

## Foundation Alert

### EFERT: CY21 Analyst Briefing Takeaways

#### Event

- Engro Fertilizer Limited (EFERT PA) held its Analyst briefing today to discuss its financial/operational performance for CY21. Following are the key takeaways of the briefing.

#### Impact

- Engro Fertilizer Limited (EFERT PA) profitability clocked in at Rs21.1bn (EPS Rs15.8, up 16% YoY) in CY21 as compared to profit of Rs18.1bn (EPS 13.6) in CY20.
- Management attributes increase in CY21 profitability to (1) higher Urea offtake amid better retention prices, (2) better DAP trading margins, (3) lower finance cost, and (4) higher other income.
- Earning growth is supported by one-offs & specials such as reassessment of useful life and scrap value, inventory gains on trading portfolio and dealers' sales tax registration.
- EFERT Urea sales clocked in at 2,296tons (up 12% YoY) in CY21. Management attributes higher offtake to large carryforward inventory by the company amid better agronomics. To highlight, EFERT Urea production declined by 7.1% YoY to 2,105K tons in CY21 due to plant maintenance of EnVen in Sep'21 and lower production in 1HCY21.
- Consistent Urea demand has grown from 5.8mn tons to 6.1mn tons during the last three years on the back of increase in cultivation area and better farmer income driving better Agri practices.
- Company management also discussed improvement in farmer agronomics and shared that farmer income from wheat crop increased by 59% YoY due to higher support prices and in sugarcane crop farmer income increased by 48% YoY in 2021.
- Cotton crop profitability increased by 3.5x in 2021 compared to 2020 on the back of better seed quality and favorable weather amid higher international prices and rupee depreciation. NY cotton futures for Mar'22 are 121cents/lb which is highest in last nine years.
- EFERT management also discussed that industry is selling Urea at 84% discount to current landed cost for imported Urea, which would result in higher pricing power for the industry.
- Furthermore, EFERT phosphate sales declined by 20% YoY to 296K tons in CY21. Decline in phosphate demand is due to higher prices as DAP prices in domestic market increased by 65% YoY to Rs5,940/bag. Overall Phosphates market recorded a decline of 13% YoY when prices were 2.3 times vs last December.
- Sales tax provision had been started since Jan'20. Pursuant to several engagements with ministries/FBR, the fertilizer industry was able to successfully obtain specific exemption vide SRO 1337(I)/2020 dated December 16, 2020. From Apr'21 onwards, EFERT discontinued sales to unregistered dealers exceeding Rs100mn per dealer. Provision for income tax has been booked in the current year in accordance with laws. However, with the registration of dealers, the risk has been substantially mitigated.
- On the positive side, the minimum tax and withholding rates for dealers have been reduced from 0.75% and 0.7% to 0.25% respectively.
- Management also shared that company is in negotiations with relevant stakeholders regarding its concessionary gas flows and has obtained interim stay order from Sindh High Court.
- Furthermore, management has also disclosed that EFERT is in continuous discussion with Gov't for extension of concessionary gas for number of days during which SNGP hasn't supplied minimum contract requirement.

- At present, company's total subsidy receivable stands at Rs6.5bn against Rs20bn of the industry and its sales tax receivable stand Rs8.94bn as compared to Rs51.1bn receivable of the industry.
- Company has booked lower depreciation expense of Rs1.7bn in 4QCY21 due to revaluation of assets.
- EFERT also booked gain of Rs44mn on account of GIDC re-measurement gain against expectation of reversal due to change in discount factor given increase in discount rate.
- EFERT finance cost declined by 50% YoY in CY21 due to decline in interest rates and lower working capital needs of the company.
- Moreover, the company continues to explore opportunities within the agricultural space to create value for the shareholders.

## Outlook

- We have an "Underperform" stance on the scrip with Dec-22 TP of Rs62.0. Furthermore, end of concessionary gas flows along with the payment of GIDC on concessionary flows as per Supreme Court directives would reduce company's profitability and dividend payouts, in our view. However, Urea dynamics are expected to remain favorable for the company given restricted urea supply and better farmer agronomics.

**Fig 1: EFERT 4QCY21 Financial highlights (Rs mn)**

| Rs (mn)                         | 4QCY21        | 4QCY20       | YoY        | QoQ        | CY21          | CY20          | YoY        |
|---------------------------------|---------------|--------------|------------|------------|---------------|---------------|------------|
| Revenue                         | 39,621        | 27,708       | 43%        | 6%         | 132,363       | 105,846       | 25%        |
| Cost of sales                   | (26,571)      | (18,321)     | 45%        | -4%        | (88,289)      | (71,592)      | 23%        |
| <b>Gross profit</b>             | <b>13,050</b> | <b>9,387</b> | <b>39%</b> | <b>36%</b> | <b>44,074</b> | <b>34,255</b> | <b>29%</b> |
| Selling & distribution expenses | (2,533)       | (2,467)      | 3%         | 19%        | (8,530)       | (8,457)       | 1%         |
| Administration Expenses         | (541)         | (673)        | -20%       | 19%        | (1,900)       | (1,908)       | 0%         |
| S&A                             | (3,074)       | (3,140)      | -2%        | 19%        | (10,430)      | (10,365)      | 1%         |
| Finance cost                    | (337)         | (473)        | -29%       | -21%       | (1,602)       | (3,236)       | -50%       |
| Other operating expense         | (1,743)       | 756          | -330%      | 141%       | (3,942)       | (1,022)       | 286%       |
| Other operating income          | 362           | 661          | -45%       | -21%       | 1,790         | 1,667         | 7%         |
| Profit before taxation          | 8,258         | 7,192        | 15%        | 30%        | 29,890        | 21,298        | 40%        |
| Profit after taxation           | 6,172         | 6,643        | -7%        | 40%        | 21,093        | 18,133        | 16%        |
| <b>EPS</b>                      | <b>4.62</b>   | <b>4.97</b>  |            |            | <b>15.80</b>  | <b>13.58</b>  |            |
| <b>DPS</b>                      | <b>5.0</b>    | <b>4.0</b>   |            |            | <b>16.5</b>   | <b>15.0</b>   |            |
| GM                              | 32.9%         | 33.9%        |            |            | 33.3%         | 32.4%         |            |
| NM                              | 15.6%         | 24.0%        |            |            | 15.9%         | 17.1%         |            |

Source: PSX, Foundation Securities, February 2022

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#### Recommendations definitions

|                                   |               |
|-----------------------------------|---------------|
| If                                |               |
| Expected return >+10%             | Outperform.   |
| Expected return from -10% to +10% | Neutral.      |
| Expected return <-10%             | Underperform. |