

PAKISTAN FERTILIZER SECTOR

Pricing power remains strong owing to low inventory levels

Thursday, August 26, 2021

As per the recent data released by NFDC, urea sales surged by 8% YoY to 0.62Mn tons in Jul’21 owing to better farm economics and pre-buying by dealers in anticipation of rise in urea prices. This takes the inventory levels to 0.32Mn tons at the end of the month. Given the low levels of inventory, we reiterate that the pricing power of industry players is still strong, evident by the recent hike in urea prices by PKR 50/bag in Aug’21. On the other hand, DAP offtake dropped by 22% YoY to 0.19Mn tons on account of higher prices and high-base effect. Note that domestic DAP prices continue to trade between PKR 5,750-6000/bag, following an increase of PKR 200/bag by the Fauji group. Overall, during 7MCY21, urea offtake has remained strong with a surge of 9% YoY to 3.5Mn tons; whereas DAP sales have declined by 6% YoY to 0.80Mn tons.

Urea offtake rose by 8% YoY in Jul’21: Urea production inched up by 3% YoY to 0.51Mn tons in Jul’21, while it largely remained stable MoM owing to closure of RLNG based fertilizer plants (expected to resume production from Sep’21). Alternatively, urea sales rose by 8% YoY to 0.62Mn tons during the same period on account of better farm economics and pre-buying by dealers in anticipation of hike in urea prices in Aug’21. Sequentially, there was a drop of 10% as the kharif sowing season neared its end. Company-wise, FFC and FFBL witnessed a surge in sales by 2.1x and 1.6x to 237K and 50K tons, respectively, whereas EFERT and FATIMA recorded a decline of 28% and 20% YoY to 240K and 78K tons, respectively, owing to high-base effect. To recap, EFERT had lowered its prices in 1HCY20 to compete with other players following the GIDC elimination which led to higher offtake in Jul’20.

DAP volumes clocked-in at 0.19Mn tons: DAP offtake was recorded at 0.19Mn tons in Jul’21, depicting a drop of 22% YoY owing to high-base of 0.25Mn tons in SPLY (resulting from clarification on the subsidy front). On the other hand, the sequential uptick in sales is likely on account of arrival of import orders during the month. On the pricing front, international DAP prices are trending at high levels with recent trade orders concluding at a price of nearly USD 660/ton. The Fauji group recently raised local DAP prices by PKR 200/bag, taking current market prices to new highs of around PKR 6,000 per bag. We expect limited exports from China and higher import demand in India and Pakistan to support international DAP prices in the near-term, however, the prices are expected to normalize after the end of Kharif season.

Table 1: Fertilizer statistics for Jul’21

Ktons	July-21	July-20	YoY (%)	June-21	% MoM	7MCY21	7MCY20	YoY (%)
Urea Off-take								
FFC	237	111	113%	247	-4%	1368	1382	-1%
EFERT	240	334	-28%	256	-6%	1407	1203	17%
FATIMA	78	98	-20%	105	-25%	402	340	18%
FFBL	50	32	56%	54	-7%	269	297	-10%
Total	622	575	8%	690	-10%	3,520	3,241	9%
DAP Off-take								
FFC	26	17	48%	1	N/A	91	60	53%
EFERT	36	72	-49%	12	202%	132	181	-27%
FFBL	93	105	-11%	23	302%	323	356	-9%
Total	193	248	-22%	68	184%	795	846	-6%

Source: NFDC, BMA Research

Fertilizer Performance vs. KSE-100 Index



%	3M	6M	12M
Absolute	1	2	7
Relative to KSE	-3	-3	-13

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FFBL, being the sole producer of DAP in the country, is expected to continue to capitalize on higher prices. Currently, local DAP margins are hovering around USD 180/ton; while as per our estimates, every USD 10/ton change in the margins has an earnings impact of ~PKR 0.7/sh.

Table 2: Urea closing inventory levels

Ktons	July-21	July-20	YoY (%)	June-21	% MoM	7MICY21	7MICY20	YoY (%)
FFC	74	119	-38%	93	-20%	74	119	-38%
EFERT	72	122	-41%	118	-39%	72	122	-41%
FATIMA	119	61	94%	147	-19%	119	61	94%
FFBL	12	16	N/A	11	3%	12	16	N/A
Total	321	334	-4%	432	-26%	321	334	-4%

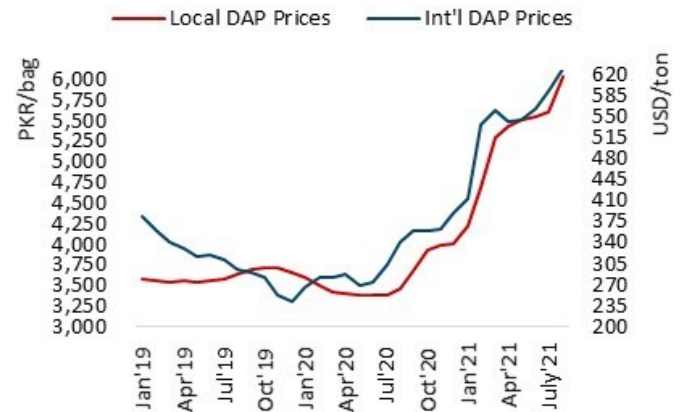
Source: NFDC, BMA Research

Urea inventory moderated to 0.32Mn tons: Urea inventory dropped to 0.32Mn tons in Jul'21 mainly due to closure of RLNG-based plants, which are expected to resume production in Sep'21. As per our calculations, even if the RLNG based plants stay operational for the remaining period of CY21 (which seems unlikely due to peak gas demand in winters), inventory levels are expected to remain low near 0.30Mn tons. Consequently, we reiterate that the pricing power of fertilizer players is high, and any potential increase in costs, including rise in gas tariff, may be passed on to end consumers. Recently, urea prices increased by PKR 50/bag in Aug'21, taking current market prices to PKR 1,779/bag, which is still at a sizable 62% discount compared to international prices.

Investment Perspective: We reiterate our positive outlook on the Fertilizer sector given improving farm economics and strong pricing power of players. Our top picks in the sector are FFC and FFBL at Jun'22 TP of PKR 135 and PKR 35 (upside of 27% and 34%), respectively. Key **downside risks** include: 1) curtailed gas supply, 2) weak agronomics, and 3) unexpected increase in gas rates and other input costs.

Chart 1: Local urea still priced at a 62% discount

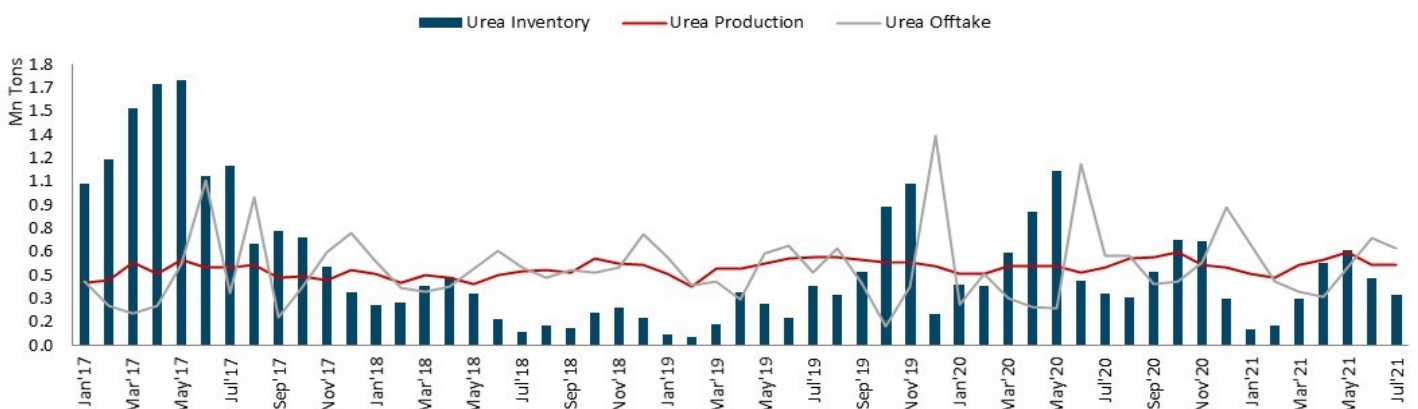
Chart 2: Domestic DAP prices continue their upwards trend



Source: NFDC, Bloomberg, BMA Research

Source: NFDC, Bloomberg, BMA Research

Chart 3: Urea inventory levels dropped to 0.32Mn tons in Jul'21



Source: NFDC, BMA Research

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Buy	>15% expected total return
Hold	10%-15% expected total return
Underperform	<10% expected total return
*Total stock return = capital gain + dividend yield	

Old rating system

Overweight	Total sector return > expected market return
Marketweight	Expected market return
Underweight	Total stock return < expected market return

Valuation Methodology

To arrive at our period end target prices, BMA Capital uses different valuation methodologies including

- Discounted cash flow (DCF, DDM)
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