Day Break

Wednesday, 26 April 2017

IGI Securities
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COMPANY UPDATE

ENGRO FERTILIZER LIMITED
FERTILIZER

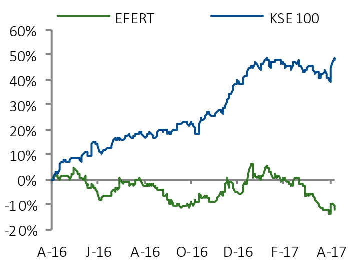
Recommendation			BUY
Target Price			85.9
Last Closing	25-Apr-17		60.9
Upside			41.1

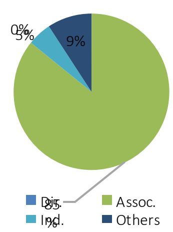
Market Data			
Bloomberg Tkr.			EFERT PA
Shares (mn)			1,335.3
Free Float Shares (mn)			598.9
Free Float Shares (%)			44.9%
Market Cap (PKRbn | USDmn)		81.3	778.4
Exchange			KSE 100
Price Info.	90D	180D	365D
Abs. Return	(15.6)	(3.6)	(12.2)
Lo	59.3	59.3	59.3
Hi	72.7	73.3	73.3

Key Company Financials
Period End: Dec

PKRbn	CY16A	CY17E	CY18F	CY19F
Total Revenue	69.5	74.0	78.2	81.7
Net Income	9.02	10.8	12.4	13.5
EPS (PKR)	6.8	8.1	9.3	10.1
DPS (PKR)	7.0	6.5	7.4	8.1
Total Assets	102.4	101.4	93.2	89.7
Total Equity	41.3	43.5	46.0	48.7
Key Financial Ratios				
ROE (%)	21.9	24.8	26.9	27.7
P/E (x)	9.0	7.5	6.6	6.0
P/B (x)	2.0	1.9	1.8	1.7
DY (%)	11.5	10.6	12.2	13.3

Relative Price Performance & Shareholding





About the Company

The Company is a public limited company incorporated on June 29, 2009 in Pakistan as a wholly owned subsidiary of Engro Corporation Limited. The principal activity of the Company is manufacturing, purchasing and marketing of fertilizers.

Source: Bloomberg, KSE 100 & IGI Research

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Fertilizer

EFERT: Baring subpar 1QCY17 result; profitability to remain healthy in upcoming quarters; Analyst breifing takeways

- Engro Fertilizer Limited (EFERT) posted earnings of PKR 1.6bn (EPS PKR 1.24), down by a massive 22%YoY as compared to PKR 2.12bn (EPS PKR 1.59) in same period last year.
- We expect 9MCY17 profitability to be better than 1QCY17, on the back of higher Urea/DAP offtake expected in 9MCY17 led by lower Urea/DAP prices and extension of urea export. Based on better earnings outlook, we expect company's dividend payout to remain healthy during current year as management is not expecting any major capital expenditure during ongoing year
- We maintain our **"BUY"** call on EFERT with our Dec-17 target price of PKR 86/share, offering a sizeable +41% upside. The company is currently trading at a CY17E P/E of 7.5x and dividend yield of 10.6%.

Engro Fertilizer Limited (EFERT) held its analyst meeting yesterday, where the company's management reviewed 1QCY17 financial results and industry outlook. To recall, EFERT for the 1QCY17 posted earnings of PKR 1.6bn (EPS PKR 1.24), down by a 22%YoY. Looking ahead, we expect 9MCY17 profitability to be better than 1QCY17, on the back of higher urea/DAP offtake expected in 9MCY17 led by lower urea/DAP prices and extension of urea export.

Poor DAP offtake along with Lower retention reduce overall revenue growth…

As per the management discussion, lower earnings during the quarter is attributed to 15%YoY decline in revenue on account of poor DAP offtake (37kTons compared to 65kTons in 1QCY16) and lower retention price of Urea (PKR 1,250/bag versus PKR 1,530/bag in 1QCY16). Lower retention prices for Urea is due to company offering heavy discounts in addition to government subsidy.

…while increase in selling and distribution further dented operating profits

Along with decline in revenues, the company also recorded an increase in selling and distribution expense, up by +51%YoY to 1.3bn. This is due to company's strategy bearing transportation cost, instead of passing onto dealers. Whereas export of Urea (31kTons) also surged up selling and distribution cost.

…however, loan re-pricing and higher other income supported bottom-line

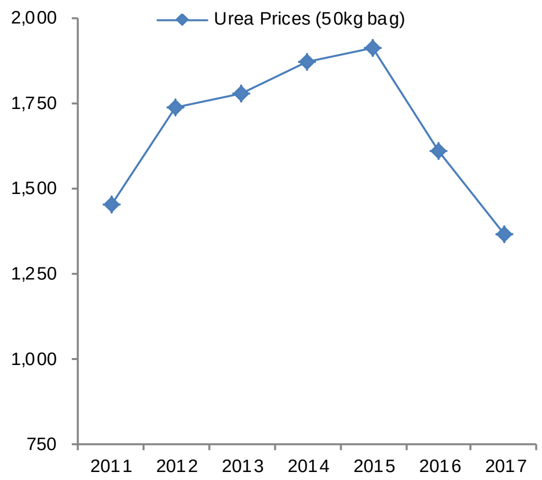
Nevertheless, the company recorded a 9%YoY decrease in financial charges owing to re-pricing of company's long term liabilities. In addition to lower financial charges, other income on account of government subsidy worth PKR 1.04bn (Urea; PKR 156/bag and DAP: PKR 300/bag) supported +21%YoY growth in company's other income during 1QCY17.

EFERT DAP market share decline; as international prices increased to USD 375/ton…

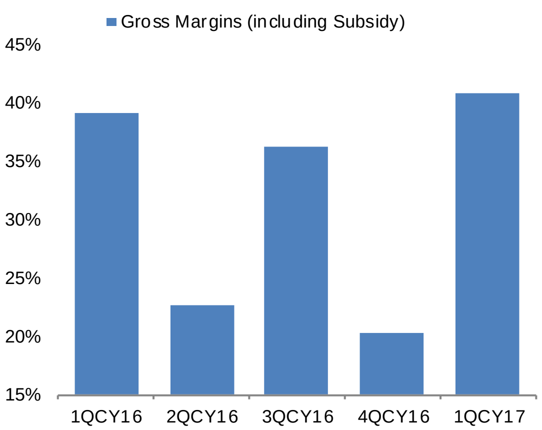
During the 1QCY17 under review, international DAP prices increased to USD 375/ton from 320/ton recorded in 4QCY16 (up by +18%QoQ); whereas local DAP transfer prices (DTP) were remained unchanged at PKR 2,300 which decrease DAP

JamaPunji
http://www.jammapunji.pk

Urea Local Price (PKR/bag)



EFERT Gross Margins(%)



Source: NFDC & IGI Research

margins. As a result the company opted to cut down its import of DAP during the 1QCY17, leading to reduce market share of ~12% during the 1QCY17 compared to ~27% recorded in CY16.

…however, the strategy of importing less DAP helped improve company's gross margins during the quarter to 41% compared to 29% witnessed in 4Q

Company's gross margins (including subsidy) improved to 40.8% in 1QCY17 as compared to 28.5% in 4QCY16. Although the company's management did not comment on improved gross margins, but we believe, this improvement in company's gross margin during 1QCY17 is due to better sales mix – lower DAP offtake contributing margins of ~8% and high reliance on new plant.

65k tons of urea exports expected at USD 200-210/ton; possible destinations include India, Afghanistan and Sri Lanka

On Urea exports company's management highlighted that the company exported ~31k tons to East Africa at USD 235-245/ton during the 1QCY17, while the remaining 64kTons of allocated urea export will most likely end-up in countries such as Afghanistan, Sri Lanka and India having an estimated retention price of USD 200-210/ton – company's management view international urea prices likely to remain soft in 2QCY17.

Exhibit:

EFERT Financial Highlights

PKRmn (Period end=Dec)	1QCY17	1QCY16	YoY	4QCY16	QoQ
Net Sales	10,064	11,871	-15%	28,627	-65%
Gross Profit	3,493	4,204	-17%	5,693	-39%
Mkting. / Dist. Cost	1,291	855	51%	3,277	-61%
Other Op. Income	1,213	1,007	21%	3,719	-67%
Finance Cost	685	751	-9%	773	-11%
Pre-Tax Profits	2,272	3,088	-26%	4,732	-52%
Profit After Tax	1,656	2,121	-22%	3,369	-51%
EPS (PKR)	1.24	1.59	-22%	2.52	
DPS (PKR)	-	-		2.50	
KEY RATIOS					
Gross Profit Margins	34.7%	35.4%		19.9%	
EBIT Margins	29.4%	32.3%		19.2%	
Effective tax rate	27.1%	31.3%		28.8%	

Source: IGI Research, Company Financials *No. of shares* *1,335.3*

Outlook: Baring 1Q result; profitability to remain healthy in upcoming quarters

Looking forward, we expect 9MCY17 profitability to be better than 1QCY17, on the back of higher urea/DAP offtake expected in 9MCY17 led by lower urea/DAP prices and extension of urea export.

Urea supply glut situation to persist in 9MCY17; exports may provide some relief

With election in sight, we see government subsidy continuing in CY17 which will keep local demand upbeat. Whereby production level is likely to remain high in the ongoing year, we see supply glut situation to persist in CY17. However, as per

EFERT's management Urea manufacturers are in a process of requesting Government of Pakistan for extension of Urea export deadline till June-17 and to increase quantity of Urea export in order to reduce inventory level.

EFERT DAP market share likely to revert to ~27% following local DAP price increase…

On DAP as per management, the company has started importing DAP as government has allowed to increase DAP price by PKR 150/bag. This is likely to increase EFERT's DAP market share for CY17 to 27% from current 12%.

Exhibit

Change in DAP prices and its impact on profitability

	Pre	Post	%
DAP MRP (PKR/bag)	2,480	2,630	6.0%
Assumption DAP offtake (kTons) – 9mCY17	545	545	
Additional Income accretion – annualized CY17		0.46	
EPS – CY17E	7.62	8.08	6.1%

Source: IGI Research

Dividend Payout to remain healthy in absence of any major CAPEX

Based on better earnings outlook, we expect company's dividend payout to remain healthy during current year as management is not expecting any major capital expenditure during ongoing year.

Recommendation

We maintain our **"BUY"** call on EFERT with our Dec-17 target price of PKR 86/share based, offering a sizeable +41% upside. The company is currently trading at a CY17E P/E of 7.5x and dividend yield of 10.6%.

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Recommendation	Rating System
Buy	If target price on aforementioned security(ies) is more than 10%, from its last closing price(s)
Hold	If target priceon aforementioned security(ies) is in between -10% and 10%, from its last closing price(s)
Sell	If target price on aforementioned security(ies) is less than -10%, from its last closing price(s)

Time Horizon: Dec - 2017

Valuation Methodology: The analyst(s) has used following valuation methodology to arrive at the target price of the said security (ies):
DCF (Discounted Cash Flow)

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