The Pakistan Credit Rating Agency Limited

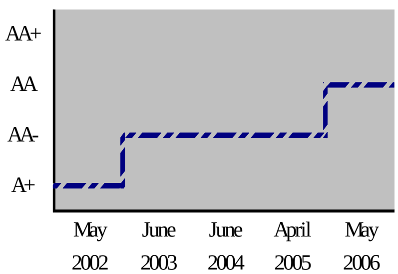
FERTILIZER

ENGRO CHEMICAL PAKISTAN LIMITED (ECPL)

Ratings (May 2006)

Entity	New	Previous
Long Term	AA	AA-
Short Term	A1+	A1+

L.T Entity Rating History



Financial Data

PKR (mln)

	31-Dec-05	31-Dec-04
Total Assets	14,111.6	13,185.36
Equity	7,375.6	6,585.9
Net Income	2,319.1	1,610.6
EBITDA	4,108.8	3,173.9
ROA (%)	16.99	12.37
ROE (%)	33.22	25.20
EBITDA / Interest (x)	19.11	11.24
Net Debt / Equity (%)	33.04	42.84

Analysts

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Rating Rationale

- ECPL's ratings reflect its very strong capital structure and sustained profitability. The ratings also reflect its low business risk profile, as the local fertilizer industry is now operating in a seller's market with assured sales and stable margins. Meanwhile, the continuous business diversification is strengthening the company's capacity to absorb the impact of any unforeseen negative developments in the sector.
- In 2005, fertilizer offtake reached new highs with urea demand rising by a record 10% to 5.2mln tons. Attractive agricultural commodity prices and enhanced water and agri-credit availability were the key driving factors for this unprecedented growth. Even though local urea production was more than the nameplate capacity, it remained insufficient to meet the local demand. The shortage in supply was met through higher cost imports. The trend in rising demand has continued in Rabi'06 and going forward, this trend is expected to be maintained, necessitating around 0.4mln tons of urea imports. Local urea prices have been consistently rising due to increasing gas prices. However, local prices remain at around 47% discount to the international prices. Given the strong local demand, manufacturers have been able to transfer the impact of rising feedstock prices to the end consumer. This trend is likely to continue going forward, thereby maintaining industry margins.
- With the production of 911,672 tons of urea, ECPL's capacity utilization increased to 107% as opposed to 102% in the previous year. This coupled with rising fertilizer prices resulted in a substantial increase in the company's turnover value. Although the cost increase emanating from higher gas prices decreased gross margin slightly, the impact was more than offset by hefty increase in the dividend income from associated companies, thereby substantially augmenting the bottom line. Going forward, the price hike with growing fertilizer demand is expected to add to Engro's profitability. The company's margins are expected to remain stable even after the increase in feedstock prices. Meanwhile, dividends from associates are expected to continue as a significant contributor to net income. In the medium term, though the new urea capacities will be added, these would primarily be directed towards filling the demand-supply gap. Hence, ECPL's exposure to business risk is expected to remain very low.
- In line with its diversification strategy, ECPL has established a wholly owned subsidiary - Engro Foods (Private) Limited (EFL) - to undertake the food business. EFL is focusing initially on dairy business with the longer term objective to explore other food businesses as well. Although EFL is likely to remain non-earning in the initial years of its commercial operations, it is expected to add towards ECPL's profitability in the long run. In addition, ECPL is in the process of enhancing its urea plant capacity by 1.1mtpa, subject to the gas allocation by the government. The company is also planning to enter into power generation through establishing its subsidiary by the name of "Engro Energy" alongwith acquiring another IPP. This increasing business diversification would inevitably further strengthen the earning base without compromising the risk profile of the company.
- ECPl's cash flows and coverages remain strong, indicating very strong capacity for timely payment of financial commitments. Currently, ECPL is operating at a low level of leverage, which is much below the targeted capital structure of the company. Going forward, investment for the company's new ventures will increase the gearing level. However, the company is likely to maintain its targeted strong level of capital structure, which will be supported by the management's policy of expanding the equity base.

Background

- Engro Chemical Pakistan Ltd. (ECPL) was incorporated in 1965 as Esso Pakistan Fertilizer Company Ltd. The core business of ECPL is manufacturing and marketing of fertilizers and it is the second largest producer of urea in the country, which is produced at the plant site in Daharki. ECPL also produces NPK (*Zarkhez*) at Port Qasim and markets MAP under the brand name *Zorawar* and DAP. Owing to the continuously declining margins in seed business, the management has decided to exit from this business in the phased manner. This manifests the management's pro-active business approach of a continuous review of operations and realigning corporate strategy according to the changing business dynamics.
- ECPL has also diversified its interests in the form of two joint ventures with foreign collaboration, the first, Engro Vopak Terminal Limited (EVTL), being a jetty and chemical terminal facility at Port Qasim, and the other, Engro Asahi Polymer and Chemicals Limited (EAPCL), the first PVC resin manufacturing plant in the country.
- The Dawood Group (DG) holds a majority 42% stake in ECPL, while the holding of Engro employees and Employee Trust stands at 13%. The BoD of ECPL comprises five members from its own management, two from the DG, and three other non-executive directors. During the current year, Mr. Hussain Dawood, chairman of DG, has been elected as the chairman of ECPL. The association of DG has augmented the capacity of the Board to guide the management in formulating its long term strategy.