The Pakistan Credit Rating Agency Limited

Rating Report

Pakarab Fertilizers Limited | PP Sukuk

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
20-Apr-2018	A	-	Stable	Preliminary	-

Rating Rationale and Key Rating Drivers

The ratings reflect the strength of the ownership structure of Pakarab: Arif Habib Group and Fatima Group. This strength has been demonstrated in the past both in terms of ongoing support and at the times of stress. The company has a sizeable loan from sponsors, considered as quasi equity. The company's operations were facing challenge due to gas shortage in the country. RLNG provided requisite support and now the company is getting natural gas from the system as well (~28%). The company has a diverse product mix with the ability to make best use of available raw material. The demand/supply dynamics in the urea industry is adequate and the product prices have also come down from historical highs. Pakarab is distinctly placed in this context, given its product mix having a lower proportion of urea. Margins have come down; given rise in LNG price. The financial sustainability of the company still drives from stability in operations, continued sponsor support and timely recovery of stuck-up receivables. The rating of the Sukuk derives strength from the security structure.

The ratings are dependent on the sustained risk profile of the company, seamless financial discipline in the wake of upcoming debt repayments. For this, continuity of profitable operations is crucial.

Disclosure	
Name of Rated Entity	Pakarab Fertilizers Limited | PP Sukuk
Type of Relationship	Solicited
Purpose of the Rating	Debt Instrument Rating
Applicable Criteria	Methodology | Sukuk Rating Methodology(Jun-17),Methodology | Debt Instruments Rating Methodology(Jun-17)
Related Research	Sector Study | Agriculture Input and Services(Jan-18)
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PAKARAB FERTILIZERS LIMITED (PFL) PROFILE	
Incorporated	1973
Major Business	The principal activity of the Company is the production of compound fertilizers Calcium Ammonium Nitrate (CAN) Nitro Phosphate (NP) and Urea.
Head Office	Lahore

OWNERSHIP

- Pakarab Fertilizers Limited, incorporated in 1973, as a result of a memorandum signed between the Government of Pakistan and the state of Abu Dhabi.
- The plant site, located in the vicinity of Multan, is home to production facilities for Urea, Ammonia, Nitric Acid, Nitro Phosphate, CAN and CO2 as well as a Co-generation power plant.
- In 2005, Pakarab was privatized and acquired by a consortium of two major business groups in Pakistan namely Fatima Group (FG) and Arif Habib Group (AHG).
- Arif Habib Group and Fatima Group are among the leading corporate groups in Pakistan, engaged in trading of commodities, manufacturing of fertilizers, textiles, sugar, mining and energy.

GOVERNANCE & MANAGEMENT

- Eight member board of directors including the Chief Executive Officer (CEO) Directors equally represented by Arif Habib Group and Fatima Group.
- The Chairman, Mr. Arif Habib, is a reputed business professional and also chairs Fatimafert Limited, Fatima Fertilizer Company Limited, Aisha Steel Mills Limited and Javedan Corporation Limited.
- Mr. Fawad Ahmed Mukhtar is the Chief Executive Officer of the Company and possesses vast business expertise spanning over three decades.
- Management team is a balanced blend of highly experienced professionals from the industry having long association with Pakarab Fertilizers Limited.

PERFORMANCE

- In 2015, Pakarab became operational on Re-gasified Liquid Natural Gas (RLNG); becoming the first fertilizer company on RLNG.
- With effect from Dec 2017, gas supply is available from SNGPL in line with industry players (current 28%; but at a high cost; approximately PKR 1,000/MMBTU.
- With respect to manufactured product mix, NP remains the top selling product followed by CAN while Urea remained insignificant.
- During CY17, the topline of the company increased by 2%, Company is expected to make a gross profit of 3% as compared to gross loss in CY2016, while operating margins deteriorated -8% majorly attributed to Operational halt for months due to gas shortage..
- Pakarab aims to issue Sukuk of amount PKR 1000mln inclusive of green shoe option of PKR 250mln. The tenor of Sukuk is 5 years and will be repaid in steps. The proceeds will be used I) to finance the cost of relocation of it liquid carbon dioxide plant (‘LCO2 plant’ or ‘LCO2 project’ or “Musharkah Assets”) and II) remaining proceeds will be used in business operation/general working capital. The plant would be relocated to the premises of Fatima Fertilizer, wherein maintained availability of raw material would enable Pakarab to service customer needs on a wide basis.
- The relocation of plant has already been initiated in Jan 2018 and expected to be completed by end of May 2018. Therefore, production and sales of LCO2 from Fatima Fertilizers site is expected from June 2018.
- The sales are expected to build up gradually. The Management forecast demonstrates that Pakarab would be able to repay the loan from the profit from the LCO2 plant
- Finance cost exhibited an increasing trend (CY17: PKR 2,164mln; CY16: PKR 1,800mln) owing to increased borrowing.
- The net loss of Pakarab is expected at PKR 2,174mln for CY17 (-1,927mln:CY16)
- Pakarab expects to be able to continue its operations on mixed gas (Natural gas + LNG) for the foreseeable future.

Financial Risk

- Pakarab’s financial structure is mainly stressed due to operational halt in the past. Post resumption of operations, financials metrics are expected to improve.
- Pakarab has a bond initiative: Sukuk (1000mln) which has a grace period of one year from the issue date and will be repaid in eight equal semiannual installments starting from 18th month from date of disbursement.
- The Sukuk is secured by Exclusive Hypothecation Charge over the Musharkah Assets with 25% margin.
- Assignment of lease agreement between Fatima Fertilizer and PFL in favor of Investment Agent. Lien on Collection Account and Debt Payment Account. The issuer will be filling DPA 50% prior to 30 days and 50% prior to 15 days from the payment date.
- Resumption of fertilizer operations are important beside the CO2 sales.
- The cash flows from LCO2 segment of PFL business will be used primarily to service the rental/profit commitments of proposed Sukuk. The monthly routing and built-up of upcoming instalment in designated account is expected to ensure timely repayments.
- Pakarab continues to enjoy unwavering sponsors support, however, it intends to repay the borrowings by way of LCO2 cashflow.

The Pakistan Credit Rating Agency Limited

PKR mln

Pakarab Fertilizers Limited (PFL)

BALANCE SHEET	31-Dec-17	31-Dec-16	31-Dec-15	31-Dec-14
	CY17	CY16	CY15	CY14
Non-Current Assets	**44,003**	**42,153**	**42,622**	**43,374**
Investments (Incl. Associates)	**473**	**467**	**405**	**361**
Equity	-	-	-	-
Debt	473	467	405	361
Current Assets	**17,014**	**17,941**	**22,653**	**8,992**
Inventory	4,228	4,070	7,661	829
Trade Receivables	2,069	2,898	2,624	188
Others	10,718	10,973	12,369	7,975
Total Assets	**61,489**	**60,561**	**65,680**	**52,727**
Debt	**19,646**	**16,173**	**20,657**	**9,365**
Short-term	10,882	9,173	17,352	7,637
Long-term (Incl. Current Maturity of Long-Term Debt)	8,764	6,999	3,305	1,727
Other Short-term Liabilities	8,977	9,811	10,992	10,073
Other Long-term Liabilities	11,477	12,569	10,120	12,516
Shareholder's Equity	**21,389**	**22,008**	**23,911**	**20,773**
Total Liabilities & Equity	**61,489**	**60,561**	**65,680**	**52,727**
INCOME STATEMENT				
Turnover	**16,531**	**16,176**	**21,920**	**14,248**
Gross Profit	487	(30)	4,568	1,984
Other Income	65	336	(1)	1,034
Financial Charges	(2,164)	(1,800)	(1,677)	(1,626)
Net Income	**(2,174)**	**(1,925)**	**2,460**	**(45)**
Cashflow Statement				
Free Cashflow from Operations (FCFO)	(1,065)	(869)	2,690	774
Net Cash changes in Working Capital	(28)	3,291	(11,745)	3,533
Net Cash from Operating Activities	(3,104)	807	(10,603)	2,797
Net Cash from InvestingActivities	(493)	(207)	50	345
Net Cash from Financing Activities	1,601	5,249	(857)	(1,789)
Net Cash generated during the period	(1,996)	5,849	(11,410)	1,352
Ratio Analysis				
Performance				
Turnover Growth	2.2%	-26.2%	53.8%	91.8%
Gross Margin	2.9%	-0.2%	20.8%	13.9%
Net Margin	-13.2%	-11.9%	11.2%	-0.3%
ROE	-6.8%	-5.7%	7.3%	-0.1%
Coverages				
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB)	-0.2	-0.2	0.3	0.1
Interest Coverage (x) (FCFO/Gross Interest)	-0.5	-0.5	1.6	0.5
Debt Payback (Years) (Total Lt.Debt (excluding Covered Short Term Borrowings) / FCFO)	-7.4	-7.4	13.0	-15.8
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	32.9	-43.0	-26.9	-48.1
Capital Structure (Total Debt/Total Debt+Equity)	60.0%	55.8%	51.0%	37.3%

DEBT INSTRUMENT RATING SCALE & DEFINITIONS

The instrument rating reflects forward-looking opinion on credit worthiness of underlying debt instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

LONG TERM RATINGS

AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments.
AA+ AA AA-	Very high credit quality. Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	High credit quality. Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	Good credit quality. Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	Moderate risk. Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	High credit risk. A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	Very high credit risk. Substantial credit risk “CCC” Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. “CC” Rating indicates that default of some kind appears probable. “C” Ratings signal imminent default.
D	Obligations are currently in default.

SHORT TERM RATINGS

A1+: The highest capacity for timely repayment.

A1:. A strong capacity for timely repayment.

A2: A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.

A3: An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.

B: The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.

C: An inadequate capacity to ensure timely repayment.

Outlook (Stable, Positive, Negative, Developing)
Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. ‘Stable’ outlook means a rating is not likely to change. ‘Positive’ means it may be raised. ‘Negative’ means it may be lowered. Where the trends have conflicting elements, the outlook may be described as ‘Developing’.

Rating Watch
Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

Suspension
It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn
A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveill the opinion due to lack of requisite information

Rating Team Statements
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term “family members” shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest
(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers’ associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst’s area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)
Probability of Default
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)
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