The Pakistan Credit Rating Agency Limited

Rating Report

Fauji Fertilizer Company Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-Jul-2018	AA+	A1+	Stable	Upgrade	-
04-Aug-2017	AA	A1+	Stable	Maintain	-
04-Aug-2016	AA	A1+	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect FFC's dynamic business profile and financial position while incorporating the sound financial strength of Fauji Group. FFC is one of the largest players in the fertilizers market in terms of its production capacity. The strong business footprint of FFC has enabled the company to build an impeccable brand in Pakistan with "Sona" being a household name in the farming community. The production facilities are secured by uninterrupted supply of gas from Mari field, representing inherent commercial strengths of the company in terms of sustainable business volumes. In line with the industry, FFC also faced urea oversupply situation in 2017. However, the export of excess urea allowed by the Government, provided much relief to the business. The latest domestic supply demand scenario is also favorable, In view of discontinuation of urea subsidy scheme and increasing production costs, the industry has increased the prices of fertilizers as well.

FFC carries a sizable book of diversified investments, both long term and short term, which has been developed to offer sustainable returns to its stakeholders. FFC marked its presence into the financial sector via a sizable stake in Askari Bank (43.15%) in 2013, which has a distinct presence in Pakistan's financial sector: dividend stream from these investments compliments FFC's ratings. Under its diversification strategy, FFC is evaluating investment in offshore fertilizer project, besides investing in the power sector of the Country; leveraging associated with business ventures will require oversight and close attention.

Disclosure

Name of Rated Entity	Fauji Fertilizer Company 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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`FAUJI FERTILIZER COMPANY LIMITED
PROFILE

Incorporated	1978
Major Business	Engaged in manufacturing of urea and sale of fertilizers
Legal Status	Listed
Head Office	Rawalpindi

INDUSTRY SNAPSHOT

Pakistan fertilizers sector has production capacity of 6.9mln MT of urea, 0.7mln MT of DAP and 1.8mln MT of others. The Industry was facing urea oversupply situation in 2017. The Government allowed export of excess urea providing relief to the fertilizer manufacturers. The latest domestic supply demand scenario is favorable, in view of discontinuation of urea subsidy scheme and increasing production costs, the industry has increased the prices of fertilizers as well.

OWNERSHIP & GROUP PROFILE

- Fauji Fertilizer Company is majority owned by Fauji Foundation (44.35%); a Charitable Trust incorporated under the Charitable Endowments Act 1890. State Life Insurance holds 9.12%, whereas other institutions and general public hold 22.76% and 23.77%, respectively.
- One of the largest urea manufacturers having a nameplate capacity of 2,048K tonnes and annual production of over 2,400K tonnes owing to investment in to efficiency enhancement through BMR. FFC's market is relatively concentrated in Punjab (68%).
- Company also provides engineering services to other chemical industries, both within and outside Pakistan.

GOVERNANCE

- FFC has a thirteen-member board of directors including the Chief Executive Officer (CEO), seven representatives of FF and four independent including one member each from SLIC and NIT.
- Lt Gen Syed Tariq Nadeem Gilani, HI-(M) Retired has recently joined the FFC's Board as a Chairman in Jan '18. He is also the MD of Fauji Foundation and Fauji Oil Terminal & Distribution Company Ltd.

MANAGEMENT

- The organizational structure of the company comprises of twelve well segregated functional departments, headed by highly experienced professionals
- FFC's management team is a balanced blend of professionals having long association with the Company.
- The Company's CEO&MD, Lt Gen Tariq Khan, HI-(M) (Retired), recently joined the FFC in March '18. He is also the CEO&MD of Fauji Fresh n Freeze Limited & FFC Energy, two wholly owned subsidiaries of FFC.

SYSTEMS & CONTROLS

- FFC has state of the art IT infrastructure in place; SAP software. The company has maintained a profound management system that smoothly sail the business processes and giving an end to end solution for financial, logistics, distribution, inventories, plant maintenance, human capital management, material management etc.
- FFC actively monitors the operations of its plant sites on daily, monthly and yearly basis, in order to keep the company's performance apt.

PERFORMANCE

- FFC's topline exhibited an increasing trend of 22%, predominately led by higher offtake of Urea and DAP besides other fertilizers.
- Company's imported DAP sales also grew by 154% (Dec17: 513 K tonnes; Dec16: 202kilo tonnes) owing to increased demand emanating from lower prices due to subsidy scheme and comparatively lower international prices on YoY basis. Government allowed urea exports contributed to the revenues as well. Urea offtake recorded an increase of 11% (Dec17: 2.70mln tonnes; Dec16: 2.43mln tonnes).
- FFC's finance costs exhibited an increasing trend (CY17: PKR 2.5bln; CY16: PKR 2.4bln) partly due to delayed subsidy reciepts and higher credit sales.
- During CY17, FFC's sizeable investment income at PKR 3.5bln (1QCY18: PKR 0.9bln) which supported the bottom-line; significantly contributed by dividend income from equity investments, return on PIBs and term deposits.
- During 1QCY18 FFC achieved a net profit of PKR 2.3bln 3% higher than the corresponding quarter of last year.

FINANCIAL RISK

- In line with industry, FFC witnessed lower inventory levels at end Mar-18. The challenges associated with higher inventory during faced during 2017 had been relieved under the GoP urea export initiative. Hence, replicating the effect on average inventory days which has declined from the previous year coming down to 28days CY17 (CY16: 53days).
- During CY17, short-term borrowings stood at PKR 11.5bln whereas long-term borrowings were PKR 15.6 bln.
- The business earned sufficient free cashflow FCFO of PKR 9.9bln in CY17 (CY16: PKR 9bln) from its operations. Therefore, leading the company into a comfortable position to conveniently pay off its borrowings. Existing long term borrowings are due by 2021; creating room for further borrowing for upcoming business ventures / diversification projects.

Fauji Fertilizer Company Limited (FFCL)

BALANCE SHEET	31-Mar-18	31-Dec-17	31-Dec-16
	3MCY18	Annual	Annual
Non-Current Assets	**24,729**	**24,877**	**23,766**
Investments (Incl. Associates)	**46,237**	**58,752**	**43,800**
Equity	23,761	22,961	22,401
Current Assets	**25,109**	**25,002**	**23,144**
Inventory	1,320	395	4,237
Trade Receivables	2,119	3,722	4,307
Others	21,670	20,885	14,599
Total Assets	**96,075**	**108,631**	**90,710**
Debt	**22,146**	**33,942**	**45,264**
Long-term (Incl. Current Maturity of Long-Term Debt)	21,885	22,403	23,088
Short-term Borrowings	261	11,539	22,177
Other Short-term Liabilities	41,614	40,639	12,422
Other Long-term Liabilities	4,597	4,697	4,812
Shareholder's Equity	**27,718**	**29,352**	**28,211**
Total Liabilities & Equity	**96,075**	**108,631**	**90,709**
INCOME STATEMENT			
Turnover	**21,670**	**97,316**	**79,856**
Gross Profit	5,205	24,695	25,029
Other Income/Expenses	592	2,091	1,925
Financial Charges	(377)	(2,471)	(2,406)
Net Income	**2,265**	**10,711**	**11,782**
Cashflow Statement			
Free Cashflow from Operations (FCFO)	1,612	9,950	9,125
Total Operating Cashflows (TCF)	1,575	12,594	12,497
Net Cash from Operating Activities	2,670	37,403	10,346
Net Cash from InvestingActivities	(251)	(3,109)	(2,099)
Net Cash from Financing Activities	(4,167)	(9,242)	(8,424)
Ratio Analysis			
Performance			
Turnover Growth	72%	22%	-7%
Gross Margin	24%	25%	31%
Net Margin	10%	11%	15%
ROE	57%	40%	44%
Coverages			
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB)	0.8	1.1	1.0
Interest Coverage (x) (FCFO/Gross Interest)	4.3	4.0	3.8
Debt Payback (Years) (Total Lt.Debt (excluding Covered Short Term Borrowings) / FCFO-Gross interest)	4.4	3.0	3.4
Liquidity			
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	27	28	53
Capital Structure (Total Debt/Total Debt+Equity)	44%	52%	62%

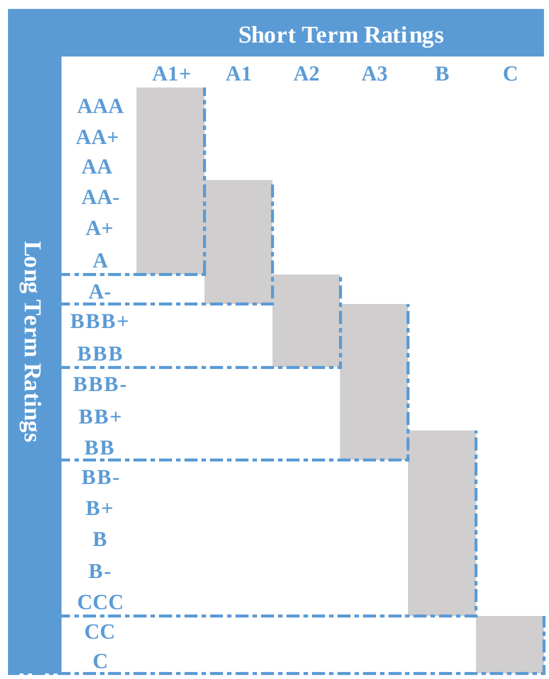
Rating Scale

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