PAKISTAN

Engro Corporation Ltd.

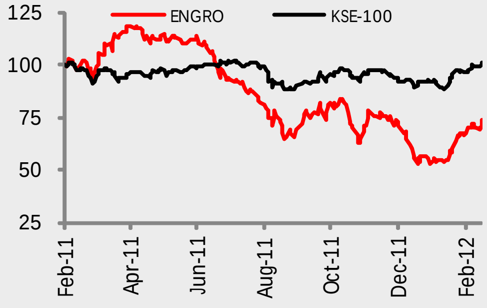
20 February 2012

ENGRO PA		Outperform
Stock price as of 17 Feb	Rs	133.9
Jun 12 target	Rs	210.1
Upside/downside	%	56.9
Valuation	Rs	210.1
- DCF based		
Fertilizer Sector		
Market cap	Rs bn	52.7
30-day avg turnover	US$m	4.6
Market cap	US$m	585.1
Number shares on issue	m	393.3

Investment fundamentals

Year end 31Dec		2010A	2011A	2012E	2013
Total revenue	m	79,976	114,612	143,125	156,835
EBIT	m	11,923	23,961	22,623	22,881
EBIT Growth	%	74.7	101.0	(5.6)	1.1
Recurring profit	m	6,790	8,060	9,908	12,066
Reported profit	m	6,790	8,060	9,908	12,066
EPS rep	Rs	17.26	20.50	25.19	30.68
EPS rep growth	%	78.4	18.7	22.9	21.8
EPS rec	Rs	17.26	20.50	25.19	30.68
EPS rec growth	%	78.4	18.7	22.9	21.8
PE rep	x	7.8	6.5	5.3	4.4
PE rec	x	7.8	6.5	5.3	4.4
Total DPS	Rs	5.00	6.00	6.00	8.00
Total div yield	%	3.7	4.5	4.5	6.0
ROA	%	4.9	4.7	5.9	7.4
ROE	%	21.9	22.9	23.1	24.8
EV/EBITDA	x	13.8	8.5	6.9	5.5
Net debt/equity	%	298.7	233.2	184.6	138.5
Price/book	x	1.5	1.3	1.1	1.0

ENGRO PK rel KSE100 performance



Source: Bloomberg, Foundation Research, Feb 2012

(all figures in PKR unless noted)

Analyst

Taha Khan Javed, CFA

92 2135612290-94 Ext 313 taha@fs.com.pk

The comeback stock

Event

- After nose-diving in CY11, Engro's stock price has recovered by a remarkable 45% in CY12, versus 10% rise of KSE-100 index. We comment on the latest developments and the CY11 result.
- We have revised our earnings estimates after updating the model given the recent development in various subsidiaries and incorporating the last urea price hike. At current price, we maintain our Outperform stance.

Analysis

- **Fertilizer business weathering the storm:** Engro's new plant (Enven) has undergone numerous shut downs in CY11 due to gas curtailment, and utilization during CY11 stands at around 35% only. Despite being highly leveraged the fertilizer business has been able to fulfill all its financial commitments, repaying PK6bn of debt through its operating cash flows in CY11. The company relied on raising urea prices to meet the shortfall. As winter season comes to end we believe start of Enven (likely from next month) will be a major trigger for the stock. The management feels that cash flow wise, there will be no need to raise urea price if Enven runs for even five and half months. Regarding reducing urea price if Enven production resumes, they are of the view that it is too early to say when they will decrease price, and depends on how sustainable the Enven gas supply is. As per the management, there are various options that are being considered but no definite plan has been finalized.
- **CY11 results show improvement in almost all the businesses:** Engro reported CY11 net income PKR8,060mn (EPS20.5) up by 19% YoY. Most of the businesses profitability improved or losses reduced in the CY11 with fertilizer, power and foods business contributing the most to the gain in profits (See Fig 1 and 2). Vopak's profitability improved due to onetime tax reversal. The company also announced final cash dividend of PKR2.0/share, taking the CY11 payout to PKR6.0/share along 30% bonus share dividend.
- **Power IPO shelved; Fertilizer IPO still on:** The board has decided to shelve the power IPO which was planned to raise funds for the holding company. The board now wants to fully retain the dollar based return asset. Fertilizer IPO whose proceeds will be used to repay its debt, was put on back burner but may occur in CY12 as Enven production starts and market sentiment towards Engro improves.
- **Avanceon to be sold:** The board has decided to dispose of its stake in Avanceon which is expected to take place in early CY12. Impairment regarding the negative equity has been provided for in CY11 accounts.

Earnings Revision

- We have revised up our CY12, CY13 and CY14 earnings by 16%, 13% and 18% respectively, after incorporating the latest urea price rise and revision in other subsidiaries earnings estimates.

Price catalyst

- June-12 price target: PKR210.1/share based on Sum of Parts valuation.

- Catalyst: Any concrete plan on the gas supply issue, boost in DAP import margin and higher income from various ventures.

Action and recommendation

- In our opinion, the company can easily meet its financial obligations if gas supply smoothes out. Engro offers the highest return potential in our FSL universe. We expect decent earnings growth to continue in CY12 and beyond despite assuming low capacity utilization. The stock is trading at an attractive CY12 P/E of 5.3x and P/B of 1.1x. We maintain our Outperform stance.

Fig 1: Engro's CY11 result

Rs mn	CY10	CY11	YoY	3QCY11	4QCY11	QoQ
Net sales	79,976	114,612	43%	32,740	35,788	9%
COGS	59,702	82,531	38%	23,247	26,240	13%
Gross Profit	20,274	32,081	58%	9,493	9,548	1%
Operating Profit	11,984	21,905	83%	6,781	6,626	-2%
Financial & other charges	5,159	14,244	176%	4,251	5,585	31%
PBT	8,277	11,459	38%	3,110	3,421	10%
Profit attributable to equity holders	6,790	8,060	19%	2,209	2,470	12%
EPS (attributable to equity holders)	17.26	20.50	19%	5.62	6.28	12%

Source: Company data, FS Research, Feb 2012

Fig 2: Engro's subsidiaries revenue and earnings

Revenue	CY10	CY11	YoY	Profit	CY10	CY11	YoY
Fertilizer	19,018	31,353	65%	Fertilizer	3,730	4,588	23%
Polymer	14,737	16,376	11%	Polymer	(770)	(706)	-8%
Food	21,050	29,859	42%	Food	176	891	407%
Power	5,727	8,338	46%	Power	1,100	1,718	56%
Vopak	2,303	2,286	-1%	Vopak	1,109	3,484	214%
Eximp	17,720	26,103	47%	Eximp	1,734	858	-51%
Avanceon	1,829	1,268	-31%	Avanceon	(196)	(169)	-14%
Engro Corp share	79,976	114,612	43%	Engro Corp share	6,790	8,060	19%

Source: Company data, FS Research, Feb 2012

About The Company

Engro Corporation Limited is the parent company of Engro Fertilizer which is the largest urea manufacturer in the country after declaring COD of its 1.3mn tons/annum urea plant. Engro Fertilizer Limited now has a total name plate capacity of 2.3mn tons per annum of urea and blended fertilizer (NPK) capacity of 160k tons per year. Additionally, the company imports and sells phosphatic fertilizers for balanced fertility and improved farm yields.

Engro Corporation also has major investments in dairy, power, business solutions, port handling and polymer industries. The company is listed on all the three stock exchanges of the country. Currently Engro Corp's two subsidiaries (Engro Polymer and Chemical Ltd and Engro Foods Ltd) are listed while plans are underway to get Fertilizer subsidiary listed.