



RATINGS (MAY 2010)

ENGRO FERTILIZERS LIMITED (EFL)

Entity	Initial	Previous
Long Term	AA-	-
Short Term	A1	-
Secured, Listed		
TFCII – PKR 4,000mln	AA	AA
TFCIII – PKR 2,000mln	AA	AA
Secured, Privately Placed		
PKR 4,000mln	AA	AA
PKR 2,000mln	AA	AA

FINANCIAL DATA

PKR (mln)

	Dec-09*	Dec-08*
Total Assets	93,709	57,164
Equity	26,888	21,054
Net Income	3,957	4,240
EBITDA	7,208	7,367
ROA (%)	5.6	8.1
ROE (%)	15.8	23.0
EBITDA / Interest (x)	5.5	4.9
Net Debt / Equity (%)	205	132.1

*Engro Chemical Pakistan Limited

ANALYSTS

Arsalan Ahmed
+92 42 35869504
a.ahmed@pacra.com

Jhangeer Hanif
+92 42 35869504
jhangeer@pacra.com

TFCs ISSUES

With the transfer of TFCs from Engro Corporation (formerly Engro Chemical Pakistan Limited) to EFL, the company has 4 rated TFCs. TFCII of PKR 4,000mln issued in Nov-07, with a tenor of 8 years, carrying profit based on 6month KIBOR plus 1.55%. The principal repayment would be in two equal installments commencing from May 2015. PPTFCs of PKR 4,000mln and PKR 2,000mln issued in Mar-08 at a markup of 6 months KIBOR plus 1.70% and 6month KIBOR plus 1.25% respectively. PPTFCs are perpetual with a five-year call and ten year put option. TFCIII of PKR 2,000mln issued in Dec09, with a tenor of 7 years, carrying profit based on of 6month KIBOR plus 2.40%. The principal repayment will be in 10 semi-annual installments, starting from June 2012. In consideration of the guarantee from ECL, instruments have been rated one notch higher than entity ratings, at par with the long term entity rating of ECL.

RATING RATIONALE AND KEY RATING DRIVERS

- The ratings reflect EFL’s relatively low business risk emanating from a stable, indeed growing, urea demand with continuing domestic supply deficit. The ratings also take into account the company’s well-conceived strategy of fortifying its position through a sizeable urea expansion project (Enven 1.3), nearing completion now. The ratings recognize the company’s ability to manage its financial profile though stretched as a result of high borrowings yet manageable with ensuing cashflows of the new capacity post planned commissioning in second half of 2010.
- These ratings are dependent on the successful commissioning of the urea expansion project without significant delays, and effective management of the company’s financial risk through a continuing depressed credit environment in the country. In addition, strengthening the human resource and technological/support infrastructure to supplement expanded operations remains critical.

ASSESSMENT

- The recent corporate restructuring has transferred all fertilizer assets and liabilities (including borrowings) from Engro Corporation Limited (ECL) – formerly Engro Chemical Pakistan Limited – to EFL effective January 01, 2010. Engro Corporation has irrevocably and unconditionally guaranteed to each secured party, covered under respective finance documents, punctual performance by EFL of all its obligations; and undertakes that whenever EFL does not pay any amount when due, it must immediately on demand by Intercreditor Agent (National Bank of Pakistan) pay that amount as if it were the principal obligor in respect of that amount. Engro Corporation is expected to monitor planned outflows and take requisite actions, including injection of equity through right issues, prior to any contingency.
- During 2009, EFL’s urea production stood at 952,000tons, 4.3% lower on YoY basis due to plant shutdown on account of maintenance after two years. Consequently, the company experienced a dip in urea offtake (09:933,000; 08:1,061,000). Nevertheless, EFL’s urea based turnover benefited from price raise, resulting in slight growth on a comparative basis during the period. Meanwhile, NPK’s production (09:91,821; 08:97,669) witnessed decline inline with the domestic demand. During 2009, DAP industry witnessed a revival after price rationalization in the international market. Resultantly, EFL saw a sizable upturn in DAP offtake. The company maintained its gross margins in urea by passing onto consumers all increases in the input costs (mainly natural gas). Although increased leverage resulted in substantially higher finance cost, a major portion of it was capitalised (~PKR 3,700mln). During 1Q10, EFL witnessed upturn in its profitability on a comparative basis. Meanwhile, EFL would continue compensating fall in production due to gas curtailment (currently: 7%) through price hike inline with other industry players.
- EFL’s new urea plant (Enven 1.3), the world’s largest single train ammonia-urea plant, is progressing towards completion. At Mar10, EFL is projected to incur PKR 6,000-8,000mln more to complete Enven1.3. This will be met through a combination of equity (profit retention) and debt. EFL had available unutilized line of PKR 3,725mln from syndicated facility and firm bilateral commitment of PKR 800mln at end Mar10. According to the latest report by independent consultants (Shaw Consultants International Limited), the project may be delayed and commercial production is expected to be achieved in 4Q10. Depending upon the extent of actual delay, EFL would have to finance shortfall in its cashflows, attributed to sizeable finance cost at peak borrowings.
- EFL’s gearing touched 85:15 debt/equity ratio at end-Mar10, because ECL retained all reserves including un-appropriated profits at the time of demerger. However, the company for its lenders’ satisfaction and compliance with debt covenants has re-valued its fixed assets as at end-Mar10. This results in debt-to-equity ratio of 70:30 – lower than the agreed benchmark ratio (73.5:26.5). With increased financial obligations, cash flows and coverages have come under pressure. Nonetheless, EFL’s already strong cash generating ability from core operations, supplemented by a corporate guarantee from Engro Corporation, largely mitigate the associated risk.

PROFILE

- EFL is a wholly owned subsidiary of Engro Corporation Limited (formerly Engro Chemical Pakistan Limited), which in turn is majority (~48%) owned by Dawood Group. The core business of EFL, the second largest producer of urea in the country, is manufacturing and marketing of fertilizers. EFL markets urea under the brand name of *Engro Urea*, MAP under the brand name of *Zorawar*, NPK under *Zarkhez* and DAP as *Engro DAP*. EFL’s urea plant, with a current capacity of 975,000tons per annum, is located at Daharki, whereas NPK plant is situated at Port Qasim.
- The ten member BoD of EFL comprises four executive directors including Mr. Asad Umar (Chairman & Chief Executive Officer), two from Dawood Group and four independent directors. After successful completion of Enven 1.3, the chairman is expected to relinquish his managerial role, succeeded by another executive director – Mr. Khalid Siraj Subhani.

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