



July 2, 2011

Pakistan Research

Food | IPO note

**Engro Foods: Value proposition ..... TP Rs 141.4/sh**

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**TRIGGERS....LONG TERM INVESTMENT PROSPECTS**

- The company is planning on being the #2 player in juices and nectar segment within the next 5 years, after Nestle;
- Planning on expanding in the growing milk powder and infant nutrition category (constituting 55% and 18% respectively of total market share) which will enable Engro Foods to attain major portion of market share;
- It has strategic advantage in terms of raw material supply, utilities, manpower and warehousing as the Ice cream plant has been set up in the same facility as the Dairy plant in Sahiwal;
- Engro Foods is also making efforts to export rice and thereby earn revenues in foreign currency;
- Engro Foods has already started incurring capital expenditure for future expansions;
- It is getting listed in order to raise finance for its future projects;
- Some expansions are already being completed in CY11 such as Rice Plant capacity expansion, Ultra Heat Treatment (UHT) machine imports already done and commercial production expected to commence in July CY11.

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**Engro**

**Foods**

**IPO note**

**ENGRO FOOD'S HISTORY AND ITS PRESENT....**

Engro Foods Limited was formed as a wholly owned subsidiary of Engro Corporation (ENGRO) in 2005. It started its operations in 2006 and since then has launched a number of products which have yielded immense margins and flourished largely in the food industry.

**Listing on KSE & LSE**

Engro Foods is now on its way to becoming enlisted on the Karachi Stock Exchange and Lahore Stock Exchange and is offering 27mn shares at an offer price of Rs25/sh (incl. Rs15/sh premium). The public subscription will take place from July 5 to July 7, 2011 in order to raise an amount of Rs675mn for financing future project.

**REVENUE GENERATING SEGMENTS....**

**Dairy and Juices**

Engro Foods main revenue generating area is the dairy segment which grew by 27% in CY10 with a sale of 310mn litres. One of the aspects of this segment is the ever increasing milk prices which will continue to give huge margins to Engro Foods.

**VALUE PROPOSITION**

Engro Foods Ltd. appears value proposition given sponsors approach of investing in home-grown businesses which is being a domain of MNCs since Pakistan's inception. Hence we have come up with a **DCF price of Rs141.4/sh & CY11 EPS of Re0.97/sh. We see earnings growth going forward in CY12 & CY13. [Subscribe](#)**

**IPO price Rs 25/sh**

**Fair price matrix**

Growth	Req. rate of Return	
	20%	21%
3%	133.4	125.5
4%	141.8	133.0
5%	151.5	141.4
6%	162.5	151.0
7%	175.3	162.1
8%	190.3	174.9

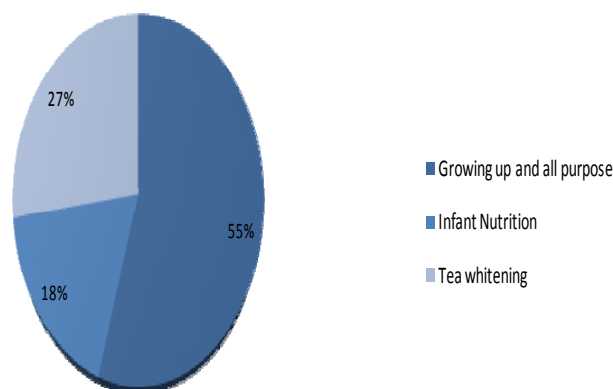
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Engro Foods has recently entered into the **juices and nectars** segment (CY10) as well with the introduction of a new brand named *Olfrute* attaining a market share 1% already. The company is planning on being the #2 player in this segment within the next 5 years, after Nestle, by introducing more brands in this area and by focusing on “Juice and Nectar” and “Value Added Still Drinks” which have a total market size of 114mn litres.

### Powder Milk

Apart from liquid milk and juices one area where Engro Foods has great potential of earning high revenues is the powder milk segment. It has already entered this segment with the launch of *Tarang* Powder Tea Creamer in CY10, thereby attaining a market share of 1%. It is now planning on increasing its market share by offering products in Growing Milk Powder (55%) and Infant Nutrition Category (18%) which will enable Engro Foods to increase its profit margins as this area has great potential for expansion in the country on account of escalating population. This will facilitate Engro Foods to capture the powder milk market to a major extent and attain its goal of achieving the 2<sup>nd</sup> place after Nestle.



### Ice-cream

Like Nestle, Engro Foods also entered into the Ice-cream segment and in a short period has acquired the 2<sup>nd</sup> place by introducing its brand *Omore*. It has managed to acquire a market share of 17% and expects to grow further.

Engro Foods current production capacity is as under:

Production Capacities	Dairy Plants (UHT processing plants) (mn litres per day)	Ice-cream Plant (mn litres per annum)
Sukker Plant	0.4	0
Sahiwal Plant	0.7	2.2

Source: Company prospectus

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### RICE EXPORT AND RICE PLANT EFFICIENCY....

The rice plant commissioned in CY10 having initial capacity to receive 60KT of rice paddy. Engro Foods is making efforts to undertake further expansion in CY11 to enhance the capacity to 120KT, hence resulting in a milling capacity of 56KT enough to process 120KT of paddy. The expansion will incur Rs350mn out of which Rs125mn has already been incurred till April CY11. This processed rice is planned on being exported to earn escalated revenue.

The positive aspect of this rice plant is that it would be very efficient in terms of utilisation of energy and manpower as the chief source of power will come from rice husk, by-product of rice processing, based boiler.

### AL-SAFA ACQUISITION....

Acquisition of *Al-Safa* is another major step to be taken by Engro Foods in order to expand their business overseas. Engro Corporation has acquired an existing brand of *Halal* meat known as *Al-Safa* in April CY11, which is the oldest *Halal* meat brand in North America. Engro Foods shall purchase the entire shareholding of Global Business Unit (GBU) from Engro Corporation by June CY12 at the actual rupee amount invested in the said business till that day by Engro Corporation.

### FUTURE EXPANSIONS...

Engro Foods is already on its way of undertaking further expansions to earn higher profits. It has decided to spend a total of Rs5184mn out of which Rs1.5bn has already been spent in the 4M CY11.

CY11 Expansions	Total Expenditure (Rs mn)	Capital Expenditure Incurred as of April	Remaining Capital Expenditure to be incurred in CY11
Dairy and Juices	3,337	654	2,683
Ice cream	1,091	539	552
Farm	406	230	176
Investment in Engro foods Supply Chain (Rice Plant)	350	125	225
<b>TOTAL</b>	<b>5,184</b>	<b>1,548</b>	<b>3,636</b>

Source: Company prospectus

### Dairy and Juices

Engro Foods will increase the **milk procurement capacity** by adding substantial number of Milk Collection Centres (MCC) to the existing network of more than 700MCCs.

**New pre-processing machines, UHT machines and filling machines** for different size Stock Keeping Units (SKU) will be added to the capacity to take the overall filling capacity to 1.4mn litres per day (LPD). UHT machinery has already arrived on site and commercial production is expected to commence by July CY11. This will enhance Engro's production resulting in increased margins.

**Raw material, Packaging and Finished goods storage space** and the overall utilities setup is also expected to be expanded to provide support to bigger plants.

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**PROFIT & LOSS ACCOUNT**

Rs '000	CY07	CY08	CY09	CY10	CYE11	CYE12	CYE13
Net sales	3,631,134	8,173,497	14,665,341	20,944,943	30,318,390	40,366,044	56,076,113
Cost of sales	3,370,423	7,127,613	12,163,291	16,552,117	23,172,964	29,661,394	40,636,109
Gross profit	260,711	1,045,884	2,502,050	4,392,826	7,145,426	10,704,650	15,440,004
Distr. and mktg. exp.	949,941	1,304,537	2,419,019	2,913,448	4,224,500	5,407,359	6,921,420
Admin. exp.	128,679	303,954	346,696	473,196	664,049	923,609	1,276,611
Other operating exp.	32,144	20,483	53,038	131,460	326,021	808,532	2,005,158
Other operating income	1,761	79,974	175,976	54,942	54,942	54,942	65,930
Operating profit(EBIT)	(848,292)	(503,116)	(140,727)	929,664	1,985,799	3,620,092	5,302,745
Finance costs	105,450	353,986	515,305	659,562	870,622	1,149,221	1,516,971
PBT	(953,742)	(857,102)	(656,032)	270,102	1,115,177	2,470,871	3,785,773
Tax @35%	(333,809)	(302,965)	(222,739)	94,478	390,312	864,805	1,325,021
PAT	(619,933)	(554,137)	(433,293)	175,624	724,865	1,606,066	2,460,753
EPS	-3.9	-2.3	-1.0	0.3	0.97	2.1	3.3
Earnings growth	0%	-11%	-22%	-141%	313%	122%	52%

Source: Standard Capital Research &amp; Company Accounts

**RATIOS & MARGINS**

Ratios	CY07	CY08	CY09	CY10	CYE11	CYE12	CYE13
cost/sales	93%	87%	83%	79%	76%	73%	72%
distr.&mktg./sales	26%	16%	16%	14%	14%	13%	12%
admin./sales	4%	4%	2%	2%	2%	2%	2%
current ratio	1.4	2.0	1.3	1.5	1.0	1.0	0.9
int. coverage	-8.0	-1.4	-0.3	1.4	2.3	3.2	3.5
debt/equity	139%	123%	108%	94%	167%	221%	283%

Source: Standard Capital Research &amp; Company Accounts

Margins	CY07	CY08	CY09	CY10	CYE11	CYE12	CYE13
GP margin	7%	13%	17%	21%	24%	27%	28%
EBITDA margin	-5%	2%	5%	11%	12%	16%	22%
EBIT margin	-23%	-6%	-1%	4%	7%	9%	9%
Net margin	-17%	-7%	-3%	1%	2%	4%	4%

**FUTURE OUTLOOK**

Engro Foods appears to be a strong company from its current operations and its future plans look enthusiastic. Engro Foods appear to be **value proposition** and hence perusing a diversified portfolio strategy in order to reduce its dependence on any one segment and hence protect itself from any adverse events in any segment. **We have come up with a DCF fair value of Rs141.4/sh & CY11 EPS of Re0.97/sh. We see earnings growth going forward in CY12 & CY13. [Subscribe](#)**

Fair value	Rs '000	CY08	CY09	CY10	CYE11	CYE12	CYE13
FCFE		896,980	(432,455)	960,259	1,518,954	10,269,589	16,162,811
FCFE/sh		5.7	(1.8)	2.1	2.7	13.7	21.6
terminal value							146
fair value		\$141.41					

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Balance Sheet	CY07	CY08	CY09	CY10	CYE11	CYE12	CYE13
<b>ASSETS</b>							
<i>non current assets</i>							
PPE	2,743,719	4,566,710	5,808,796	7,148,219	12,332,219	14,182,052	16,876,642
long term investments	-	-	153,000	980,000	2,310,180	3,559,987	5,485,941
biological assets	10,065	306,826	438,873	428,293	513,952	570,486	684,584
intangible assets	3,971	18,688	27,804	142,433	213,650	320,474	487,121
long term loans and advances	5,612	8,758	7,846	16,086	916,086	925,247	934,499
long term deposits	-	-	-	7,040	6,336	6,399	7,039
<b>total non current assets</b>	<b>2,763,367</b>	<b>4,900,982</b>	<b>6,436,319</b>	<b>8,722,071</b>	<b>16,292,422</b>	<b>19,564,646</b>	<b>24,475,825</b>
<i>Current assets</i>							
stores spares loose tools	78,792	187,726	289,655	441,841	680,435	1,047,870	1,613,720
stock in trade	418,132	1,239,258	1,163,807	2,089,221	3,133,832	5,327,514	8,950,223
trade debts, unsecured	8,067	8,574	24,683	51,879	97,014	209,996	356,993
advances deposits and prepayments	40,623	122,403	338,589	244,209	366,314	549,470	796,732
other receivables	864,852	711,230	572,274	720,735	915,333	1,539,076	2,123,924
taxes recoverable	415	55,882	31,425	9,417	3,767	1,507	1,205
derivative financial instruments	-	-	-	510	-	-	-
cash and bank balances	155,165	99,477	148,434	180,181	775,181	434,839	239,904
<b>total current assets</b>	<b>1,566,046</b>	<b>2,424,550</b>	<b>2,568,867</b>	<b>3,737,993</b>	<b>5,971,875</b>	<b>9,110,272</b>	<b>14,082,701</b>
<b>TOTAL ASSETS</b>	<b>4,329,413</b>	<b>7,325,532</b>	<b>9,005,186</b>	<b>12,460,064</b>	<b>22,264,297</b>	<b>28,674,918</b>	<b>38,558,526</b>
<b>EQUITY</b>							
share capital	2,200,000	4,300,000	5,423,000	7,000,000	7,480,000	7,480,000	7,480,000
share premium	-	-	-	-	405,000	405,000	405,000
advance against issue of share capital	200,000	50,000	-	-	-	-	-
hedging reserve	-	-	-	331	-	-	-
accumulated loss	(1,064,116)	(1,618,253)	(2,051,546)	(1,875,924)	(1,894,683)	(1,913,630)	(1,722,267)
	1,335,884	2,731,747	3,371,454	5,124,407	5,990,317	5,971,370	6,162,733
<i>non current liabilities</i>							
long term finances	1,393,000	2,741,667	3,325,001	4,625,000	9,712,500	13,014,750	17,179,470
obligations under finance lease	12,034	15,287	7,838	4,714	4,667	3,733	2,016
deferred taxation	451,699	598,534	301,447	180,964	271,446	165,582	248,373
deferred liabilities	2,199	2,592	2,696	3,462	4,328	5,453	7,034
<b>total non current liabilities</b>	<b>1,858,932</b>	<b>3,358,080</b>	<b>3,636,982</b>	<b>4,814,140</b>	<b>9,992,940</b>	<b>13,189,518</b>	<b>17,436,893</b>
<i>current liabilities</i>							
current portion of							
*long term finances	-	58,333	116,666	200,000	500,000	870,000	1,522,500
*obligations under finance lease	5,197	7,843	5,443	3,675	6,248	10,308	14,947
trade and other payables	618,223	790,217	1,582,531	2,040,575	4,453,503	6,279,439	9,419,158
accrued interest / mark up on							
*long term finances	-	176,411	182,561	275,077	412,616	635,428	972,205
*-short term finances	-	23,367	1,781	2,190	12,045	42,158	134,904
short term finances	511,187	179,532	107,768	-	896,630	1,676,698	2,895,186
<b>total current liabilities</b>	<b>1,134,607</b>	<b>1,235,703</b>	<b>1,996,750</b>	<b>2,521,517</b>	<b>6,281,040</b>	<b>9,514,030</b>	<b>14,958,900</b>
<b>TOTAL LIABILITIES</b>	<b>2,993,539</b>	<b>4,593,783</b>	<b>5,633,732</b>	<b>7,335,657</b>	<b>16,273,981</b>	<b>22,703,548</b>	<b>32,395,793</b>
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>4,329,423</b>	<b>7,325,530</b>	<b>9,005,186</b>	<b>12,460,064</b>	<b>22,264,297</b>	<b>28,674,918</b>	<b>38,558,526</b>

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