

# Engro Polymer & Chemicals Ltd. (EPCL): Margins uptrend continues

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*Prices as of November 16, 2021*

## Maintain 'BUY' with PT of PKR 80/share

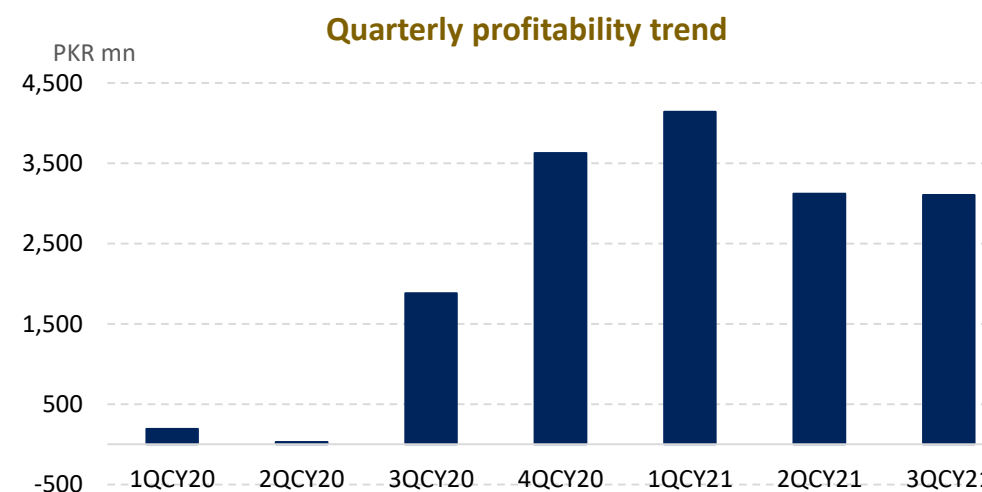
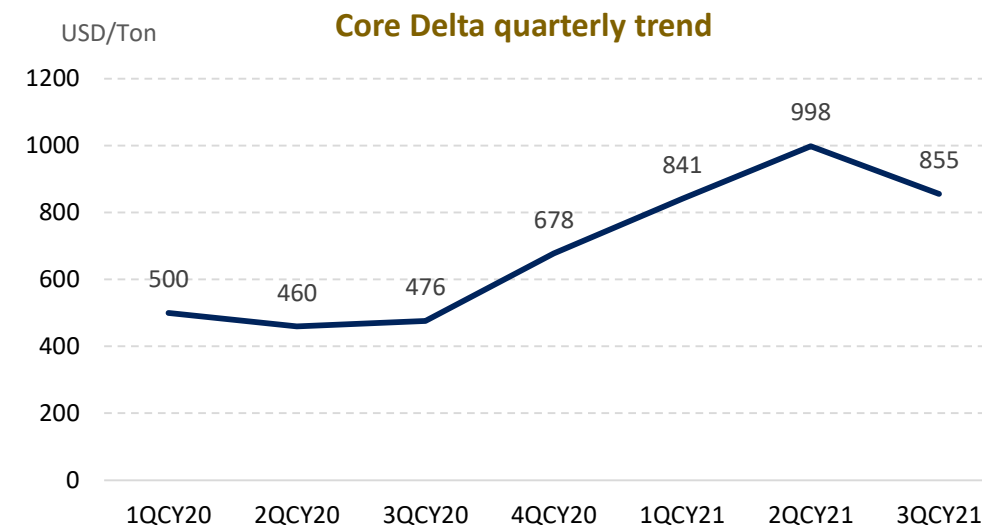
- We revise our earnings estimates upward for Engro Polymer & Chemicals Ltd (EPCL) post robust 9MCY21 results announcement and consistent uptrend in PVC prices globally. Our revised EPS for CY21E now stands at PKR 16.07, compared to previous estimates of PKR 15.85/share, up by 1.4% YoY.
- We maintain our BUY stance on Engro Polymer & Chemicals Ltd (EPCL) with revised June-22 price target (PT) of PKR 80/share; offering a 38% potential upside and 5.2% dividend yield. The stock trades at an attractive CY21E P/E of 3.6x.
- Our investment case on EPCL is intact based on:
  - Increase in PVC market share to 94%.
  - Capacity expansions to meet local and regional demand.
  - Uptrend in PVC and Ethylene prices, resulting in higher core delta.
- The downside risk to our investment case is:
  - Sharp decline in PVC prices affecting primary margins.
  - Further delay in ongoing projects (Hydrogen Peroxide, OVR and HTDC).

Key Data	
Bloomberg	EPCL.PA
Reuters	EPCL.PSX
<b>PSX Ticker</b>	<b>EPCL</b>
Target Price (PKR)	80
Current Price (PKR)	57.94
Upside/(Downside) (%)	38%
Dividend Yield (%)	5.2%
Total Return (%)	43%
12-month High (PKR)	65.45
12-month Low (PKR)	42.49
Outstanding Shares (mn)	909
Market Cap (PKR mn)	52,663
Year End	December

Key Financial Ratios						
	CY18A	CY19A	CY20A	CY21E	CY22F	CY23F
EPS	6.22	4.07	6.30	16.07	7.22	7.82
EPS Growth	112%	-35%	55%	155%	-55%	8%
DPS	1.10	0.80	1.25	11.80	3.00	3.25
P/E	9.31	14.25	9.19	3.61	8.02	7.41
Dividend Yield	2%	1%	2%	20%	5%	6%
EV/EBITDA	5.78	8.63	6.29	2.84	4.53	4.02
P/B	2.73	2.96	2.02	1.75	1.56	1.39
ROE	40%	21%	26%	52%	21%	20%

## Higher capacity and uptrend in prices elevated 9MCY21 earnings

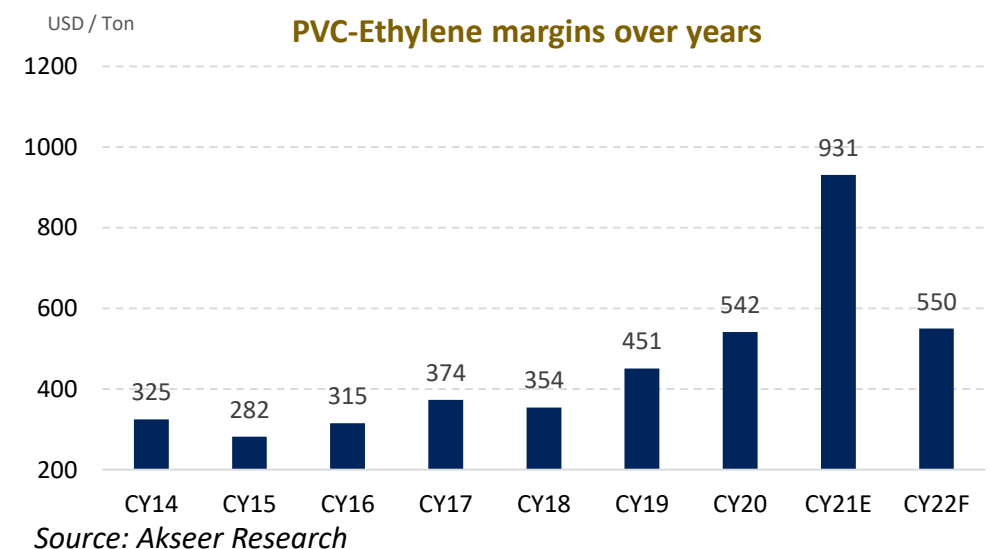
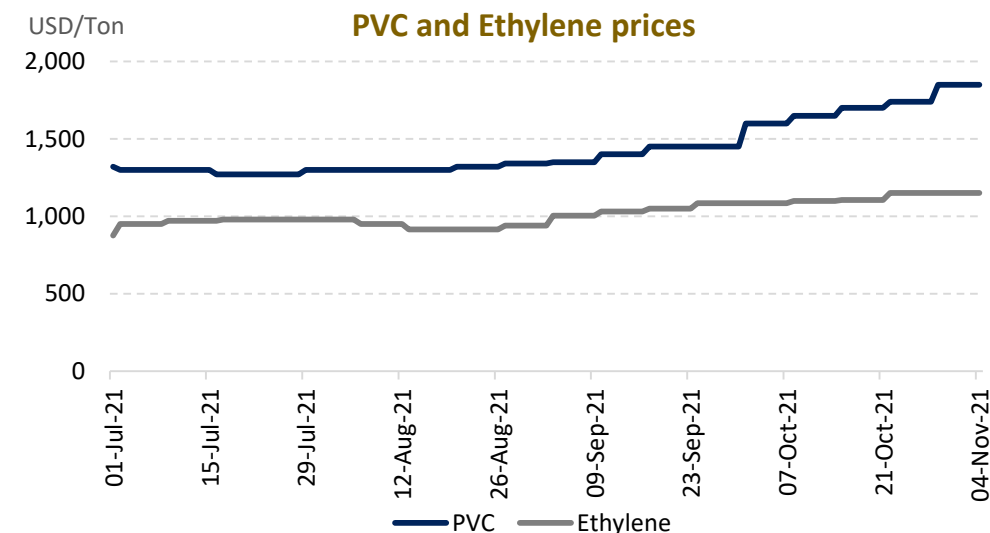
- During 3QCY21, EPCL's net sales grew 87% YoY primarily driven by 80% YoY surge in the core delta to average at USD 855/ton during the quarter. Net earnings for 3QCY21 came in at PKR 3.42/share vs. PKR 2.07/share, up 65% YoY.
- Cumulatively, during 9MCY21 the company reported net earnings of PKR 11.41/share vs. PKR 2.31/share during 9MCY20, up by 5.0x YoY. EPCL also paid highest ever interim dividend of PKR 10.80/share along with the results during 9MCY21.
- During 9MCY21, the new PVC line led to higher volumetric growth, taking local PVC sales volume at 153K MT ( up 1.5x YoY) and exports at 16K MT. The company also exported Caustic Liquid of 4K MT and Caustic Flakes of 1K MT during the period.
- Supported by the PVC prices uptrend, we maintain our current core delta assumption of USD 1,000/ton for 4QCY21, leading to net earnings of PKR 4.66/share for 4Q, taking full year CY21E EPS to PKR 16.07/share.
- It is pertinent to mention that a USD 50/ton change in core delta changes the earnings by PKR 1.3/share.
- We have kept forward annualized margin assumption at USD 550/ton in our investment horizon post CY21 as we believe that global PVC producers will strive hard to resume operations amid strong PVC demand.



Source: Akseer Research

## PVC – Ethylene Margins at historic high of USD 1,196/ton

- PVC – Ethylene margins are currently hovering at record high levels of USD 1,196/ton, up 3% /71% on MoM /YoY basis.
- The higher margins in international market are primarily on back of upward revision in PVC prices of 2%/ 60% MoM/YoY. For Ethylene, the prices were flat on MoM basis but up by 41%YoY.
- QTD, the average PVC – Ethylene margins have clocked in at USD 1,180/ton vs. USD 855/ton for the previous quarter, up by 38% QoQ basis.
- Multiple outages since the start of CY21 has affected supply/demand dynamics in international market. To note, The Hurricane Ida hit Louisiana in late Aug-21, affecting nearly 41% of PVC capacity in North America. Shintech, one of the world’s largest producer of PVC, had to shut its 1.45mn MT PVC capacity after an upstream equipment line disruption, resulting in nearly 51% loss of PVC production in the region.
- These events, along with strong demand for PVC due to resumption in construction activities worldwide has led to increase in PVC prices.





## Risk - Return Profile

### Valuation Basis

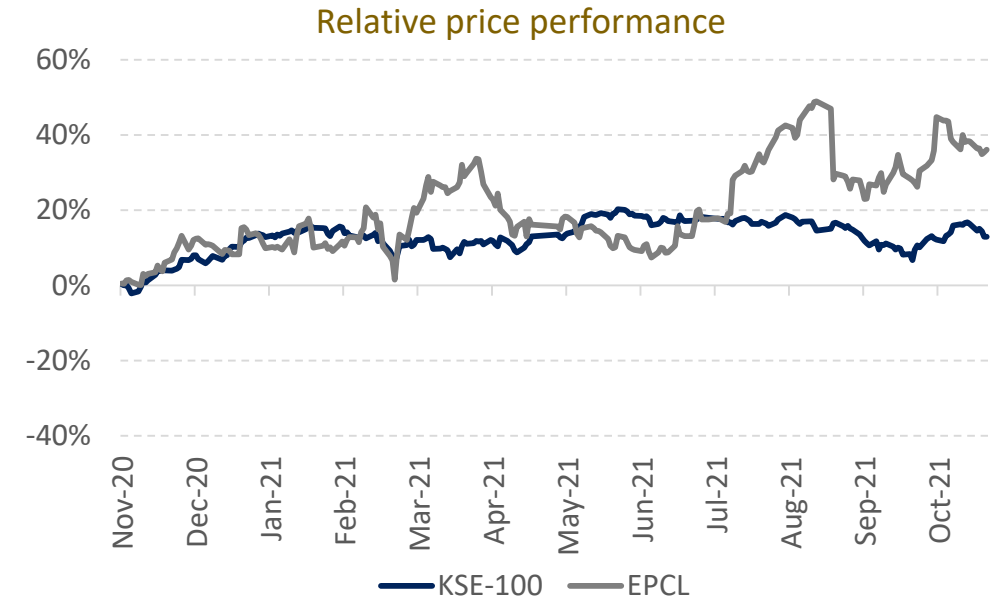
- Our PT for Engro Polymer & Chemicals Ltd (EPCL) has been computed using the Free cash flow to Firm (FCFF) method. We have used a risk-free rate of 11% beta of 1.0 & a market risk premium of 6% to arrive at the cost of equity of 17%.

### Investment Thesis

- Our investment case on EPCL is based on:
  - 1) Higher PVC prices driving earnings,
  - 2) Major diversification and efficiency projects in pipeline.
  - 3) Incremental capacity in FY21 to grow revenue.

### Risks

- Key risks to our investment thesis are
  - 1) Volatility in primary margins,
  - 2) Reduction in PVC import duty,
  - 3) Delay in projects.

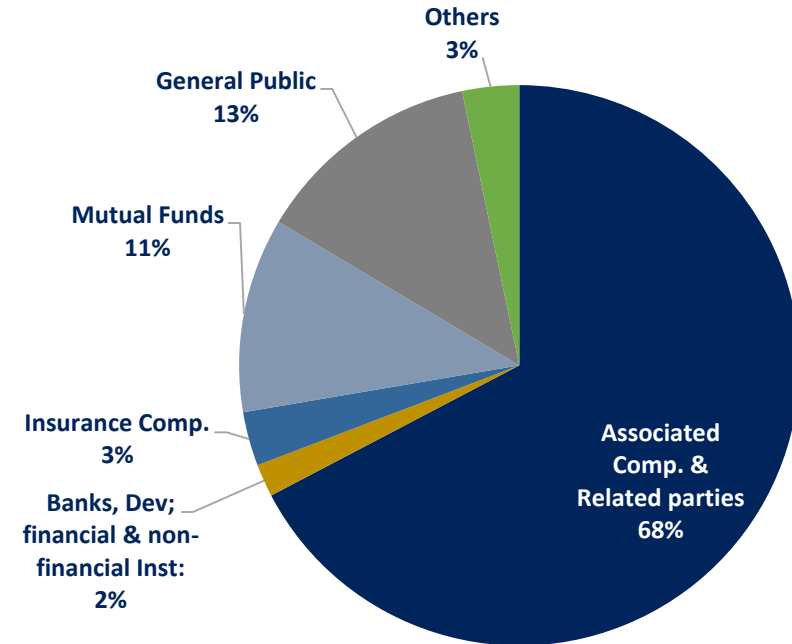


Source: PSX & Akseer Research

## Company Overview

- Engro Polymer & Chemicals Ltd (EPCL) is partially owned subsidiary of Engro Corporation and is the only integrated chlor-vinyl chemical complex in Pakistan. The company started as Engro Asahi Polymer & Chemicals Limited in 1999 and got its shareholding divested in 2006 from Asahi Glass Limited.
- The company is engaged in the manufacturing of PVC resin, chlor-alkali products like Caustic Soda, Sodium Hypochlorite and Hydrochloric Acid. EPCL sells, markets and distributes PVC under the brand name “SABZ”. It is further exploring other avenues such as Hydrogen Peroxide.
- Over the course of its operations, EPCL has successfully increased its PVC capacity from 100k MT/annum to 295k MT/annum, Caustic Soda Liquid plant at 106k MT/annum, Sodium Hypochlorite at 30k MT/annum, and Hydrochloric Acid at 60 MT/annum. Apart from that, EPCL has in-house power generation of 66 MW that supplies excess power to Engro Fertilizers Ltd.
- Engro Peroxide, Engro Plasticizer, and Think PVC are 100% owned subsidiaries of Engro Polymer & Chemicals Ltd.

**Shareholding Pattern (Dec-20)**



Source: Company Accounts & Akseer Research

## Financial Highlights

Income Statement (PKR mn)	CY18	CY19	CY20	CY21E	CY22F	CY23F
Net sales	35,272	37,837	35,331	68,015	44,611	47,730
Cost of sales	26,536	29,731	24,382	44,773	31,749	34,429
<b>Gross Profit</b>	<b>8,736</b>	<b>8,106</b>	<b>10,949</b>	<b>23,242</b>	<b>12,862</b>	<b>13,302</b>
SG & A	2,044	962	845	940	850	867
<b>Operating Profit</b>	<b>6,692</b>	<b>7,144</b>	<b>10,105</b>	<b>22,303</b>	<b>12,012</b>	<b>12,435</b>
Other income	1,249	930	1,180	1,343	1,136	1,161
Other charges	872	1,241	859	2,312	1,655	1,580
Finance cost	606	1,794	2,191	1,995	2,246	2,009
<b>Profit before tax</b>	<b>6,463</b>	<b>5,039</b>	<b>8,234</b>	<b>19,338</b>	<b>9,247</b>	<b>10,007</b>
Taxation	1,533	1,343	2,504	4,730	2,682	2,902
<b>Profit after tax</b>	<b>4,930</b>	<b>3,696</b>	<b>5,730</b>	<b>14,608</b>	<b>6,565</b>	<b>7,105</b>
Balance Sheet (PKR mn)	CY18	CY19	CY20	CY21E	CY22F	CY23F
PPE	19,398	31,433	37,614	40,520	39,946	38,754
Non-Current Assets	1,065	710	192	191	8,436	7,098
Current assets	16,434	17,650	24,382	38,963	38,528	37,687
<b>Total Assets</b>	<b>36,023</b>	<b>57,519</b>	<b>69,094</b>	<b>85,366</b>	<b>84,907</b>	<b>83,529</b>
Non-Current liabilities	7,890	23,933	27,579	33,861	32,523	27,001
Current liabilities	11,337	15,810	15,388	21,496	18,537	18,529
<b>Total Liabilities</b>	<b>19,228</b>	<b>39,743</b>	<b>42,968</b>	<b>55,358</b>	<b>51,060</b>	<b>45,530</b>
Equity	16,796	17,776	26,126	30,009	33,847	37,998
<b>Total Equity &amp; liabilities</b>	<b>36,024</b>	<b>57,519</b>	<b>69,094</b>	<b>85,366</b>	<b>84,907</b>	<b>83,529</b>

Source: Company Accounts & Akseer Research

## Financial Highlights

Cash Flow Statement (PKR mn)	CY18	CY19	CY20	CY21E	CY22F	CY23F
Net Income	4,930	3,696	5,730	14,608	6,565	7,105
Non-cash Charges	4,798	(8,147)	(884)	6,610	1,829	3,198
<b>Operating Cash flows</b>	<b>9,728</b>	<b>(4,451)</b>	<b>4,846</b>	<b>21,218</b>	<b>8,395</b>	<b>10,303</b>
<b>FCFF</b>	5,843	(19,372)	(1,113)	17,012	7,323	9,387
Net borrowings	(1,250)	15,035	172	7,084	675	(5,954)
<b>FCFE</b>	<b>4,131</b>	<b>(5,652)</b>	<b>(2,466)</b>	<b>22,588</b>	<b>6,403</b>	<b>2,007</b>
Net change in cash	679	(570)	154	11,863	3,676	(947)
<b>Closing cash</b>	<b>1,362</b>	<b>792</b>	<b>946</b>	<b>12,809</b>	<b>16,485</b>	<b>15,538</b>

Source: Company Accounts & Akseer Research



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