Day Break

Wednesday, 04 April 2018

COMPANY UPDATE

Engro Fertilizers Limited
Fertilizer

Recommendation	**BUY**
Target Price:	80.8
Last Closing: 3-Apr-18	69.5
Upside:	16.3
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)	600.9
Free Float Shares (%)	45.0%
Market Cap (PKRbn | USDmn)	92.7 | 799.8
Exchange	KSE 100

Price Info.	90D	06M	12M
Abs. Return	1.5	12.4	11.3
Lo	67.4	59.1	51.9
Hi	71.0	71.0	71.0

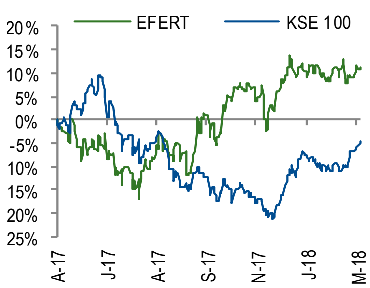
Key Company Financials
Period End: Dec

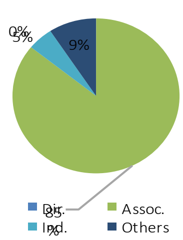
PKRbn	**CY16A**	**CY17A**	**CY18E**	**CY19F**
Total Revenue	69.5	77.1	78.4	80.9
Net Income	9.0	11.2	11.0	11.2
EPS (PKR)	6.8	8.4	8.2	8.4
DPS (PKR)	7.0	8.5	7.0	8.0
Total Assets	102.4	111.8	91.9	98.4
Total Equity	41.3	42.5	44.1	44.6

Key Financial Ratios

ROE (%)	21.9	26.3	24.9	25.0
P/E (x)	10.3	8.3	8.4	8.3
P/B (x)	2.2	2.2	2.1	2.1
DY (%)	10.1	12.2	10.1	11.5

Relative Price Performance





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 keep "BUY" call intact

- We reiterate our **"BUY"** stance on the scrip based on strong fundamentals ensuing from stable earnings outlook captured by favorable urea and DAP demand. We have revised our earnings estimates after incorporating CY17 results and have adjusted our assumptions accordingly.
- With industry demand expected to reach at ~5.7mn and 2.3mn tons for urea /DAP we expect company to maintain its foothold in both urea and DAP, keeping its market share intact at 31% and 22%.
- In addition, retention price of urea is expected to improve (~PKR 1,250/bag) with DAP margins to hover on average at ~PKR 300/bag.
- Moreover, with respect to upcoming budget proposals; price increase of PKR 100/bag in urea and removal of subsidy bodes well for the company as this will result in improved cash flows.
- We have a **'BUY'** call on the scrip based on a Dec-18 target price of PKR 80.8/share, offering +16% upside from its last closing. The company is currently trading at CY18E P/E of 8.4x and offers a dividend yield of 10.1%.

We reiterate our **"BUY"** stance on the scrip based on strong fundamentals ensuing from stable earnings outlook captured by favorable urea and DAP demand. We have revised our earnings estimates upwards after incorporating CY17 results and have adjusted our assumptions accordingly. In addition, multiple factors support our stance on the scrip a) healthy market share in urea and DAP, b) concessionary feed gas rate ($0.7/MMBtu) keeping margins smooth and c) attractive dividend yield of 11% amongst its peers. Moreover, with respect to upcoming budget proposals; price increase of PKR 100/bag in urea and removal of subsidy bodes well for the company as this will result in improved cash flows. Our target price has revised down slightly by 4% to PKR 80.8/share.

Earnings revised upwards on average by +6% to PKR 8.2/8.3/8.4/share for CY18E/CY19/CY20

We have revised our earnings estimates upwards on average by +6% to PKR 8.2/8.3/8.4/share for CY18E/CY19/CY20 after adjusting domestic prices given current pricing dynamics, and favorable demand outlook for urea and DAP.

Stable market share supported by healthy offtake in urea and DAP

The company during the outgoing year maintained its market share of 30% in urea accompanied by a decline in DAP share to 21%. Henceforth, with industry demand expected to reach at ~5.7mn and 2.3mn tons for urea /DAP we expect company to maintain its foothold in both urea and DAP, keeping its market share intact at 31% and 22%. Although, LNG based fertilizer manufacturers may pose a threat to market share, nevertheless this seems unlikely given high cost of RLNG associated with urea production (no production output in the past six months).

Strong pricing dynamics and low feed cost to keep margins stable

As per the fertilizer policy (2001), the company enjoys concessionary feed cost ($0.70/MMBtu) for its Enven plant and hence incurs average gas cost of PKR 200/bag v/s PKR 500/bag compared to other major players in the industry. Accordingly, we see margins to remain intact at ~29% which may slide down post CY22 given GIDC and feed cost to replace concessionary feed rate. In addition, retention price of urea is expected to improve (~PKR 1,250/bag) owing to low discounts relative to that in the preceding year wherein substantial discounts by the company trickled prices down to ~PKR 1,100/bag. Moreover, for DAP with international prices following upward trajectory (USD 430/ton) and local prices crossing PKR 3,000/bag we expect margins on average at ~PKR 300/bag.

High payout ratio offering attractive dividend yield of 11%

The company offers attractive dividend yield on average at 11% amongst its peers with payout crossing 100% in the last two years. We have revised our payout assumptions and restricted it to 90% going forward, as we expect company to curtail its dividend payout for subsequent debt re-payments.

Exhibit:
Urea, DAP and NP/NPK offtake (k tons)

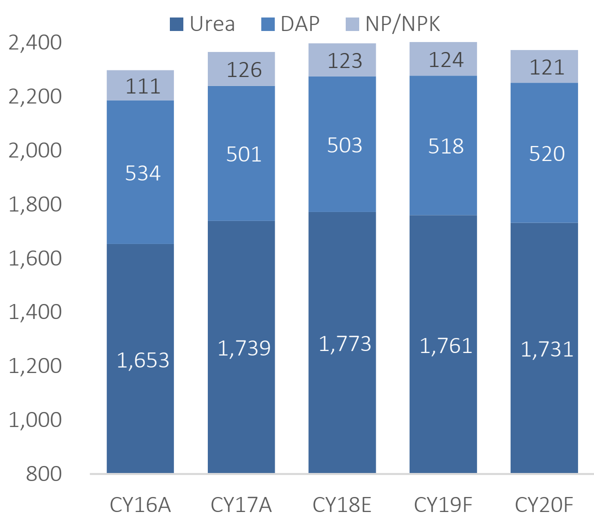
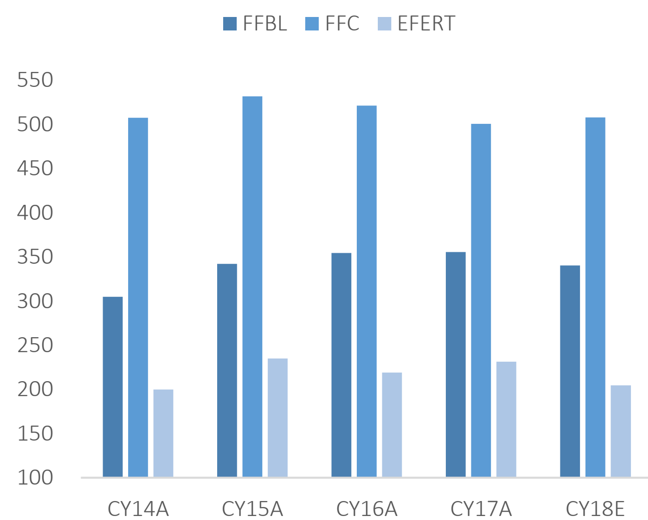


Exhibit:
Feed cost (PKR/bag) comparison amongst major players



Source: IGI Research, Company Financials, Bloomberg

Earnings for CY17 increased by+23%YoY to PKR 11.3bn (EPS: PKR 8.36/share)

To recall, the company reported earnings of PKR 11.3bn for CY17 (EPS: PKR 8.36), up by +20%YoY attributable to healthy offtake in urea/DAP clocking at 1.7mn tons (enhanced by exports of 223k tons) and 502k tons respectively. In addition, low inventory and handling costs during the 4QCY17 coupled with improved gross margins (29%; increase of +800bps YoY) and one-off gains (sale of land at PKR 0.7bn) also lifted earnings by +19%YoY.

Outlook:

With budget around the corner, fertilizer manufacturers have demanded various proposals. The major ones being: (i) removal of subsidy (PKR 100/bag) and corresponding increase in urea price and (ii) removal of GIDC (PKR 300/MMBtu) on feed gas. The former proposal suits well for the industry as a whole, provided demand remains sustained with government offering subsidy to farmers as prices may reach PKR 1,500/bag. For EFERT, in particular this will result in improved cash flows in the future as current outstanding subsidy amounts to PKR ~7.3bn. However, removal of GIDC on feed gas bodes well for players such as FFC (GIDC cost: PKR 351/bag) and FFBL (PKR 400/bag for urea; PKR 156/bag for DAP) as this will uplift margins and hence profitability, whereas for EFERT this may come as a setback as the competitive advantage (concessionary feed gas) which the company has will cease to exist.

Recommendation

We have a **'BUY'** call on the scrip based on a Dec-18 target price of PKR 80.8/share, offering +16% upside from its last closing. The company is currently trading at CY18E P/E of 8.4x and offers a dividend yield of 10.1%.

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