

September 07, 2009

**Pakistan Market****EPCL: 1H2009 accounts review/'Hold' maintained**

KSE100 Index: Closing 9002.68 ↑ (+185.08)

**MORNING BRIEFING**

Engro Polymer and Chemicals (EPCL) in its 1H2009 results posted earnings of Rs7.1mn (EPS 0.01) as against Rs427mn (EPS of 0.83) in corresponding period last year, depicting a decline of 98%YoY. Dwindling gross margins (down 1,247bps) and sizeable jump of 665% in finance costs were the key reasons for the decline in profitability of the company. In today's briefing we discuss its recently released 1H2009 detailed accounts.

prices have not seen any significant slip post EPCL's plant coming online in July 2009. International Ethylene prices, a major cost driver for VCM production, are also down 28% since June 30 due to facilities coming online in the Middle East. Hence, gross margins for the company are expected to benefit from these developments. With EPCL currently trading at 2010E PE of 8.2x, at par with the market's multiple, we maintain our 'Hold' stance on the scrip.

Engro Polymer	
<b>Market Price:</b> Rs21.83	<b>Kats Code:</b> EPCL
<b>Market Cap:</b> Rs11.4bn (US\$137mn)	<b>Bloomberg Code:</b> EPCL PA
<b>1-yrs Avg. Daily Volume:</b> 1.0mn shares, Rs21mn (US\$0.3mn)	<b>Reuters Code:</b> EPCL.KA
<b>1-year High/Low:</b> Rs26.25/12.50	

**Gross profit down 54%YoY despite sales up 13%**

EPCL posted net sales of Rs4.9bn versus Rs4.4bn, a rise of 13%YoY. Increase in volumetric sales was the driving factor behind this increase as it also compensated for lower PVC prices during the period. Though volumetric sales rose by 22% to 60,900 tons from 49,800 tons in 1H2008, capacity utilization fell to 81% from 100% as capacity increased by 50k to 150k tons. Moreover, PVC prices on average fell by approximately 60%YoY at the back of global recessionary woes. Despite VCM prices, a major raw material for PVC, declining by 53%YoY, cost of sales rose to Rs4.5bn led by 20% rupee depreciation. Resultantly, gross profit fell by 54%YoY to Rs415mn with gross margins down 1,247bps to 8%.

**7x jump in financial charges hurt bottom-line**

Financial cost for the company rose to Rs119mn in 1H2009, up 665% at the back of borrowings to finance its horizontal expansion. Moreover, distribution & administration expenses also saw a jump of 19%YoY thus bringing down net margins by 963bps to 0.14% (net profit down 98%YoY).

**Recommendation: 'Hold' maintained**

Though the Chlor-alkali and EDC plants have commenced production, successful commissioning of the VCM plant will be the key to boost profitability of the company. The plant is expected to come online during the third quarter of 2009. Moreover, PVC prices have risen 8% since June 30, 2009 and are currently trading at US\$938/ton while Caustic Soda

**Table: Financial Highlights**

(Rs mn)	1H2009	1H2008	Δ%
Net Sales	4,945	4,369	13%
Cost of Sales	4,530	3,457	31%
Gross Profit	415	912	-54%
<i>Gross Margin</i>	8.4%	20.9%	
Distribution expenses	182	149	22%
Administrative expenses	78	70	12%
Other operating expenses	88	132	-34%
Other operating income	55	88	-38%
Operating profit	123	649	-81%
Finance costs	119	16	665%
PBT	4	633	-99%
Taxation	(3)	206	-102%
PAT	7	427	-98%
<i>Net Margin</i>	0.1%	9.8%	
EPS	0.01	0.83	98%

Source: Company Accounts

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**Also in focus****WB proposes changes in local tax regime**

The World Bank in its recently released report on Tax policy has proposed multiple measures to enhance the tax base in the country. The report proposes creation of a withholding system for the agriculture income tax (AIT), introducing a modern value added tax, taxing short term stock market related capital gains and tax broker's income according to the non-salaried income tax schedule. The report estimates additional tax revenue of Rs400bn from the implementation of these proposed measures.

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