Pakistan Fertilizer Sector

ENGRO FERTILIZERS LIMITED

Better fertilizer offtake supports earnings growth

Engro Fertilizers Limited (EFERT) held its analyst briefing session today to shed light on 1QCY21 financial result and future roadmap. To recall, the company posted record-high earnings of PKR 5.7Bn (EPS: PKR 4.3) in 1QCY21, up 10.1x YoY. Improvement in earnings was primarily on account of better margins and higher fertilizer offtake during the period. Key takeaways from the briefing are summarized below:

- The company recorded lower urea production of 0.52Mn tons (↓ 9% YoY) compared to 0.57Mn tons in SPLY due to plant turnaround in 1QCY21. on the other hand, urea offtake witnessed a massive surge of 3.4x YoY to 0.60Mn tons due to improved farm economics and low base effect.

- On the prices frond, local urea is trading at a substantial discount of nearly 46% at PKR1,751/bag relative to international prices of USD 350/ton (Landed equivalent of PKR 3,226/bag). According to the management, the industry continues to face challenges due to the pending subsidy receivables from the government (PKR 20.0Bn and PKR 6.5Bn for industry and EFERT, respectively) as the company has already passed subsidy benefit of 2.3x to farmers in form of lower prices.

- On the other hand, the DAP market expanded by 40% YoY to 0.3Mn tons in 1QCY21, with EFERT having a market share of 19% and sales of 62K tons in the same period. Currently, as per the company, DAP prices have maintained their bullish run and are hovering between USD 560-580/ton. The company has increased local prices by 9% in 1QCY21 relative to international DAP prices which surged by 12% during the same period.

- With regards to sales tax disallowance, the company mentioned that they have already obtained specific exemption from providing for input tax on sales to unregistered dealers (SRO 1337(i)/2020 dated December 16, 2020). The company will account for reversal in provision in coming quarters. Additionally, the reduction in minimum and withholding tax rates for dealers from 0.75% to 0.7% and 0.25%, respectively, will encourage more dealers to get themselves registered under the Sales Tax Act. Currently, nearly 59% of EFERT's dealers have been registered.

- The management also stated that for the upcoming budget (FY22), they have proposed FBR to eliminate the mismatch in the sales tax regime on supply of feed (5%) and fuel (17%) stock to fertiliser sector against the output tax (2%) on sale of finished goods. This will lessen the burden of sales tax refundable for the company.

- Commenting on the lack of clarity with regards to suspension of concessionary gas, the company mentioned that they are in talks with SNGPL regarding the timeline and may pursue legal options in case of an unfavourable decision. As per the management, the suspension of concessionary gas will have an earnings impact of ~PKR 2.5/sh.

- To mitigate the impact of suspension of concessionary gas, the company is working on a BMR project to improve the efficiency of its base plant. In this regard, they have also applied for SBP's TERF facility.

- We reiterate our BUY stance on the scrip with our Dec'21 TP of PKR 75/sh, which offers a potential price gain of 15% from the last close.

EFERT vs. KSE-100 Index

%	3M	6M	12M
Absolute	-5	12	32
Relative to KSE	-3	-1	-2

Source: PSX

Recommendation	BUY
Price (PKR)	65
Price Date	19-Apr-21
Target price (PKR)	75
Target Price Date	Dec'21
Potential Price gain (%)	15%

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Buy	>15% expected total return
Hold	10%-15% expected total return
Underperform	<10% expected total return
*Total stock return = capital gain + dividend yield	

Old rating system

Overweight	Total sector return > expected market return
Marketweight	Expected market return
Underweight	Total stock return < expected market return

Valuation Methodology

To arrive at our period end target prices, BMA Capital uses different valuation methodologies including

- Discounted cash flow (DCF, DDM)
- Relative Valuation (P/E, P/B, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)