The Pakistan Credit Rating Agency Limited

Rating Report

Fatima Fertilizer Company Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
19-Feb-2019	AA-	A1+	Stable	Maintain	-
01-Nov-2018	AA-	A1+	Stable	Maintain	-
08-Aug-2017	AA-	A1+	Stable	Maintain	-
11-Nov-2016	AA-	A1+	Stable	Maintain	-
12-Nov-2015	AA-	A1+	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

The ratings reflect strong business profile of the company on the back of diversified product mix. Secure supply of gas from Mari field together with lower feed stock price (under fertilizer policy -2001 up till 2021), represents inherent strengths of the company compared to its peers. Overall capacity utilization continued to exceed 100% (previously: 90% - 98%) based on ammonia debottlenecking. In view of discontinuation of urea subsidy scheme, the industry has increased the prices of fertilizers as well. GIDC related developments are expected to crystallize over the course of time, of which the impact will be clear once materialized. Eyeing for a prolific business model, Fatima Fertilizer has proposed merger with its wholly owned subsidiary - Fatimafert along with the acquisition of production and operating plants of its associate - Pakarab Fertilizer Limited including Ammonia, Urea, Nitric Acid, NP, CAN and clean development mechanism. Both mentioned transactions are at an advance stage of being materialized. Post-acquisition, Fatima Fertilizer tends to become a prominent supplier of CAN & NP with the overall nameplate capacity of 2,572,400 Metric tonnes/year. Fatima Group has also ventured an undertaking to secure gas supply to Pakarab by laying gas pipeline. The leveraging is expected to move up yet would remain aligned with the risk profile of the entity. Given strong cashflows, financial risk remain comfortable.

The ratings are dependent upon the company’s ability to absorb debt profile of the proposed acquisitions. Revival of Pakarab's plants, acquired by Fatima Fertilizer is underway.

Disclosure	
Name of Rated Entity	Fatima Fertilizer Company 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 | Fertilizer(Jan-19)
Rating Analysts	Raniya Tanawar | raniya.tanawar@pacra.com | +92-42-35869504

Profile

Legal Structure Fatima Fertilizer Company Limited (FFCL), incorporated in Dec 2003, is listed on Pakistan Stock Exchange since (PSX) 2010.

Background FFCL was formed by way of a joint venture between two major business groups in Pakistan namely, Fatima Group and Arif Habib Group. The company is based in Lahore, with its fertilizer complex located at Mukhtar Garh, Sadiqabad, Rahim Yar Khan which began it commercial production in July 2011.

Operations FFCL core business involves supply of fertilizers (Urea, CAN and NP) to 58 districts and 3000 dealers, spanning over 10 regions across Pakistan. FFCL is the second fertilizer company in Pakistan to produce CAN followed by its associate Pakarab Fertilizers Limited (PFL). It is the largest producer of Nitrogen Phosphate (NP), followed by PFL, with an allocated 110MMCFD of gas from the dedicated Mari Gas Fields.

Ownership

Ownership Structure Fatima Group (FG), the key sponsors, holds 45%, while Arif Habib Group holds 34% and the remaining is held by Fazal Group (11%).

Stability Ownership structure is represented by strong conglomerates, having a stable in share in the company since inception.

Business Acumen The Company's establishment as one of the key players in the fertilizer sector, over a considerable timeframe basis is a representation of strong business acumen.

Financial Strength Fatima Fertilizer's has the back of strong partnership of Fatima Group and Arif Habib Group; two renowned names of Pakistan's corporate industry. Arif Habib Group ranks amongst the prominent financial services group in Pakistan, having diversified investments.

Governance

Board Structure FFCL's business control vests with eight member board of directors, including the CEO, Mr. Fawad Ahmed Mukhtar. Strong governance adhered by two independent directors on board along with represents members of both partnering group

Members' Profile Members profile of the company is enriched with seasoned professionals. Mr. Arif Habib, chairman of the board, has more than four decades of experience. He is a well-known business professional of the country and also chairman of Arif Habib Group.

Board Effectiveness Formally, six meetings have been convened throughout the period under review 9MCY18. The board has two committees namely Human Resource and Remuneration Committee and Board Audit Committee, witnessing strong participation by the board members

Financial Transparency The external auditors of the company is Deloitte Yousaf Adil, Chartered Accountants rated 'A' on the SBP panel, have expressed an unqualified opinion on the financial statements for the year Ended Dec, 2017. The Company's Financial statements of CY18 are in the process of finalization.

Management

Organizational Structure The organizational structure of the company is divided into various functional departments, namely: (i) Operations, (ii) Finance, (iii) Administration, (iv) Procurement (v) Human Resource (vi) IT (vii) Marketing, and (viii) Internal Audit. The management is a balanced blend of professional people from the industry

Management Team FFCL has filled its management palette with experienced professionals with strong leadership reign. Mr. Fawad, CEO of Fatima Fertilizer is also on the board of group companies while Mr. Asad Murad, a finance professional, has been aptly deploying his services as Chief Finance Officer (CFO), with more than two decades of experience in the relevant industry.

Effectiveness FFCL does not have formal management committees as the directors themselves are involved in the day to day operations of the business.

MIS FFCL's operating system is an upgraded Oracle based ERP system, marking in timely MIS reporting framework. Business maintains a regimen of updated IT systems from time to time.

Control Environment The Company has smooth trail of integrated business processes from initiation to customers' feedback and disaster management.

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 With sustainable growth despite gas curtailment and water shortage issues, Fatima is relatively placed prominent in the industry. After the closure of PakArab Fertilizer, FFCL currently holds the highest share in CAN market. As part of strategic expansion plan, sponsors of the company are in the process of amalgamating Fatimafert (previously its wholly owned subsidiary) with Fatima fertilizer and acquired major plants of its associated company Pakarab Fertilizer Limited. Henceforth, giving FFCL a competitive edge to become the sole supplier of CAN & NP with a total nameplate capacity of 2,572,400 Metric tonnes/year. The proposed expansion plan is at the advance stage awaiting regulatory approvals.

Revenues Continued growth is observed in Fatima's topline, which stood at PKR 35bln in 9MCY18, 32% higher than the corresponding period (PKR ~26bln) attributable to increase in sale volumes by ~6% and price hike in 9MCY18; major contributors were Urea and NP with 9% and 12% growth respectively.

Margins Effective resource utilization and operational efficacy coupled with increase in urea prices resulted in persistent gross and operating margins for the period 9MCY18; 60% and 41%; higher by 8% and 9%, respectively, from the previous years. Net profit clocked in at PKR ~9bln for the period 9MCY18 (9MCY17: PKR ~7bln)

Sustainability With an aim to form a prolific business model, Fatima Fertilizer will be acquiring the major fertilizer plants of its associate - Pakarab Fertilizer Limited including; Ammonia, Urea, Nitric Acid, NP, CAN and clean development mechanism. FFCL also ventures an undertaking to secure gas supply to Pakarab's plants by laying a dedicated pipeline which is expected to capitalize in shorter horizon.

Financial Risk

Working Capital In line with the industry dynamics, working capital cycle remained in comfortable zone during 9MCY18. Receivable days continue to be variant (CY17: 19days, CY16: 13days) since past two years and came down to 9days in 9MCY18. Net cash cycle was recorded at 23days for 9MCY18 (CY17: 59 days). A downward trend is witnessed in company's short term borrowings since CY15 (CY17: PKR ~1bln, CY16: PKR ~8bln, CY15: PKR ~10bln) and continue to be standing at ~1bln during 9MCY18 due to strong internal cash generation.

Coverages FCFO of Fatima amounted to PKR 15bln, which is sufficient to fulfill its debt financing appetite for 9MCY18 (CMLTD: 5.6bln and interest: 0.9bln). Debt coverage resorts in better position largely due to reduced short term borrowings 4x in 9MCY18 (CY17: 1.9x). Proposed expansion will result in reasonable outflows a) gas pipeline cost b) consideration price of Pakarab's plants; PKR~9bln, consequently placing a pressure on company's cashflows. The mode of consideration payment to Pakarab Fertilizer will be in 4 phases and shall be carried out either through cash outflow or external borrowings. The first tranche of the transaction shall be disbursed in CY19 while remaining in next 3 years. The company's overall coverages remain comfortable, however, planned acquisition is expected to exert pressure as a result of consolidating Fatimafert's debt burden.

Capitalization During 9MCY18 FFCL has maintained low leverage capital structure. Long term borrowing (LT), amounting PKR~13.6bln and short term borrowings PKR ~1bln, representing 92%; 8% respectively, of the total debt (9MCY18: PKR ~15 bln) respectively. Debt to Equity was locked 20% in 9MCY18. Company financial position is adequate enough to absorb the accompanied debt with Fatimafert merger (PKR ~8bln). The company has a listed, rated and secured Sukuk of PKR 10.5bln, which has a tenor of 5 years, ending by Nov '21. Redemption of the Sukuk is left with 7 semi-annual installments with a coupon payments @6MK+1.10%.

Fatima Fertilizer Company Limited

BALANCE SHEET	30-Sep-18	31-Dec-17	31-Dec-16
	9MCY18	CY17	CY16
Non-Current Assets	**74,885**	**73,142**	**73,089**
Investments (Incl. associates)	**11,981**	**9,204**	**7,686**
Equity	2,240	2,238	2,238
Debt	9,741	6,966	5,448
Current Assets	**18,906**	**16,990**	**29,822**
Inventory	3,775	3,814	6,243
Trade Receivables	1,665	1,796	2,116
Others	13,465	11,380	21,463
Total Assets	**105,772**	**99,336**	**110,597**
Debt	**6,766**	**7,378**	**13,529**
Short-term	1,168	1,726	8,011
Long-term (Inlc. Current Maturity of long-term debt)	5,599	5,652	5,518
Other shortterm liabilities	16,245	11,627	17,658
Other Longterm Liabilities	24,306	26,589	32,035
Shareholder's Equity	**58,455**	**53,742**	**47,374**
Total Liabilities & Equity	**105,772**	**99,336**	**110,597**

INCOME STATEMENT			
Turnover	**34,511**	**37,612**	**33,765**
Gross Profit	20,770	20,337	17,985
Other Income	589	517	420
Financial Charges	(969)	(2,198)	(2,739)
Net Income	**9,439**	**10,576**	**9,782**

Cashflow Statement			
Free Cashflow from Operations (FCFO)	15,009	15,152	15,976
Net Cash changes in Working Capital	14,242	12,346	12,801
Net Cash from Operating Activities	14,153	16,754	18,775
Net Cash from InvestingActivities	(6,180)	(2,948)	(5,012)
Net Cash from Financing Activities	(8,200)	(24,096)	(2,958)
Net Cash generated during the period	(228)	(10,290)	10,805

Ratio Analysis			
Performance			
Turnover Growth	32%	11%	12%
Gross Margin	60%	54%	53%
Net Margin	27%	28%	29%
ROE	28%	19%	22%
Coverages			
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB)	4.0	1.9	1.9
Interest Coverage (x) (FCFO/Gross Interest)	15.5	6.9	5.8
Debt Payback (Years) (Total Lt.Debt (excluding Covered Short Term Borrowings) / FCF(	0.5	1.3	1.7
Liquidity			
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	23	59	62
Capital Structure (Total Debt/Total Debt+Equity)	20%	25%	39%

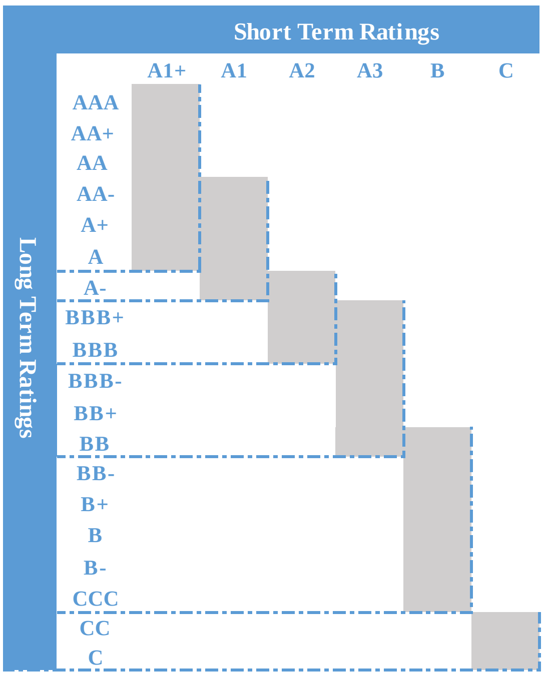
Rating Scale

Credit Rating Scale & Definitions

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

Long Term Ratings	
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short Term Ratings	
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
C	An inadequate capacity to ensure timely repayment.



Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.	**Rating Watch** Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.	**Suspension** It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.	**Withdrawn** A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) PACRA finds it impractical to surveill the opinion due to lack of requisite information.	**Harmonization** A change in rating due to revision in applicable methodology or underlying scale.

Disclaimer: PACRA's ratings are an assessment of the credit standing of entities/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA's opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security's market price or suitability for a particular investor.

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