The Pakistan Credit Rating Agency Limited

ENGRO FERTILIZERS LIMITED (EFERT)

	NEW [APR-17]	PREVIOUS [NOV-16]
Entity Rating:		
Long-Term	AA-	AA-
Short-Term	A1+	A1+
Outlook	Stable	Stable

APRIL 2017

Profile & Ownership

- Engro Fertilizers Limited (EFert), demerged from Engro chemicals in 2010, and is listed on Pakistan Stock exchange.
- Majority owned by Engro Corp (56.45%); during the year, ECorp divested 22% stake, as part of strategic re-alignment to explore opportunities in energy sector.
- The total designed capacity of EFert's urea plants – base plant: 975,000 MT per annum and Enven: 1,300,000 MT per annum – accounts for ~25% of industry's demonstrated capacity – second largest capacity.

Governance and Management

- EFert's board comprises 2 Engro Corp's executives, one DG representatives and four independent directors. However, there is one position vacant.
- Mr.Ghias Khan, the CEO of the holding company, is the Board Chairman**.** Mr. Ruhail Muhammad, the President and CEO of EFert, is a seasoned professional with a long association with Engro group.

Performance

- Capacity utilization remained persistently above 80% throughout CY16, except May-16, when it dropped to 53% due to closure of one plant on account of turnaround.
- In CY16, EFert's topline substantially decreased by 18% to ~PKR 70bln (CY15: PKR 85bln); predominately decline in urea – volumes (12%).
- Urea volumes remained under check until Jun16, in anticipation of price cut due to expected subsidy.
- Company offloaded urea, post subsidy, at hefty discount to compete amidst abundant supply in the market; all manufacturers operated at full capacity due to improved availability of gas.
- The gross margins of the company plummeted to 25% (CY15:35%)
- However, subsidy (CY16: PKR 8bln, CY15: 3bln) recoverable from GoP, and classified as other income, supplemented operating profit of (PKR ~10bln, CY15: PKR 23bln)
- The finance cost of the company declined due to re-profiling of long term debt. The company profitability stood at PKR 9bln (CY15: PKR 15bln)

Business Strategy

- Going forward, the company envisages continuous supplies of gas, whereas additional gas supply (13.5MMCFD) from Mari is procured in a decision by ECC.
- Offtakes kicked off post clarity on subsidy. However, real challenge remains offloading inventory in hand, Govt.'s decision to allow exports shall be beneficial.
- Reduced parity with international price shall continue to keep local price under check, herein, gas pricing plays critical role to keep margins afloat.
- Although GIDC declared null and void by Sindh High Court. GoP would challenge the decision or may some other mechanism to fill the revenue gap; hence, transfer of beneficial impact remains uncertain.

Financial Risk

- During CY16, EFert's working capital requirement increased significantly trickled down by supply surplus situation in the country – mainly urea and delay in subsidy from the government.
- The company met the working capital needs of PKR ~14bln, through internal sources (cash generated from operations: PKR ~15bln).
- Free cash flows from operations (FCFO) declined by 31% to PKR 18bln, in line with topline of the company (18%), whereby, debt coverage improved to 2.2 times (CY15: 1.8x)
- Debt level remained at same level (PKR 37bln). The company replaced expensive PPTFC with low cost debt.
- Going forward, the company envisages to keep leveraging at current level – an optimal capital structure considered by the management.

RATING RATIONALE

The ratings take into account sustained operations of the company; capacity utilization at both plants remained high on the back of continued gas supply from Mari and other. The risk of gas curtailment has diminished with strengthening of local reservoirs and continued import of RLNG. Better availability of gas has improved overall availability of urea in the market. This, along with declining international prices, has kept local prices under check. Lately, higher inventory levels forced competitive price reduction, in turn reduction in margins. Industry's ability to manage high business risk is dependent on price induced local demand increase – that should help off load high inventories and create absorption of improved production levels – amidst low international urea price. Wherein, any further reduction may force price cut. EFert business fundamentals remain largely in line with industry dynamics. It has experienced squeeze in margins and, in turn, cashflows. The financial risk profile of the company is characterized by moderate leveraging. EFert continues to derive strength from its association with Engro Corporation – a corporate conglomerate.

KEY RATING DRIVERS

The ratings are dependent on sustained risk profile of the company. Any constraint to perceived ability to keep business and financial risk in respective matrix may impact the ratings

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 supply surplus issues because of increased capacity utilization and lower international urea price. Margins, though high, are under pressure.

PKR mln

Engro Fertilizers Limited (EFert)

BALANCE SHEET	31-Dec-16	31-Dec-15	31-Dec-14
	CY16	CY15	CY15
Non-Current Assets	**74,740**	**72,459**	**75,175**
Investments (Incl. Associates)	**560**	**4,383**	**-**
Equity	560	4,383	-
Current Assets	**26,986**	**16,627**	**11,467**
Inventory	6,820	6,942	1,101
Trade Receivables	7,587	2,262	757
Others	12,580	7,423	9,609
Total Assets	**102,429**	**105,382**	**111,726**
Debt	**34,601**	**36,074**	**44,003**
Long-term (Incl. Current Maturity of Long-Term Debt)	34,601	36,074	44,003
Other Short-term Liabilities	18,828	20,164	27,643
Other Long-term Liabilities	7,718	6,617	5,347
Shareholder's Equity	**41,283**	**42,526**	**34,478**
Total Liabilities & Equity	**102,429**	**105,382**	**111,472**
INCOME STATEMENT			
Turnover	**69,519**	**85,003**	**61,425**
Gross Profit	17,111	29,568	22,603
Other Income	6,991	2,506	1,131
Financial Charges	(3,136)	(4,588)	(6,625)
Net Income	**9,025**	**15,028**	**8,208**
Cashflow Statement			
Free Cashflow from Operations (FCFO)	17,995	26,174	19,493
Net Cash changes in Working Capital	(13,839)	(17,142)	6,661
Net Cash from Operating Activities	775	4,642	19,063
Net Cash from InvestingActivities	(2,422)	8,165	(5,641)
Net Cash from Financing Activities	(10,748)	(16,384)	(13,692)
Net Cash generated during the period	(12,394)	(3,577)	(270)
Ratio Analysis			
Performance			
Turnover Growth	-18.2%	430.1%	291.1%
Gross Margin	24.6%	34.8%	36.8%
Net Margin	13.0%	17.7%	13.4%
ROE	14.4%	35.3%	23.8%
Coverages			
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB)	2.2	1.8	1.5
Interest Coverage (x) (FCFO/Gross Interest)	5.7	6.0	3.2
Debt Payback (Years) (Total Lt.Debt (excluding Covered Short Term Borrowings) / FCFO)	2.3	1.6	3.0
Liquidity			
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	9.1	-21.3	-25.2
Capital Structure (Total Debt/Total Debt+Equity)	46.7%	45.9%	56.1%

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

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Name of Issuer	Engro Fertilizers Limited
Sector	Fertilizers
Type of Relationship	Solicited
Purpose of the Rating	Independent Risk Assessment

Rating History

Dissemination Date	Long Term	Short Term	Outlook	Action
18-Nov-16	AA-	A1+	Stable	Maintain
18-Nov-15	AA-	A1+	Stable	Upgrade
08-Jan-15	A+	A1	Stable	Upgrade
27-Jan-14	A	A1	Stable	Upgrade
28-Jun-13	A-	A2	Stable	Maintain

Related Criteria and Research

Rating Methodology: Corporate Rating Methodology
Research: Fertilizer Sector | Overview | October 2016

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Rating Team Statement

Rating Procedure
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PACRA reviews all the outstanding ratings on annual basis or as and when required by any stakeholder (including creditor) or upon the occurrence of such an event which requires to do so
PACRA initiates immediate review of the outstanding rating(s) upon becoming aware of any information that may be reasonable be expected to result in any change (including downgrade) in the rating

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Probability of Default (PD)

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