The Pakistan Credit Rating Agency Limited

Rating Report

Fatima Fertilizer Company Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
19-Aug-2020	AA-	A1+	Stable	Maintain	-
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. Lately, Pakistan's urea market has witnessed certain key changes on the pricing front. In January 2020, the Government decided to prospectively reduce the GIDC from PKR400/bag of urea, as a way to subsidize costs incurred by farmers. Urea prices stabilized in 2QCY20, following varying price cuts by the industry players in the first quarter of CY20. The overall industry demand has largely remained stable despite the outbreak of the COVID-19 pandemic. Some fluctuation was noted in the industry's urea offtake, as depicted by an uneven Month-on-Month (MoM) trend, amid subsequent lockdowns. The industry continues to face challenges in terms of enhancement of business costs. Going forward, these enhanced business costs or any hike in gas tariffs may have to be passed on to the customers. Delay in implementation of subsidy mechanism (most notably for phosphate fertilizer) and in prevention measures against further spread of locust swarms, may put pressure on the farmers' already tightened purchasing power, potentially bearing an impact on fertilizer offtake. Eyeing for a prolific business model and as envisaged, Fatima Fertilizer is in the process of acquiring the production and operating plants of its associate - Pakarab Fertilizers Limited including Ammonia, Urea, Nitric Acid, NP, CAN and Clean Development Mechanism. The proposed merger with its wholly owned subsidiary - Fatimafert has fully materilised. Post-acquisition, Fatima Fertilizer tends to become a prominent supplier of CAN & NP too. Fatima Group has also ventured an undertaking to secure gas supply to Pakarab by laying gas pipeline - which has been operational since Jan'20. Given strong cashflows on balance sheet, financial risk profile remains comfortable.

The ratings are dependent upon the company's aptness to uphold its financial risk profile following proposed acquisition of its associate's plants. Meanwhile, improved economic inflows to support additional debt burden, are imperative.

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-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 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 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. Further company has ensured compliance with Code of Corporate Govenance by inclusion of female director on board.

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 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, 2019.

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 morethan 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 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, as a way to subsidize costs incurred by farmers. The market players reduced the pricing with varying extents, creating a price disparity in the 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 With sustainable growth FATIMA is relatively placed prominent in the industry. 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 have merged Fatimafert (previously its wholly owned subsidiary) with FATIMA and are in process of acquiring production plants of its associated company PakArab Fertilizers Limited. The later transactions is close to completion stage. With reference to Urea & phosphate industry Fatima captures a market share of ~17% each, in 1QCY20 hence sustaining its strong position in fertilizer industry.

Revenues Continued growth is observed in the Company's topline, which stood at PKR~14bln in 3MCY20 (CY19: PKR~75bln), which is ~8% higher than the corresponding period (3MCY19: PKR~13bln).

Margins Despite rising input prices due to inflation and Rupee devaluation that resulted in 44% increase in the cost of sales during 3MCY20, margins remained relatively strong. Effective resource utilization and operational efficacy coupled with increase in fertilizers prices resulted in persistent gross and operating margins for the period 3MCY20; ~46% and ~34%, respectively. Finance cost increased due to the increasing Policy Rate by SBP; 3MCY20: PKR~1.2bln from PKR ~3.7bln in CY19. Net margins continue to remained unchanged - stood at ~17% during 3MCY20 against ~16% during CY19.

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 Fertilizers Limited Ammonia, Urea, Nitric Acid, NP, CAN and Clean Development Mechanism. The transaction is not yet materialised because of delay in review by sponsors mainly due to COVID situation. However the transaction is at its final stages and expected to be completed by the end of 3QCY20. Fatima Group has successfully completed its undertaking of securing 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 in Jan20. The total consideration agreed to be paid by FATIMA to Pak Arab Fertilizers is PKR~9bln, out of which PKR~4bln has been paid till Dec'19

Financial Risk

Working Capital Working capital cycle showed an escalating trend as compared to previous years. During 3MCY20 net cash cycle was recorded at 38days for (CY19: 26 days). FATIMA's short term borrowings slightly elevated in current quarter as compared to previous years (CY19: PKR~16bln CY18: PKR~4.8bln,) and clocked in at ~17bln in 3MCY20.

Coverages The free cash flows from operations (FCFO) during 3MCY20 stood at PKR~4.3bln (CY19: PKR 16.7bln), on the back lower business volumes resulted in lower quantum profits, ultimately effecting FCFOs. This in turn reflected in the coverages of the company; however company positioned itself in a comfortable zone. Core coverages and interest cover slid a bit yet remained strong at 4.2X during 3MCY20 (CY19: 4.9x) and 5.2X during 3MCY20 against 6.8X in CY19.

Capitalization Since begining FATIMA's capital structure has been moderately leveraged, standing at ~27.3% 3MCY20 (CY19:~27.5%, CY18;~22.3%) as a result of low reliance on borrowings which recorded at the following numbers; 3MCY20: PKR~30bln (CY19: PKR~29.5bln). 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 Agriculture and Allied	Mar-20 3M	Dec-19 12M	Dec-18 12M	Dec-17 12M
A BALANCE SHEET				
1 Non-Current Assets	106,685	106,776	78,595	73,142
2 Investments	1,638	1,244	711	86
3 Related Party Exposure	6,333	6,330	10,225	9,118
4 Current Assets	44,754	40,767	20,420	16,990
a Inventories	*11,261*	*11,518*	*5,028*	*3,814*
b Trade Receivables	*10,453*	*7,207*	*2,397*	*1,796*
5 Total Assets	159,410	155,116	109,951	99,336
6 Current Liabilities	28,703	27,511	13,981	11,627
a Trade Payables	*14,531*	*13,962*	*1,561*	*1,035*
7 Borrowings	30,191	29,594	17,852	18,152
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	20,049	20,004	15,856	15,815
10 Net Assets	80,468	78,008	62,261	53,742
11 Shareholders' Equity	80,468	78,008	62,261	53,742
B INCOME STATEMENT				
1 Sales	14,433	74,964	45,964	37,612
a Cost of Good Sold	*(7,852)*	*(47,065)*	*(19,483)*	*(17,275)*
2 Gross Profit	6,581	27,899	26,481	20,337
a Operating Expenses	(1,682)	(6,579)	(5,728)	(5,016)
3 Operating Profit	4,899	21,320	20,754	15,321
a Non Operating Income or (Expense)	*(125)*	*(366)*	*(793)*	*(387)*
4 Profit or (Loss) before Interest and Tax	4,774	20,954	19,961	14,935
a Total Finance Cost	*(1,248)*	*(3,761)*	*(1,450)*	*(2,198)*
b Taxation	*(1,066)*	*(5,124)*	*(5,238)*	*(2,160)*
6 Net Income Or (Loss)	2,459	12,070	13,272	10,576
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*4,290*	*16,741*	*19,866*	*15,152*
b Net Cash from Operating Activities before Working Capital Changes	*3,328*	*13,582*	*17,620*	*12,346*
c Changes in Working Capital	*(2,622)*	*(6,704)*	*(1,912)*	*4,408*
1 Net Cash provided by Operating Activities	706	6,879	15,708	16,754
2 Net Cash (Used in) or Available From Investing Activities	(898)	(10,322)	(10,644)	(2,948)
3 Net Cash (Used in) or Available From Financing Activities	361	3,241	(5,336)	(24,096)
4 Net Cash generated or (Used) during the period	169	(203)	(272)	(10,290)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	-23.0%	63.1%	22.2%	11.4%
b Gross Profit Margin	45.6%	37.2%	57.6%	54.1%
c Net Profit Margin	17.0%	16.1%	28.9%	28.1%
d Cash Conversion Efficiency (EBITDA/Sales)	36.7%	30.9%	51.7%	45.2%
e Return on Equity (ROE)	12.4%	17.2%	22.9%	20.9%
2 Working Capital Management				
a Gross Working Capital (Average Days)	128	64	52	68
b Net Working Capital (Average Days)	38	26	41	59
c Current Ratio (Total Current Assets/Total Current Liabilities)	1.6	1.5	1.5	1.5
3 Coverages				
a EBITDA / Finance Cost	5.2	6.8	17.3	9.0
b FCFO / Finance Cost+CMLTB+Excess STB	1.5	1.3	2.6	2.0
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	1.0	1.2	0.7	1.2
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	27.3%	27.5%	22.3%	25.2%
b Interest or Markup Payable (Days)	99.7	89.5	0.0	0.0
c Average Borrowing Rate	13.6%	14.4%	7.6%	7.9%

Credit Rating

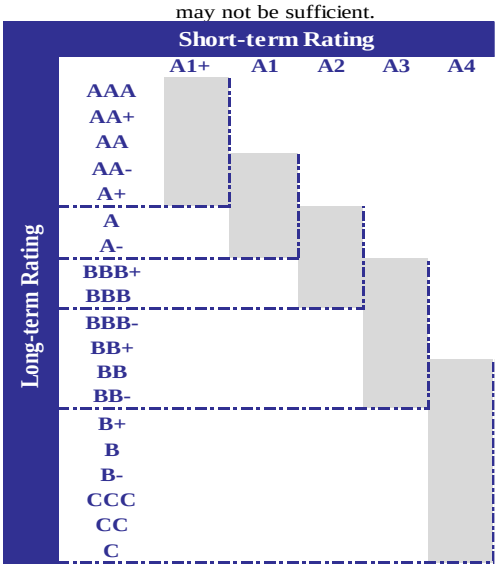
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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