

Day Break

Friday, 17 January 2020

COMPANY UPDATE

Engro Polymer & Chemicals Limited

Chemical

Recommendation	BUY
Target Price: Dec/20	45.3
Last Closing: 15-Jan-20	35.3
Upside:	28.3
Valuation Methodology:	Discounted Cash Flow (DCF)

Time Horizon: 12M

Market Data

Bloomberg Tkr.	EPCL PA		
Shares (mn)	908.9		
Free Float Shares (mn)	318.1		
Free Float Shares (%)	35.0%		
Market Cap (PKRbn USDmn)	32.1	207.3	
Exchange	KSE 100		
Price Info.	90D	06M	12M
Abs. Return	20.3	29.4	(13.7)
Lo	26.8	20.9	20.9
Hi	37.4	37.4	41.8

Key Company Financials

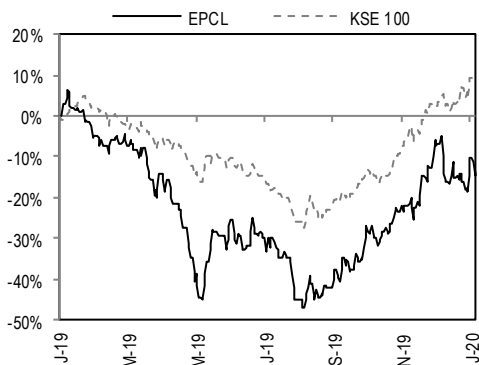
Period End: Dec

PKRbn	CY18a	CY19e	CY20f	CY21f
Total Revenue	35.3	36.0	39.0	41.1
Net Income	4.9	4.1	4.3	4.3
EPS (PKR)	5.4	4.5	4.7	4.7
DPS (PKR)	1.1	1.0	1.5	0.5
Total Assets	36.0	39.3	42.5	45.9
Total Equity	16.8	20.0	23.0	26.8

Key Financial Ratios

ROE (%)	40.2	22.4	20.1	17.3
P/E (x)	6.5	7.8	7.4	7.5
P/B (x)	1.9	1.6	1.4	1.2
DY (%)	3.1	2.8	4.2	1.4

Relative Price Performance



Source: Bloomberg, PSX & IGI Research

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Chemicals

EPCL: Issuance of Preference shares deems positive on earnings

- ✓ According to the notice issued, EPCL may issue preference shares with different rights and privileges having face value of PKR 10 each aggregating up to PKR 3.0bn.
- ✓ The said amount will be utilized for funding capex requirement for PVC expansion and debottlenecking of Vinyl Chloride Monomer (VCM). The company intends to avail tax benefit which we think falls under section 65 (E) of income tax ordinance. Our calculation suggests the impact on earnings is positive.
- ✓ We still have a “BUY” call on the scrip based on our Dec-20 target price of PKR 45/share, offering 32% upside from its last closing. The company is currently trading at CY20 P/E of 7.3x, offering a dividend yield of 4.4%.

EPCL to raise additional PKR 3.0bn through preference shares

As per the stock notice issued EPCL plans to raise PKR 3.0bn through preference shares. The said amount will be utilized for funding capital expenditure (capex) requirement for its PVC expansion and debottlenecking of Vinyl Chloride Monomer (VCM). The company intends to avail a tax credit which we as per our understanding falls under 65 (E) of income tax ordinance. Based on our estimates this hold positive for EPCL earnings.

Funding PVC expansion and VCM debottlenecking project

The total amount aggregates up to PKR 3.0bn which will be utilized to expand the company's PVC capacity and debottlenecking of VCM production capacity. To note, the initial capex for the projects amounted to PKR 7.6bn, of which PKR 5.4bn was raised through right share issue. This addition of new equity (PKR 3.0bn) raises the total amount to PKR 10.6bn. As per the management notice, the company rather than seeking loan from banks for additional funding through preference share issue will maintain its leverage ratios. Moreover, the company will also be able to avail tax credit through this new equity injection.

Investment falls under the criteria of section 65 (E) of Income Tax Ordinance

As per the section 65(E) of the income tax ordinance the company can avail tax credit if it invests an amount equivalent to at least 70% of the total project cost through issuance of new shares.

Our analysis suggests, the company meets this criteria as the total equity portion comprises of ~80% of the project cost (PKR 10.6bn) taking into account addition of PKR 3.0bn through preference shares. More so, the benefit can be availed for a period of five years beginning from the date of setting up or commencement of commercial production from the expansion project which in the case of EPCL is for a period of 2020-24 we think.

The net impact on earnings is positive

As per our calculation the impact is positive on earnings. For calculating preference dividend we have assumed 13% KIBOR and reduced it to 11% for the years 2020-24. For tax credit, we have followed calculation methodology stated under sub-section (3) of 65E ordinance i.e. we have used investment amount of PKR 8.4bn as a proportion of total equity. More so, we have excluded PKR 5.4bn from the initial equity amount of PKR 17.5bn (Sep-19 accounts) to arrive at the opening equity balance of PKR 12.2bn.

Exhibit: Project Cost	
PKRbn	
Total Expansion Cost	10.6
- Right Share	5.4
- Existing (Debt)	2.2
	7.6
- Preference share	3.0
Total Equity Investment	8.40

Exhibit: Tax credit working					
PKRbn	2020	2021	2022	2023	2024
Opening Equity	12.2	23.3	27.0	29.8	32.2
Right Shares	5.4				
Pf Shares	3.0				
Profit before tax	6.0	5.9	5.8	6.3	6.6
Tax Credit	0.63	0.53	0.48	0.48	0.47
Pf shares dividend	(0.5)	(0.4)	(0.4)	(0.4)	(0.4)
Tax Charge	(1.7)	(1.7)	(1.7)	(1.8)	(1.9)
Dividend	(1.7)	(0.6)	(1.4)	(2.2)	(2.8)
Retained earnings	2.7	3.7	2.8	2.3	2.0
Closing Equity	23.3	27.0	29.8	32.2	34.2

Exhibit: Earnings impact					
PKRbn	2020	2021	2022	2023	2024
KIBOR 6m - Assumption	13.0%	11.0%	11.0%	11.0%	11.0%
PF Dividend	(0.50)	(0.44)	(0.44)	(0.44)	(0.44)
Profit before tax	5.5	5.4	5.4	5.9	6.2
Tax Credit	0.63	0.53	0.48	0.48	0.47
Tax Charge	1.11	1.17	1.21	1.36	1.45
Profit after tax	4.39	4.25	4.18	4.55	4.75
EPS (PKR)	4.8	4.7	4.6	5.0	5.2
DPS (PKR)	1.5	0.5	1.3	2.0	2.5
Net EPS Impact	0.15	0.10	0.05	0.05	0.04
Total 5yrs tax credit	2.59				
Total 5yrs Pf shares dividend	(2.24)				

Recommendation

We have a “BUY” call on the scrip based on our Dec-20 target price of PKR 45/share, offering 32% upside from its last closing. The company is currently trading at CY20 P/E of 7.3x, offering a dividend yield of 4.4%.

Exhibit: Features of listed Preference Shares	
Duration	Perpetual
Cumulative / Non-cumulative	Cumulative
Call Features	Exercisable by the Company after the expiry of 12
Conversion period	80-months
Conversion rate	1:1
Dividend Rate	KIBOR 6m + 3.5% spread / annum

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Buy	If target price on aforementioned security(ies) is more than 10%, from its last closing price(s)
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Sell	If target price on aforementioned security(ies) is less than -10%, from its last closing price(s)

Time Horizon: Dec – 2019

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

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