



The Pakistan Credit Rating Agency Limited

Rating Report

Pak Arab Fertilizers Limited

Report Contents

1. Rating Analysis
2. Financial Information
3. Rating Scale
4. Regulatory and Supplementary Disclosure

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-Oct-2018	A-	A2	Stable	Maintain	YES
20-Apr-2018	A-	A2	Stable	Maintain	-
12-Oct-2017	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The company leverages on its ownership strength derived from Fatima Group and Arif Habib Group. Sponsor patronage in the shape of a turnaround plan has come to the rescue. A group level business strategy has been laid out as per which Fatima Fertilizer Company Limited (FFCL) is planned to acquire its wholly owned subsidiary-Fatimafert Limited along with major operating plants of its associated Company Pakarab Fertilizers; including Ammonia, Urea, Nitric Acid, NP, CAN and clean development mechanism. Materialization of the proposed plan is to be achieved. The strained risk profile of the company, owing to gas curtailment persisted to be the major hurdle. The Company's financial profile is reflected by a thin topline, majorly secured through DAP trading. Eroded margins accompanied by hiked borrowings added stress to the dwindled position. Post acquisition, Pakarab Fertilizer is expected to develop a small yet a sustainable business model. Revenue stream would majorly include income from DAP trading, Carbon Dioxide plant activity, and other non core activities, these income stream alongside consideration for acquisition from Fatima Fertilizer should enable the company in meeting its financial need.

The rating are kept under 'Rating watch' to surveil the roll-out of the acquisition plan. The ratings would be updated once the evolving position is settled.

Disclosure

Name of Rated Entity	Pak Arab Fertilizers Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Corporate Ratings(Jun-18),Methodology Criteria Rating Modifier(Jun-18),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
Related Research	Sector Study Agriculture Input and Services(Jan-18)
Rating Analysts	Raniya Tanawar raniya.tanawar@pacra.com +92-42-35869504



Profile

Legal Structure Pakarab Fertilizer is registered as a public unlisted company.

Background Pakarab Fertilizers Limited was incorporated in 1973 as a result of an agreement between Government of Pakistan and the state of Abu Dhabi. Pakistan Industrial Development Corporation (PIDC); representative of Government of Pakistan (52%), National Fertilizer Corporation (NFC) and Abu Dhabi National Oil Company (ADNOC), an International Petroleum Investment Company; representative of the state of Abu Dhabi 48%. In 2005, Pakarab Fertilizers Limited (PAFL) was acquired by a consortium of Arif Habib Group and Fatima Group, under the Government of Pakistan's privatization programme.

Operations Pakarab Fertilizers Limited produces Calcium Ammonium Nitrate (CAN), Nitro Phosphate (NP) and Urea. It supplies fertilizer products domestically with a distribution network, with 920 sales points with 2,262 business associates, mainly concentrated in Punjab. Pakarab also has an LCO2 plant that produces 99.9% pure Carbon dioxide CO2 with a capacity of 192MTPD (63,360 MTPA).

Ownership

Ownership Structure Pakarab is owned by a consortium of Fatima Group and Arif Habib Group. Arif Habib Group, the key sponsor, holds 50% shareholding in Pakarab, while the Fatima Group holds 41% and the Fazal Group holds the smallest stake of 9%.

Stability Pakarab has profound backing and inevitable support of its sponsors; Arif Habib group and Fatima Group

Business Acumen Arif Habib group holds interests in the securities brokerage, investment and financial advisory, investment management, commercial banking, commodities, and private equity, cement and fertilizer industries. Fatima Group is another leading group under the corporate sector in Pakistan, engaged in trading of commodities, manufacturing of fertilizers, textiles, sugar, mining and energy

Financial Strength Arif Habib Group and Fatima Group are among the leading corporate groups in Pakistan, with multi-faceted investment portfolio including trading of commodities, manufacturing of fertilizers, textiles, sugar, mining and energy.

Governance

Board Structure Overall control of the company falls to eight-member board of directors (BoD).

Members' Profile The chairman of Arif Habib Group, Mr. Arif Habib, a reputed business professional, chairs the company's board. He is also the chairman of Fatimafert Limited, Fatima Fertilizer Company Limited, Aisha Steel Mills Limited and Javedan Corporation Limited.

Board Effectiveness Company's board keeps oversight on overall business. The company conducted five board meetings witnessing good level of attendance.

Financial Transparency An effective Internal Audit department is in place that reports to the CEO. The External Auditor of the company are M/s A.F. Ferguson & Co, Chartered Accountants, one of the big four firms.

Management

Organizational Structure Pakarab Fertilizer has a proper organizational structure with defined reporting lines.

Management Team Pakarab is enriched with experienced management team with a balanced blend of professionals from the Industry. Mr. Fawad Ahmed Mukhtar is the Chief Executive Officer of the Company with vast business acumen spanning over three decades. Mr. Asad Murad, a highly qualified finance professional, has been deployed as the Chief Finance Officer (CFO) of PFL possessing more than two decades of experience in the relevant industry. He is also the Director Finance of Fatima Fertilizer Company Limited

Effectiveness All members of management team are qualified and experienced individuals and carry extensive experience of the fertilizer industry. They have only one formal committee; Audit committee

MIS The Company's MIS reporting framework consists of a comprehensive daily, weekly and monthly report, focusing on all important areas of the company's business.

Control Environment Pakarab enjoys sound production facilities and expertise for the plant operations. The quality control reports are generated and reviewed by senior engineers on daily as well as on weekly basis.

Business Risk

Industry Dynamics The fertilizer industry is prevalent for Agriculture & allied sector of the country. The industry revived from the supply surplus situation but came down to supply shortage of Urea, as some of the major urea plants remained closed. Removal of subsidy by the GoP resulted in increased Urea prices which provided cushion to industry players to enhance their margins.

Relative Position The ongoing CY18 has brought both ups and downs for PFL. Company's fertilizer plants continue to be non-operative from the start of 2018, due to severe gas curtailment. Keeping in view of the circumstances, sponsors of the company chalked down solutions to encounter its prevailing woes. Fatima fertilizer, the group entity, is set to acquire all fertilizer plants of PFL.

Revenues Despite being non-operating fertilizer plants, during 1HCY18, on the back of DAP sales, PFL earned small revenues of PKR ~2,677mln as compared to corresponding period (1HCY17: PKR ~10,864mln). Pakarab's market share, based on urea and DAP sales, recorded at 3% while the company lost its market share in NP and CAN segments, left secluded in the market.

Margins The revenue of the company has been facing fluctuation from CY17 onwards. It saw a meager growth of ~2% in CY17 and gigantic fall by 75% during the period 1HCY18, consequently denting the gross margins (1HCY18: -21%, CY17: 2.2%). Finance cost witnessed a rise from the previous year (CY17: PKR 2,164mln, CY16: PKR ~1,800mln) due to hiked borrowings. Bottom line of the business was eventually further strained, recorded at a loss of PKR ~3,942mln in CY17, far more than previous year loss (CY16: ~1,925mln).

Sustainability After the recent decision of fertilizer plants acquisition by Fatima Fertilizer, Pakarab fertilizer is expected to be converted into a sustainable model Income streams would generally include DAP trading and Carbon dioxide business, along with other non-core cashflow sources. Since Pakarab has also started receiving cashflows from its relocated LCO2 plant, it is also expected to add value to the overall business of Pakarab.

Financial Risk

Working Capital Net cash cycle continued to be high side (164 days) in 1HCY18. PFL bought excessive DAP before the start of the season which reflects in the shape of high inventory.

Coverages The business plan envisages fast recovery of all stuck-up operations. Negative Profit before tax led FCFO in adverse in a bad shape (1HCY18: PKR ~1,153mln, CY17: PKR -1,056mln, CY16: PKR -869mln), hence damaging the overall debt coverage's. During 1HCY18, Short term borrowings saw a minimal decrease but continue to be at a higher level standing at PKR 10bln; trade debts and stock-in-trade stands at PKR 10bln.

Capitalization By the end Jun18, although declining but there is a sizeable long term debt (1HCY18: PKR 4,494mln, CY17: PKR 5,508mln) resulting in upheaved leverage structure with a debt to debt plus equity ratio of 56% (CY17: 61%). In May-16 the company issued a privately placed term finance certificates (PPTFC) of PKR 450mln in order to meet its working capital expenditures along with expenses relating to its stock and spares. Payments would be payable in six equal instalments with the first payment falling at the end of 30th month (30th December 2018) from the first disbursement date (30th June 2016) and subsequently every six months afterwards till June 2021.



Pakarab Fertilizers Limited (PFL)

BALANCE SHEET	30-Jun-18	31-Dec-17	31-Dec-16	31-Dec-15
	1H CY18	CY17	CY16	CY15
Non-Current Assets	42,384	44,018	42,153	42,622
Investments (Incl. Associates)	559	556	467	405
Equity	-	-	-	-
Debt	559	556	467	405
Current Assets	19,059	16,910	17,941	22,653
Inventory	6,961	4,129	4,070	7,661
Trade Receivables	847	2,069	2,898	2,624
Others	11,251	10,713	10,973	12,369
Total Assets	62,002	61,483	60,561	65,680
Debt	19,316	19,543	16,173	20,657
Short-term	10,393	10,779	9,173	17,352
Long-term (Incl. Current Maturity of Long-Term Debt)	8,923	8,764	6,999	3,305
Other Short-term Liabilities	13,026	9,116	9,811	10,992
Other Long-term Liabilities	11,180	13,121	12,569	10,120
Shareholder's Equity	18,479	19,702	22,008	23,911
Total Liabilities & Equity	62,001	61,483	60,561	65,680

INCOME STATEMENT

Turnover	2,677	16,531	16,176	21,920
Gross Profit	(554)	372	(30)	4,568
Other Income	(8)	96	336	(1)
Financial Charges	(1,018)	(2,164)	(1,800)	(1,677)
Net Income	(1,223)	(3,941)	(1,925)	2,460

Cashflow Statement

Free Cashflow from Operations (FCFO)	(1,153)	(1,056)	(869)	2,690
Net Cash changes in Working Capital	(272)	(11)	3,291	(11,745)
Net Cash from Operating Activities	(2,242)	(3,004)	807	(10,603)
Net Cash from Investing Activities	1,805	(471)	(207)	50
Net Cash from Financing Activities	1,133	1,579	5,249	(857)
Net Cash generated during the period	696	(1,896)	5,849	(11,410)

Ratio Analysis

Performance

Turnover Growth	-75.4%	2.2%	-26.2%	53.8%
Gross Margin	-20.7%	2.2%	-0.2%	20.8%
Net Margin	-45.7%	-23.8%	-11.9%	11.2%
ROE	-6.6%	-13.4%	-5.7%	7.3%

Coverages

Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered)	-0.3	-0.1	-0.2	0.3
Interest Coverage (x) (FCFO/Gross Interest)	-1.1	-0.5	-0.5	1.6
Debt Payback (Years) (Total Lt. Debt (excluding Covered Short Term B	-4.1	-7.5	-7.4	13.0

Liquidity

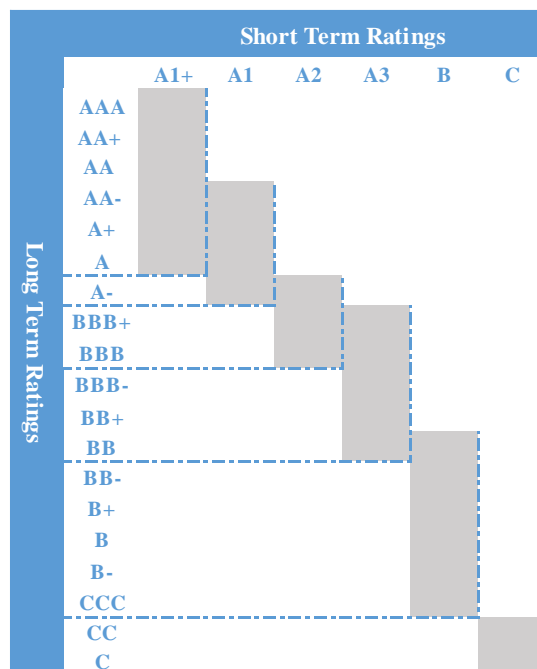
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	164.4	20.9	-43.0	-26.9
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Capital Structure (Total Debt/Total Debt+Equity)	56.3%	61.8%	55.8%	51.0%
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Credit Rating Scale & Definitions

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		Short Term Ratings	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
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.	A1	A strong capacity for timely repayment.
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.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial 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.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
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.	C	An inadequate capacity to ensure timely repayment.
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.		



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 surveil the opinion due to lack of requisite information.

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

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(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

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- (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)
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- (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)

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- (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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