

Tide turning on core operations

Date: May 5, 2017

Recommendation	BUY
Target Price	PKR 40
Current Price	PKR 31

Stock Details

Bloomberg	EPCL.PA
Reuters	EPCL.KA
KATS	EPCL
Shares Outstanding (mn)	663.47
Free Float (%)	28%
12M ADT (mn)	6.03
52-Weeks High/Low (PKR)	30.36/8.31
Market Cap (PKR bn/USD mn)	20.14/192.13
12M ADTV (PKR mn/ USD mn)	118/1.12
KSE-100 Index Weightage (%)	0.21

Source: PSX, BIPL Research

Stock Performance

	1M	3M	12M
Absolute %	18.4	20.5	216.6
Relative to KSE %	15.9	21.0	177.0

Earnings and Dividend Estimates

	CY16A	CY17F	CY18F	CY19F
EPS	1.0	3.3	3.7	4.2
DPS	0.0	0.0	1.5	1.5

Source: Company Account, BIPL Research

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REP 039



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- We initiate our coverage on Engro Polymer Ltd. (EPCL) with a Target Price of PKR40/sh, offering an upside of 31% on the last closing.
- Our conviction on the scrip stems from i) pricing premium charged by the company in the local market, ii) higher PVC ethylene core delta and iii) spurt in local PVC demand courtesy CPEC.
- Owing to a spurt in construction activity, the company has been able to charge premiums of as high as 21% in the local market. We expect the premiums to continue though at normalized levels.
- Additionally, debottlenecking of the existing PVC capacity is expected to add PKR0.8/sh to the bottomline assuming a core delta of USD350/ton.
- While ethylene price has rebounded owing to seasonal turnaround, weighing in on core delta, we expect the pricing pressure to ease off owing to global oversupply.

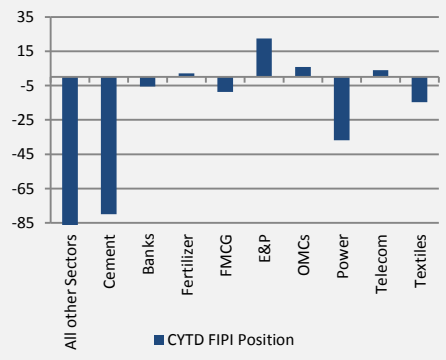
Demand spurt in the local market: With the spurt in local construction activity courtesy CPEC, the demand for PVC has increased in the domestic market. The total market size for the product has increased by 14%YoY to 248k tons according to the numbers reported in 1QCY17. With a market share of 71%, the company is all set to benefit from a spurt in local PVC demand. In this regard, the company reported the highest production in 1QCY17 of 48k tons with a utilization rate of 100%. Given the growth outlook for the construction sector, the company might be expected to go for further expansion, although there is no development on this front yet. In this regard, assuming the PVC market grows at a 3 year CAGR of 10%, the total demand will likely increase to 330k tons, diluting the company's market share to 59%. To cater to growing demand, the company may potentially undertake capacity expansion of 135k tons to capture the entire local market share.

Pricing premium in the local market: Being the major PVC resin producer in the local market, the surge in construction activity has enabled the company to charge high premiums in the market. As per our estimates, the company charged a premium of ~21% in 1QCY17 (compared to historical premiums of 10%-12%) which drove margins, expanding them by 16ppsYoY (owing to both 71%YoY higher core delta and pricing premiums). We expect the company will be able to charge premiums in the local market, going forward, owing to rising local demand. For every 1% change in the premium charged, the earnings will have an impact of PKR0.18/sh (assuming a core delta of USD350/ton). We have incorporated a premium of 15% in our model for CY17 and 12% thereafter. However, higher pricing premiums may lead to increasing threat of imports which may weigh on sales volumes.

Debottlenecking impact: The company announced debottlenecking of its PVC facility which will increase the capacity from 178k tons to 195k tons with a cost of USD9mn by Dec'17. Assuming core delta of USD350/ton (CY17 estimated average) and a premium of 12% in the local market, the additional capacity will add ~PKR0.8/sh to the bottomline of the company CY18 onwards.

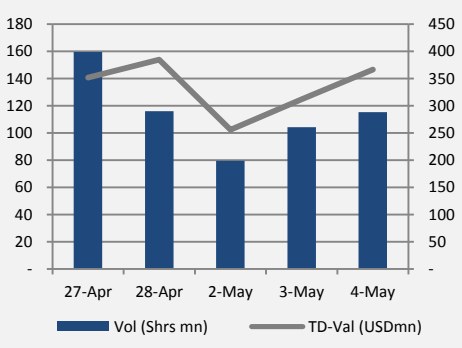
Ethylene and PVC price outlook: While ethylene price is expected to take a correction ahead owing to oversupply in the international market and expected stability in crude oil price, PVC price might rebound on account of expected tight supply situation. With mercury based PVC producers in EU expected to shut down by Dec'17 (19.7% of total EU PVC share) and easing supplies in China owing to stringent regulations on coal usage, PVC price is likely to increase, going forward. Given the aforementioned scenario, the core delta might potentially expand, boosting earnings for the company.

Sector wise Net FIPI (USDmn)



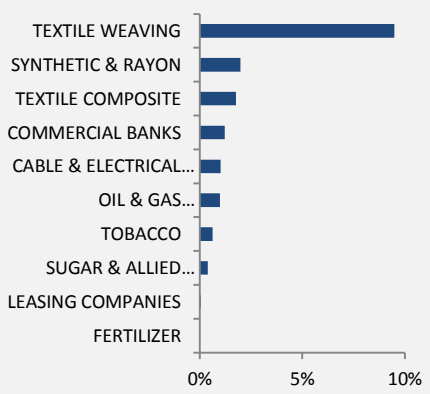
Source: NCCPL

KSE Market Participation



Source: PSX

Sector Performance WoW



Source: PSX

Core delta sensitivity: With PVC contributing 81% to the topline, EPCL's earnings are highly sensitive to international PVC-Ethylene spread. With rise in international PVC price in 1QCY17 by 25%YoY compared to increase of 4%YoY in ethylene price, the core delta of the company expanded to USD378/ton. However, ethylene price has started rebounding owing to international capacity turnarounds which has weighed on international core delta (down to USD325/ton). For every USD20/ton increase in core delta, there will be a bottomline accretion of PKR0.4/sh. We have assumed a core delta of USD350/ton in our model for the ongoing year which results in full year earnings of PKR3.25/sh.

Sensitivity Analysis

Local Premium	-5%	0%	5%	10%	15%	20%
Delta (USD/ton)						
300	-1.6	-0.7	0.3	1.2	2.1	3.1
320	-1.2	-0.3	0.7	1.6	2.5	3.5
340	-0.8	0.2	1.1	2.0	2.9	3.9
360	-0.4	0.6	1.5	2.4	3.3	4.3
380	0.0	1.0	1.9	2.8	3.7	4.7
400	0.4	1.4	2.3	3.2	4.1	5.1
420	0.8	1.8	2.7	3.6	4.5	5.5
440	1.2	2.2	3.1	4.0	4.9	5.9

Source: BIPL Research

Potential risks: Further rebound in ethylene price, downtrend in PVC price, PVC imports and removal of RD on PVC are potential threats to our investment thesis.

Investment Perspective: With i) a positive growth outlook for the construction industry ii) premium charged in the local market and iii) debottlenecking resulting in increasing capacity, we have a BUY stance on the scrip at our TP of PKR40/sh, offering a total return of 31% on the last closing.

Morning News

Pakistan to get USD2.5bn from ADB: Pakistan will hopefully get financial allocation of \$ 2.5 billion as infrastructural financing from Asian Development Bank (ADB), which would help country's economy to post 7 per cent growth rate by 2019.

Telecom sector seeks duty reduction: The telecom sector is lobbying with the government to reduce the withholding tax and sales tax rates in the budget slated to be announced by the end of this month. Currently, the withholding tax rate stands at 14pc which remains a major source of revenue generation for the Federal Board of Revenue (FBR).

Govt. plans Thar-Lahore transmission line: The federal govt. plans to launch another high voltage power line from Thar to Lahore to transmit more than 4,000MW of electricity.

World Markets and Commodity Prices

International Equity Markets

Asian Markets (Last trading session's)

	Price	Abs. Chg.	% Chg.
All Ordinaries	5,904.52	-15.4	-0.26
Shanghai Composite	3,127.37	-8.0	-0.25
Hang Seng	24,683.88	-12.3	-0.05
BSE 30	30,126.21	231.4	0.77
Jakarta Composite	5,669.44	22.1	0.39
KLSE Composite	1,758.67	-13.8	-0.78
Nikkei 225	19,310.52	113.8	0.59
NZSE 50	7,378.42	-27.4	-0.37
Straits Times	3,228.62	-9.2	-0.28
Seoul Composite	2,219.67	14.2	0.65
Taiwan Weighted	9,967.64	12.3	0.12
KSE-100 Index	49,283.65	678.51	1.40

Source: Bloomberg

European Markets (Last Trading Session's Rates)

	Price	Abs. Chg.	% Chg.
ATX	2,997.41	-15.2	-0.5
BEL-20	3,932.86	23.0	0.6
CAC 40	5,301.00	-3.1	-0.1
DAX	12,527.84	19.9	0.2
AEX General	525.20	-0.3	-0.1
Swiss Market	8,891.89	23.3	0.3
FTSE 100	7,234.53	-15.5	-0.2
American Markets			
Dow Jones Ind. Average	20,957.90	8.0	0.0
NASDAQ Composite	6,072.55	-22.8	-0.4
NASDAQ -100	5,625.16	-18.9	-0.3
S&P 500 Index, RTH	2,388.13	-3.0	-0.1

Foreign Portfolio Investment in Equities

Country	Day (US\$m)	WTD (US\$m)	MTD (US\$m)	YTD (US\$m)	12M (US\$m)	Date
Pakistan	-6.9	-14.5	-50.8	-212.1	-443.5	04-05
India	-14.6	-66.5	-411.3	6,287.4	7,456.5	03-05
Indonesia	-23.5	64.6	1,114.6	1,740.7	2,776.2	04-05
Japan	-	2,368.7	9,239.8	-8,721.9	-3,603.6	21-04
Philippines	0.4	10.3	208.5	-140.4	-95.7	05-05
South Korea	403.1	520.3	1,472.2	6,237.8	13,850.6	05-05
Sri Lanka	0.4	0.6	71.5	108.6	141.8	05-05
Taiwan	164.8	742.3	1,900.5	7,481.7	13,850.0	05-05
Thailand	-14.1	-29.1	22.7	207.6	2,090.6	05-05
Vietnam	2.4	-9.2	89.8	233.7	-12.4	05-05
Abu Dhabi	8.8	20.8	22.6	369.4	630.1	04-05

Source: Bloomberg, NCCPL

Forex and Money Market snapshot

	Current	Abs. Chg.	% Chg.
6-Month KIBOR (Offer)	6.15	6.16	-0.01
12-M T-Bill (Average)	6.02	6.05	-0.03
10- year PIB (Average)	8.25	8.20	0.05
PkR/ US\$	104.84	104.83	0.01

Source: Bloomberg

Commodity Prices

	Price	Abs. Chg.	% Chg.
WTI (Crude Oil)	45.52	-2.30	-4.8
Gold	1228.1	-10.05	-0.8
CRB Index	177.0083	-3.39	-1.9

Source: Bloomberg

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The rating system

Rating Definition	
Buy	Total stock return \geq 15%
Hold	0% \leq Total stock return < 15%
Sell	Total stock return < 0%

* Total stock return = capital gains + dividend yield

Valuation Methodology

To arrive at our period end target prices, BIPL Securities uses different valuation methodologies including

- Discounted cash flow (DCF, DDM)
- Relative Valuation (P/E, P/B, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)