The Pakistan Credit Rating Agency Limited

Rating Report

Engro Fertilizers Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
27-Jul-2018	AA	A1+	Stable	Upgrade	-
30-Dec-2017	AA-	A1+	Stable	Maintain	-
20-Apr-2017	AA-	A1+	Stable	Maintain	-
18-Nov-2016	AA-	A1+	Stable	Maintain	-
18-Nov-2015	AA-	A1+	Stable	Upgrade	-

Rating Rationale and Key Rating Drivers

The ratings take into account sustained operations of the company; capacity utilization at both plants remained high on the back of continued gas supply from Mari and other. The risk of gas curtailment has diminished with strengthening of local reservoirs and continued import of RLNG. The company has been able to secure sustainable gas supply. Efert is benefiting from the incentivized gas pricing of 70 cents under the fertilizer policy 2001.
Efert was facing challenge due to oversupply in the domestic market. This challenge was met by exploring export market. Plus, the domestic supply demand scenario is now favourable, owing to the shutdown of LNG based fertilizer plants that borne negative margins on RLNG. The industry has been able to raise the price of urea as well. Meanwhile, timely recovery of remaining subsidy is important. The financial risk profile of the company is characterized by moderate leveraging. EFert continues to derive strength from its association with Engro Corporation – a corporate conglomerate.

The ratings are dependent on sustainability of operations and profitability, resulting in sustained risk profile of the company. Any constraint to perceived ability to keep business and financial risk in respective matrix may impact the ratings.

Disclosure

Name of Rated Entity	Engro Fertilizers Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating Methodology(Jul-17),Methodology | Correlation between long-term and short-term rating scale(Jun-17)
Related Research	Sector Study | Agriculture Input and Services(Jan-18)
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ENGRO FERTILIZERS LIMITED (EFERT) PROFILE	
Incorporated	2010
Major Business	Fertilizers
Legal Status	Listed Company
Head Office	Karachi

INDUSTRY SNAPSHOT

Pakistan fertilizers sector has production capacity of 6.9mln MT of urea, 0.7mln MT of DAP and 2.2mln MT of others. The industry benefits from the latent demand of its major product urea and oligopolistic market conditions. Industry has recovered from supply surplus issues because of urea exports and improved urea prices.

OWNERSHIP

- Engro Fertilizer is 56% owned by Engro Corporation (ECorp), a corporate conglomerate. The shareholding was gradually reduced from 100% as part of strategic re-alignment to explore new opportunities in other promising sectors.
- The total designed capacity of EFert's urea plants – base plant: 975,000 MT per annum and Enven: 1,300,000 MT per annum – accounts for ~33% of industry's demonstrated capacity – second largest capacity.

GOVERNANCE

- EFert's board comprises three Engro Corp's executives, one DG representatives and four independent directors.
- Mr. Ghias Khan, the CEO of the holding company, is the Board Chairman. He is a seasoned professional with a long association with Engro Group.
- EFert has two board committees viz. Board Audit Committee and Board Compensation Committee while ECorp's Board Investment Committee oversees the investment related matters of EFert and other subsidiaries as well.

MANAGEMENT

- Mr. Ruhail Muhammad joined EFert as a President and Chief Executive Officer, in 2012. Prior to joining EFert in his current capacity, he served as Chief Financial Officer of ECorp and also as CEO of Engro Powergen Limited. He has been associated with Engro for more than 15 years.
- The operations of the company are divided into six major departments, headed by able professionals, who report directly to the CEO. Mr. Atif Kaludi is the CFO of the company. Earlier he was associated with EngroPower Gen Limited.
- EFert's quality of management remains its core strength and is duly recognized for its highly professional and long-term outlook. The top management is highly qualified and well experienced in their respective fields.

BUSINESS RISK

- Industry Urea sales in 1QCY18 clocked in at 1,242 KT vs 869 KT in 1QCY17 up by 43%. The production remained stable at 1,333 KT in 1QCY18 vs 1,353 KT in 1QCY17. The challenges with offloading the stock piles have been resolved, the industry's closing inventory in 1QCY18 stood at 282 KT vs 1,532 KT in 1QCY17.
- In 1QCY18, EFert's market share stood at 39.7% in urea and 14.7% in DAP. Company's topline increased by 58% to ~PKR 16bln (1QCY17: PKR 10bln); predominately led by higher offtakes as well as due to higher domestic prices and lower inventory levels.
- EFert's total domestic sales of urea were observed at 497 KT at end-March18; an increase of ~80% (end-March17: 269KT). DAP sales recorded a 46% increase at end-March18 to 54KT vs 37KT at end-March17. The gross margins of the company witnessed a rise of 119% (end-March17:-29 %). Subsidy recoverable from GoP stood at PKR 7.7bln.
- The finance cost of the company declined to PKR 0.5bln (end-March17: PKR 0.69bln) due to loan repayments and lower interest rates.
- In 1QCY18 the company profitability stood at PKR 3.7bln, an increase of ~118% over end-March17 PKR 1.7bln.
- Going forward, the company has been able to secure sustainable gas supply. Efert is benefiting from incentivized gas pricing of 70 cents mmbtu under the Fertilizer Policy 2001. Previously the company was facing challenge due to oversupply of urea in the domestic market. The challenge was met by exploring export market. Plus, the latest domestic supply demand scenario is favorable, owing to the shutdown of LNG based fertilizer plants that borne negative margins on RLNG. The industry has been able to raise the prices of urea as well.

FINANCIAL RISK

- Free cash flows from operations (FCFO) increased to PKR 6.6bln 1QCY18 (end-March17 PKR 4.1bln), Debt coverage increased to 3.5 times 1QCY18 (end-March17: 1.5x), which is in line with reduced short-term liabilities.
- Debt level decreased to PKR 33bln in end-Dec17 as compared to end-Dec16 (PKR 37bln). The company has replaced expensive PPTFC with low cost debt.
- Going forward, the company envisages to keep leveraging at current level – an optimal capital structure considered by the management.

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Engro Fertilizers Limited (EFert)

BALANCE SHEET	31-Mar-18	31-Dec-17	31-Dec-16	31-Dec-15
	3MCY18	CY17	CY16	CY15
Non-Current Assets	**73,442**	**73,533**	**74,740**	**72,459**
Investments (Incl. Associates)	**5,864**	**9,644**	**703**	**16,297**
Equity	560	560	560	4,383
Debt	5,304	9,083	143	11,914
Current Assets	**21,105**	**23,156**	**26,985**	**16,627**
Inventory	3,565	3,528	6,820	6,942
Trade Receivables	2,056	3,485	7,585	2,262
Others	15,484	16,143	12,580	7,423
Total Assets	**100,411**	**106,333**	**102,428**	**105,382**
Debt	**25,153**	**32,626**	**36,510**	**36,074**
Long-term (Incl. Current Maturity of Long-Term Debt)	24,082	30,954	34,601	36,074
Other Short-term Liabilities	26,129	24,739	18,827	20,164
Other Long-term Liabilities	9,485	9,627	7,718	6,617
Shareholder's Equity	**40,716**	**41,013**	**41,283**	**42,526**
Total Liabilities & Equity	**101,482**	**108,005**	**104,338**	**105,382**
INCOME STATEMENT				
Turnover	**15,903**	**67,990**	**77,397**	**87,615**
Gross Profit	7,650	25,452	24,989	32,180
Other Income	(183)	(136)	(887)	(106)
Financial Charges	(503)	(2,560)	(3,136)	(4,588)
Net Income	**3,709**	**10,137**	**9,025**	**15,028**
Cashflow Statement				
Free Cashflow from Operations (FCFO)	6,603	18,730	17,995	26,174
Net Cash changes in Working Capital	(2,149)	12,090	(13,839)	(17,142)
Net Cash from Operating Activities	3,702	28,205	775	4,642
Net Cash from InvestingActivities	(2,427)	(5,136)	(2,422)	8,165
Net Cash from Financing Activities	(6,877)	(15,062)	(10,748)	(16,384)
Net Cash generated during the period	(5,601)	8,006	(12,394)	(3,577)
Ratio Analysis				
Performance				
Turnover Growth	58.0%	-12.2%	-11.7%	42.6%
Gross Margin	48.1%	37.4%	32.3%	36.7%
Net Margin	23.3%	14.9%	11.7%	17.2%
Coverages				
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB)	3.5	1.7	2.2	1.8
Interest Coverage (x) (FCFO/Gross Interest)	13.1	7.3	5.7	6.0
Debt Payback (Years) (Total Lt.Debt (excluding Covered Short Term Borrowings) / FCI	1.1	1.9	2.3	1.6
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	12.2	26.3	9.6	-33.8
Capital Structure (Total Debt/Total Debt+Equity)	38.2%	44.3%	46.9%	45.9%

Rating Scale

Credit Rating Scale & Definitions

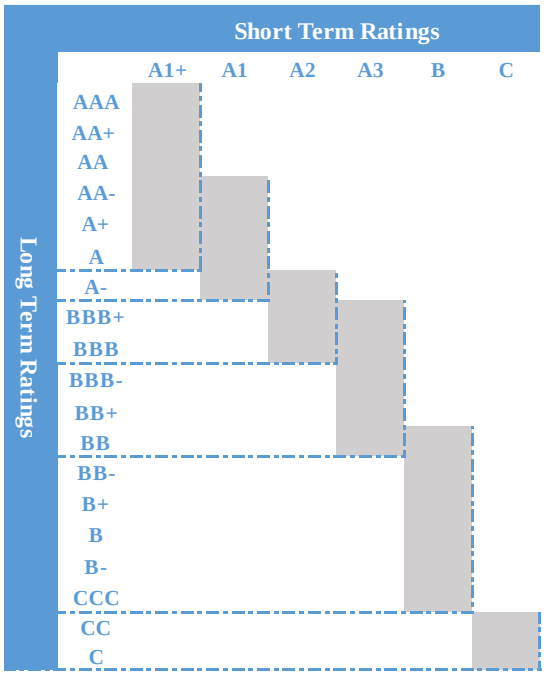
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

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)
Proprietary Information