

# Day Break

Monday, 10 October 2016

## Company Update

### Engro Foods Ltd.

Food & Personal Care Products

|                       |            |
|-----------------------|------------|
| <b>Recommendation</b> | <b>BUY</b> |
| Target Price          | 162.8      |
| Last Closing          | 147.2      |
| Upside                | 11%        |

### Market Data

|                            |                 |
|----------------------------|-----------------|
| Bloomberg Tkr.             | EFOODS PA       |
| Shares (mn)                | 766.6           |
| Market Cap (PKRbn   USDmn) | 112.9   1,078.8 |
| Exchange                   | KSE 100         |

### Price Info.

|             |       |       |       |
|-------------|-------|-------|-------|
|             | 90D   | 180D  | 365D  |
| Abs. Return | (5.1) | (4.9) | (8.0) |
| Low         | 137.3 | 137.3 | 119.5 |
| High        | 155.2 | 170.8 | 170.8 |

### Key Company Financials

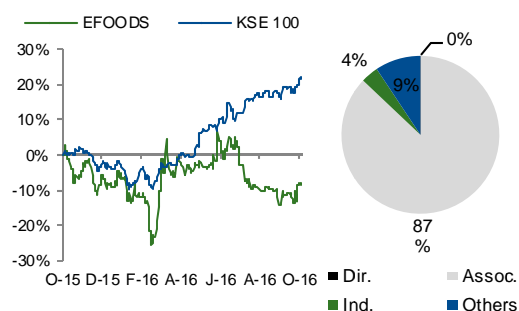
Period End: Dec

| PKRbn         | CY15A | CY16E | CY17F | CY18F |
|---------------|-------|-------|-------|-------|
| Total Revenue | 49.8  | 50.5  | 55.8  | 62.9  |
| Net Income    | 3.2   | 3.8   | 4.2   | 5.5   |
| EPS (PKR)     | 4.1   | 4.9   | 5.4   | 7.1   |
| DPS (PKR)     | -     | -     | -     | -     |
| Total Assets  | 26.3  | 28.0  | 29.8  | 35.9  |
| Total Equity  | 14.9  | 18.7  | 22.9  | 28.3  |

### Key Financial Ratios

|         |      |      |      |      |
|---------|------|------|------|------|
| ROE (%) | 21%  | 20%  | 18%  | 19%  |
| P/E (x) | 35.7 | 30.0 | 27.0 | 20.6 |
| P/B (x) | 7.6  | 6.0  | 4.9  | 4.0  |
| DY (%)  | -    | -    | -    | -    |

### Relative Price Performance & Shareholding



### About the Company

The Company is a public limited company incorporated in Pakistan. The principal activity of the Company is to manufacture, process and sell of dairy, beverages, and frozen desserts.

Source: Bloomberg, KSE 100 & IGI Research

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## Engro Foods Limited

### RFC Acquisition of EFOODS- likely to be a Game Changer

- We have rolled forward our target price for EFOODS to Jun-17 at PKR 163/share which implies a +11% capital upside. We have not yet incorporated company management view post completion of Royal Friesland Campina (RFC) transaction.
- In Jun-16, RFC entered into a Sale and Purchase Agreement (SPA) with Engro Corp to acquire 341mn shares at PKR 122.31/share, whereas the remaining 50mn shares will be purchased through public offering at PKR 151.84/share was made in Sept-16. Upon completion of the transaction, RFC's direct holding via FrieslandCampina would be 41% (313mn shares), whereas the consortium would likely hold 51% in EFOODS.
- Company's profitability took a hit of 1%YoY to PKR 2bn (EPS PKR 2.56) in 1HCY16, despite 139bps increase in gross margin to +27%. Revenue has faltered by 6% YoY primarily due to 8%YoY decline in revenues from dairy and juices segment, which can be attributed to tough competition in UHT milk and Tea Whitener segments.

### Price target rolled forward, to PKR 163/share

We have rolled forward our target price for EFOODS to Jun-17 at PKR 163/share which implies a +11% capital upside. We have not yet incorporated company management view post completion of Royal Friesland Campina (RFC) transaction.

### Too Many Jumping the Bandwagon

Company's profitability took a hit of 1%YoY to PKR 2bn (EPS PKR 2.56) in 1HCY16, despite 139bps increase in gross margin to +27%. Revenue has faltered by 6% YoY primarily due to 8%YoY decline in revenues from dairy and juices segment, which can be attributed to tough competition in UHT milk and Tea Whitener segments. However, 60%YoY drop in financial charges to 214mn has supported the bottom line, where company's debt stands at PKR 6.2bn in 1HCY16 as compared to PKR 10.5bn in 1HCY15.

### Lower Milk Prices and Power Cost supporting Bottom-Line

Earnings dived by 6%YoY to PKR 853mn (EPS PKR 1.11) in 2QCY16, however gross margin inched up by 198bps. In our view, lower earnings are largely due to contracted volumetric sales and discounts on the back of new entrants/discounted players in the market. Whereas reduced milk

prices in tandem with bottomed out power cost helped EFOODS to increase its margin.

**Exhibit: Financial Highlights**

| PKR mn             | 2QCY16 | 2QCY15 | YoY  | 1HCY16 | 1HCY15 | YoY  |
|--------------------|--------|--------|------|--------|--------|------|
| Revenue            | 11,588 | 12,253 | -5%  | 23,331 | 24,829 | -6%  |
| Gross Profit       | 3,093  | 3,028  | 2%   | 6,397  | 6,463  | -1%  |
| Selling and Admin  | 1,400  | 1,537  | -9%  | 2,984  | 3,113  | -4%  |
| Financial Charges  | 111    | 272    | -59% | 214    | 539    | -60% |
| PBT                | 1,429  | 1,554  | -8%  | 2,983  | 2,734  | 9%   |
| Tax                | 576    | 265    | 117% | 1,022  | 757    | 35%  |
| Net profit         | 853    | 909    | -6%  | 1,961  | 1,978  | -1%  |
| EPS                | 1.11   | 1.19   |      | 2.56   | 2.58   |      |
| Key Ratios         |        |        |      |        |        |      |
| Gross Margin       | 27%    | 25%    |      | 27%    | 26%    |      |
| Net Margin         | 7%     | 7%     |      | 8%     | 8%     |      |
| Effective Tax Rate | 40%    | 17%    |      | 34%    | 28%    |      |

Source: IGI Research, Company Financials

**Exhibit: Segment Wise Financials**

| PKR mn            | 1HCY16 | 1HCY15 | YoY |
|-------------------|--------|--------|-----|
| <b>Revenue</b>    |        |        |     |
| Dairy and Juices  | 21,230 | 23,180 | -8% |
| Ice Cream         | 2,087  | 1,815  | 15% |
| Farm              | 513    | 436    | 18% |
| <b>Net profit</b> |        |        |     |
| Dairy and Juices  | 1,932  | 1,998  | -3% |
| Ice Cream         | 77     | (39)   | N/A |
| Farm              | (48)   | 18     | N/A |
| <b>Net Margin</b> |        |        |     |
| Dairy and Juices  | 9%     | 9%     | 0%  |
| Ice Cream         | 4%     | -2%    | N/A |
| Farm              | -9%    | 4%     | N/A |

Source: IGI Research, Company Financials

**Friesland Campina Acquisition – Changing Horses in the Midstream**

Earlier in Jun-16, Netherlands based Royal Friesland Campina (RFC) NV, announced its intention to acquire 51% stake (391mn shares) in Engro Foods (EFOODS) from Engro Corporation (ENGRO) through RFC's wholly owned subsidiary FrieslandCampina International Holding B.V. In Jun-16, RFC entered into a Sale and Purchase Agreement (SPA) with Engro Corp to acquire 341mn shares at PKR 122.31/share, whereas the remaining 50mn shares will be purchased through public offering at PKR 151.84/share was made in Sept-16. Upon completion of the transaction, RFC's direct holding via FrieslandCampina would be 41% (313mn shares), whereas the consortium would likely hold 51% in EFOODS.

RFC internationally is invested in the businesses of manufacturing and sale of dairy based beverages, yoghurts, deserts, coffee creamers, condensed milk, infant nutrition, milk powder, butter, branded cheese, fruit juices and beverages. We believe, with RFC's hands on experience, EFOODS would be able to capitalize the untapped market of milk powder and expand its reach in UHT milk, tea whiteners, juices and ice creams. However we await completion of transaction and plans by new management to be disclosed, to incorporate the impact in our model.

**Exhibit: Acquisition Transaction Details**

|                         | mn Shares | %age Holding |
|-------------------------|-----------|--------------|
| Engro Foods             | 766       | 100%         |
| Engro Corp Holding      | 667       | 87%          |
| <b>Post-Acquisition</b> |           |              |
| RFC                     | 391       | 51%          |
| - Friesland Campina     | 313       | 41%          |
| - IFC                   | 39        | 5%           |
| - FMO                   | 39        | 5%           |
| Engro                   | 326       | 43%          |
| Others                  | 49        | 6%           |
| Total                   | 766       | 100%         |

Source: IGI Research, Company Financials, PSX

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|----------------|--|
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**Time Horizon:** Jun - 2017

**Valuation Methodology:** The analyst(s) has used following valuation methodology to arrive at the target price of the said security (ies):

Free Cash Flow (FCF)

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