Day Break

Wednesday, 20 December 2017

IGI Securities
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COMPANY UPDATE

ENGRO FERTILIZER LIMITED
FERTILIZER

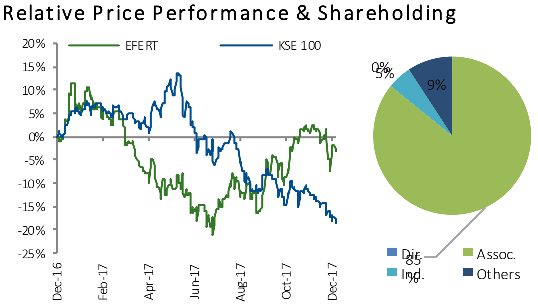
Recommendation		BUY
Target Price:		84.3
Last Closing:	19-Dec-17	63.7
Upside:		32.3
Valuation Methodology:		Discounted Cash Flow (DCF)
Time Horizon:		Dec-18

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)		85.1	774.5
Exchange			KSE 100
Price Info.	90D	180D	365D
Abs. Return	2.7	13.6	(2.8)
Lo	59.1	51.9	51.9
Hi	67.3	67.3	73.3

Key Company Financials
Period End: Dec

PKRbn	CY16A	CY17E	CY18F	CY19F
Total Revenue	69.5	72.9	76.0	79.3
Net Income	9.0	9.7	9.5	8.1
EPS (PKR)	6.8	7.3	7.1	6.1
DPS (PKR)	7.0	5.0	5.0	4.0
Total Assets	102.4	98.7	95.1	93.2
Total Equity	41.3	44.8	47.6	50.4
Key Financial Ratios				
ROE (%)	21.9	21.8	20.0	16.1
P/E (x)	9.4	8.7	8.9	10.5
P/B (x)	2.1	1.9	1.8	1.7
DY (%)	11.0	7.8	7.8	6.3

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, PSX & IGI Research

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Fertilizer

EFERT: Strong fundamentals and attractive valuation to keep "BUY" call intact

- We have estimated earnings of PKR7.3/share for CY17E on the scrip. As of now, company has attained 9MCY17 earnings of PKR5.01/share (+29%YoY) led by surge (+27%/+30%YoY) in urea and DAP offtake to 1,296/306ktons.
- Our calculations take into account multiple factors a) improved sales to keep urea and DAP market share intact, b) ample production capacity (2.3Mn tons) to consistently meet urea demand, c) concessionary feed gas rate keeping margins smooth and d) attractive yield of 7.6% with a payout ratio of 70%.
- We have a **"BUY"** call on EFERT, based on our Dec-18 target price of PKR 84/share, offering +32% upside from its last closing. The company is currently trading at CY18E P/E of 8.9x and offers a dividend yield of 7.8%.

We have estimated earnings of PKR7.3/share for CY17E on the scrip and subsequently our target price to PKR 84.3/share offering +32% upside. Our calculations take into account multiple factors a) improved sales to keep urea and DAP market share intact, b) ample production capacity (2.3Mn tons) to consistently meet urea demand, c) concessionary feed gas rate keeping margins smooth and d) attractive yield of 7.6% with a payout ratio of 70%.

Earnings estimated to climb by+8%YoY to PKR 7.3/share; offtake expected at 2.6k tons

As of now, company has attained 9MCY17 earnings of PKR5.01/share (+29%YoY) led by surge (+27%/+30%YoY) in urea and DAP offtake to 1,296/306ktons. For urea, exports in particular (256ktons) have also boosted company's earnings during the period. Henceforth, we expect earnings to climb by +8% YoY to PKR7.3/share based on the estimated offtakes of urea and Dap, tuning at 1.8k tons (+8%YoY) and 475k tons (10%YoY), respectively. In addition, our calculations incorporate Np/NPK offtake at 55/60ktons for CY17.

Market share to remain steadfast in urea and DAP

Over the years the company has attained favorable market share in primary products (Urea and DAP). As of now, the company is the second most in capturing 31% share in urea market, while for DAP the share stands moderately at 25%. Going forward, taking conservative approach we expect company to maintain its share in urea and DAP market at current levels. Although, LNG based fertilizer manufactures remain an imminent threat in case of urea, however we expect minimal impact as of now owing to closure of plants.

Operating capacity to run at maximum levels: enVen plant supporting the offtake

The company has sufficient capacity of 2.3Mn tons to produce urea, having two operating plants each having a capacity of 975k tons and 1.2Mn tons (enVen). The enVen plant incorporated under the Fertilizer policy 2001 is utilized at maximum levels (consistent gas supply at concessionary rate). Henceforth, we expect company to continue utilizing its enVen plant at maximum level of 97%, whereas the old plant to remain operational at 55%.

Pricing dynamics and concessionary feed rate to keep margins intact

The company enjoys competitive advantage in bearing low feed cost owing to low tariff rate ($0.70/mmbtu) as per the fertilizer policy. As a result, the company is able to garner some support in margins which over the past two years have compressed (600 bps on average) amid decline in local urea and DAP prices. On international front, DAP prices have increased (USD 365/bag) owing to limited supply from China and increase in raw material costs. As a result, we see DAP margins squeezing on average at PKR 56/bag during the period. Although globally, new supply additions will keep DAP prices bearish but the overall effect will be countered by PKR depreciation. Nevertheless, we have increased DAP prices by 3.4% to counter the effect. Similarly, we have also increased urea prices by 3.4% stemming from increase in gas prices. Overall effect, will result in margins to hover around at 29%.

High payout ratio offering attractive yield of 7.6% on average

Taking in to account 3 year average we estimate company to plow out 70% of its income at a dividend yield of 7.6%. We expect company to utilize the retained earnings in meeting debt repayments, which are expected to retire by CY21.

Recommendations

We have a **"BUY"** call on EFERT, based on our Dec-18 target price of PKR 85/share, offering +32% upside from its last closing. The company is currently trading at CY18E P/E of 8.9x and offers a dividend yield of 7.8%.

Exhibit: Capacity Utilization

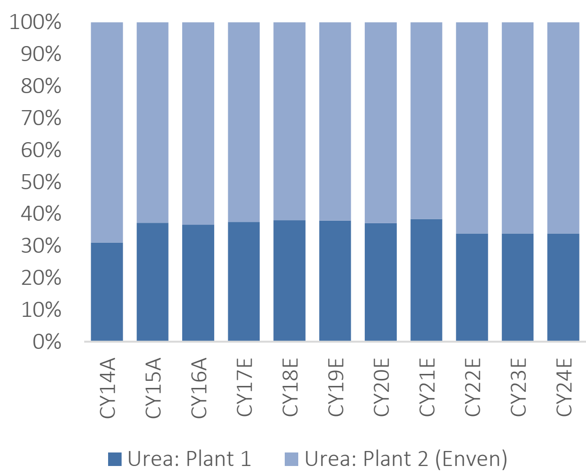


Exhibit: Local Prices and Gross margins

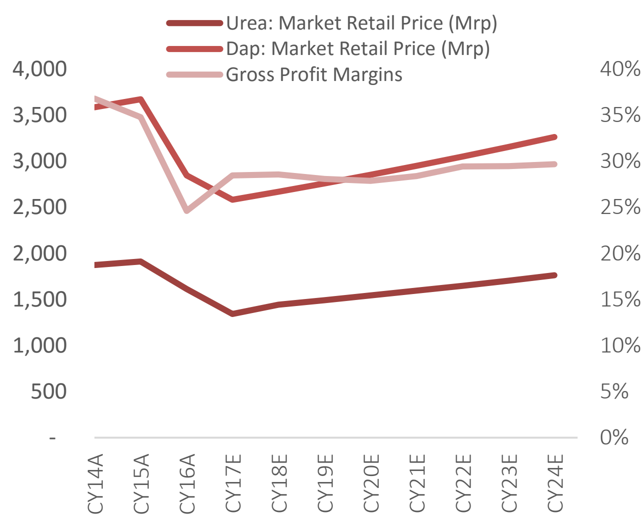


Exhibit: Market share in DAP –CY17E

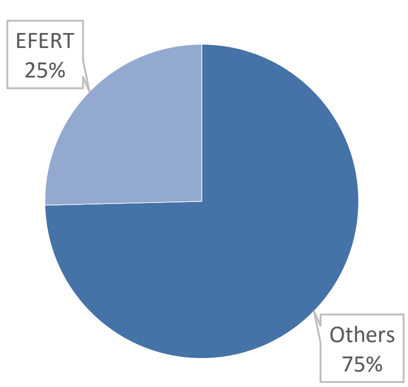
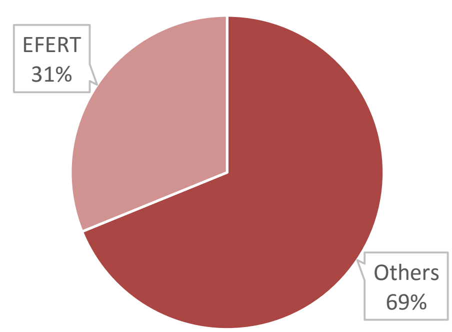


Exhibit: Market share in urea-CY17E



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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 price on 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 – 2018

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.

Basic Definitions and Terminologies used: Target Price: A price target is the projected price level of a financial security stated by an investment analyst or advisor. It represents a security's price that, if achieved, results in a trader recognizing the best possible outcome for his investment. **Market Cap.:** Market capitalization is calculated by multiplying a company's shares outstanding by current trading price. **ROE:** Return on equity is the amount of net income returned as a percentage of shareholders' equity. **P/E:** Price to Earnings ratio of a company's share price to its per-share earnings. **P/B:** Price to Book ratio used to compare a stock's market value to its book value. **DY:** The dividend yield is dividend per share, divided by the price per share.

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