



The Pakistan Credit Rating Agency Limited

## Rating Report

### Fauji Fertilizer Company Limited

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#### Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-Jan-2019	AA+	A1+	Stable	Maintain	-
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. FFC is relatively placed prominent in the industry. GIDC related developments are expected to crystallize over the shorter horizon, which are likely to provide benefit to industry players generally and FFC particularly. The recent 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.

As part of Company's strategic plan, FFC carries a sizable book of diversified investments in both long term and short term, which has been developed to offer sustainable returns to its stakeholders. Henceforth, this continues to expand in the power sector by recently having an investment in Thar Energy Limited: dividend stream from these investments compliments FFC's ratings. Under its diversification strategy, FFC is evaluating investment in offshore fertilizer project, leveraging associated with business ventures will require oversight and close attention.

#### Disclosure

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

## Profile

**Legal Structure** Fauji Fertilizer Company Limited (hereinafter referred to as "the Company" or "FFC") incorporated in 1978, is listed on Pakistan Stock Exchange.

**Background** Initially it was established as a joint venture between Fauji Foundation (FF) – a leading charitable trust in Pakistan – and Haldor Topsoe A/S of Denmark – a world class leader in catalysts. Subsequently, FF continued as the only major sponsor of the company. The Company has a total number of 3,364 employees as at Dec 17 with its head office in Rawalpindi.

**Operations** FFC core business involves manufacturing and trading of fertilizer products, mainly Urea and DAP. It is one of the largest urea manufacturers having a nameplate capacity of 2,048K tonnes and annual production of over 2,400K tons owing to investment in 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.

## Ownership

**Ownership Structure** 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.

**Stability** Long standing stake of a renowned business conglomerate - Fauji Group, denotes strong foothold in the market

**Business Acumen** Fauji Foundation (FF), founded in 1954, has emerged as one of the leading conglomerates of the country with established business interests in various diversified sectors.

**Financial Strength** FFC has established itself as one of the leading names of Pakistan's fertilizer sector with prominent presence in the industry besides holding strong financial position. The company has an extensive investment book, including 2 subsidiaries, 4 associated companies and 1 joint venture.

## Governance

**Board Structure** FFC has a thirteen-member board of directors including the Chief Executive (CE), seven representatives of Fauji Foundation and four independent directors including one member from State Life Insurance Cooperation.

**Members' Profile** Lt Gen Syed Tariq Nadeem Gilani, HI-(M) Retired 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. Members profile is considered strong

**Board Effectiveness** Formally, Six meetings have been convened throughout the period under review with good participation of the members. In order to keep up with the proper standards of the business, there are four sub-committees of the board; Audit Committee, HR and Remuneration Committee, System & Technology Committee and Project Diversification Committee.

**Financial Transparency** The auditor of the company, KPMG Taseer Hadi & Co, expressed an unqualified opinion on the financial statements for the year ended Dec' 17 and an unmodified review for 1HCY18.

## Management

**Organizational Structure** The organizational structure of the company comprises twelve well segregated functional departments, headed by highly experienced professionals

**Management Team** FFC's management team is a balanced blend of professionals having long association with the Company. The Company's CE & MD, Lt Gen Tariq Khan, HI-(M) (Retired), joined FFC in March '18. He is also the CE&MD of Fauji Fresh n Freeze Limited & FFC Energy Limited, two wholly owned subsidiaries of FFC.

**Effectiveness** The company follows the best practices to ensure effectiveness throughout the course of operations. The company has three principal operational committees, – i) Executive Committee – review company's operations and ensures implementation and execution of strategy, ii) Business Strategy Committee – oversees the business development plans and prospective opportunities, iii) Corporate Social Responsibility Committee enabling and ensuring the social responsibilities of the company

**MIS** FFC has state of the art IT infrastructure in place including SAP software. The company has maintained a profound management system that smoothly sails the business processes and provides an end to end solution for financial, logistics, distribution, inventories, plant maintenance, human capital management, material management etc

**Control Environment** FFC actively monitors the operations of its plant sites on daily, monthly and yearly basis, in order to keep the company's performance apt.

## Business Risk

**Industry Dynamics** The fertilizer industry is prevalent for Agriculture & allied sector of the country. The production capacity is of 6.9mln MT of urea, 0.7mln MT of DAP and 2.2mln MT of others. The industry benefits from the demand of its major product urea. The fertilizer industry has been facing volatility in past two years with respect to i) gas availability and price fluctuation ii) shutdown of LNG based urea plants iii) water shortage, discontinuation of subsidy and iv) Urea price hike. The industry revived from the supply surplus situation in CY16 but came down to supply shortage of Urea by the end of CY18, however with GoP's assistance the situation got controlled.

**Relative Position** Sustainable growth by defying all the odds of gas curtailment and water shortage issues, FFC is relatively placed prominent in the industry with a combined market share of FFC/FFBL ~55 %, increased by ~6%, by the end-Sept' 18.

**Revenues** The company laid a benchmark in terms of highest sales of all products; 2169K tonnes in 9MCY18. Replicating in FFC's topline, exhibiting through an increase of 17%, predominately led by higher offtake of Urea and DAP besides other fertilizers. Whereas aggregate revenue (including subsidy) was registered at the record level of PKR ~73.08bln as against ~63bln in 9MCY17.

**Margins** Company's overall margins continue to improve: Gross margin for 9MCY18 were 28% (9MCY17: 26%). FFC's Income on deposits also increased to PKR 1.7bln compared to PKR 903mln last year, while finance cost continues to decrease. As borrowing level dropped, finance costs exhibited a decreasing trend PKR ~1.2bln (9MCY17: PKR 1.9bln). These factors, combined with higher revenues, more than compensated the decline in dividend income, besides the consistent levy of Super tax, resulting in improved profit after tax PKR~8.5bln (9MCY17: PKR~5.9bln), representing an increase of ~44%.

**Sustainability** As part of strategic plan, FFC carries a sizable book of diversified investments which continues to expand in the power sector by recently having an investment in Thar Energy Limited (~30%). Going forward, the significant increase in gas prices, substantial devaluation of PKR, besides persistent pricing pressure and regulatory measures on the fertilizer industry, continue to pose risks to the operations and profitability of the Company

## Financial Risk

**Working Capital** FFC witnessed higher inventory levels at end Sept-18 due to increased stock, mainly DAP, in anticipation of hike in prices. Hence, replicating the effect on average inventory days which has increased from the previous year coming down to 43days in 9MCY18 (CY17: 26days). Net working capital moved to an upper edge: 38days in 9MCY18 (CY17: 28days). This effect is expected to ease off by end-Dec18. Working Capital requirements are fulfilled majorly through a mix of internal cash and short term borrowings. During 9MCY18, short-term borrowings stood at PKR 5.6bln whereas long-term borrowings were PKR ~11bln.

**Coverages** The company earned sufficient free cash flows (FCFO) from operations during 9MCY18 - PKR 10bln (CY17 PKR 9.9bln) majorly attributable to better profitability. While FCFO coverage to debt obligations (finance cost, CMLTD and uncovered short term borrowing) stands at 1.4 times (CY17: 1.1 times).

**Capitalization** The Company urges to reduce its dependence on debt. Borrowings are decreasing every passing year, also positively reflecting in the capital structure; 9MCY18: 45% (CY17: 52%, CY16: 62%). Lower borrowing levels leads the company's capital structure into a comfortable position. Existing long term borrowings are due by 2021.



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## Fauji Fertilizer Company Limited (FFCL)

BALANCE SHEET	30-Sep-18 9MCY18	31-Dec-17 Annual	31-Dec-16 Annual
<b>Non-Current Assets</b>	<b>24,367</b>	<b>24,877</b>	<b>23,766</b>
<b>Investments (Incl. Associates)</b>	<b>49,599</b>	<b>58,752</b>	<b>43,800</b>
Equity	25,851	22,961	22,401
<b>Current Assets</b>	<b>42,557</b>	<b>25,002</b>	<b>23,144</b>
Inventory	16,015	395	4,237
Trade Receivables	3,429	3,722	4,307
Others	23,112	20,885	14,599
<b>Total Assets</b>	<b>116,522</b>	<b>108,631</b>	<b>90,710</b>
<b>Debt</b>	<b>24,253</b>	<b>33,942</b>	<b>45,264</b>
Long-term (Incl. Current Maturity of Long-Term Debt)	18,694	22,403	23,088
Short-term Borrowings	5,559	11,539	22,177
Other Short-term Liabilities	58,135	40,639	12,422
Other Long-term Liabilities	4,307	4,697	4,812
<b>Shareholder's Equity</b>	<b>29,828</b>	<b>29,352</b>	<b>28,211</b>
<b>Total Liabilities &amp; Equity</b>	<b>116,522</b>	<b>108,631</b>	<b>90,709</b>
<b>INCOME STATEMENT</b>			
<b>Turnover</b>	<b>73,080</b>	<b>97,316</b>	<b>79,856</b>
Gross Profit	20,515	24,695	25,029
Other Income/Expenses	1,097	2,091	1,925
Financial Charges	(1,183)	(2,471)	(2,406)
<b>Net Income</b>	<b>8,525</b>	<b>10,711</b>	<b>11,782</b>
<b>Cashflow Statement</b>			
Free Cashflow from Operations (FCFO)	10,160	9,950	9,125
Total Operating Cashflows (TCF)	10,160	9,950	12,497
Net Cash from Operating Activities	6,604	34,759	10,346
Net Cash from Investing Activities	(10,918)	(465)	(2,099)
Net Cash from Financing Activities	(9,751)	(9,242)	(8,424)
<b>Ratio Analysis</b>			
<b>Performance</b>			
Turnover Growth	17%	22%	-7%
Gross Margin	28%	25%	31%
Net Margin	12%	11%	15%
ROE	43%	40%	44%
<b>Coverages</b>			
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB)	1.4	1.1	1.0
Interest Coverage (x) (FCFO/Gross Interest)	8.6	4.0	3.8
Debt Payback (Years) (Total Lt.Debt (excluding Covered Short Term Borrowings) / FCFO-Gross interest)	1.6	3.0	3.4
<b>Liquidity</b>			
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	38	28	53
<b>Capital Structure</b> (Total Debt/Total Debt+Equity)			
	45%	52%	62%

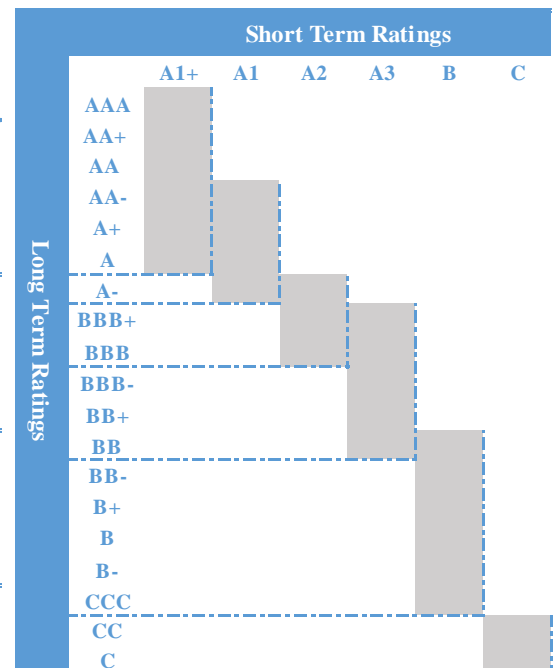
Fauji Fertilizer Company Limited (FFCL)

Jan-19

## 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	
<b>AAA</b>	<b>Highest credit quality.</b> Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	<b>A1+</b>	The highest capacity for timely repayment.
<b>AA+</b> <b>AA</b> <b>AA-</b>	<b>Very high credit quality.</b> 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.	<b>A1</b>	A strong capacity for timely repayment.
<b>A+</b> <b>A</b> <b>A-</b>	<b>High credit quality.</b> 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.	<b>A2</b>	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
<b>BBB+</b> <b>BBB</b> <b>BBB-</b>	<b>Good credit quality.</b> 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.	<b>A3</b>	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
<b>BB+</b> <b>BB</b> <b>BB-</b>	<b>Moderate risk.</b> 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>	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
<b>B+</b> <b>B</b> <b>B-</b>	<b>High credit risk.</b> 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.	<b>C</b>	An inadequate capacity to ensure timely repayment.
<b>CCC</b> <b>CC</b> <b>C</b>	<b>Very high credit risk.</b> 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.		
<b>D</b>	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)

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- 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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- (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.
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- (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)
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- (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)
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### **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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