February 20, 2012

Pakistan Market

MORNING BRIEFING

Engro Corporation's analyst briefing takeaways

KSE100 Index: Closing 12,495.68 ↑ (91.44)

Engro Corporation held its analyst briefing on Friday to discuss its 2011 financial result. The company posted earnings of Rs8.1bn (EPS: Rs20.50) compared to a profit after tax of Rs6.8bn (EPS: Rs17.27) in 2010, up 19%YoY. Engro Fertilizers, Engro Foods, Engro Powergen and Engro Vopak were the major growth drivers as these subsidiaries recorded profits of Rs4.6bn, Rs0.9bn, Rs1.7bn and Rs3.5bn, respectively. However, losses posted by Engro Polymer and Avanceon resulted in a profitability drag during the period. One of the key takeaways from the analyst briefing was the urea price hike of Rs549/bag that was attributable to offset production losses due to 198 days of gas related shutdowns. Although the management is continuously looking for alternate gas supply solution to their Enven plant, there has not been any concrete development on the issue. As the likelihood of the resumption of gas supply on continuous basis to SNGPL based plants seems dim, the urea prices may not come down and exorbitant margins enjoyed by other urea plants like FFC and FFBL will continue. Consequently, we have an 'Overweight' stance on the sector.

After tax profits

(Rs mn)	2011	2010
Engro Fertilizers	4,588	3,730
Engro Foods	891	176
Engro Polymer	(706)	(770)
Engro Powergen	1,718	1,100
Engro Eimp	858	1,734
Engro Vopak	3,484	1,109
Avanceon	(169)	(196)
Engro Corp.(Consolidated)	8,060	6,790
EPS (Rs)	20.50	17.27

Source: Company presentation

Fertilizer, Foods and Powergen lead growth

Higher urea prices together with increased volumetric sales (due to addition of the Enven plant) helped Engro Fertilizer report earnings of Rs4.6bn, 23%YoY higher from Rs3.7bn in last year. Engro Foods also contributed significantly towards growth by reporting earnings of Rs891mn, up 406%YoY that is mainly attributable to the dairy and juices segment. Strong financial performance of Powergen due to higher load factor also contributed positively to the bottom line of the company. Engro Vopak continued with its smooth operations, however, due to tax reversal of Rs2bn, the company's profit enhanced by 214%YoY to Rs3.5bn.

Engro Polymer and Chemicals and Avanceon remained in the red territory. The primary reason for EPCL's losses is the unstable operations of its VCM along with the low primary margins on PVC production. The sales in Pakistan and UAE for Avancon declined due to macroeconomic slowdown. Furthermore, Engro's board has decided to divest from this business for which the MOU has been signed to handover the business to Wain family that is expected to be completed by early 2012.

Gas availability in 2012

Engro Fertilizer's Enven plant produced merely 448k tons in 2011. The lower production was attributable to gas related woes due to which urea prices were increased by Rs549/bag during 2011 to incorporate production losses of 198 days. Although the management is continuously looking for alternate gas supply solution to their Enven plant, there has not been any concrete development on the issue. The alternatives like gas supply through SSGC, Mari network or through LNG imports; all seem unfeasible solutions at this point in time due to various reasons. Therefore, the likelihood of the resumption of gas supply on continuous basis to SNGPL based plants seems dim.

Fertilizer sector: Best may be sustained

If the gas supply situation on the SNGPL based plants continues this way, ENGRO will be able to retain its margins. ENGRO will continue to operate at its desired level of profitability even if it's Enven plant is provided gas for 5 and a half months in 2012. Even if the gas supply situation gets worse, the company still has room for further increase in urea prices as international urea prices are still at a premium of ~40% compared to local urea prices.

On the other hand, the downside of other urea manufacturers also seems limited in the current scenario. As the probability of reduction in urea prices is directly linked to Engro's gas supply. According to Engro's management, if gas is supplied to them on a continuous basis, only then it would consider reducing urea prices. Consequently, the urea prices may not come down and exorbitant margins enjoyed by other urea plants like FFC and FFBL will continue. At this moment, the only threat to other urea manufacturers remains the equalization tax, which plans to tax those fertilizer producers facing lesser gas curtailment. Nevertheless, we believe the fertilizer sector will continue to perform and we have an 'Overweight' stance on the sector.

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Engro Corporation Limited

Market Price: Rs133.99	**Kats Code:** ENGRO
Market Cap: Rs52.7bn (US$580.3mn)	**Bloomberg Code:** ENGRO PA
1-yrs Avg. Daily Volume: 2.4mn shares, Rs357.1mn (US$3.9mn)	**Reuters Code:** EGCH.KA
1-year High/Low: Rs237.19/91.97	

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