ENGRO: Investment case intact despite earnings blip

- Engro Corporation Limited (ENGRO) announced a relatively higher dividend payout in 2QCY22 of Rs11/share, despite the company posting a loss of Rs558mn (LPS: Rs0.97) compared to a profit of Rs8.7bn (EPS: Rs15.13) in the same period last year. Engro's profitability decreased primarily due to lower contribution from Chemical and Fertilizer business.
- Engro offers a well-diversified exposure to Pakistan agriculture, consumer, connectivity, energy and chemicals space at a discount, where our SoTP based TP stands at Rs350; upside of ~38%. Dividends are expected to remain on a sustainable track with a 2022E D/Y of ~12%, where dividends might witness a change in the historical pattern of quarterly payouts.
- In terms of much awaited growth initiatives, following on from a Rs21bn commitment to towers' business, Engro is working on a number of feasibilities in the connectivity, petrochemical and renewable energy space. Management, in the recently held briefing, shared that the final decision on the feasibility study for its US$2bn polypropylene project is expected by 4QCY22.

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Bloomberg Code: ENGRO PA
Target Price: Rs350
Market Price: Rs253.65
Market Cap: Rs146bn, US$683mn
1-yr ADTO: 0.4mn shares, Rs96mn, US$0.5mn
1-yr High / Low: Rs302.70 / 232.11
Estimated free float: 317mn shares (55%)

Dividend income remained elevated despite loss in 2QCY22

Engro Corporation (ENGRO) announced a higher than expected dividend pay-out in 2QCY22 of Rs11/share, bringing half year dividend pay-out to Rs23/sh. The company posted a loss of Rs557.5mn on a consolidated basis translating into an LPS of Rs0.97 for 2QCY22. Engro's profitability decreased by 106% YoY primarily due to lower contribution from Chemical and Fertilizer business.

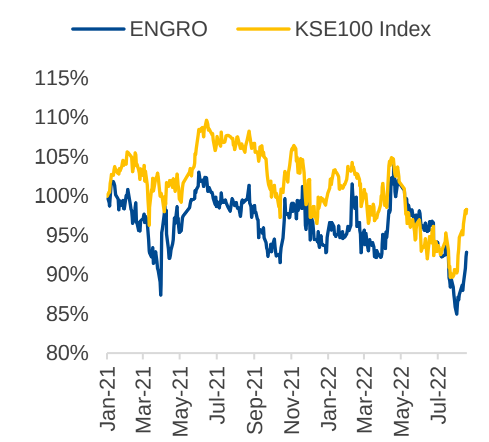
During the same period, company's flagship fertilizer business skipped dividend due to higher tax and exchange losses. EPQL and EPCL announced dividends of Rs5.0/share and Rs2.5/share, respectively. For Engro Powergen Thar, management expects a dividend announcement in 2HCY22.

Inferring from company's historical practice, a higher pay-out is witnessed in first three quarters. But there might be a change this time around as lower dividend income from subsidiaries will flow in the third quarter due to decline in profitability, leading to a more even split between 3Q and 4Q. The annual dividend yield and investment case however remains unchanged, where we expect dividend of Rs30/sh for CY22.

Quarterly DPS trend over the years

Source: Company accounts, JS Research

Price performance relative to KSE100



Source: PSX, JS Research

A value play with attractive dividend yield

We believe the company offers a well-diversified portfolio (exposure to Pakistan agriculture, consumer, connectivity, energy and chemicals space) and is currently trading at a discount. With a number of prospective fruitful investments, ENGRO's dividend stream is expected to continue to remain on a sustainable track with a 2022E D/Y of 12% and leads us to maintain our "Overweight" stance on the conglomerate. We have an SoTP based TP of Rs350, which does not include potential investment in the Petrochemicals space.

Super tax dented Fertilizer & Chemical segments in 2QCY22

Engro Fertilizers Limited (EFERT) posted a loss of Rs98mn (LPS of Rs0.07) during 2QCY22 vis-à-vis PAT of Rs4.8bn (EPS of Rs3.57) in 2QCY21. The company showed a slight increase of 1ppt QoQ at the gross margin level in 2QCY22, mainly due to better retention prices. The one-time 10% super tax, charge related to deferred tax due to 4% increase in future tax rates (impact of Rs1.6bn) and higher other expenses owing to exchange loss on DAP shipments to the tune of Rs700mn were major reasons for the loss. Engro's management shared that CAPEX estimate for Enven plant repair is around Rs1bn. In light of the above reasons, EFERT did not announce any dividend for the quarter.

Engro Polymer and Chemicals Limited (EPCL) posted a decline in profitability of 26%/50% on YoY/QoQ basis. Profit after tax came in at Rs2.3bn translating into an EPS of Rs2.45 for 2QCY22 (1HCY22 EPS: 7.56, -5% YoY). Finance Act implications wiped out around Rs2.1bn from the profitability. Along with the result, the company announced a DPS of Rs2.5, taking 1HCY22 DPS to Rs7.5. The group is conducting a Front-End Engineering Design (FEED) study at a cost of US$4mn for the debottlenecking of EPCL's VCM facility to further enhance capacity. The study will take around 12 months and will have a potential bottom-line impact of Rs800mn for EPCL.

Power and Terminal businesses showed mixed performance

Engro Powergen Thar Ltd (EPTL) achieved a collection rate of 93% versus 91% in 1HCY21. EPTL's plant was faced with an incident in 1QCY22 and the company booked a provision of Rs2.3bn on the plant. Post the incident, however, both the units of EPTL operated at 100% utilization. During Jun-22, NEPRA decided the tariff for EPTL but the management is of the view that certain adjustments and disallowances in the Tariff are against principles set forth in the upfront tariff and ENGRO has filed an appeal against it.

SECMC's Phase-II expansion is underway and it is expected to double the existing capacity to 7.6MT/annum. The management is targeting to achieve CoD by 4QCY22 vs 3QCY22 indicated earlier. Phase-III of the expansion has also been approved by the Board. Moreover, EPQL's PAT decreased by 55% YoY on account of scheduled major inspection.

Engro's Elengy terminal handled 37 vessels in 1HCY22 (35 vessels handled in SPLY) whereas Vopak terminal handled 724kt of chemical volume in 1HCY22 versus 641kt in 1HCY21. Company highlighted that LPG marine imports remained subdued however chemical products handling supported the operational inflow and occupancy.

ENGRO SoTP

	Contribution (Rs/sh)
Engro Fertilizers	73
Frieslandcampina Engro Pakistan	29
Engro Polymer & Chemicals	40
Eximp Agriproducts	5
Engro Powergen Qadirpur	6
Engro Vopak	15
Engro ELENGY	11
Engro Powergen Thar	65
Sind Engro Coal Mining	11
Enfrashare	25
Engro Total	**279**
Less: Net Debt	(71)
Engro's value	**350**

Source: JS Research

Enfrashare continues to expand its footprint

The management of the company, in its Corporate Briefing session held yesterday, shared that it is quite enthusiastic about its telecom and connectivity venture Engro Connect (EConnect). The management apprised that E Connect's subsidiary, Enfrashare added additional towers during 1HCY22 taking the total operational sites to 2,937 towers. Management shared that company witnessed the highest tenancy growth in 1HCY22 and closed the period with a 50% market share in the segment. Enfrashare achieved a tenancy ratio of 1.14x during the first half. The company expects the EBITDA to magnify due to economies of scale as more tenants come in at a marginal cost and company is also going for Solarization to save energy costs. At present, more than 40 sites are energized by solar power.

Entry into Renewables

The company's subsidiary, Engro Energy has signed an MoU with the Sindh Transmission and Dispatch Company for the 1st Hybrid Renewable Energy Park. Phase I of project will accommodate 400MW out of which 240MW would be attributable to wind projects and 160MW to solar. The project is expected to eventually scale up to 1GW.

The Propane Dehydrogenation project

Management shared that feasibility study of the polypropylene project is underway. To recall, an amount of US$32mn was allocated for the feasibility studies including the Front-End Engineering Design and Technical studies. Company expects the FEED study results by 3QCY22 whereas the Final Investment Decision is expected by 4QCY22. We believe the project is expected to take around 4 years from the date of announcement of the final decision. The project will have an estimated investment of c. US$2.0bn as per estimates shared earlier and will lead to import substitution catering to a market of around US$750mn.

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