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
01-Aug-2019	AA+	A1+	Stable	Maintain	-
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. Its strong business footprint has enabled it 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 has maintained highest production levels and the related profitability is sanguine. FFC is prominently placed in the industry. In view of the discontinuation of urea subsidy scheme and increasing production costs, the industry has included the impact thereof in urea prices to maintain the margins. GIDC related developments, as and when crystallized, would provide benefit to the industry players.

The ratings take into account FFC's sizable book of diversified investments, both in the long term and short term, which has been developed to offer sustainable returns to its stakeholders. Dividend stream from these investments compliments FFC's ratings. FFC continued the expansion of its investment portfolio by extending its reach to the power sector, as evident from its investment in Thar Energy Limited. Under its diversification strategy, FFC is going ahead with an investment in an offshore fertilizer project. 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	PACRA_Methodology_Corporate_FY19(Jun-19),PACRA_Crtieria_LT ST Relationship_FY19(Jun-19),PACRA_Criteria_Rating Modifiers_FY19(Jun-19)
Related Research	Sector Study | Fertilizer(Jan-19)
Rating Analysts	Jhangeer Hanif | jhangeer@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 the Pakistan Stock Exchange.

Background 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 major sponsor of the company. The Company has in employment a total number of 3,357 employees as at End-Dec'18. Its Head Office is located in Rawalpindi.

Operations FFC's core business involves manufacturing and marketing of fertilizer products, mainly Urea and DAP. It is one of the largest urea manufacturers of the country having a nameplate capacity of 2,048K tones and an annual production of over 2,500K tons, owing to investment in efficiency enhancement through BMR. FFC’s market is relatively concentrated in Punjab (68%). The Company also provides marketing services to its group company in the fertilizer business, i.e. Fauji Fertilizer Bin Qasim Ltd. and technical services to other chemical industries.

Ownership

Ownership Structure FFC is majority owned by Fauji Foundation (44.35%); a Charitable Trust incorporated under the Charitable Endowments Act 1890. State Life Insurance holds ~9.13%, whereas other institutions and general public hold ~25.42% and ~21.10%, respectively.

Stability Long standing stake of a renowned business conglomerate - Fauji Group denotes a strong foothold and sustainability 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. Evolution of FFC as the largest fertilizer player in the market is an explicit demonstration of its sponsors' business acumen.

Financial Strength Besides holding a formidable equity strength in FFC, the sponsors have an extensive investment book, including 2 subsidiaries, 4 associated companies and 1 joint venture, which fortifies their sound financial strength.

Governance

Board Structure The board of directors comprises thirteen members; one executive director and twelve non-executive directors. Out of the twelve non-executive directors, four are independent directors including two directors representing minority/non-controlling interests.

Members’ Profile Lt Gen Syed Tariq Nadeem Gilani, HI-(M) Retired, joined the FFC’s Board as the Chairman in Jan'18. He is also the MD of Fauji Foundation and Fauji Oil Terminal & Distribution Company Ltd. The members profile is considered strong.

Board Effectiveness Board meetings have been convened on a quarterly basis 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 auditors of the company, KPMG Taseer Hadi & Co, expressed an unqualified opinion on the financial statements for CY18.

Management

Organizational Structure The organizational structure of the company comprises 12 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 CEO & MD, Lt Gen Tariq Khan, HI-(M) (Retired), joined FFC in March'18. He is also the CEO & MD of Fauji Fresh n Freeze Limited & FFC Energy Limited, wholly owned subsidiaries of FFC.

Effectiveness The company follows best practices to ensure effectiveness throughout the course of operations. It has three principal operational committees, i) Executive Committee – reviews 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 – enables and ensures the social responsibilities of the company.

MIS FFC has a state of the art IT infrastructure in place, including SAP software. The company has maintained a profound management system that enables smooth operations of 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 a daily, monthly and yearly basis, in order to keep the company’s performance sustainable.

Business Risk

Industry Dynamics The fertilizer industry is a major part of the agriculture & allied sector of the country. The production capacity consists of 7.1mln MT of Urea and CAN and 1.7mln MT of DAP, NP and NPK. The fertilizer industry benefits from the significant demand of its major product, urea. The industry has been facing immense pressure not to pass the inflation/enhanced input cost due to price fixation by the Government, owing to subsidy regimes.

Relative Position Sustained growth has been achieved by FFC, in spite of factors such gas curtailment and water shortage issues. FFC has maintained its market share in the industry. Its combined market share with FFBL stands at ~53% for Urea and ~52% for DAP, as at End CY18.

Revenues Sona urea sales were recorded at ~2,527 thousand tons, for CY18, ~6% lower than the prior year in volumetric terms, while DAP offtake of FFC stood at ~480 thousand tons, also down by ~6% compared to CY17. In spite of lower quantitative sales, FFC achieved its highest ever sales revenue amounting to ~PKR 105.9bln, mainly due to favourable selling prices during CY18. Topline for 1QCY19 exhibited a decreasing trend of ~25% from same period last year (SPLY), predominately due to lower offtakes especially with respect to DAP. DAP sales witnessed a downslide in demand owing to high prices in the country.

Margins Apart from increasing revenues, investment income reached to PKR~3.6bln in CY18 (CY17: PKR~3.5bln). Despite a rise in interest rates, finance cost was curtailed at PKR~1.64bln in CY18, a decrease of ~33% as compared to the prior year, mainly due to significant repayments of debt. It was noted that the overall gross margins further increased to ~29% in 1QCY19; (CY18: ~28%). The same trend was seen in the net profit margins, with it increasing to ~18.2% in 1QCY19 (CY18:~13.3%).

Sustainability As part of its strategic decision, FFC carries a sizable book of diversified investments. It has recently expanded in the power sector, by an investment in Thar Energy Limited (~30%).

Financial Risk

Working Capital In CY18, the average inventory days increased to 22 days (CY17: 9 days). On the other hand, the average debtor days reduced to 12 days (CY17: 15 days). The trade payable days have remained consistent with the prior years. (CY18: 7 days, CY17: 6 days). In accumulation, FFC’s Gross working capital cycle lands in to a comfortable zone i.e. CY18: 35 days (CY17: 24 days). The same is true for the Net working capital cycle i.e. CY18: 27 days (CY17: 18 days). With regards to 1QCY19, the net working capital cycle has risen to 58 days, mainly due to higher inventory levels of DAP, in anticipation of a hike in prices. The short term borrowings of the company as at 1QCY19 stood at PKR~11.7bln, decreasing sharply from PKR~28.5bln as at End-CY18.

Coverages The free cash flows from operations (FCFO) during CY18 amounted to PKR~16.5bln, increasing by ~67% YoY basis. FCFO to total current debt obligations stood at 1.9 times in CY18 (CY17: 1.1 times), representing a comfortable cushion. The Cash conversion efficiency for 1QCY19 stood at ~15%, similar to CY18 i.e. ~15.3%, depicting that while the free cash flows have declined in 1QCY19, it is in line with the fall in revenue. This trend is expected to reverse in the subsequent months to March'19.

Capitalization The total borrowings of the company as at End-Mar'19 stood at PKR~26.7bln (Short Term: PKR11.7bln; Long Term: PKR15.0bln), decreasing sharply from PKR~44.3bln (Short Term: PKR28.5bln; Long Term: PKR15.8bln) as at End-Dec'18. Leveraging mix comprises short term and long-term borrowings amounting to PKR 18.9bln (including current maturity of long term borrowings) and PKR 7.8bln respectively. Equity amounted to PKR 32.1bln as at 1QCY19 (CY18: PKR 33.4bln). The company intends to pay off its current debt by CY21; creating room for further borrowing for upcoming business ventures. This trend holds true as the gearing levels have been on a declining trend since CY16. During 1QCY19, leveraging clocked in at ~45.4% compared to ~57.1% in CY18.

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Financial Summary
PKR mln

Fauji Fertilizer Company Fertilizer	Mar-19 3M	Dec-18 12M	Dec-17 12M	Dec-16 12M
A BALANCE SHEET				
1 Non-Current Assets	24,119	24,237	24,877	23,766
2 Investments	40,320	55,423	35,791	21,400
3 Related Party Exposure	28,544	27,069	24,154	22,800
4 Current Assets	36,592	39,761	23,809	22,745
a Inventories	*12,770*	*12,932*	*395*	*4,237*
b Trade Receivables	*1,727*	*3,679*	*3,722*	*4,307*
5 Total Assets	129,575	146,490	108,631	90,710
6 Current Liabilities	66,410	64,180	40,639	12,423
a Trade Payables	*2,529*	*2,651*	*1,792*	*1,256*
7 Borrowings	26,665	44,348	33,942	45,264
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	4,392	4,578	4,697	4,812
10 Net Assets	32,108	33,383	29,352	28,211
11 Shareholders' Equity	32,108	33,383	29,352	28,211
B INCOME STATEMENT				
1 Sales	20,311	108,365	97,316	79,856
a Cost of Good Sold	*(14,348)*	*(77,986)*	*(72,621)*	*(54,827)*
2 Gross Profit	5,963	30,379	24,695	25,029
a Operating Expenses	(2,007)	(8,833)	(8,574)	(7,154)
3 Operating Profit	3,956	21,545	16,121	17,874
a Non Operating Income or (Expense)	*1,516*	*1,774*	*2,091*	*1,925*
4 Profit or (Loss) before Interest and Tax	5,472	23,320	18,212	19,800
a Total Finance Cost	*(469)*	*(1,637)*	*(2,471)*	*(2,406)*
b Taxation	*(1,307)*	*(7,244)*	*(5,030)*	*(5,612)*
6 Net Income Or (Loss)	3,696	14,439	10,711	11,782
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*3,054*	*16,590*	*9,920*	*9,125*
b Net Cash from Operating Activities before Working Capital Changes	*2,784*	*15,063*	*7,345*	*6,739*
c Changes in Working Capital	*(1,792)*	*7,803*	*27,362*	*235*
1 Net Cash provided by Operating Activities	992	22,866	34,707	6,974
2 Net Cash (Used in) or Available From Investing Activities	1,084	(21,108)	(1,779)	1,273
3 Net Cash (Used in) or Available From Financing Activities	(4,758)	348	(33,741)	(8,461)
4 Net Cash generated or (Used) during the period	(2,682)	2,105	(813)	(213)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	-25.0%	11.4%	21.9%	-7.5%
b Gross Profit Margin	29.4%	28.0%	25.4%	31.3%
c Net Profit Margin	18.2%	13.3%	11.0%	14.8%
d Cash Conversion Efficiency (EBITDA/Sales)	21.3%	18.9%	10.5%	14.3%
e Return on Equity (ROE)	45.2%	46.0%	37.2%	41.8%
2 Working Capital Management				
a Gross Working Capital (Average Days)	70	35	24	62
b Net Working Capital (Average Days)	58	27	18	56
c Current Ratio (Total Current Assets/Total Current Liabilities)	0.6	0.6	0.6	1.8
3 Coverages				
a EBITDA / Finance Cost	9.4	12.7	4.2	4.8
b FCFO / Finance Cost+CMLTB+Excess STB	1.2	1.9	1.1	1.0
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	1.6	1.1	3.0	3.4
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	45.4%	57.1%	53.6%	61.6%
b Interest or Markup Payable (Days)	56.7	68.0	28.6	49.3
c Average Borrowing Rate	5.2%	4.1%	6.2%	5.3%

#	Notes
D.1.a	**Sales growth figure (Mar-19) is based on proration of 1QCY19 to full year CY19, hence reflecting decline.**

Credit Rating Scale & Definitions

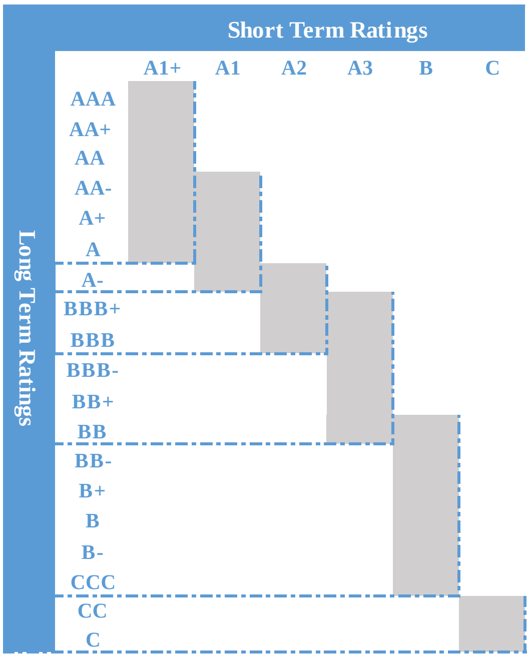
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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.

Regulatory and Supplementary Disclosure

(Credit Rating Companies Regulations,2016)

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