

Pakistan Fertilizer Sector

FFBL: Merger alongside strong fundamentals - BUY

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FinanceAsia

Best Investment Bank: 2022

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Fauji Fertilizer Bin Qasim Limited

Merger alongside strong fundamentals

- We re-iterate a “Buy” stance on Fauji Fertilizer Bin Qasim (FFBL) with our Jun’25 target price of PKR 63.36/share. Our liking for the stock stems from i) potential amalgamation of FFBL and FFC, ii) stable DAP margins, iii) expectation of higher dividend income from subsidiaries, and iv) improvement in FFL’s business operations.

Evaluation of potential amalgamation with FFC

- Fauji Fertilizer Bin Qasim Limited (FFBL) and Fauji Fertilizer Company Limited (FFC) both held board meeting on 19th Jul’24 in which they have given an in-principle approval to evaluate potential merger scheme of arrangement.
- The companies will be appointing advisors to evaluate the proposed amalgamation, after which the findings will be presented to the respective boards for consideration.
- FFBL has 1,291mn outstanding shares while FFC has 1,272mn outstanding shares. Moreover, FFC holds 49.9% stake in FFBL.
- The notices have not disclosed details of the amalgamation. Based on our DCF valuation, the swap ratio comes to be 3.3 shares of FFBL for every 1 share of FFC.
- In case a 1:3.3 swap ratio is decided, then the book value of the merged entity would be PKR 121.53/share with FFC issuing 196mn new shares to FFBL’s minority shareholders.
- As of Mar’24, consolidated book value of FFC and FFBL stands at PKR 125.29/share and PKR 44.65/share, respectively.
- Pertinently, FFC has an annual capacity of 2.04mn tons of urea, while FFBL’s urea and DAP capacity stands at 0.55mn tons and 0.65mn tons, respectively.
- Post-merger, the total capacity of the merged entity is expected to be 2.60mn and 0.65mn tons of urea and DAP, respectively, we view.
- As an amalgamated company, the entity is projected to have a leading market share in urea and DAP of ~43% and ~60%, respectively.
- The horizontal merger will also eliminate the double taxation and synergies will be created.

	FFBL
Recommendation	Buy
Target Price (Jun-25)	63.4
Last Closing	40.9
Upside (%)	54.9
Shares (mn)	1,291.3
Free float (%)	35.0
Market Cap. (PKR mn)	52,864
Market Cap. (USD mn)	190.1
Source: PSX, AHL Research	

Exhibit.: Consolidated Book Value based on swap ratio of 1:3				
		FFC	FFBL	Merged Entity
Total Equity	PKR mn	159,405	57,654	178,454
Book value	PKR / share	125.29	44.65	121.53
Source: Company Financials, AHL Research				

Exhibit: Key Indicators			
As of Mar’24		FFC	FFBL
Market capitalization*	PKR mn	207,324	52,864
Total debt	PKR mn	25,214	32,639
Cash	PKR mn	2,067	30,956
Short term investments	PKR mn	96,791	38,386
Source: Company Financials, AHL Research *LDCP			

Fauji Fertilizer Bin Qasim Limited

Merger alongside strong fundamentals

3-Yr earnings CAGR of 49%

- The company's earnings are expected to achieve a 3-Yr forward CAGR of 49%. We expect EPS at PKR 9.29 and PKR 11.22 in CY24 and CY25, respectively.
- The significant growth in profitability is expected on the back of better DAP margins, higher dividend income from subsidiaries such as FFBL Power Company Limited (FPCL) and Askari Bank Limited (AKBL), and potential decline in finance cost amid lower short term borrowings.

Stable DAP margins:

- The international DAP price came down to USD 539/tons in Jun'24 from USD 592/bag in Jan'24, down by 9%.
- The decline in international DAP price comes primarily on the back of reduction in phosphoric acid prices, which was USD 948/ton in Jun'24 compared to USD 985/ton in Jan'24, down by 4%.
- Keeping in view the decline in international DAP and phosphoric acid price, the FFBL has reduced DAP price from PKR 13,075/bag in May'24 to PKR 11,275/bag.
- At the current FFBL's DAP price and phosphoric price (USD 948/ton), the DAP margin is ~USD 289/ton.
- We expect FFBL's primary DAP margin to be USD 306/ton and USD 290/ton in CY24 and CY25, respectively.

Potential for higher dividend:

- FFBL has cash and cash balances of PKR 65bn as of Mar'24 vis-à-vis PKR 21bn in Mar'23.
- We expect the company to announce a cash dividend of PKR 4.00/share and PKR 6.00/share in CY24 and CY25, respectively.

Significant reduction in short term borrowing

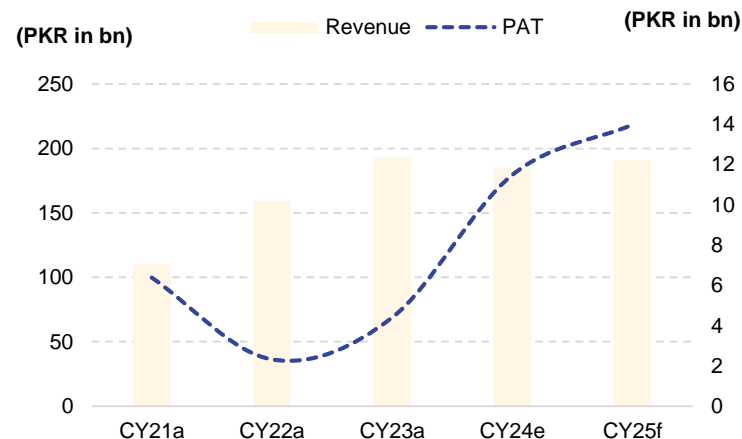
- The company has significantly reduced its short term borrowings to PKR 2.7bn as of Mar'24 compared to PKR 13.4bn in Dec'23.
- Albeit, the company's debt-to-asset ratio has come down to 13.26% in Mar'24 compared to 43.84% in Mar'23.

Exhibit: Ratio Analysis

		CY23a	CY24e	CY25f
Earnings per share*	PKR	3.41	9.29	11.22
Dividend per share	PKR	-	4.00	6.00
Book value per share	PKR	21.0	29.1	38.3
Price to Earning	x	9.4	4.4	3.7
Price to Book	x	1.5	1.4	1.1
Dividend Yield	%	-	9.8	14.7
Net Margins	%	2.3	6.5	7.6

Source (s): Company Financials, AHL Research, *unconsol

Exhibit: Revenue in relation to Profitability



Source (s): Company financials, AHL Research

Fauji Fertilizer Bin Qasim Limited

Merger alongside strong fundamentals

- Therefore, the company's finance cost are expected to be on lower side.

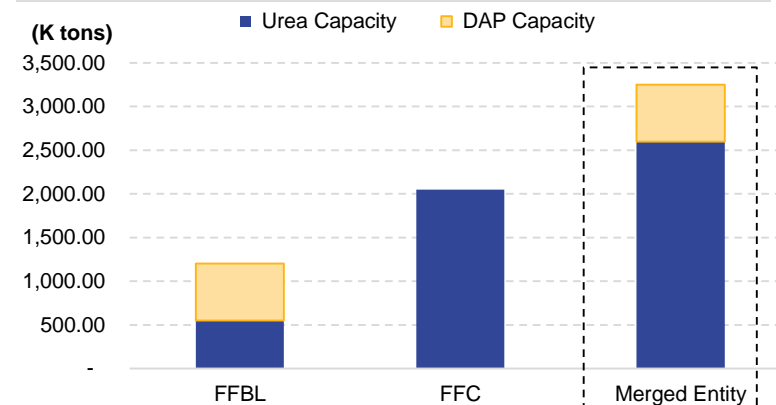
Urea and DAP offtake

- We expect DAP offtake in CY24 and CY25 to 0.6mn tons each.
- For urea sales, we view that it will remain stable at 0.3mn tons. Meanwhile, we expect the urea sales to climb up by 35% YoY to 0.4mn in CY25.

Subsidiary Fauji Food Limited (FFL) profitable after 11 years

- FFL became profitable first time after 11 years posting earnings of PKR 605mn (EPS: PKR 0.24) in CY23, due to operational efficiencies, and focus on high margin products.
- During CY24, FFL acquired Fauji Infraavest Foods and Fauji Cereals, adding cereals and pasta to its portfolio.
- In CY23, FFL used funds generated through the issuance of shares other than the right issue to pay off all the debt. Hence, FFL is debt-free and shariah compliant.
- Albeit, FFL is expected to remain profitable in CY24, with strong net sales.

Exhibit: Fertilizer Capacity Pre and Post Merger

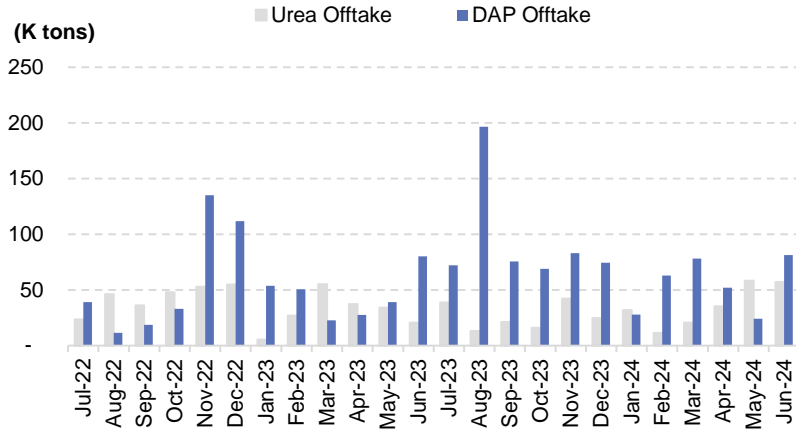


Source (s): Company financials, AHL Research

Fauji Fertilizer Bin Qasim Limited

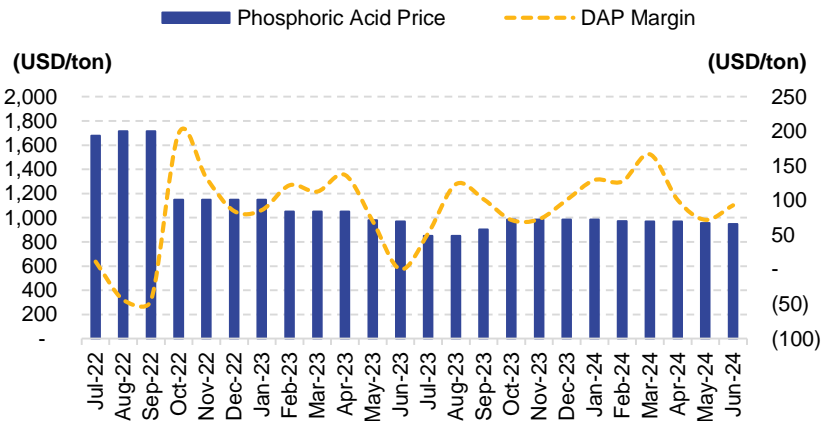
Merger alongside strong fundamentals

Exhibit: FFBL's Fertilizer Sales



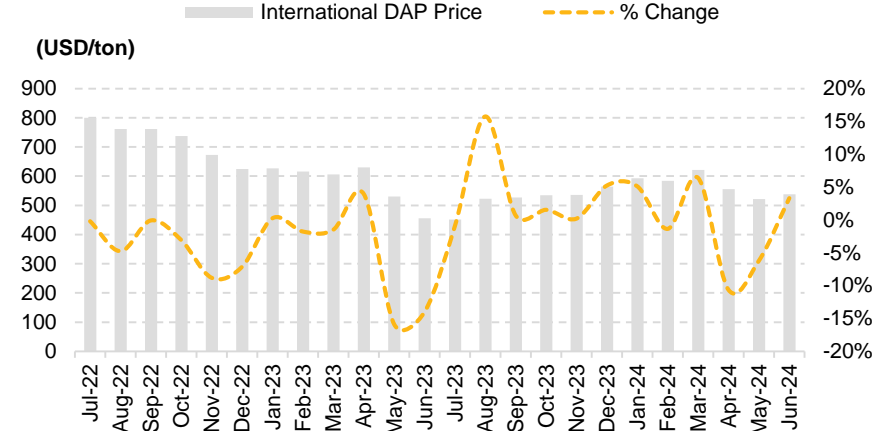
Source (s): Company financials, AHL Research

Exhibit: International DAP margins



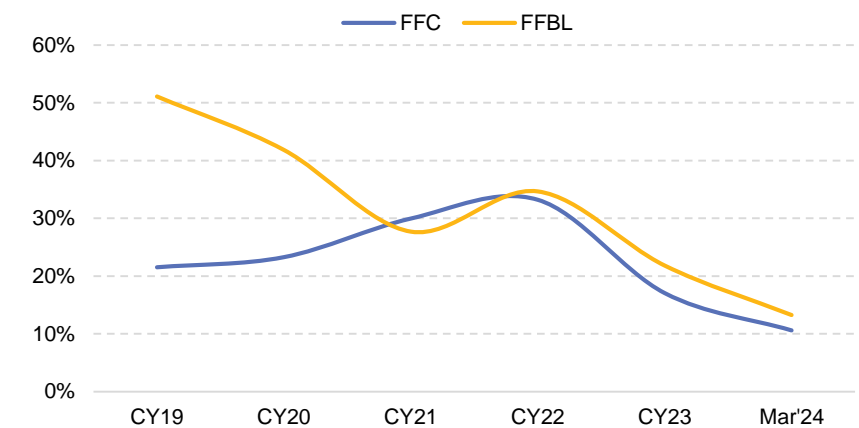
Source (s): Company financials, AHL Research

Exhibit: International DAP price trend



Source (s): Company financials, AHL Research

Exhibit: Debt-to-Asset ratio trend of FFBL and FFC



Source (s): Company financials, AHL Research

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Arif Habib Limited (AHL) uses three rating categories, depending upon return from current market price, with Target period as Jun 2025 for Target Price. In addition, return excludes all type of taxes. For more details, kindly refer the following table;

Rating	Description
BUY	Upside* of subject security(ies) is more than +15% from last closing of market price(s)
HOLD	Upside* of subject security(ies) is between -15% and +15% from last closing of market price(s)
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Equity Valuation Methodology

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

- Discounted Cash Flow (DCF)
- Dividend Discount Model (DDM)
- Sum of the Parts (SoTP)
- Justified Price to Book (JPTB)
- Reserved Base Valuation (RBV)

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

- Market risk
- Interest Rate Risk
- Exchange Rate (Currency) Risk

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