

April 30, 2010

Pakistan Market**Engro Corporation analyst briefing takeaways****MORNING BRIEFING**

KSE100 Index: Closing 10454.63 ↓ (-64.39)

Engro Corporation (Engro) held its analyst briefing yesterday to discuss its 1Q2010 result. The company posted earnings of Rs1.9bn (EPS: Rs5.76) compared to profit after tax of Rs684mn (EPS: Rs2.09) in 1Q2009, up 176%YoY. Engro Fertilizer Limited (EFL), the fertilizer arm, Engro Eximp (the trading arm) and the chemical storage business (Engro Vopak) were major growth drivers as these subsidiaries recorded profits of Rs773mn, Rs897mn and Rs264mn respectively. However, losses posted by Engro Polymer and Avanceon remained minor irritants during the period. However, despite a robust result the investor's confidence in the stock has been hit by the on going energy crisis which has forced the government to curtail gas supply to the fertilizer sector.

Gas curtailment and its impact

The major focus of the discussion remained on gas curtailment, which is likely to affect its fertilizer business. As per the gas load management plan, the government has cut gas supply to the fertilizer sector in the vicinity of 15-20% for a period of 2-3 months. If the gas supply is reduced by 20%, we believe the company will take a 20% production hit. However, the impact on its earnings is likely to be higher given the element of fixed cost.

While, Engro currently remains least sensitive to the gas load shedding due to its diverse structure, gas supply disruptions to the new plant could severely dent earnings of the Fertilizer business. According to our estimates, a 20% gas curtailment would see EFL's earnings decline by 64% to Rs3.9 per share in 2011. FFC and FFBL earnings on the other hand would witness a fall of 27% and 31%, respectively. Our estimation ignores the impact of any price hike, which is likely to be undertaken by the manufactures.

Moreover, commissioning of the new IPPs by the Nishat Group and Hubco in 2H2010, together with possible sanctioning of some RPPs could result in lower gas curtailment in 2H2010.

Sensitivity of Gas curtailment

Base Case	2010	2011	2012	* TP
FFC	14.0	14.5	15.0	135.0
FFBL	4.2	4.2	4.3	35.0
Engro Fert. (old)	10.0	10.5	14.5	240.0
Engro Fert. (old & new plant)	10.0	10.5	14.5	240.0
10% gas curtailment	2010	2011	2012	* TP
FFC	12.6	12.3	12.9	115.0
FFBL	3.6	3.6	3.7	29.5
Engro Fert. (old)	8.6	9.1	13.6	228.0
Engro Fert. (old & new plant)	8.1	7.4	10.9	205.0
20% gas curtailment	2010	2011	2012	* TP
FFC	11.4	10.5	10.9	98.0
FFBL	3.0	2.9	3.0	24.5
Engro Fert. (old)	7.4	8.5	12.4	211.0
Engro Fert. (old & new plant)	6.8	3.8	7.2	170.0

Source: JS Research; TP = Target Price

* TP for Engro Fert refers to Engro Corp

Foods and Energy to be major earning drivers

Amidst the energy crisis, Engro's diverse portfolio is likely to provide a hedge against the current gas curtailment issue. Engro's investment in the energy sector has already started to pay off, as Engro Energy registered a profit of Rs44mn in 1Q2010. Similarly, the foods business is expected to break even in 2010 and take off strongly in 2011.

Outlook

In the backdrop of the gas supply issue, and major uncertainties regarding the duration of gas curtailment, we advise investors to remain cautious on the sector and switch to the relatively defensive textile and telecom sectors.

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Also in focus**FFC: 1Q2010 EPS stood at Rs4.02, up 1%YoY**

Fauji Fertilizer Company (FFC) announced its first quarter (2010) result today. The company posted below expectation earnings of Rs2.7bn (EPS Rs4.02) versus profits of Rs2.7bn (EPS Rs3.96) in 1Q2009 – an increase of a meager 1%YoY.

Though the topline of the company depicted a growth of 15% primarily on the back of higher urea prices (average urea price: Rs760 per bag, up 12%YoY), 271bps decline in gross margins to 43% diluted the impact of the revenue growth. Moreover, a 20% growth in distribution costs restricted earnings in 1Q2010.

Along with the results, the company announced a first interim cash dividend of Rs4 per share.

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