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WE Detailed Report

June 2015

Engro Corporation Limited

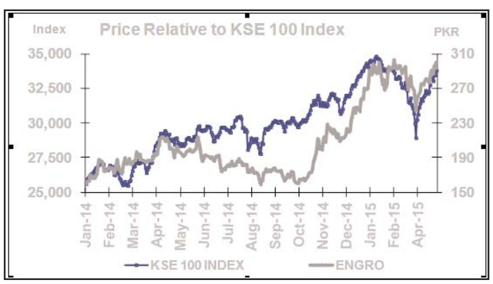
ENGRO - An eminent business consortium

We value Engro Corporation Limited (Engro) as our top pick in the Fertilizer sector mainly due to better earnings outlook base on assumption that subsidizes gas would be continued. Our SOTP based Dec'15 target price of the scrip has been calculated at Rs 346/share which indicates upside potential of 11%. Our optimistic stance further encompasses 1) Output from both fertilizer plants; 2) Highest ever UHT market share by Efoods; 3) Engro Power to contribute swiftly with guaranteed USD base return IRR; 4) ETPL - Sole player grabbing all the business. On the other hand, the key hazards that could hit our valuations are 1) GIDC Bill implementation on new plant; 2) Exchange rate volatility; 3) Imposition of Super-Tax. Establishing in 1966 with the production of urea, Engro Corporation Limited (ENGRO) has accomplished multifold since then. As of now, Engro is maintaining a diversified portfolio comprising of Fertilizer, Food, Power & chemical storage and handling under the name Engro Vopak.

KEY DATA

KATS Code	ENGRO
Reuters Code	EGCH.KA
Current Price (Rs)	304
Year High, Low (Rs)	318.99, 222.10
Market Cap (Rs' bn)	159.3
Market Cap (US$ mn)	1547
Shares Outstanding (mn)	524
Free Float (%)	31.8

Source: KSE, Reuters & WE Research



Source: KSE & WE Research

ENGRO Financial Snapshot

	CY14A	CY15E	CY16E	CY17E
Net Sales (Rs mn)	175,958	181,519	192,774	198,595
Gross Profit (Rs mn)	36,189	50,569	54,953	56,470
Profit after Taxation (Rs mn)	7,801	17,060	18,806	19,750
EPS (Rs)	13.38	30.26	33.40	35.10
Book Value (Rs/share)	129.9	152.3	175.0	198.6
DPS (Rs)	6.00	12.00	13.00	15.00
P/E (x)	22.72	10.05	9.10	8.66
P/BV (x)	2.34	2.00	1.74	1.53
Dividend Yield (%)	2.0	3.9	4.3	4.9

Source: Company Reports & WE Research

Valuation: BUY with a Target Price of Rs 346.45

We have used Sum of the Parts (SOTP) valuation method to arrive at Dec'15 Target Price of Rs 346.45/share, which offers an upside of 11% from current levels-BUY! We have remained conservative and assumed a 20% conglomerate discount on equity value of all businesses. If we ignore the discount, our Dec-15 Target Price for the stock is Rs 440/share whereas Engro trades at CY16E/CY17E P/E of 9.1x/8.7x respectively.

SOTP Method

Rs/Share	**Dec-15 Equity Value**	**(%) holding**	**Conglomerate Discount**
Engro Fertilizer	212	87%	169.23
Engro Foods	163	87%	130.01
Engro Polymer and Chemicals	6	56%	4.46
Engro Vopak	8	50%	6.50
Engro Powergen	18	69%	14.36
Elengy Terminal	34	100%	27.03
TOTAL	**440**		**346.45**

Source: Company Reports and WE Research

Contribution in Earnings

PAT	**CY14A**	**CY15E**	**CY16E**
Engro Fertilizer	64%	64%	57%
Engro Foods	7%	15%	15%
Engro Polymer and Chemicals	-5%	-2%	-2%
Engro Vopak	14%	9%	7%
Engro Eximp	8%	-2%	0%
Engro Powergen	13%	10%	8%
Elengy Terminal	0%	6%	15%
TOTAL	100%	100%	100%

Source: Company Reports and WE Research

During March 2015, Oil and Gas Regulatory Authority has approved the agreement between Engro Fertilizers, Sui Northern Gas Pipelines and Mari Petroleum for the supply of gas at concessionary rate of $0.7/mmbtu to Engro Fertilizers (EFERT)'s EnVen plant. This will continue to be key earning prospect for ENGRO as well as EFERT as a whole.

Engro Fertilizers Limited - US$0.7/mmbtu gas, a fantasy come true

During March 2015, Oil and Gas Regulatory Authority has approved the agreement between Engro Fertilizers, Sui Northern Gas Pipelines and Mari Petroleum for the supply of gas at concessionary rate of $0.7/mmbtu to Engro Fertilizers (EFERT)'s EnVen plant. This will continue to be key earning prospect for ENGRO as well as EFERT as a whole. With these concessionary gas rates, we expect EFERT's gross margins to inflate to 42% in CY15. The company also started enjoying healthy earnings with better sales of Zarkhez & Engro NP that is expected to continue throughout the year, thanks to uninterrupted gas supply that made both the plants running. We expects to continue receiving 60 MMSCFD additional gas from Mari Shallow throughout the year. In addition to it, ECC approved additional 3 MMSCFD gas to the Company from Maru East which is likely to flow in the next few weeks.

Rs in million	**CY14A**	**CY15E**	**CY16E**
Net Sales	61,425	88,972	84,962
Cost of Sales	(38,822)	(53,864)	(52,416)
Gross Profit	22,603	35,107	32,546
Admin Expense	(4,441)	(5,386)	(5,334)
Distribution Exp	(772)	(916)	(982)
Finance Cost	(6,625)	(4,963)	(3,638)
Other Income	2,449	1,999	1,444
Profit Before Tax	11,895	23,970	22,131
Profit After Tax	8,208	16,139	15,160

Source: Company Reports and WE Research

Declining international urea prices, not a big hazard

Local prices of urea are available at an offering rate of Rs 1,818/bag, whereas the landed cost of imported urea is around Rs 2,256/bag. Hence, the declining price of international urea is still far away to threat local producers.

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DAP business now in EFERT

To broaden its business network, Engro fertilizer also took over trading section of Engro Eximp in Rs 4.4 billion, after which the company will also be occupied in import and marketing of phosphate based fertilizers (DAP & MAP) and micronutrients. The consolidation of fertilizers business under one entity will further strengthen synergies between the Engro's business lines and allow the Group to create value and increase its footprint in agricultural inputs. To uphold attention on the core business, Eximp has ceased its Coal and Agri-commodities dealings. On the other hand, Engro Fertilizer Company is also exploring venues in consideration of expansion in UAE and Africa due to prevailing gas crisis in Pakistan..

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EFERT's Balance sheet all set to absorb vigorous payouts

Going forward, the cash flows of Engro fertilizer are expected to remain strong. Despite outstanding payments of Rs 10 billion under debt obligation and Gas Infrastructure Development Cess, we expect the company to maintain healthy EPS. This calculation has been maintained due to the fact that Engro fertilizer will get benefits from concessionary gas as well as EXIMP business involvement.

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Budget FY15-16 - Agricultural sector remained main focus

Government kept Rs 145 billion to gather through GIDC that is in line with revised estimates for FY14-15 budget, hence brought good news for Engro Fertilizer.

Custom duty on import of DAP is revised to 2% from 1%; but it will not impact the company books, as we expect the difference to be transferred to end consumer.

Different brands comprises of Olper's (UHT milk, low-fat milk, cream, desi ghee, lassi and flavored drinks), Omoré (frozen desserts), Tarang (tea whitener) and Dairy Omung (UHT dairy liquid and dessert cream). Improved macroeconomic indicators and declining commodity prices are indicating better future for the company that will continue its thrust to grow in all categories, including its highest ever UHT market share, by making significant brand investment and remains confident of maintaining a strong performance for the year 2015.

Custom duty on Skim Milk Powder is decreased to 20% on import from non-SAARC countries. Efoods placed Olpers for elite target market; hence imposition of Sales Tax may not bring any problem as such for this product. Having said this, we believe the company might seek wait and see approach for its competitors to take the first step in price increase.

Engro Foods - Cream of the crop
EFoods is an 87% owned subsidiary of Engro Corporation. It is engaged in the manufacturing, processing and marketing of dairy products, frozen desserts and fruit drinks. Different brands comprises of Olper's (UHT milk, low-fat milk, cream, desi ghee, lassi and flavored drinks), Omoré (frozen desserts), Tarang (tea whitener) and Dairy Omung (UHT dairy liquid and dessert cream). Improved macroeconomic indicators and declining commodity prices are indicating better future for the company that will continue its thrust to grow in all categories, including its highest ever UHT market share, by making significant brand investment and remains confident of maintaining a strong performance for the year 2015.

Majority converted from Zero-rated sales tax to tax exempted
As per the proposal of FBR, the government converted the status of dairy products from Zero-rated to sales tax exempted category, except baby formula milk. Non branded milk and dairy products would be exempted from sales tax which means that the input taxes paid at the procurement stage were earlier claimed by the companies from the government, but this will not be the case anymore. Further, the government also imposed 10% sales tax on branded dairy products including flavored milk, cream, desi ghee, yoghurt, milk, cream and cheese. On the other hand, the custom duty on Skim Milk Powder is decreased to 20% on import from non-SAARC countries. Efoods placed Olpers for elite target market; hence imposition of Sales Tax may not bring any problem as such for this product. Having said this, we believe the company might seek wait and see approach for its competitors to take the first step in price increase. On the other hand, Omang will face the main test, since it was positioned for middle class. Cheaper and GST-free loose milk will give tough competition to the brand. Tarang's high price elasticity of demand will also make it difficult to pass through the cost impact.

Rs in million	**CY14A**	**CY15E**	**CY16E**
Net Sales	43,027	49,629	51,900
Gross Profit	8,101	12,990	13,072
Profit After Tax	888.831	3,828	4,323

Source: Company Reports and WE Research

Key Risks

GIDC Bill - Is the honeymoon period over?
During May 2015, Gas Infrastructure Development Cess Bill has been levied according to which new fertilizer feed plants are required to pay Rs 300/MMBTU as Cess. Before this bill, Engro Fertilizers Company limited was enjoying the CESS exemption benefit under Fertilizer Policy 2001. Although the company has taken stay order, but the leverage seems to be blur for longer time. If they were unable to get the stay order, their yearly earnings would slip from Rs 12.22/share to Rs 7.90/share.

Failure of Long Term Gas Supply
Any delay or failure of materialization of long term gas supply would significantly affect Engro's valuations and target price as gas from Guddu would be available till Dec'15.

Super Tax Imposition - An inevitable hit to gulp
One-time super tax has been introduced in Federal Budget FY15-16, according to which all those companies enjoying PAT of over and above Rs 500 million in tax year 2015 will have to pay 3% of their income. This amount will be utilized for the rehabilitation of Temporarily Displaced Persons.

Company Introduction
Engro is one of Pakistan's largest conglomerates with various business entities. The principal activity of the Company is to manage investments in subsidiary companies and joint venture, engaged in fertilizers, PVC resin manufacturing and marketing, food, energy, LNG and chemical terminal & storage businesses. Engro is Pakistan's 2nd largest urea manufacturer with production capacity of 2.275 million tons along with largest phosphate importer in Pakistan.

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ENGRO - Financial Highlights

Valuation

	CY14A	CY15E	CY16E	CY17E
EPS (Rs)	13.38	30.26	33.40	35.10
Book Value (Rs/share)	129.9	152.3	175.0	198.6
DPS (Rs)	6.00	12.00	13.00	15.00
P/E (x)	22.72	10.05	9.10	8.66
P/BV (x)	2.34	2.00	1.74	1.53
Dividend Yield (%)	2.0	3.9	4.3	4.9
Dividend Payout (%)	44.9	39.7	38.9	22.8

Source: Company Reports & WE Research

Key Ratio Analysis

	CY14A	CY15E	CY16E	CY17E
Current Ratio (x)	0.88	1.13	1.21	1.32
ROE (%)	10.3	19.9	19.1	17.7
ROA (%)	3.2	7.5	8.2	8.7
Gross Margins (%)	20.57	27.86	28.51	28.43
Net Margins (%)	4.0	8.7	9.1	9.3
Sales Growth (%)	13.3	3.2	6.2	3.0
PAT Growth (%)	(10.4)	126.2	10.4	5.1

Source: Company Reports & WE Research

Income Statement

Rs in million	**CY14A**	**CY15E**	**CY16E**	**CY17E**
Sales	175,958	181,519	192,774	198,595
Cost of Sales	139,770	130,950	137,821	142,125
Gross Profit	36,189	50,569	54,953	56,470
Marketing Expenses	14,804	16,577	17,695	18,529
Operating Profit	21,384	33,992	37,258	37,940
Other Expenses	2,500	2,835	3,025	3,076
Finance Cost	12,344	12,034	11,615	10,827
Profit Before Tax	10,983	23,603	26,388	27,793
Taxation	3,182	6,543	7,582	8,043
Profit After Tax	7,801	17,060	18,806	19,750

Source: Company Reports & WE Research

Balance Sheet

Rs in million	CY14A	CY15E	CY16E	CY17E
Share Capital	5,238	5,238	5,238	5,238
Shareholder Equity	68,025	79,778	91,657	104,020
Non-Current Liabilities	62,187	54,353	41,196	28,057
Current Liabilities	86,875	77,714	79,458	80,343
Total Liabilities	149,062	132,067	120,654	108,400
Non-Current Assets	140,796	124,171	115,932	106,437
Current Assets	76,291	87,675	96,379	105,983
Total Assets	217,087	211,845	212,311	212,421

Source: Company Reports & WE Research

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