Day Break

Monday, 03 April 2017

IGI Securities
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COMPANY UPDATE

ENGRO FERTILIZER LIMITED

FERTILIZER

Recommendation		BUY
Target Price		85.9
Last Closing	31-Mar-17	62.7
Upside		37.1

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)	83.7	798.2
Exchange		KSE 100

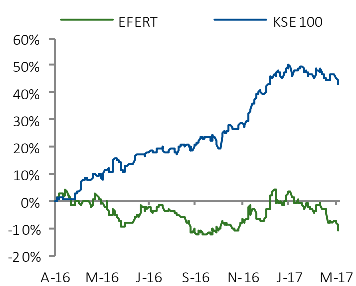
Price Info.	90D	180D	365D
Abs. Return	(7.8)	1.6	(10.8)
Lo	62.7	61.5	61.5
Hi	73.3	73.3	73.3

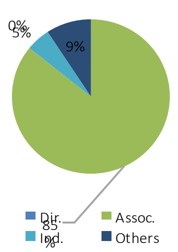
Key Company Financials

Period End: Dec

PKRbn	CY16A	CY17E	CY18F	CY19F
Total Revenue	69.5	73.5	79.0	82.5
Net Income	9.02	10.8	13.0	14.2
EPS (PKR)	6.8	8.1	9.8	10.6
DPS (PKR)	7.0	6.5	7.8	8.5
Total Assets	102.4	101.4	93.5	90.1
Total Equity	41.3	43.5	46.1	49.0
Key Financial Ratios				
ROE (%)	21.9	24.8	28.2	29.0
P/E (x)	9.3	7.8	6.4	5.9
P/B (x)	2.0	1.9	1.8	1.7
DY (%)	11.2	10.3	12.5	13.6

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: Impressive earnings growth; Inexpensive Valuation; Calls in for a strong BUY stance

- Company's earnings are expected to grow by +19%YoY to PKR 10.77bn (EPS PKR 8.1) in CY17. We estimate growth in earnings on the basis of +7% uptick in local urea offtake to 1,769kTon on the back of lower prices as we see high probability of government continuing the subsidy in FY17.
- In CY16 EFERT improved its dividend profile and paid healthy cash dividend of PKR 7.0/share (payout ratio 103%). We believe company dividend payout to remain healthy in CY17 as we expect company will generate ~16% (compared IGI Fertiliser coverage average yield of ~10.1%) free cash flow yield as we do not expect major capital expenditure in coming years.
- EFERT is currently trading at CY17E P/E multiple of 7.8x. With our Dec-17 TP of PKR 86/share, the stock offers upside of +37% and dividend yield of 10.3%, hence we maintain **"BUY"** call on the scrip.

Impressive earnings growth; Inexpensive Valuation; Calls in for a strong BUY stance

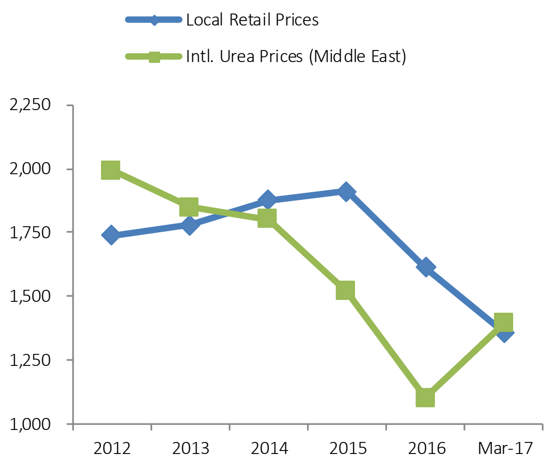
Amongst our fertiliser coverage companies we recommend EFERT, with Dec-17 target price of PKR 86/share offering a sizeable upside of +37% along with a dividend yield of 10.3%, giving it a strong '**BUY'.**

Engro Fertilizer Limited (EFERT) earnings dropped by 40%YoY in CY16 to PKR 9.02bn (EPS PKR 6.78). For CY17, we expect company's earnings to increase by +19%YoY to 10.77bn (EPS PKR 8.1), owing to a) +7% volumetric growth in local Urea sales along with additional export of 90k tons. Moreover, we also expect company lowering financial cost to further support bottom line. One key concern regarding application of Gas Infrastructure Development Cess (GIDC) on concessionary gas available to EFERT still hangs, to which company has obtained a stay order as it is a direct contravention with Fertiliser Policy 2001. We believe this decision to hold and hence have not incorporated additional GIDC payable by EFERT in our company's earnings estimates and concurrently valuation.

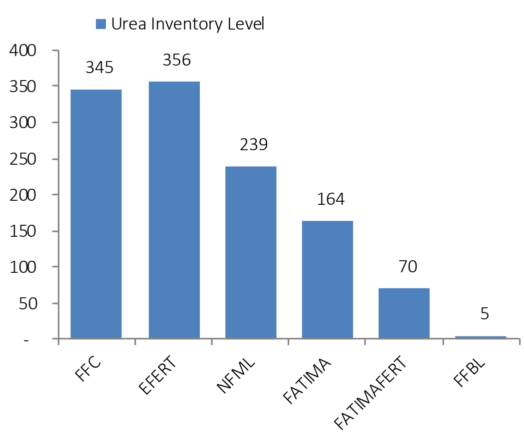
Lower revenues combined with higher distribution cost, dragged CY16 earnings by 40%YoY to 6.78/share

EFERT posted earnings of PKR 9.02bn (EPS PKR 6.78) down by 40%YoY in CY16 as compared to PKR 15.03bn (EPS PKR 11.29) last year. Key reasons for company's dismal earnings performance includes, drop in company's revenue by 21% due to lower retention prices of urea/DAP following government subsidy measure and steep discounts offered to offload excess inventory. Moreover, the company also faced declining Urea sales by 12% to 1,653kTon. With raw material cost staying relatively unchanged, company's gross margins dropped to 25% in CY16 from 37% last year excluding subsidy (37% in CY15 to 34% in CY16 including subsidy). In

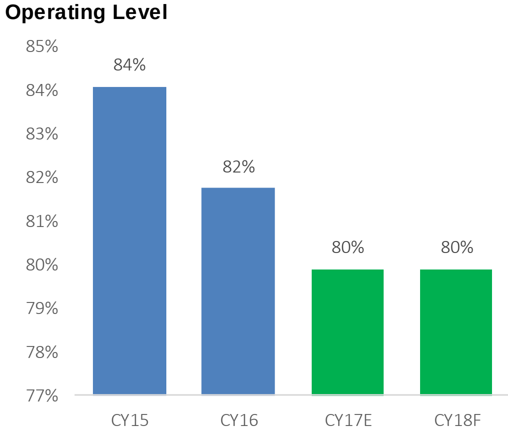
Urea Prices (PKR/bag)



Urea inventory Level (kTon) as at Feb-17



Operating Level



Source: NFDC & IGI Research

addition to lower revenue recorded, company's selling and distribution also racked up +23%YoY on the account of higher warehousing charges.

For CY17, volumetric growth along with lower financial charges to uplift earnings to PKR 8.1/share (+19%YoY)

Company's earnings are expected to grow by +19%YoY to PKR 10.77bn (EPS PKR 8.1) in CY17. We estimate earnings on the basis of +7% uptick in local urea offtake to 1,769kTon on the back of lower prices as we see high probability of government continuing the subsidy in FY17. Further, the government has allowed Urea export of 0.3mn tons of which EFERT has been allocated 90k tons. This would further ramp up company's volumetric sale to 1,859kTon (+12%YoY). In addition to rising volumetric sales, we estimate company's financial charges to drop by 20%YoY owing to re-pricing of loans at lower interest rates.

Urea exports already underway

As per our talks with industry sources, EFERT has already exported ~35.5kTons prilled urea to Turkey at average price of ~240-250/ton. Considering price tag of USD 245/ton and 90k ton quantity estimated annualized EPS accretion for EFERT stands at PKR0.93/share (~11% of CY17E EPS).

Plants operating level expected to reduce to ~80% in CY17; as inventory piles up

Despite formal allocation of 12.5mmscfd of gas from Mari field, it is most likely that EFERT might reduce operating level of plants to ~80% from 82% achieved in CY16 as to ease off inventory levels which by year-end stood at 287kTon. As of Feb-17, inventory level has reached 357kTon, which is highest amongst Urea manufacturers. Moreover, we foresee Urea supply glut situation to persist into CY17 as Pak-Arab and Agri-tech will likely continue to operate due to stable oil prices (hovering in range of USD 45-55/bbl) subsequently dictating LNG prices. On export front, international prilled urea prices are down to USD 220/ton (or PKR 1,155/bag) from a high of USD 282/ton (or PKR 1,480/bag) recorded in Jan-17. This will reduce company's margins to PKR 236/bag or (USD 44/ton) given net local retention price of PKR ~1,400/bag (including subsidy), fading prospects of further export quantities. Based on aforesaid factors, we think EFERT would most likely reduce its production levels.

Healthy dividend payout, entailing attractive dividend yield of 10%

In CY16 EFERT improved its dividend profile and paid healthy cash dividend of PKR 7.0/share (payout ratio 103%). We believe company dividend payout to remain healthy in CY17 as we expect company will generate ~16% (compared IGI Fertiliser coverage average yield of ~10.1%) free cash flow yield as we do not expect major capital expenditure in coming years.

Recommendation

EFERT is currently trading at CY17E P/E multiple of 7.8x. With our Dec-17 TP of PKR 86/share, the stock offers upside of +37% and dividend yield of 10.3%, hence we maintain **"BUY"** call on the scrip.

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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)

Risk: Investment in securities are subject to economic risk, market risk, interest rate risks, currency risks, credit risks, political and geopolitical risks. The performance of company(ies) covered herein mightunfavorably be affected by multiple factors including, business, economic, and political conditions. Hence, there is no assurance or guarantee that estimates, recommendation, opinion, etc. given about the security(ies)/company(ies) in the report will be achieved.

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