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
21-Aug-2019	AA-	A1+	Stable	Maintain	-
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	-
27-Nov-2014	AA-	A1+	Stable	Upgrade	-

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. 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. The future demand supply scenario depends upon the economic dynamics of the farmer community, given input price escalation, and production from the stand-by plants (Agritech and Fatimafert). Eyeing for a prolific business model and as per plan, Fatima Fertilizer is in process of acquiring the production and operating plants of its associate - Pakarab Fertilizer Limited including Ammonia, Urea, Nitric Acid, NP, CAN and clean development mechanism. The proposed merger with its wholly owned subsidiary - Fatimafert and asset deal with Pakarab Fertilizer is yet to crystallize - awaiting regulatory approvals. 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 - which is in last phase of its completion. 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	PACRA_Methodology_Corporate_FY19(Jun-19),PACRA_Crtieria_LT ST Relationship_FY19(Jun-19)
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 (herein referred to as "FATIMA" or "the company") was incorporated in December 2003. It got listed on Pakistan Stock Exchange (PSX) in 2010.

Background FATIMA 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 The company's core business involves the supply of fertilizers (Urea, CAN and NP) to 61 districts and 4863 dealers, spanning over 10 regions across Pakistan. FATIMA is the second largest fertilizer company in Pakistan to produce CAN followed by its associate Pakarab Fertilizers Limited (PFL). It is also 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 sponsor, holds ~45%, equity stake 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 has the backing of a 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 portfolio of investments.

Governance

Board Structure FATIMA’s business control vests with eight member board of directors, including the CEO, Mr. Fawad Ahmed Mukhtar. Strong governance is adhered by two independent directors on board along with representative members of both partnering groups.

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

Board Effectiveness Formally, six meetings have been convened throughout the period under review - CY18. The board has two committees namely Human Resource and Remuneration Committee and Board Audit Committee, witnessing good participation by the board members.

Financial Transparency The External Auditors of the company are Deloitte Yousaf Adil, Chartered Accountants rated ‘A’ on the SBP panel. They 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 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 The company has an enriched management palette with experienced professionals holding strong leadership reign. Mr. Fawad, the CEO of FATIMA, 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 The Company does not have formal management committees as the directors themselves are involved in the day to day operations of the business.

MIS FATIMA’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 a smooth trail of integrated business processes from initiation to customers’ feedback and disaster management.

Business Risk

Industry Dynamics Fertilizer industry benefits from the demand of its major product - urea and its oligopolistic market conditions. The industry has been facing underlying continued issues in the past two years with respect to i) gas availability (ii) removal of subsidy and (iii) volatility in urea prices. Demand for urea is met largely through local production, however, where shortfall arises, the Government is compelled to resume the closed LNG based plants on subsidized gas rates (Fatimafert & Agritech). The country imported 100KT urea in Dec'18 to avoid urea shortfall. On the pricing front, recent gas price notification from OGRA has depicted a wholesome increase in the gas price for the sector. However, the related hike on urea prices is not made in the same ratio by the industry players. The future demand supply scenario depends upon the economic dynamics of the farmer community, given input price escalation.

Relative Position With sustainable growth despite gas curtailment and water shortage issues, FATIMA is relatively placed prominent in the industry. After the closure of Pak-Arab Fertilizer's plants, FATIMA holds the highest share in NP and CAN market on a standalone basis. As part of a strategic expansion plan, Sponsors of the company are in the process of merging Fatimafert (previously its wholly owned subsidiary) with FATIMA and acquiring production plants of its associated company Pak-Arab Fertilizer Limited. Henceforth, giving a competitive edge to FATIMA to become market leader in NP & CAN market, with a total fertilizer nameplate capacity of 2,572,400 Metric tonnes/year. The proposed expansion plan is awaiting regulatory approvals.

Revenues FATIMA’s revenue mix continues to be contributed by diversified fertilizer products; NP (39%), CAN (26%), and Urea (35%). Continued growth is observed in the Company’s topline, which stood at PKR~45bln in CY18 (3MCY19: PKR~13bln), which is ~22% higher than the corresponding period (CY17: PKR~37bln) attributable to increase in sale volumes and price hikes during CY18; major contributor was Urea which increased 6% in terms of sales volumes`.

Margins Effective resource utilization and operational efficacy coupled with increase in fertilizers prices resulted in persistent gross and operating margins for the period CY18; ~58% and ~45% ; higher by 3% and 4%, respectively, from the previous years. Finance cost dropped by ~34% resulting in a net profit of PKR~13bln for CY18 (3MCY19: PKR~4bln)

Sustainability In pursuance of adapting a prolific business model, FATIMA is in the process of acquiring the production and operating plants of its associate - Pak-Arab Fertilizer Limited including, awaiting regulatory approvals; Ammonia, Urea, Nitric Acid, NP, CAN and clean development mechanism. Fatima Group ventures an undertaking to secure gas supply to Pak-Arab’s plants by laying a dedicated pipeline from Mari gas fields connected to SNGPL network for provision of uninterrupted gas. Materialization of the transaction is, however, taking more than expected timeframe, due to certain regulatory approval delays. The total consideration agreed to be paid by FATIMA is PKR~9bln, out of which PKR~2.25bln has been paid till Dec'18 and the remaining payment is to be deferred over 3 years semi annual installments with a markup of 6MK+1.25%.

Financial Risk

Working Capital In line with the industry dynamics, working capital cycle remained in comfortable zone during CY18. Receivable days continue to be stable CY18: 17 days (CY17: 19 days, CY16: 13days) - similar pattern being seen in in 3MCY19: ~15days. Net cash cycle was recorded at 41 days for CY18 (CY17: 59 days). FATIMA's short term borrowings remained fluctuating since CY15 (CY18: PKR~5bln CY17: PKR~2bln, CY16: PKR~8bln) and clocked in at PKR~4bln during 3MCY19.

Coverages The free cash flows from operations (FCFO) during CY18 stood at PKR~20bln, up by 33% YoY, on the back of improved margins and elevated turnover. This in turn reflected in the coverages of the company; hence, company positioned itself in a comfortable zone. In attribution to repayment of loan, finance cost decreased by ~27% YoY, resulting in improved core coverage of 2.6x (CY17: 2x).

Capitalization Since CY16, FATIMA’s capital structure has been adequately leveraged, standing at ~20% 3MCY19 (CY18:~22%, CY17;~25%: CY16;~39%) as a result of an overall decline in borrowings which recorded at the following numbers; 3MCY19: PKR~16bln (CY18: PKR~17bln). The repayments are expected to keep FATIMA's capital structure sound. The company also 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 4 semi-annual installments with coupon payments @6MK+1.10%.

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Financial Summary
PKR mln

Fatima Fertilizer Company Limited Fertilizer	Mar-19 3M	Dec-18 12M	Dec-17 12M	Dec-16 12M
A BALANCE SHEET				
1 Non-Current Assets	79,813	78,595	73,142	73,089
2 Investments	815	711	86	86
3 Related Party Exposure	11,336	10,225	9,118	7,600
4 Current Assets	21,986	20,420	16,990	29,822
a Inventories	*5,081*	*5,028*	*3,814*	*6,243*
b Trade Receivables	*1,954*	*2,397*	*1,796*	*2,116*
5 Total Assets	113,950	109,951	99,336	110,597
6 Current Liabilities	15,433	13,981	11,627	17,658
a Trade Payables	*14,806*	*1,561*	*1,035*	*801*
7 Borrowings	16,636	17,852	18,152	29,872
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	15,981	15,856	15,815	15,693
10 Net Assets	65,900	62,261	53,742	47,374
11 Shareholders' Equity	65,900	62,261	53,742	47,374
B INCOME STATEMENT				
1 Sales	13,347	45,964	37,612	33,765
a Cost of Good Sold	*(5,459)*	*(19,483)*	*(17,275)*	*(15,780)*
2 Gross Profit	7,887	26,481	20,337	17,985
a Operating Expenses	(1,829)	(5,728)	(5,016)	(3,691)
3 Operating Profit	6,058	20,754	15,321	14,294
a Non Operating Income or (Expense)	*(287)*	*(793)*	*(387)*	*72*
4 Profit or (Loss) before Interest and Tax	5,772	19,961	14,935	14,366
a Total Finance Cost	*(563)*	*(1,450)*	*(2,198)*	*(2,739)*
b Taxation	*(1,571)*	*(5,238)*	*(2,160)*	*(1,844)*
6 Net Income Or (Loss)	3,638	13,272	10,576	9,782
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*5,742*	*19,866*	*15,152*	*15,976*
b Net Cash from Operating Activities before Working Capital Changes	*5,256*	*17,620*	*12,346*	*12,801*
c Changes in Working Capital	*(977)*	*(1,912)*	*4,408*	*5,973*
1 Net Cash provided by Operating Activities	4,279	15,708	16,754	18,775
2 Net Cash (Used in) or Available From Investing Activities	(3,033)	(10,644)	(2,948)	(5,012)
3 Net Cash (Used in) or Available From Financing Activities	(1,269)	(5,336)	(24,096)	(2,958)
4 Net Cash generated or (Used) during the period	(23)	(272)	(10,290)	10,805
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	16.2%	22.2%	11.4%	--
b Gross Profit Margin	59.1%	57.6%	54.1%	53.3%
c Net Profit Margin	27.3%	28.9%	28.1%	29.0%
d Cash Conversion Efficiency (EBITDA/Sales)	48.3%	51.7%	45.2%	50.9%
e Return on Equity (ROE)	22.7%	22.9%	20.9%	22.8%
2 Working Capital Management				
a Gross Working Capital (Average Days)	49	52	68	85
b Net Working Capital (Average Days)	-7	41	59	62
c Current Ratio (Total Current Assets/Total Current Liabilities)	1.4	1.5	1.5	1.7
3 Coverages				
a EBITDA / Finance Cost	12.1	17.3	9.0	7.2
b FCFO / Finance Cost+CMLTB+Excess STB	2.8	2.6	2.0	2.0
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.6	0.7	1.2	1.6
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	20.2%	22.3%	25.2%	38.7%
b Interest or Markup Payable (Days)	0.0	0.0	0.0	0.0
c Average Borrowing Rate	12.4%	7.6%	7.9%	7.9%

#	Notes
D1a	Sales growth is annualised for quarters
A7	Borrowings comprises CMLTD, Long term borrowings, short term borrowings and debt instruments
-	-
-	-
-	-

Rating Scale | Corporate

2019

Credit Rating Scale & Definitions

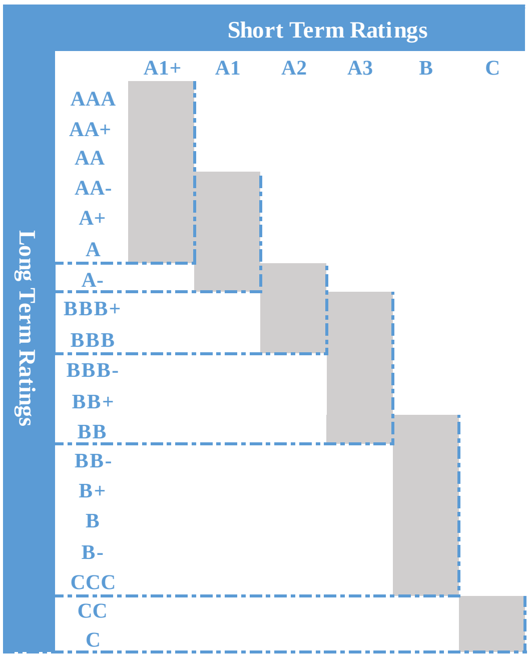
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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