The Pakistan Credit Rating Agency Limited

FAUJI FERTILIZER COMPANY LIMITED (FFC)

ENTITY RATINGS REPORT

	INITIAL [AUG-16]
Long-term Rating	AA
Short-term Rating	A1+
Outlook	Stable

REPORT CONTENTS

AUGUST 2016

Profile & Ownership

- Fauji Fertilizer Company Limited (FFC), incorporated in 1978, is listed on Pakistan Stock Exchange
- One of the largest urea manufacturers having a nameplate capacity of 2,048K tonnes but due to efficiency enhancement through BMR, the demonstrated production has remained above 2,400K tonnes
- Fauji Foundation (FF) - a charitable trust - is the major shareholder of the company with stake of 44.35%
- FF has emerged as one of the leading conglomerates of Pakistan with interest in various sectors including energy, gas supply, fertilizer, cement, banking and food

Governance and Management

- Thirteen member board of directors including the Chief Executive Officer (CEO)
- Seven directors represent FF, one member for each NIT and GoP, while four are independent members
- The CEO, Lt Gen Shafqaat Ahmed HI (M), Retd., joined the board in March'15, and is also the CEO of the two subsidiaries of FFC; Fauji Fresh n Freeze and FFC Energy Ltd
- Management team is a balanced blend of highly experienced professionals from the industry having long association with FFC

Performance

- FFC's capacity utilization has consistently remained above 100% due to efficient management of its facilities and uninterrupted supply of gas from Mari Network
- Predominant portion of revenue of PKR 85bln, in CY15, comprises urea (88%), while 12% represents sale of imported fertilizers
- Topline grew by 4%, wherein imported fertilizer sales grew substantially whereas urea sale witnessed a nominal rise
- Net average selling price of urea (PKR 30,993/ton) witnessed marginal rise of 1%, while volumes remained suppressed in anticipation of price reduction by GoP; which scenario started from Aug'15 and has prevailed till Jun'16
- Urea margins declined (CY15: 37%, CY14: 40%) due to suppressed pass through ability of gas price hike
- Imported fertilizer margins declined to 9% (CY14: 20%) only because of classification of subsidy (PKR 1.5bln) to other income; margins normalize to 21% for CY15 after re-classification of subsidy as revenue

Investments

- Sizeable strategic investment portfolio of PKR 39.5bln at end-Dec15, comprising equity investments in group companies (54%), PIBs (21%) and TDRs (25%)
- Sizeable investment income of PKR 5bln supports bottom-line; contributed by significant stream of dividend income from equity investments and interest income
- Equity investments in group companies comprise of; Askari Bank Limited (cost PKR 10.5bln, div yield: 9%), Fauji Fertilizer Bin Qasim Limited (cost PKR 4.7bln, div yield: 6%), Fauji Cement Company Limited (cost PKR 1.5bln, div yield: 7%), Pakistan Maroc Phosphore S.A., Morocco (cost PKR 0.7bln); FFC recently formed a wholly owned subsidiary FFC Energy Limited (cost PKR 2.4bln) and Fauji Fresh n Freeze Limited (PKR 1.4bln).

Business Strategy

- Relatively depressed sales in IH16 is expected to pick up pace after recent subsidy announcement on fertilizer by the GoP, effective end-Jun16
- The Company, together with its international consortium partners intends to establish the first fertilizer plant in Tanzania
- Evaluation of mining operations in Thar coalfield is in process

Financial Risk

- The historically low working capital requirement witnessed escalation due to inventory pile up, which is considered a temporary phase expected to normalize in 2H16
- Moderately leveraged (58%), with short term borrowings covered by investments in PIBs and TDR
- Debt coverage stands at 2.2times, when topped up with investment income, it stands strong (3.2times), with a robust debt payback period of 1.8yrs
- Going forward, as the company undertakes expansion in new projects further borrowings may be availed; associated leveraging will require oversight and close attention

RATING RATIONALE

The rating reflects FFC's dynamic business profile and strong financial position while incorporating the sound financial strength of Fauji Group. FFC is one of the largest players in the fertilizers market. The strong business/professional footprint of FFC has enabled the company to build an impeccable brand in Pakistan with "Sona" being a household name in the farmer community. The production facilities are secured by uninterrupted supply of gas from Mari field, representing inherent commercial strengths of the company thereby ensuring sustainable business volumes for FFC. Urea market itself has strong fundamentals historically; demand has exceeded supply. The only challenge is parity with international prices; yet FFC is committed towards costs economization for sustained returns for the company.
FFC carries a sizable book of diversified investments, which has been developed to offer sustainable returns to its stakeholders. FFC recently diversified into the financial sector by acquiring a sizable stake in Askari Bank (43.15%), which has a distinct presence in Pakistan's financial sector: dividend stream from these investments compliments FFC's ratings. FFC is eyeing expansion in fertilizer (outside Pakistan) and mining operations; leveraging associated with new projects will require oversight and close attention.

INDUSTRY

Fertilizers industry in Pakistan possesses capacity to produce 6.8mln tonnes of urea, 0.7mln tonnes of DAP and 2.2mln tonnes of other fertilizers. The industry benefits from the demand of its major product urea. While DAP capacity is short to meet historical demand, local urea capacity, after recent expansions, slightly surpasses the indigenous demand. Effective end-Feb'16, all players are being supplied with full gas, following imports of LNG in the country and improved supplies form Mari Network; resulting in full capacity utilization. Moreover, GoP announced subsidy on nitrogenous and phosphoric fertilizer, effective end-Jun'16. The country has faced historic urea inventory pile up at end-Jun'16 (~1.65 tonnes) as dealers delayed buying to take benefit from subsidized prices. Sales would pick up in 2H16.

PKR mln

Fauji Fertilizer Company Limited (FFC)

BALANCE SHEET	31-Mar-16	31-Dec-15	31-Dec-14
	1Q	Annual	Annual
Non-Current Assets	**24,036**	**23,786**	**22,544**
Investments (Incl. Associates)	**31,613**	**39,464**	**55,567**
Equity	21,201	21,201	20,801
Current Assets	**19,037**	**16,880**	**8,450**
Inventory	9,279	5,100	982
Trade Receivables	1,884	1,774	822
Others	7,874	10,006	6,646
Total Assets	**74,686**	**80,130**	**86,562**
Debt	**34,201**	**38,423**	**15,882**
Long-term (Incl. Current Maturity of Long-Term Debt)	20,652	20,402	4,280
Short-term Borrowings	13,548	18,021	11,602
Other Short-term Liabilities	10,050	9,795	40,436
Other Long-term Liabilities	4,632	4,600	4,574
Shareholder's Equity	**25,802**	**27,311**	**25,670**
Total Liabilities & Equity	**74,686**	**80,130**	**86,562**
INCOME STATEMENT			
Turnover	**11,646**	**84,831**	**81,240**
Gross Profit	3,052	28,882	31,103
Other Income	2,562	4,496	4,230
Financial Charges	(561)	(1,475)	(849)
Net Income	**2,728**	**16,766**	**18,171**
Cashflow Statement			
Free Cashflow from Operations (FCFO)	329	12,938	15,060
Total Operating Cashflows (TCF)	3,710	17,415	18,921
Net Cash from Operating Activities	(2,099)	(18,548)	32,951
Net Cash from InvestingActivities	(237)	(3,203)	(11,592)
Net Cash from Financing Activities	9,014	9,210	(33,198)
Net Cash generated during the period	6,677	(12,541)	(11,839)
Ratio Analysis			
Performance			
Turnover Growth	-43%	4%	9%
Gross Margin	26%	34%	38%
Net Margin	23%	20%	22%
ROE	11%	61%	71%
Coverages			
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB)	0.2	2.2	1.3
Interest Coverage (x) (FCFO/Gross Interest)	0.6	8.8	17.7
Debt Payback (Years) (Total LT Debt Including UnCovered Total STBs) / (FCFO- Gross Interest)	1.1	1.8	0.3
Liquidity			
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	58	-26	-118
Capital Structure (Total Debt/Total Debt+Equity)	57%	58%	38%

STANDARD RATING SCALES & 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 or 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**. "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.

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. Rating Watch may carry designation – Positive (rating may be raised, negative (lowered), or developing (direction is unclear). A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled.

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'.

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, a suspended 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, or e) the entity/issuer defaults.

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Regulatory and Supplementary Disclosure

Rated Entity

Name of Rated Entity Fauji Fertilizer Company Limited
Sector Fertilizer
Type of Relationship Solicited

Purpose of the Rating: Independent Risk Assessment

Rating History

Dissemination Date	Long Term	Short Term	Outlook	Action
4-Aug-16	AA	A1+	Stable	Initial

Related Criteria and Research

Methodology: Corporate Rating Methodology
Research: Fertilizer Sector - Viewpoint | October - 15

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Rating Team Statement

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