# Engro Polymer & Chemicals Ltd

PKR44.9- SELL

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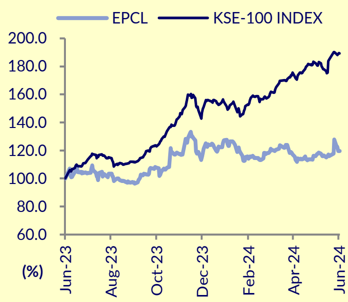
**Pakistan**
**Chemical**

| | |
|---|---|
| **Reuters** | **EPCL.PSX** |
| **Bloomberg** | **EPCL PA** |
| **Priced on 30 June 2024** | |
| KSE100 @ 78,444.9 | |
| **12M hi/lo** | PKR50.1/36.2 |
| **June-25 price target** | PKR36.5 |
| **±% potential** | -18.7% |
| **Shares in issue** | 908.9m |
| **Free float** | 25.0% |
| **Mkt. cap** | USD146.7m |
| **3M ADV** | USD0.2m |

**EPCL vs KSE100 performance**




Source: PSX, Bloomberg

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# Nothing in favour

**Primary margins under pressure; RLNG pricing making things worse**

**EPCL was already in hot waters due to escalating energy costs and lower international margins. Recent IMF condition of RLNG pricing for captive power plants is expected to put further stress on profitability. Moreover, contractionary budgetary measures are expected to constrict already depressed construction demand. Thus, we have incorporated RLNG pricing and lower volumes into our assumptions. Doing so, we downgrade our earnings and valuations. We issue a "SELL" call with June-25 TP of PKR36.5/sh and a downside of ~19%. We see the company posting an EPS of PKR-0.81/0.94/2.52/sh in CY24/25/26.**

**All captive gas at RLNG rates**: IMF has mandated an increase in gas prices for Captive Power Plants; putting them at par with RLNG rates by Jan 1, 2025. In this context, the government plans to increase gas prices by PKR250/mmbtu from July 1, 2024 and the remainder by the cutoff date. We have incorporated RLNG pricing in our assumptions, which shall dent the profits. Recall that first quarter saw a loss as RLNG pricing and lower realized PVC margins (USD332/ton) led to subdued results

**Contractionary budget may affect volumes:** FY25 budget is contractionary across all verticals with special emphasis on the real estate sector. Increased cost of real estate development following higher i) FED on cements ii) Advance tax on purchase, and iii) deemed income tax for developers and iv) FED on first purchase, along with reduced purchasing power of masses though higher taxes on income, presents a bleak outlook on PVC sales. Thus, we have cut down our local volumetric assumption to 195/204/216k tons for CY24/CY25/26 respectively.

**PVC margins remain below historical average:** Global shipping disruptions have once again led to increased price volatility in global commodities. This has already led spot core delta to USD375/ton compared to USD330/ton in 2QCY24. However, a pricing delta of more than USD100/ton has emerged between South Asian (SA) and South East Asian (SEA) PVC prices. We highlight that If SEA prices move up to converge to SA prices, EPCL's core delta may increase further, though it might be short-lived, in our opinion. Note that 15-year average historical margins stand at USD427/ton. Recall that for every USD10/ton change in PVC margins, earnings move approximately by PKR0.45/sh.

**Key valuation methodology**

We have used two stage Gordon growth model to value EPCL.

**Financials Snapshot**

| Year to 31 Dec | CY22A | CY23A | CY24E | CY25E | CY26E |
|---|---|---|---|---|---|
| EPS (PKR) - basic | 12.39 | 9.45 | (0.81) | 0.94 | 2.52 |
| DPS (PKR) | 12.50 | 6.00 | - | 0.85 | 2.26 |
| Dividend Yield (%) | 27.8% | 13.4% | 0.0% | 1.9% | 5.0% |
| P/BV | 1.50 | 1.40 | 1.49 | 1.47 | 1.44 |
| BVPS | 29.9 | 32.0 | 30.1 | 30.5 | 31.1 |
| ROA(%) | 14.5% | 11.1% | -0.7% | 1.1% | 3.0% |
| ROE(%) | 41.0% | 32.8% | -1.9% | 3.1% | 8.2% |

Source: Company Accounts, Alfalah CLSA Research

**Downside risks**

PVC core delta going down again

Start of imports, which may affect EPCL's local market share

**Upside risks**

South East Asian prices converging to South Asian prices

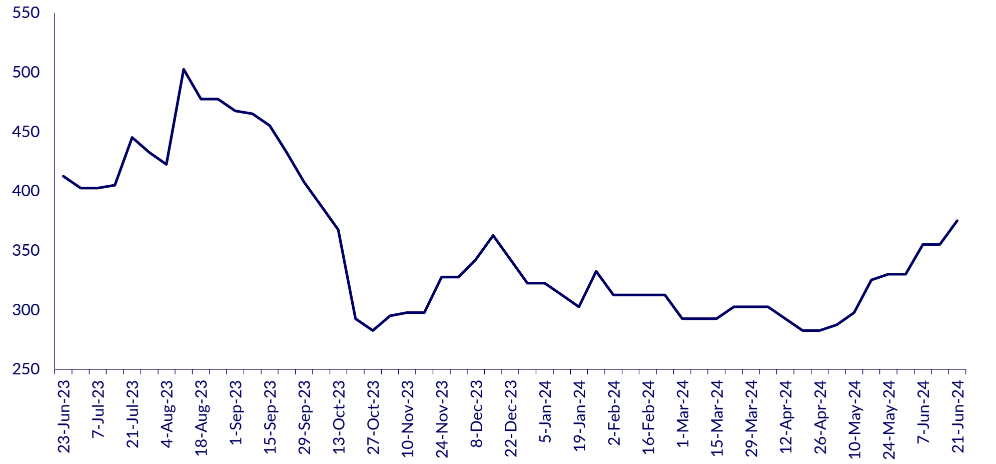
PVC demand recovery in the local market

**Recommendation**

We maintain our stance on EPCL and reiterate "SELL" with June-25 price target of PKR36.5/sh, implying a downside of ~19%. We see the company posting an EPS of PKR-0.81/0.94/2.52 in CY22/23/24.

Figure 1

**PVC margins**




Source: Bloomberg, Alfalah CLSA Research

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