

December 14, 2009
Pakistan Market

MORNING BRIEFING



Engro: Company update 'Buy' maintained

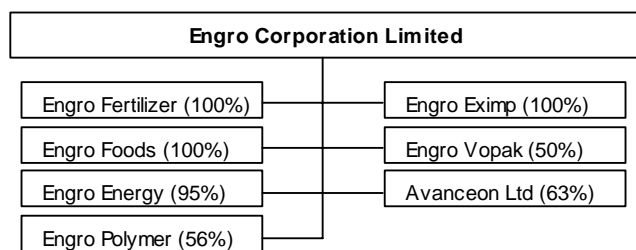
KSE100 Index: Closing 9037.30 ↑ (+37.91)

The approval of the demerger petition granted by the Sindh High Court, marked the conclusion of Engro Chemical Pakistan Limited (ECPL)'s demerging process. According to the petition, ECL (Engro Corporation Limited, formerly known as ECPL), will act as a holding company, with a wholly owned subsidiary Engro Fertilizer Limited (EFL) handling its fertilizer business. Consequently, ECL's earnings are likely to be revised upwards owing to a change in the benchmark; going to consolidated accounts from stand alone accounts. However, fundamentally speaking, the demerger is not going to cause any changes to our valuation, as we already take account of subsidiary earnings using the Sum of the Parts (SoTP) valuation method. Trading at a 2010F PE of 9.8x, we reiterate our 'Buy' stance on the scrip.

Demerger a positive step; no impact on valuation

The demerger is likely to bode well, as it will allow EFL's management to focus solely on the fertilizer business, and ECL to concentrate on strategizing to generate stronger results, raise more capital at the entity level when required and clearly define the roles for each of its affiliates.

Graph: ECPL after demerger



Source: JS Research

Though the demerger would have no major impact on our earnings estimate, a change in point of reference to consolidated accounts (previously standalone) will result in an upward revision in our forecasts. Interestingly, till now, the

difference between the two sets of account had been negligible, as high start up costs for the affiliates such as Engro Foods (advertising costs), and development and expansion costs for the power business had been muting overall earnings. Going forward, through higher than expected milk share gains (up 4% in the last quarter to 39%) from Engro Foods, a 1.3mn tons urea expansion plan and a 220MW power plant set to come online, are likely to generate higher revenues for ECL. However, as fore-mentioned, no changes will be made to our valuation as we have been taking into account all the affiliates data, in estimating our SoTP target price.

Standalone 2009E EPS: Rs12.3

With high prevailing higher urea prices (avg. Rs700 per bag in 2009) and a higher DAP offtake (at lower prices compared to last year), we expect ECPL to post net revenues of Rs31bn in 2009 compared to Rs23bn in 2008. 10M2009 urea offtake for Engro stands at 758mn tons, while DAP offtake has risen considerably by 195% to 214mn tons. However, higher input costs and lower DAP prices are likely to suppress gross margins to 23% from 27% in 2009. Further, lower dividend income expected from Engro Eximp in 2009, will result in a 14% earnings decline in 2009. Consequently, we are expecting ECPL, pre demerger, to post earnings of Rs3.7bn (EPS of Rs12.3) in 2009 as against profits of Rs4.2bn (EPS of Rs14.2) in 2008.

Valuation: 'Buy' maintained

The 1.3mn tons urea expansion, 220MW power plant and expected positive cashflows from Engro Foods beyond 2010 are key valuation triggers for the company. The scrip is presently, trading at a 2010F PE of 9.8x, thus we reiterate our 'Buy' stance.

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Also in focus

Trade deficit down 16% in Nov 09 to US\$986mn

Pakistan's trade deficit has narrowed to US\$986mn in the month of November 2009, as compared to US\$1.18bn November, last year, down 16%YoY. According to the Federal Bureau of Statistics, exports stood at US\$1.54bn, against US\$1.52bn in the same month last year, while imports have declined from US\$2.71bn in November last year to US\$2.52bn this year. The trade deficit for 5MFY10 has declined 37.6% to US\$5.47bn, mainly on the back of lower commodity prices in the current fiscal year. Our full year estimate for the deficit in FY10 stands at US\$14bn as against an actual deficit of US\$17bn in FY09.

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