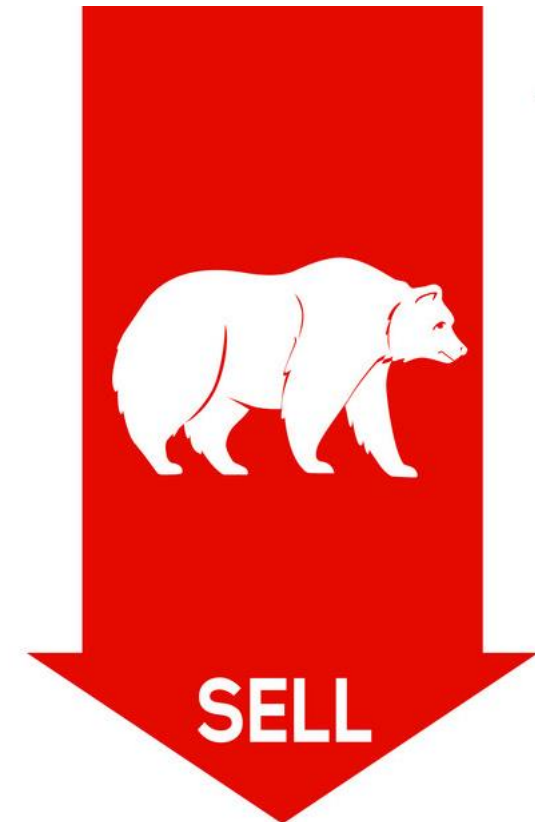




engro fertilizers

Switching Strategy
BUY FFC; SELL EFERT

April 19, 2022



BUY FFC; SELL EFERT

- FFC is far more attractively valued than EFERT
 - Our Dec-22 PT for FFC is PKR 140. FFC provides an upside of 15.6% along with a dividend yield of 13%, taking total expected return to 28.6%.
 - Our Dec-22 PT for EFERT is PKR 85. EFERT offers a downside of 10.0% at current levels, with an expected dividend yield of 14.9%, taking total expected return to 4.9%.
- 1QCY22 results expectation
 - FFC is expected to post EPS of PKR 4.71 (up 3.1% YoY) during 1QCY21, while DPS is expected at PKR 3.75.
 - EFERT’s EPS is likely to clock in at PKR 3.94 (down 8.4% YoY). We expect EFERT to announce DPS of PKR 3.5 in 1QCY22.
- EFERT has a downside risk from GIDC on concessional gas.
 - On Nov 02, 2020, the Honorable Supreme Court of Pakistan (SCP) gave its verdict in favor of the Government of Pakistan to receive GIDC from fertilizer companies in 48 monthly installment. The decision implied that fertilizer companies getting concessional gas will also be required to pay GIDC. Subsequently, EFERT received an invoice from SNGPL on concessional gas supplied under fixed price gas sale and purchase agreement on feed stock gas supplied to its new plant. On December 17, 2020, EFERT along with another industry player filed a review and taken a stay.
 - If EFERT is forced to pay GIDC on concessional gas, **EPS impact would be a negative PKR 27.7/share**. Assuming 48 monthly installments, EFERT will have to cut dividend to PKR 5.0/share annually.

EFERT | Price: 94 Target: 85 Downside: 10.0%

| EFERT | CY19A | CY20A | CY21A | CY22F | CY23F | CY24F |
|----------------|-------|-------|-------|-------|-------|-------|
| EPS | 12.63 | 13.58 | 15.80 | 17.26 | 17.65 | 17.36 |
| DPS | 13.00 | 13.00 | 16.50 | 14.00 | 14.00 | 14.00 |
| PER | 7.4 | 6.9 | 5.9 | 5.4 | 5.3 | 5.4 |
| Dividend Yield | 15.0% | 15.0% | 19.0% | 14.9% | 14.9% | 14.9% |
| P/B | 2.9 | 2.7 | 2.7 | 2.4 | 2.2 | 2.1 |
| ROE | 39.0% | 38.8% | 44.8% | 44.8% | 41.9% | 38.1% |

FFC | Price: 121 Target: 140 Upside: 15.6%

| FFC | CY19A | CY20A | CY21A | CY22F | CY23F | CY24F |
|----------------|-------|-------|-------|-------|-------|-------|
| EPS | 13.4 | 16.4 | 17.2 | 19.3 | 20.1 | 20.9 |
| DPS | 10.8 | 11.2 | 14.5 | 15.5 | 16.0 | 16.8 |
| PER | 9.0 | 7.4 | 7.1 | 6.3 | 6.0 | 5.8 |
| Dividend Yield | 8.9% | 9.2% | 11.9% | 12.8% | 13.2% | 13.8% |
| P/B | 4.3 | 3.6 | 3.2 | 3.0 | 2.7 | 2.5 |
| ROE | 48.1% | 48.9% | 46.1% | 46.9% | 44.5% | 42.3% |

BUY FFC; SELL EFERT

- FFC is more cash rich than EFERT
 - FFC’s net cash and cash equivalents (net of short-term debt and GIDC payable) improved to a negative PKR 1.7bn as of Dec-21 compared to negative PKR 9.6bn in Dec-16.
 - EFERT’s cash and cash equivalents (net of short-term debt and GIDC payable) fell to negative PKR 5.8bn as of Dec-21 compared to negative PKR 2.6bn in Dec-16.
 - This indicates that EFERT has been paying higher dividends recently by lowering its net cash position whereas FFC has been strengthening its cash position. As such FFC’s payouts have higher likelihood of sustaining in the future, versus EFERT.
- Current margins are at a 7-year high, which means an increased downside risk
 - CY22 gross margins for FFC and EFERT are expected at 35.4% and 33.4% respectively, highest since 2015. While margins are likely to remain strong in the near term, given high international urea and commodities prices, there may not be much further upside in margins or volumes. Hence earnings growth from fertilizer business will likely remain timid.
- FFC has a much stronger dividend growth potential
 - While EFERT is a pure fertilizer play with limited growth potential, FFC has a strong investment portfolio comprising FFBL, Wind Power, Thar Energy, PMP and Askari Bank. Wind Power, PMP, Askari Bank and FFBL are already contributing to dividends whereas dividends from Thar Energy will likely commence in CY23.

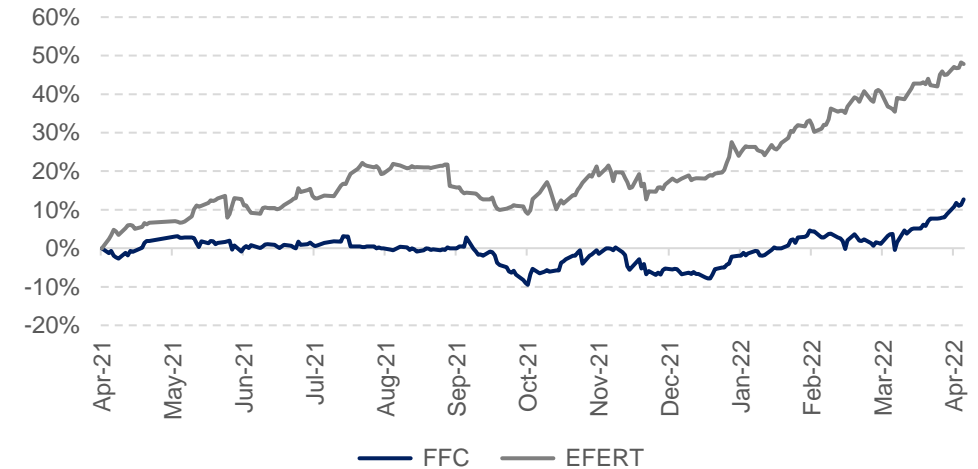
| EFERT | CY16A | CY17A | CY18A | CY19A | CY20A | CY21A |
|-------------------------|---------|---------|---------|----------|--------|---------|
| Cash & Cash Equivalents | 1,124 | 9,984 | 8,469 | 8,925 | 30,374 | 16,504 |
| Less: St Debt | 1,910 | 5,264 | 1,010 | 1,986 | 425 | 4,118 |
| Less: GIDC Payable | 1,783 | 7,001 | 12,576 | 18,944 | 17,437 | 18,180 |
| Net Cash & Cash Eq | (2,568) | (2,281) | (5,117) | (12,004) | 12,512 | (5,793) |

| FFC | CY16A | CY17A | CY18A | CY19A | CY20A | CY21A |
|-------------------------|---------|---------|----------|----------|--------|---------|
| Cash & Cash Equivalents | 16,670 | 32,595 | 58,404 | 53,735 | 83,056 | 96,386 |
| Less: St Debt | 22,177 | 11,539 | 28,526 | 21,803 | 25,258 | 38,954 |
| Less: GIDC Payable | 4,052 | 22,944 | 42,083 | 61,064 | 56,717 | 59,158 |
| Net Cash & Cash Eq | (9,559) | (1,888) | (12,206) | (29,131) | 1,081 | (1,727) |

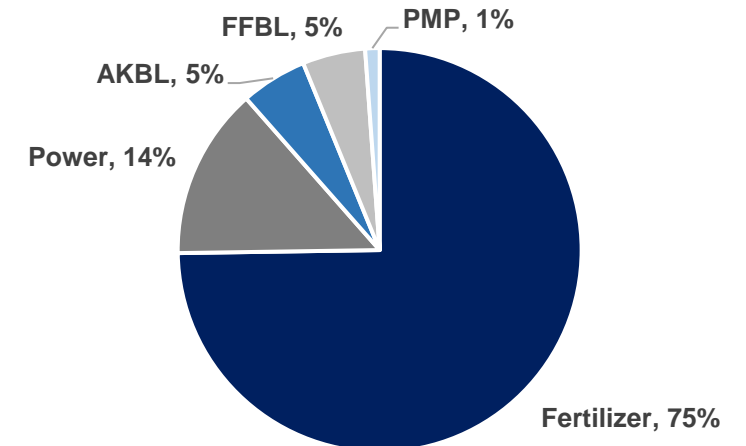
BUY FFC; SELL EFERT

- FFC has underperformed EFERT during the last 12 months, but future may be different
 - During the last 12 months, FFC's share price has risen by 12.6%, much lower than EFERT's 47.9%. Additionally, FFC's dividend return at 12.1% is also lower than EFERT's 17.5%. However, we believe that FFC will substantially outperform EFERT going forward.
- Sharia Compliance
 - FFC cash reserves earmarked for payment of its GIDC liability in short term Treasury bills and earns interest on it. We believe, once payment of GIDC commences, contribution from interest income will also decline which will pave the way for the company to become shariah complaint. We have assumed GIDC payment from CY23 onwards.

Relative Price Performance



FFC-Segment wise earning contribution in CY23



BUY FFC; SELL EFERT

| EFERT | CY19A | CY20A | CY21A | CY22F | CY23F | CY24F |
|----------------------------------|---------|---------|---------|---------|---------|---------|
| Income Statement (PKR mn) | | | | | | |
| Net sales | 121,355 | 105,846 | 132,363 | 141,029 | 130,570 | 136,735 |
| Gross Profit | 39,540 | 34,255 | 44,074 | 47,123 | 48,268 | 48,520 |
| SG & A | 9,985 | 10,365 | 10,430 | 10,710 | 10,870 | 11,123 |
| Depreciation | 5,677 | 5,343 | 3,029 | 3,225 | 3,346 | 3,471 |
| Other income | 4,352 | 1,667 | 1,790 | 1,589 | 1,610 | 1,099 |
| Finance cost | 3,887 | 3,236 | 1,602 | 2,339 | 2,685 | 2,959 |
| Profit after tax | 16,871 | 18,134 | 21,093 | 23,058 | 23,573 | 23,182 |
| Balance Sheet | | | | | | |
| Non-Current Assets | 71,159 | 70,981 | 78,394 | 81,226 | 84,166 | 85,642 |
| Current assets | 55,888 | 60,733 | 54,425 | 53,782 | 46,676 | 44,241 |
| Total Assets | 127,047 | 131,713 | 132,818 | 135,008 | 130,842 | 129,883 |
| Non-Current liabilities | 34,632 | 35,975 | 30,924 | 22,018 | 14,592 | 13,396 |
| Current liabilities | 49,135 | 49,007 | 54,808 | 61,540 | 59,921 | 55,669 |
| Total Liabilities | 83,767 | 84,983 | 85,732 | 83,558 | 74,513 | 69,066 |
| Equity | 43,279 | 46,731 | 47,087 | 51,451 | 56,330 | 60,818 |
| Total Equity & liabilities | 127,047 | 131,713 | 132,818 | 135,008 | 130,842 | 129,883 |
| Cashflow Statement | | | | | | |
| Net Income | 16,871 | 18,134 | 21,093 | 23,058 | 23,573 | 23,182 |
| Non cash Charges | 5,677 | 5,343 | 3,029 | 3,225 | 3,346 | 3,471 |
| Operating Cash flows | 21,786 | 33,043 | 18,192 | 22,291 | 24,602 | 25,912 |
| FCFF | 20,782 | 30,645 | 8,997 | 17,920 | 20,247 | 23,090 |
| Net borrowings | 1,182 | 8,242 | -999 | -74 | -3,642 | -5,606 |
| FCFE | 19,571 | 36,132 | 6,867 | 16,185 | 14,699 | 15,383 |
| Net change in cash | 2,684 | 198 | -2,345 | -519 | -21 | -66 |
| Cash & Cash equivalents | 8,925 | 30,374 | 16,504 | 13,984 | 9,984 | 6,672 |

| FFC | CY19A | CY20A | CY21A | CY22F | CY23F | CY24F |
|----------------------------------|---------|---------|---------|---------|---------|---------|
| Income Statement (PKR mn) | | | | | | |
| Net sales | 105,783 | 97,655 | 108,651 | 127,371 | 116,607 | 121,005 |
| Gross Profit | 30,737 | 31,583 | 38,879 | 45,050 | 43,459 | 44,480 |
| SG & A | 8,288 | 7,848 | 8,409 | 9,094 | 9,371 | 9,628 |
| Depreciation | 2,286 | 2,310 | 2,435 | 2,354 | 2,269 | 2,219 |
| Other income | 7,191 | 6,429 | 7,919 | 8,181 | 11,867 | 11,733 |
| Finance cost | 2,477 | 1,874 | 2,292 | 3,636 | 3,525 | 2,344 |
| Profit after tax | 17,110 | 20,819 | 21,896 | 24,539 | 25,615 | 26,548 |
| Balance Sheet | | | | | | |
| Non-Current Assets | 56,089 | 61,047 | 74,737 | 74,993 | 74,423 | 73,856 |
| Current assets | 97,301 | 111,902 | 126,270 | 132,603 | 113,655 | 103,248 |
| Total Assets | 153,390 | 172,949 | 201,007 | 207,596 | 188,078 | 177,104 |
| Non-Current liabilities | 10,947 | 48,742 | 41,323 | 22,834 | 10,486 | 5,561 |
| Current liabilities | 106,876 | 81,671 | 112,169 | 132,427 | 119,999 | 108,710 |
| Total Liabilities | 117,823 | 130,413 | 153,492 | 155,261 | 130,485 | 114,271 |
| Equity | 35,567 | 42,536 | 47,514 | 52,335 | 57,594 | 62,832 |
| Total Equity & liabilities | 153,390 | 172,949 | 201,007 | 207,596 | 188,078 | 177,104 |
| Cashflow Statement | | | | | | |
| Net Income | 17,110 | 20,819 | 21,896 | 24,539 | 25,615 | 26,548 |
| Non cash Charges | 2,286 | 2,310 | 2,435 | 2,354 | 2,269 | 2,219 |
| Operating Cash flows | 28,670 | 9,621 | 37,332 | 37,918 | 27,025 | 16,325 |
| FCFF | 29,844 | -29,443 | 10,667 | 35,682 | 47,387 | 30,465 |
| Net borrowings | -11,256 | 40,070 | 7,941 | -13,174 | -24,073 | -7,123 |
| FCFE | 16,804 | 9,309 | 16,954 | 19,927 | 20,811 | 21,677 |
| Net change in cash | 3,818 | 5,695 | 1,153 | 1,190 | 1,397 | 1,852 |
| Closing cash | 83,056 | 96,386 | 98,497 | 79,532 | 65,917 | 55,380 |

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|--------|-------------------------------|
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| Hold | Between -5% and +15% |
| Sell | Less than or equal to -5% |

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