



ENGRO ISSUES REVISITED....

CY11 PE 7.8x - Buy

Investor concerns

Recently investor concerns have been rising regarding gas issues being faced by Engro along with high gearing ratios and its bumpy relation with the government. We have analyzed financials of the company and also discussed various issues with relevant company officials.

The new plant EnVen is creating suspicions among the investors whether it will be able to operate on full capacity in the midst of gas scarcity coupled with soaring feedstock and fuel stock gas prices. The plant incurred USD1.1bn and has a production capacity of 1.3mn tons which combined with the existing plant of capacity 1mn tons, sums up the total production capacity to 2.3mn tons.

In order to give a birds eye view of Engro's liquidity and gearing position we have conducted an analysis of Engro's financial statements and have come up with the following ratios.

Ratios	CY07	CY08	CY09	CY10
Cash balance	2,133	2,198	6,880	4,120
Debt/Equity	50.30%	63.92%	74.29%	72.50%
Current ratio	2.5	1.7	1.3	0.9
Quick ratio	2.0	1.0	0.9	0.5
Account receivable turnover(times)	22.8	22.1	76.7	22.6
Account receivable turnover(days)	16	17	5	16
Inventory turnover(times)	10.1	6.4	5.4	11.4
Inventory turnover(days)	36	57	68	32

Source: Standard Capital Research

It can be seen that Engro's debt equity has been increasing since CY07 towering to 74.29% in CY09 which is considered very high. The company's current ratio is also deteriorating falling below 1, with quick ratio plunging to 0.53 in CY10 hence showing lack of liquidity of the company. The accounts receivable turnover has remained quite constant since CY07 except for in CY09 when turnover days reached 5 which is less than half of its normal turnover days. Inventory turnover in days is improving from 56 days in CY08 to 32 days in CY10 thereby showing improved inventory management.

The cash base is quite volatile with 2197.6mn in CY08 and 4120mn in CY10

However to clear some of our doubt regarding Engro's stability and operations we had a telephonic Q&A session with an Engro scribe who gave the following replies.

*ACCA (affiliate)

ENGRO closing	162.02
% change	1.83
52weeks high	238.5
52weeks low	155.0
Total shares	393.25mn
Free float sh.	147.48mn
CY10 PE	9.38x
CYE11 PE	7.8x
3 – YEAR AVG PE	10x

Disclaimer: This report has been prepared by Standard Capital Securities (Pvt) Ltd and is provided for information purposes only. The information and data on which this report is based are obtained from sources which we believe to be reliable but we do not guarantee that it is accurate or complete. Standard Capital Securities (Pvt) Ltd accepts no responsibility whatsoever for any direct or indirect consequential loss arising from any use of this report or its contents. Investors are advised to take professional advice before making investments and Standard Capital Securities (Pvt) Ltd does not take any responsibility and shall not be held liable for undue reliance on this report. This report may not be reproduced, distributed or published by any recipient for any purpose.

1) High Gearing of Engro....

The company has planned to reduce its gearing by 5% every year. This is expected to be done through:

- IPOs of its various subsidiaries such as Engro Foods , Powergen, Engro Fertilizers;
- The cash inflows expected from the plant operation etc.
- It was also noted that some company partners are even ready to convert debt into equity.

2) Gas Issue...

As far as the gas issue is concerned we were assured that the EnVen plant is currently operating at an average capacity of 80% while obtaining 80%+ gas supply from the SNGPL and even if this gas constraint continues Engro is optimistic about having no problem in its growth and stability as it will pass on the impact of gas shortage onto the customers through increasing prices of their products. The company had already increased the urea prices by 23% i.e. Rs190 per bag and would increase prices further if gas issues continue.

Industry Urea prices

Rs 1234/ 50 kg bag

Industry DAP prices

Rs 4050/ 50 kg bag

3) Delay in Plant operation...

As for the delay in the EnVen plant operation, the Engro people believe that they started the production in the fourth quarter of 2010 as per their plan. However, problem related to gas surfaced which prompted the company to go to court.

4) Engro's standing on legal grounds...

Lately we saw Engro fighting court cases on account of gas stoppages by the SNGPL causing hindrances in Engro's production schedules. However we have been told that on legal grounds Engro has won its case in the court and thus it's an obligation onto the government to resume its gas supply restart.

Our Outlook...

On basis of the replies it appears that Engro will not be jolted by the gas scarcity and we expect reduced gearing , improved liquidity through IPOs and EnVen plant operation as the plant is expected to make the country self sufficient in urea and therefore we expect optimum sales of EnVen's production.

We have already covered Engro Foods thereby obtaining a DCF fair value of Rs141.4/sh and are also on the verge of fine tuning the Engro Corporation model. We will come up with our opinion on Engro Fertilizer as soon after its IPO in CY11. We expect Engro Corp. to accumulate gains on the IPOs of both the companies.

Engro Corp. yield CY11 PE of 7.8x. Engro Corp. 3-year average PE range is 10x. Even though, Engro's dividend yield is lowest among competitors mainly at the pretext that it offers 'value proposition'. BUY

Standard Capital Securities, 7th Floor, Business Plaza, Mumtaz Hasan Road, off I.I Chundrigar Road, Karachi- Pakistan

Disclaimer: This report has been prepared by Standard Capital Securities (Pvt) Ltd and is provided for information purposes only. The information and data on which this report is based are obtained from sources which we believe to be reliable but we do not guarantee that it is accurate or complete. Standard Capital Securities (Pvt) Ltd accepts no responsibility whatsoever for any direct or indirect consequential loss arising from any use of this report or its contents. Investors are advised to take professional advice before making investments and Standard Capital Securities (Pvt) Ltd does not take any responsibility and shall not be held liable for undue reliance on this report. This report may not be reproduced, distributed or published by any recipient for any purpose.