WE Detailed Report

December 2015

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Engro Fertilizer Company Limited

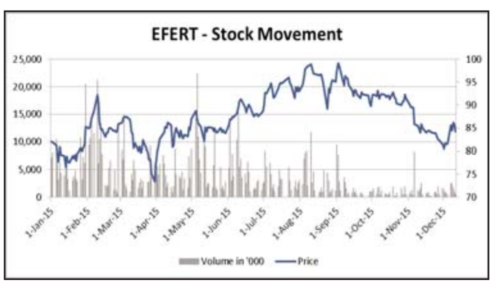
EFERT: Increased confidence on gas supply

We initiate coverage on Engro Fertilizer Company Limited (EFERT) with DCF based Dec'16 target price of Rs 108/share, offering a striking upside potential of 29% from closing price of Rs 83.49/share. We expect optimistic stance due to expected increased urea off-take backed by government subsidy announced in the farmers' package; the likelihood of Mari Shallow to continue its blessing in 2016 for atleast three months; discounted price may attract more sale; 4QCY15 likely to witness higher DAP Off-take; Power generation shift to LNG leaves hope for more gas availability; Inventory pile likely to reduce amid discounted prices and more discoveries from Mari fields. Furthermore, Deleveraging would improve the bottom-line by redcuing financing cost to Rs 3,231 million in CY17 form Rs 4,576 million in CY15 due to retirement of debt. On the contrary, the key risks linked to our report are imposition of GIDC; lower differential of imported urea; irregular gas supply for urea manufacturing; and another gas price increment. The company is currently trading at PE multiple of 8.3x and 8.4x for CY16 and CY17 respectively.

KEY DATA

KATS Code	EFERT
Reuters Code	ENGR.KA
Current Price (Rs)	83.49
Year High, Low (Rs)	100.72, 71.50
Market Cap (Rs' bn)	111.1
Market Cap (US$ mn)	1,058
Shares Outstanding (mn)	1,330.93

Source: KSE, Reuters & WE Research



Source: KSE & WE Research

EFERT Financial Snapshot

	CY14A	CY15E	CY16E	CY17E
Net Sales (Rs mn)	61,425	82,947	77,190	77,882
Gross Profit (Rs mn)	22,603	31,245	28,952	28,660
Profit after Taxation (Rs mn)	8,208	14,668	13,320	13,251
EPS (Rs)	6.21	11.10	10.08	10.03
BVPS (Rs)	26.10	33.21	38.29	42.33
DPS (Rs)	-	4.00	5.00	6.00
P/E (x)	13.52	7.56	8.33	8.37
P/BV (x)	0.31	0.40	0.46	0.50
ROE (%)	28%	37%	28%	25%
ROA (%)	7%	14%	13%	13%

Source: Company Reports & WE Research

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Our Dec'16 Target Price for EFERT is Rs 108/share; offering an upside scope of 29%-Buy!

Valuation: BUY with a Target Price of Rs 108

We have used Discounted Cash Flow (DCF) methodology with an assumption of 15.8% cost of equity (9.8% Risk free rate and 6% Risk premium) and 4% growth rate, thus our Dec'16 Target Price for EFERT is Rs 108/share; offering an upside scope of 29%-Buy!

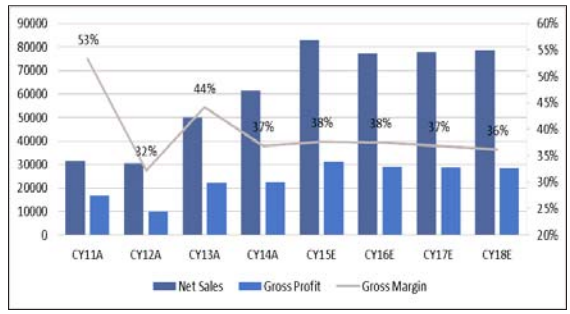
DCF based value of Engro Fertlizer

Rs in million	**CY16F**	**CY17F**	**CY18F**
EBIT (1-t)	14,863	14,649	14,331
Non-Cash Expense	5,457	5,566	5,677
Change in Working Capital	(1,083)	96	81
Capex	(2,128)	(2,170)	(2,214)
Free Cash Flow to Firm	17,108	18,141	17,875
Less: after tax interest	(2,132)	(1,835)	(1,568)
Discounted Free Cash Flow	14,976	14,458	12,478
PV of Terminal Value	139,477		
Total Value	181,390		
(-) Debt	(38,120)		
Shares Outstanding	1,331		
Target Price Dec'16 (Rs)	**108**		

Source: Company Reports and WE Research

Gross margin to remain firm

Gross margins of the company are relied upon to clock in at 38% during the year 2016; attributable to concessionary gas available at $0.7/mmbtu, uninterrupted gas supply to Engro new plant Enven, 3 month extension of gas for old plant and record DAP sales expected with better margin. Furthermore, more gas would be available to old plant remain key risk for upside.



Source: WE Research

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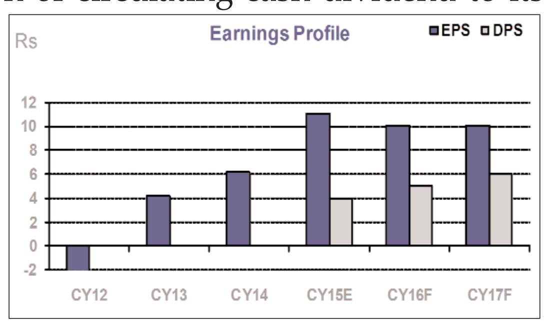
Strong bottom line likely to carry on

On the back of expected stable offtake and lower financing cost during CY16, we expect the income of Engro Fertilizer Company Limited to remain stable in the coming years even with Enven. EFERT is anticipated to earn a profit after tax of Rs 13,320 million (EPS: Rs 10.08) in CY16. Notwithstanding the solid profitability, the organization is relied upon to proceed with its reputation of circulating cash dividend to its shareholders, where we anticipate that the organization will declare a cash profit of Rs 5/share and Rs 6/share in CY16 and CY17, respectively.



Source: WE Research

Engro fertilizer dividend payout ratio for CY15 to remain at 36% and we expect going forward dividends payout would average at 60%

Dividend payout ratio to continue

Engro fertilizer dividend payout ratio for CY15 to remain at 36% and we expect going forward dividends payout would average at 60%. Company has no expansion on cards in fertilizer business, while financing cost to decline in next three years.

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Gas from Mari shallow to continue?

We believe diverted gas from Guddu would continue to flow towards EFERT beyond December 2015 and for at least for 3 months.

Engro Fertilizer (EFERT) as of now gets 60mmcfd gas, which has been redirected from Guddu power plant to company on temporary arrangement, which is set to terminate by the end of December 2015 and the gas is required to return back to Guddu Power Plant. In any case, foreseeing country's urea demand and supply dynamics, and government's focus on managing fiscal and external accounts, we believe diverted gas from Guddu would continue to flow towards EFERT beyond December 2015 and for at least for 3 months. According to most recent news of Mari Petroleum adding 200mmcfd to the framework, we anticipate that organization will be one of the recipients of this development and get required gas from Mari system to run the base plant alongside full usage of Enven. The following table presents a sensitivity analysis of Engro Fertilizer earnings to. In the base case scenario, we assume gas to remain for next 3 moths in CY16 and later diverted to Guddu Power Plant.

	CY16F	**CY17F**	**Dec'16 TP (Rs)**
Base case	10.08	10.03	108
Gas to new Plant only	8.97	8.92	94.7
Gas to both Plant	13.83	13.78	151

Source: WE Research

Higher inventories drove by urea value vulnerability and deals focus at year-end have brought about rebates being offered by all significant fertilizer producers. However with the pick in off-take during November 2015, EFERT has decreased the markdown to Rs 120/bag.

Inventory pile likely to reduce amid discounted prices

Higher inventories drove by urea value vulnerability and deals focus at year-end have brought about rebates being offered by all significant fertilizer producers. However with the pick in off-take during November 2015, EFERT has decreased the markdown to Rs 120/bag. We have done sensitively analysis under different price scenario. In the base case scenario, we assume price of Rs 1995/bag for CY16 and CY17 and gas to remain for next 3 moths in CY16.

	CY16F	**CY17F**	**Dec'16 TP (Rs)**
Base case	10.08	10.03	108
Price @ Rs 1900/bag	9.02	8.95	95.4
Price @ Rs 1850/bag	8.44	8.36	88.70

Source: WE Research

It is anticipated that urea off-take will proceed with force in upcoming months after organization's endeavors to meet the year-end sales target.

Engro Fertilizer posted robust growth of 80% in after tax profitability since the company managed to earn a PAT of Rs 9,905 million with an EPS of Rs 7.21/share during 9MCY15 as compared to Rs 5,511 million with EPS of Rs 4.19/share in 9MCY14.

Price and Sales playing hide and seek

After 63% and 23% increment in feed and fuel gas cost by government on September 1, 2015 to Rs 200/mmbtu and Rs 600/mmbtu respectively, fertilizer companies expanded urea cost by Rs 159/bag from 1st week of September 2015. Following this urea price hike, government committed cut in gas prices. This created price uncertainty in the market. Subsequently, urea off-take for company declined. It is anticipated that urea off-take will proceed with force in upcoming months after organization's endeavors to meet the year-end sales target.

4QCY15 likely to witness higher DAP Off-take

With Rs 500/bag endowment declared for DAP under Kissan Package and higher interest of phosphate fertilizer amid winter season, we anticipate that organization will post high DAP off-take of 205k tons in 4QCY15. Furthermore urea offtake to increase at 418k tons in 4QCY15. This is anticipated to drive profit in 4QCY15.

Concessionary gas jacking up profitability

Engro Fertilizer posted robust growth of 80% in after tax profitability since the company managed to earn a PAT of Rs 9,905 million with an EPS of Rs 7.21/share during 9MCY15 as compared to Rs 5,511 million with EPS of Rs 4.19/share in 9MCY14. The increment took place on the back of uninterrupted gas supply to both of its plants, and lower finance cost. The company announced an interim cash dividend on Rs 1.50/share, which is in addition to Rs 1.50/share already paid in previous quarter. Net sales revenue of the company hike by 19% to Rs 51,928 million in 9MCY15 compared to Rs 43,692 million in 9MCY14. The Company offtake drop by 2% to 1,295k tons in 9MCY15 versus 1,322k tons in 9MCY14 owing to ambiguity over increase in prices after gas price hike. EFERT produced 3.9 metric tons of urea during the period under review as against 3.6 metric tons during the same period last year. The increment took place due to lower outage days and better gas supply that lead both the plants operational. DAP offtake fell by 21% YoY as the industry awaited the announced subsidy implementation, which amounts to Rs 500/bag.

Key Risks

Imposition of GIDC on concessionary gas

Government has forced GIDC on concessionary gas on review basis through GIDC Act 2015. However, the organization has gotten a stay request against it and is certain on its inversion as the imposition is in negation of the Fertilizer Policy 2001. Unfriendly decision of court would remain a key risk of downgrade our valuation.

Burden of imported urea

In September 2015, the Trading Corporation of Pakistan (TCP) got green signal from the government to import 150,000 tons of urea by floating international tenders to bridge the demand-supply gap in the Kharif sowing season. Unfortunately, urea prices from local manufacturers are marginal lower than the imported urea. Hence, any price differentiation could lead to lower off-take of domestic urea.

Another gas price increment likely

As guaranteed to IMF, government is set to increment gas tariff further in 2016, which is prone to put further weight on farmers and off-take assuming organizations attempt to pass on the effect of increase in cost. We trust feed costs will stay at current level considering lower costs of products, decreased farm income and lower global urea costs.

Company Introduction

Engro Fertilizers Limited is a subsidiary of Engro Corporation and a renowned name in Pakistan's fertilizer industry. Engro is also a leading importer and seller of Phosphate products, which are marketed extensively across Pakistan as phospatic fertilizers.Engro Fertilizers Limited was incorporated in June 2009, following a decision to demerge fertilizer concern from its parent company Engro Chemical Pakistan Limited. To facilitate better oversight, Engro Chemical Pakistan was converted into a holding company named Engro Corporation, and its fertilizer business was subsequently demerged to a newly formed Engro subsidiary -Engro Fertilizers Limited.

EFERT - Financial Highlights

Valuation

	CY14A	CY15E	CY16E	CY17E
EPS (Rs)	6.21	11.10	10.08	10.03
Book Value (Rs/share)	26.10	33.21	38.29	42.33
DPS (Rs)	-	4.00	5.00	6.00
P/E (x)	13.52	7.56	8.33	8.37
P/BV(x)	0.31	0.40	0.46	0.50

Source: Company Reports & WE Research

Key Ratio Analysis

	CY14A	CY15E	CY16E	CY17E
Current Ratio (x)	1.02	0.97	1.07	1.30
ROE (%)	28%	37%	28%	25%
ROA (%)	7%	14%	13%	13%
Gross Margin (%)	37%	38%	38%	37%
Net Margin (%)	13%	18%	17%	17%
Sales Growth (%)	23%	35%	-7%	1%
PAT Growth (%)	49%	79%	-9%	-1%

Source: Company Reports & WE Research

Income Statement

Rs in million	CY14A	CY15E	CY16E	CY17E
Sales	61,425	82,947	77,190	77,882
Cost of Goods Sold	(38,822)	(51,702)	(48,239)	(49,222)
Gross Profit	22,603	31,245	28,952	28,660
Administrative Expense	(772)	(912)	(978)	(1,054)
Distribution Cost	(4,441)	(4,945)	(4,541)	(4,798)
Other Income	2,449	1,541	1,444	1,219
Other Expenses	(1,318)	(1,632)	(1,735)	(1,730)
Finance Cost	(6,625)	(4,576)	(3,697)	(3,231)
Profit before Taxation	11,895	20,721	19,445	19,067
Taxation	(3,687)	(6,053)	(6,125)	(5,815)
Profit after Taxation	8,208	14,668	13,320	13,251

Source: Company Reports & WE Research

Balance Sheet

Rs in million	CY14A	CY15E	CY16E	CY17E
Share Capital	13,183	13,183	13,183	13,183
Shareholder Equity	34,478	43,862	50,578	55,904
Non-Current Liabilities	41,437	31,107	23,974	20,399
Current Liabilities	35,556	30,470	26,280	23,817
Total Liabilities	76,993	61,577	50,254	44,216
Non-Current Assets	75,175	75,959	72,630	69,235
Current Assets	36,297	29,480	28,201	30,886
Total Assets	111,472	105,440	100,832	100,121

Source: Company Reports & WE Research

Cash Flow Statement

Rs in million	CY14A	CY15E	CY16E	CY17E
Cash from Operations	20,969	10,439	17,693	18,913
Cash from Investing activities	(337)	(6,134)	(2,128)	(2,170)
Cash from Financing	(13,884)	(11,167)	(15,964)	(14,058)
Net change in Cash	6,748	(6,862)	(399)	2,685
Beginning Cash balance	22,516	29,265	22,402	22,003
Ending Cash balance	29,265	22,402	22,003	24,688

Source: Company Reports & WE Research

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