The Pakistan Credit Rating Agency Limited

Rating Report

Pak Arab Fertilizers Limited

Report Contents

Rating History					
Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
21-Aug-2020	A-	A2	Developing	Maintain	YES
21-Aug-2019	A-	A2	Developing	Maintain	YES
19-Feb-2019	A-	A2	Stable	Maintain	YES
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. As per the Group level Strategic plan, Fatima Fertilizer is in the process of acquiring major operating plants of its associated Company Pakarab Fertilizers; including Ammonia, Urea, Nitric Acid, NP, CAN and clean development mechanism. Half of the consideration from Fatima Fertilizer, in this regard has been received by the company while the complete roll-out is expected over a short horizon in an installment pattern. In this connection, Fatima Group has successfully finalized its venture to secure gas supply to Pakarab's plant by laying a gas pipeline network from Mari Petroleum, and the gas supply has commenced since Jan'20. Currently, due to a shortfall in the gas requirement, Pakarab's plant is producing NP and CAN at full capacity with a very nominal share of urea production. The revenue is currently being recorded on Pakarab's book as the Asset Sale Purchase Agreement (SPA) is yet to finalize. In the former periods, persistent gas curtailment impacting economic inflows - a major hurdle - coupled with elevated borrowing book posed a key threat to Pakarab's risk profile. With the finalization of the Asset SPA, the Company's financial risk profile is expected to relieve in the way that Fatima Fertilizer shall assume the ultimate liability of Pak Arab's debt obligations in substance, though the borrowing book shall remain on Pakarab's balance sheet. Post-acquisition, Pakarab Fertilizer is expected to develop a small yet a sustainable business model. Revenue stream shall 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 would enable the company in meeting its financial needs.

The rating are kept under 'Rating watch' with 'Developing' outlook in anticipation to surveil the complete 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-20),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria | Rating Modifier(Jun-20)
Related Research	Sector Study | Fertilizer(Jan-20)
Rating Analysts	Bazahtul Qamar | bazahtul.qamar@pacra.com | +92-42-35869504

Profile

Legal Structure Pakarab Fertilizers Limited (referred to as "Pakarab") is a Public Unlisted Company.
Background Pakarab was incorporated in 1973 as a result of an agreement between the Government of Pakistan (GoP) and the State of Abu Dhabi. Pakistan Industrial Development Corporation (PIDC) - the representative of GoP assigned 52% of its shares to National Fertilizer Corporation (NFC) and ADNOC (Abu Dhabi National Oil Company) - representative of the State of Abu Dhabi, assigned its 48% shares to the International Petroleum Investment Company.
Operations Pakarab produces Calcium Ammonium Nitrate (CAN), Nitro Phosphate (NP) and Urea. It is also involved in DAP trading. 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 a diversified portfolio including Securities brokerage, Investment and Financial Advisory, Investment Management, Commercial Banking, Commodities & Private Equity, Cement and Fertilizer Industries. Fatima Group, on the other hand, is also a leading group in 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 vests with eight-member Board of Directors (BoD).
Members' Profile The Chairman of Arif Habib Group, Mr. Arif Habib, a renowned Industrialist, chairs the Company's Board. He is also the Chairman of Fatima Fertilizer Company Limited, Aisha Steel Mills Limited and Javedan Corporation Limited.
Board Effectiveness The Company's board keeps an oversight of the business. It conducted five board meetings during the period under review, witnessing good level of attendance.
Financial Transparency The auditors of the company A.F Fergusons & Company, a member of PWC expressed an unqualified opinon on Financial Statments of CY17.

Management

Organizational Structure Pakarab has a well defined organizational structure with clearly demarcated reporting lines.
Management Team Pakarab is enriched with an experienced management team comprising a balanced blend of professionals from the Industry. Mr. Fawad Ahmed Mukhtar is the Chief Executive Officer of the Company (CEO) 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 Pakarab possessing more than two decades of experience in the relevant industry.
Effectiveness All members of the 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 stands up to the mark of the Industry's requirements.
Control Environment Pakarab relishes on advanced production facilities and expertise for the plant operations. Quality control reports are generated and reviewed by senior engineers on a periodic frequency.

Business Risk

Industry Dynamics The production capacity of the country's fertilizer industry comprises 7.1mln MT of Urea and CAN and 1.7mln MT of DAP, NP and NPK. In CY19, an unprecedented demand for Urea was noted. This coincided with a fall in farmers' preference for DAP due to unfavorable pricing, as depicted by a decline of ~10% in its offtake, compared to CY18. In Jan'20, the Economic Coordination Committee opted to prospectively reduce the Gas Infrastructure Development Cess from PKR400/bag to PKR5/bag, as a way to subsidize costs incurred by farmers. The market players reduced the pricing with varying extents, creating a price disparity in them urea market, leading to a shift in market share of the industry players. With availability of gas not an immediate concern, certainty in the supply side mechanics is noted. On the other hand, deteriorating economic conditions in the wake of Covid-19 poses a risk to the demand within the industry. Going forward, gas tariff changes and announcement of subsidy, is expected to play a major role in dictating the industry behavior.
Relative Position Due to severe gas curtailment, the Company's fertilizer plants continued to be non-operative for most part of CY19. However the gas supply has been resumed through a Group Level strategy that was chalked out to encounter Pakarab's prevailing woes. Gas supply to Pakarab's plants came to life in Jan 2020 through an agreement of Fatima with Mari Petroleum. Resultantly, Fatima fertilizer, the group entity, is at an advanced stage of acquiring all fertilizer operating plants of Pakarab.
Revenues During CY19, the revenues of Pakarab remained thin with negative growth . Pakarab earned small revenues of PKR ~6bln as compared to corresponding period (CY18: PKR ~12bln), a gigantic fall of ~50%, which was entirely on the back of DAP sales. Pakarab lost its market share in NP and CAN segments, currently rephrasing its business model. Following Jan'2020, with the resumption of gas to Pakarab's plants, the Company has revived its production of CAN and NP, while urea produce still remains low. Topline for the Company is, therefore, expected to heal till the time Pakarab's Sale Purchase Agreements (SPA) is completed with Fatima. Afterwards, Business Model of Pakarab shall be rephrased and revenue streams shall majorly comprise of DAP trading, LCO2 Plant sales and Rental Income.
Margins As company's revenue base suffered from declining trend, gross profits also converted into losses during CY19 (PKR 784mln) and CY18 (1,667 mln) thereby denting the gross margins (CY19: -12.8%, CY18: -13.5%). Finance cost witnessed an increase on account of hike in interest rates; CY19: PKR~3.2bln (CY18: PKR 2.9bln,). Bottom line of the business was eventually further strained, recording a loss of PKR ~2.7bln in CY19 as against CY18 loss of PKR~8.2mln, although the pace of incurring losses appears to shrink. As per management assertion, with the resumption of plant operations, currently recorded on Pakarab's books, the Company's margins are provided with a breather in 1HCY20.
Sustainability Post SPA, Pakarab 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. Moreover, Fatima Group has finalised an undertaking to secure gas supply to Pak Arab's plant by laying gas pipeline -which was completed in Jan'20. The group company Fatima Fertilizer is in the process of acquiring the production and operating plants of Pakarab. the transaction has not yet materialised due to delay in review by the sponsors and obtaining of Lender NOCs because of COVID-19 situation. However the process is at its final stages and is expected to be completed by Sep'20.

Financial Risk

Working Capital During CY19, the Company's short term borrowings remained at a lower level, standing at PKR~7bln (CY18: 12bln). Post group level expansions and operational transitioning, financial metrics are expected to improve as all liabilities will be taken over by Fatima in substance but not in form.
Coverages The business plan envisages fast recovery of all stuck-up operations. A significant improvement in FCFO is observed (CY19; PKR ~-0.97bln, CY18: PKR -3.1bln), mainly on the back of decreased losses.
Capitalization Pakarab has a sizable debt load, which stresses its capitalization levels, comprising long term debt, Current maturity of long term debt-CMLTD and short term borrowings. Resultantly, debt to debt plus equity ratio clocked in at 71.6% (CY18: 83.6%). In May'16 the Company issued privately placed term finance certificate (PPTFC) of PKR 450mln in order to meet its working capital expenditures along with expenses relating to its stock and spares. Payments are 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 2022. This facility has been obtained from PAIR Investment Company Ltd and has a tenor of five years. The company is going into deferment of its long term debt and term finance. The approval for deferment has been received, while agreements will be finalised shortly.

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Financial Summary
PKR mln

Pak Arab Fertilizers Limited Fertilizer	Dec-19 12M	Dec-18 12M	Dec-17 12M
A BALANCE SHEET			
1 Non-Current Assets	19,050	19,606	44,018
2 Investments	-	-	-
3 Related Party Exposure	591	586	547
4 Current Assets	23,342	29,789	16,919
a Inventories	*1,042*	*5,036*	*4,129*
b Trade Receivables	*784*	*2,925*	*2,069*
5 Total Assets	42,983	49,981	61,484
6 Current Liabilities	20,004	16,973	9,116
a Trade Payables	*16,878*	*13,269*	*6,074*
7 Borrowings	10,894	18,245	18,179
8 Related Party Exposure	4,999	7,873	6,873
9 Non-Current Liabilities	789	1,761	7,614
10 Net Assets	6,297	5,129	19,702
11 Shareholders' Equity	6,297	5,129	19,702
B INCOME STATEMENT			
1 Sales	6,101	12,281	16,531
a Cost of Good Sold	*(6,885)*	*(13,945)*	*(16,160)*
2 Gross Profit	(784)	(1,664)	372
a Operating Expenses	(825)	(1,324)	(1,819)
3 Operating Profit	(1,609)	(2,988)	(1,448)
a Non Operating Income or (Expense)	*1,259*	*(5,080)*	*96*
4 Profit or (Loss) before Interest and Tax	(350)	(8,068)	(1,352)
a Total Finance Cost	*(3,175)*	*(2,888)*	*(780)*
b Taxation	*824*	*2,743*	*(425)*
6 Net Income Or (Loss)	(2,701)	(8,212)	(2,557)
C CASH FLOW STATEMENT			
a Free Cash Flows from Operations (FCFO)	*(971)*	*(3,100)*	*(1,056)*
b Net Cash from Operating Activities before Working Capital Changes	*(4,709)*	*(5,295)*	*(2,993)*
c Changes in Working Capital	*10,769*	*1,967*	*(11)*
1 Net Cash provided by Operating Activities	6,060	(3,328)	(3,004)
2 Net Cash (Used in) or Available From Investing Activities	281	1,782	(471)
3 Net Cash (Used in) or Available From Financing Activities	(1,651)	49	3,185
4 Net Cash generated or (Used) during the period	4,690	(1,497)	(291)
D RATIO ANALYSIS			
1 Performance			
a Sales Growth (for the period)	-50.3%	-25.7%	2.2%
b Gross Profit Margin	-12.8%	-13.5%	2.2%
c Net Profit Margin	-44.3%	-66.9%	-15.5%
d Cash Conversion Efficiency (EBITDA/Sales)	-18.6%	-20.9%	-2.9%
e Return on Equity (ROE)	-47.3%	-66.1%	-12.3%
2 Working Capital Management			
a Gross Working Capital (Average Days)	293	265	147
b Net Working Capital (Average Days)	-609	-22	3
c Current Ratio (Total Current Assets/Total Current Liabilities)	1.2	1.8	1.9
3 Coverages			
a EBITDA / Finance Cost	-0.4	-0.9	-0.7
b FCFO / Finance Cost+CMLTB+Excess STB	-0.1	-0.5	-0.2
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	-3.0	-2.4	-9.7
4 Capital Structure (Total Debt/Total Debt+Equity)			
a Total Borrowings / Total Borrowings+Equity	71.6%	83.6%	56.0%
b Interest or Markup Payable (Days)	106.7	190.3	0.0
c Average Borrowing Rate	15.1%	11.3%	3.1%

Credit Rating

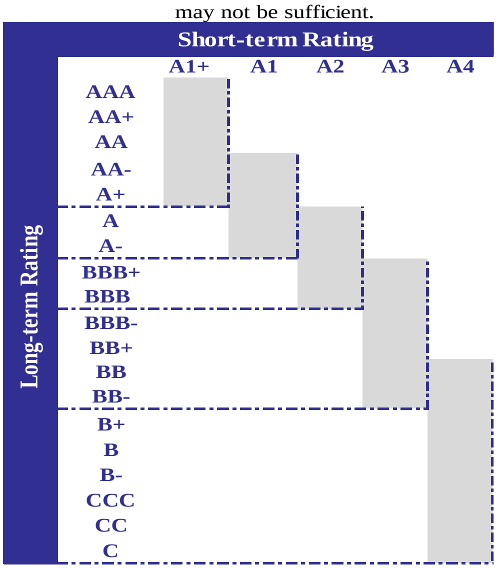
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
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 Rating

Scale	Definition
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
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

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 some material identifiable event with indeterminable rating implications. 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 rating 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) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) 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.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

Entities

a) Broker Entity Rating
b) Corporate Rating
c) Financial Institution Rating
d) Holding Company Rating
e) Independent Power Producer Rating
f) Microfinance Institution Rating
g) Non-Banking Finance Companies (NBFCs) Rating

Instruments

a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk Rating

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