |
| 4.2 | 167.6 | 39.9 | 41 | 172.3 |

Source: Topline Research

| FFC SoTP | | | |
|---------------------|----------------|----------------|--------------|
| Rsmn | % shareholding | Valuation | Remarks |
| Fertilizer Business | | 216,907 | DCF |
| Fauji Cement | 4.3% | 2,393 | Market Value |
| FFBL | 49.9% | 26,501 | Market Value |
| Askari Bank | 43.1% | 17,290 | Market Value |
| Thar Energy | 30% | 15,436 | 3.7x PE |
| FFL | 18.45% | 4,115 | Market Value |
| PMP | 12.50% | 11,963 | 5.0x PE |
| Energy businesses | 80-100% | 39,146 | 3.7x PE |
| FFNF | 100% | 7,007 | P/S 1.3x |
| Total Value | | 340,759 | |
| No of Shares | | 1,272 | |
| SoTP/Share | | 268 | |

Source: Topline Research

- **Market Approach of Valuation:** Based on our back of the envelope working, Sum of The Parts (SoTP) value of FFC is estimated at Rs253, with core fertilizer business valued at 61% of total, and portfolio companies at 39%. While, SoTP value of the FFBL is estimated at Rs75/share with core fertilizer business constituting 62% of the total value while rest is coming from portfolio companies. In this approach, we have used market approach in valuing fertilizer business of both companies with multiple of 6.2x, last 10 years forward multiple of fertilizer sector. This translates into likely SWAP ratio of 3.36x, suggesting long approach FFBL.
- **Income Approach of Valuation:** Similarly, if we value core fertilizer business using income approach (DCF) for FFC, we arrive at SoTP value of Rs271/share with core fertilizer business contributing 63%. Similarly, for FFBL using DCF for core fertilizer business, we arrive at SoTP value of Rs74.5/share, suggesting SWAP ratio of 3.59x.
- **Breakup Value Method:** FFC book value as of Mar 2024 is Rs121 and FFBL book value is Rs37, this suggest SWAP ratio of 3.26 shares of FFBL against 1 share of FFC.
- **SWAP ratio below 4 is favorable for FFBL investors:** We believe, SWAP ratio arrives below 4x, it will be favourable for FFBL investors, while ratio above 4x will be favourable for FFC investors.

| FFBL SoTP | | | |
|--------------------|----------------|---------------|--------------|
| Rsmn | % shareholding | Valuation | Remarks |
| Fertilizer | | 59,274 | DCF |
| PMP | 25.00% | 4,785 | 5x PE |
| AKBL | 21.57% | 8,645 | Market Value |
| FFBL power | 75.00% | 10,906 | 3.7x PE |
| FFL | 63.71% | 12,697 | Market Value |
| Total Value | | 96,307 | |
| No of Shares | | 1,291 | |
| SoTP/Share | | 75 | |

Source: Topline Research

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|---------|--|
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|---------------|---------------------------------------|
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