The Pakistan Credit Rating Agency Limited

FATIMA FERTILIZER COMPANY LIMITED (FATIMA)

INSTRUMENT RATING REPORT

	INITIAL [JAN-17]	PRELIMINARY [NOV-16]
Listed and secured Sukuk (PKR 10.5bln)	AA-	AA-
Outlook	Stable	Stable

REPORT CONTENTS

JANUARY 2017

Sukuk Issue:
- Fatima is issuing a listed, rated and secured Sukuk of PKR 10.5bln and has a tenor of 5 years. It would be issued in the Pre-IPO and IPO portion in the ratio of 75:25. Redemption of the Sukuk will be in 10 semi-annual installments, starting from date of first disbursement, and coupon payments are payable @6MK+1.10%. The instrument, initially, would be secured with a ranking charge which would be upgraded into first pari-passu charge over all the present and future fixed assets with a minimum 25% margin, within 90 days of first disbursement. The company is required to create a Debt Payment Account with National Bank of Pakistan (NBP), which are the advisor and arranger of the Sukuk. An early redemption of the issue is allowed after 3 years of the issue. The Sukuk proceeds would be utilized to settle existing Syndicated Term Finance Facility.

Profile & Ownership
- Fatima Fertilizer Company Limited (Fatima), incorporated in 2003, is listed on Pakistan Stock Exchange
- Majority owned by Fatima Group (45%) and Arif Habib Group (31%); Fatima Group retains the management control
- The group has interests in textile, sugar, mining and energy sectors and in addition owns Pakarab Fertilizer
- Fatima owns a fertilizer complex with nameplate capacity of 1.28mln MT p.a (Urea, Can and NP combined), located at Mukhtar Garh, Rahim Yar Khan
- Fatima Fert (formerly DH Fert) is a wholly owned subsidiary of Fatima adding 455K MT of additional capacity

Governance and Management
- Eight member board of directors including the CEO; four representative of Fatima Group, two of Arif Habib Group and two independent members
- The chairman of Arif Habib Group, Mr. Arif Habib, a reputed business professional, chairs the company's board
- Mr. Fawad Ahmed Mukhtar, a seasoned entrepreneur, is the CEO of Fatima as well as of Pak Arab and Fatima Fert

Performance
- Fatima's revenue, in 9M16, continued to be driven by diversified fertilizer products; NP (38%), CAN (31%), and Urea (31%)
- Market share declined to 18%, though company is the market leader in CAN (66%) and NP (72%)
- Capacity utilization surpassed 100% level; benefiting from completion of ammonia plant revamp in Nov'15
- Commissioning of Waste Gas Boiler by April'16, boosted the energy efficiency
- Topline grew by 3%, wherein sizeable increase in NP sales (69%) diluted by decrease in urea (2%) and CAN (5%)
- Increased offtake in the month of Sep'16, alone, on account of hefty discounts; compensated the previous months impasse generating a gross profit margin of 52%, highest in the industry
- Net profit margin of 28% remained highest among industry players

Business Strategy
- Fatima envisages the optimal mix of urea, CAN and NP to keep margins afloat
- Continue efforts in improving farmer's knowledge through providing technical assistance; conducting awareness seminars, meetings and trainings
- Greenfield project (Cots: USD 2.5bln) of fertilizer complex (2.6mln MTPA), owned by Midwest Fertilizer Corp (MFC) based in Indiana state of the US is at advanced stage; financial close delayed till 1Q17 (previously 1Q16)
- Fatima envisages to have 35% shareholding in MFC's equity total worth of USD 840-860mln

Financial Risk
- Traditionally low working capital requirement witnessed upspring due to inventory pile up; a phenomenon in line with industry
- Increased working capital requirements (Sep'16: PKR 7,014mln) have been financed by hefty short term borrowings (Sep'16: PKR 11,334mln, Dec15: PKR 10,229mln)
- Moderately leveraged (42%), however short term borrowings pushed up debt level (PKR 31,244 mln) despite significant repayment (PKR 3,696mln)
- Debt coverage stands at 4.2times with robust debt payback of 2.4yrs
- Fatima's plans of investment (~PKR 30bln) in MFC's fertilizer complex would raise the debt level. In this regard, Fatima envisages to issue 7-year US dollar denominated bonds with bullet payment falling due in 2023; keeping Fatima's financial risk profile within comfortable ranges

RATING RATIONALE

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 July'2021), represents inherent strengths of the company compared to peers. The overall capacity utilization has exceeded above 100% throughout CY16 (previously: 90% - 98%) after the ammonia plant debottlenecking was completed. Efficiency in fuel consumption was also achieved with the installation of Waste Gas Boiler. Gross margins are sanguine, with the uptick in off takes post subsidy announcement. The company faces competition from peers amidst supply surplus situation in the country, mainly on the back of improved gas situation in the country; experiencing huge inventory pile up of urea. The pending risk needs immediate attention of all stakeholders. Another risk is reduced international pricing, a significant threat to current profits. Fatima's carry over inventories and working capital needs have pushed up short term borrowings. This has hampered the incremental benefit on leveraging enabled by retirement of long term borrowings. The ratings are dependent on the company's ability to maintain its cash flows.

INDUSTRY

Pakistan fertilizers sector has production capacity of 6.9mln MT of urea, 0.7mln MT of DAP and 2.2mln MT of others. The industry benefits from the latent demand of its major product urea and oligopolistic market conditions. Industry is currently facing urea supply surplus due to low offtakes; uncertain pricing and low farmers economics. Another challenge is low international urea prices making exports unfeasible. Margins, though high, are under pressure.

PKR mln

Fatima Fertilizer Limited

BALANCE SHEET	30-Sep-16	31-Dec-15	31-Dec-14
	9M16	Annual	Annual
Non-Current Assets	**73,777**	**73,150**	**68,867**
Investments (Incl. associates)	**5,605**	**4,806**	**3,086**
Equity	2,106	2,106	86
Debt	3,499	2,700	3,000
Current Assets	**23,189**	**16,833**	**11,169**
Inventory	7,085	7,003	2,681
Trade Receivables	502	335	448
Others	15,602	9,495	8,039
Total Assets	**102,572**	**94,789**	**83,121**
Debt	**18,642**	**17,042**	**6,975**
Short-term	11,334	10,229	600
Long-term (Inlc. Current Maturity of long-term debt)	7,309	6,812	6,375
Other shortterm liabilities	11,928	8,906	7,633
Other Longterm Liabilities	28,228	28,613	31,756
Shareholder's Equity	**43,974**	**40,229**	**36,757**
Total Liabilities & Equity	**102,772**	**94,789**	**83,121**
INCOME STATEMENT			
Turnover	**22,908**	**29,733**	**36,169**
Gross Profit	11,966	17,122	21,461
Other Income	294	349	381
Financial Charges	(1,924)	(2,379)	(3,767)
Net Income	**6,371**	**9,254**	**9,258**
Cashflow Statement			
Free Cashflow from Operations (FCFO)	9,987	14,139	18,666
Net Cash changes in Working Capital	8,722	12,050	15,126
Net Cash from Operating Activities	1,708	6,463	15,319
Net Cash from InvestingActivities	(2,652)	(7,246)	(2,784)
Net Cash from Financing Activities	1,035	130	(11,824)
Net Cash generated during the period	90	(654)	711
Ratio Analysis			
Performance			
Turnover Growth	5%	-18%	8%
Gross Margin	52%	58%	59%
Net Margin	28%	31%	26%
ROE	19%	23%	26%
Coverages			
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB)	1.3	1.5	1.8
Interest Coverage (x) (FCFO/Gross Interest)	5.2	5.9	5.0
Debt Payback (Years) (Total Lt.Debt (excluding Covered Short Term Borrow	1.9	1.7	1.6
Liquidity			
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	118	89	62
Capital Structure (Total Debt/Total Debt+Equity)	42%	43%	40%

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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		Short Term Ratings
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments.	**A1+:** The highest capacity for timely repayment.
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.	**A1:.** A strong capacity for timely repayment.
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.	**A2:** A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial 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.	**A3:** An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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:** The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
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.	**C:** An inadequate capacity to ensure timely repayment.
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.	

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.

Regulatory and Supplementary Disclosure

Name of Issuer Fatima Fertilizer Comapny Limited
Name of Issue Fatima Fertilizer Company Limited | Sukuk | TBI
Sector Fertilizer
Type of Relationship Solicited

Purpose of the Rating Independent Risk Assessment

Rating History

Dissemination Date	Rating	Outlook	Action
26-Jan-17	AA-	Stable	Initial
11-Nov-16	AA-	Stable	Preliminary

Instrument Details

Nature of Instrument	Size of Issue (PKR mln)	Tenor (yrs)	Security	Nature of Assets	Trustee
Sukuk	PKR 10,500mln	5	First pari-passu charge with 25% margin on all present and future fixed assets of Fatima	All present and future fixed assets including land and builidng	National Bank of Pakistan (NBP)

Amortization Schedule Refer to Annexure

Related Criteria and Research Fertilizer Sector | Overview | October 2016

Rating Methodology Corporate Rating Methodology
Debt Instrument Rating Methodology

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Rating Team Statement

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