The Pakistan Credit Rating Agency Limited

FAUJI FERTILIZER COMPANY LIMITED (FFC)

	NEW [AUG-17]	PREVIOUS [AUG-16]
Long-Term	AA	AA
Short-Term	A1+	A1+
Action	Maintain	Initial
Outlook	Stable	Stable

REPORT CONTENTS

AUGUST 2017

Profile & Ownership

- Fauji Fertilizer Company Limited (FFC), incorporated in 1978, is listed on Pakistan Stock Exchange
- 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%. State Life Insurance holds 9%, whereas other institutions and general public hold 22.41% and 24.24%, respectively.
- 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, while four are independent including one member each from SLIC and NIT.
- 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 reven ue of PKR 73bln, in CY16, comprises urea (88%), while 12% represents sale of imported fertilizers.
- Topline declined by 14% (7.5% decrease including subsidy) owing to decreased prices due to suppressed selling prices owing to supply surplus and subsidy scheme, wherein Urea sales witnessed an increase of 1% (Dec16: 2.5mln tonnes; Dec15: 2.4mln tonnes). Imported DAP sales also grew by 22% (Dec16: 202k tonnes; Dec15: 165ktonnes) due to increased demand emanating from subsidy and comparatively lower international prices on YoY bais.
- Decline in Urea margins was of 10% (CY16: 27%; CY15: 37%), due to clubbing of subsidy as other income, whereas on imported fertilizer margins were restricted to 7% (CY15: 9%).
- Decreased Gross margins (4%) including subsidy amount (Dec16: 31%; Dec15: 35%). Company secured a bottom line of PKR 11,782mln (Dec15: PKR: 16,766mln).
- Finance cost exhibited an increasing trend (CY16: PKR 2.4bln; CY15: PKR 1.5bln).
- During1QCY17, besides stagnant pricing conditions, Urea and DAP off takes exhibited an increasing trend translating into a net profit of PKR 2.2bln (1QCY16: PKR 2.7bln).

Investments

- Sizeable strategic investment portfolio of PKR 36bln at end-Mar17, comprising equity investments in group companies (62%), PIBs (21%) and TDRs (13%) and MFs (4%).
- During CY16, sizeable investment income of PKR 3.5bln (1QCY17: PKR 1.1bln) supports bottom-line; contributed by significant stream of dividend income from equity investments and interest income.
- Equity investments in group companies as at end-Dec16 comprise of; Askari Bank Limited (cost PKR 10.5bln, div yield: 5%), Fauji Fertilizer Bin Qasim Limited (cost PKR 4.7bln, div yield: 6%), Fauji Cement Company Limited (cost PKR 1.5bln, div yield: 6%), Pakistan Maroc Phosphore S.A., Morocco (cost PKR 0.7bln, div yield: 7%); FFC has two wholly owned subsidiaries FFC Energy Limited (cost PKR 2.4bln) and Fauji Fresh n Freeze Limited (PKR 2.6bln).

Business Strategy

- During CY17, Government allowed 0.6mln tonnes urea export, which would contribute in better offtakes.
- Urea industry surplus and FFC's dividend stream would be a challenge.
- The Company, together with its international consortium partners intends to establish the first fertilizer plant in Tanzania. Tariff determination of which is under process.
- The Company is also participating with HUBCO to setup 330MW coal-based power project; Thar Energy Limited. The FFC equity share would be of 30%. Tariff of the project has been decided by NEPRA authority.

Financial Risk

- Short term borrowings fund working capital plus short term investments.
- Moderately leveraged (58%), with short term borrowings covered by investments in PIBs and TDR.
- Debt coverage stands at 2times, when topped up with investment income with a robust debt payback period of 1.7yrs.
- 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 ratings reflect 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 in terms of its production. The strong business footprint of FFC has enabled the company to build an impeccable brand in Pakistan with "Sona" being a household name in the farming community. The production facilities are secured by uninterrupted supply of gas from Mari field, representing inherent commercial strengths of the company in terms of sustainable business volumes. The industry currently faces price competition due to surplus urea inventory in the country, mainly due to higher production on the back of improved gas situation and lower international prices. Inventory risk is being mitigated through prospective urea exports under the Government' urea export quota (0.6mln tonnes).

KEY RATING DRIVERS

FFC carries a sizable book of diversified investments – both long term and short term- which has been developed to offer sustainable returns to its stakeholders. Dividend stream from the investment portfolio supplements FFC's profitability. FFC is eyeing expansion in fertilizer (outside Pakistan) and energy; leveraging associated with new projects will require oversight and close attention.

Fauji Fertilizer Company Limited (FFCL)

BALANCE SHEET	31-Mar-17	31-Dec-16	31-Dec-15	31-Dec-14
	3MCY17	CY16	CY15	CY14
Non-Current Assets	**23,726**	**23,766**	**23,786**	**22,544**
Investments (Incl. Associates)	**36,039**	**43,800**	**39,464**	**55,567**
Equity	22,414	22,401	21,201	20,801
Current Assets	**27,080**	**23,144**	**16,880**	**8,450**
Inventory	8,765	4,237	5,100	982
Trade Receivables	3,331	4,307	1,774	822
Others	14,984	14,599	10,006	6,646
Total Assets	**86,845**	**90,710**	**80,130**	**86,562**
Debt	**37,384**	**45,264**	**38,423**	**15,882**
Long-term (Incl. Current Maturity of Long-Term Debt)	22,506	23,088	20,402	4,280
Short-term Borrowings	14,878	22,177	18,021	11,602
Other Short-term Liabilities	17,853	12,422	9,795	40,436
Other Long-term Liabilities	4,733	4,812	4,600	4,574
Shareholder's Equity	**26,874**	**28,212**	**27,311**	**25,670**
Total Liabilities & Equity	**86,845**	**90,710**	**80,130**	**86,562**
INCOME STATEMENT				
Turnover	**11,190**	**72,877**	**84,831**	**81,240**
Gross Profit	2,601	18,050	28,882	31,103
Other Income/Expenses	2,470	8,904	3,910	2,418
Financial Charges	(536)	(2,406)	(1,475)	(849)
Net Income	**2,192**	**11,782**	**16,766**	**18,171**
Cashflow Statement				
Free Cashflow from Operations (FCFO)	1,840	9,125	12,916	15,341
Total Operating Cashflows (TCF)	2,551	12,497	17,393	18,921
Net Cash from Operating Activities	1,998	10,346	(18,548)	32,951
Net Cash from InvestingActivities	(505)	(2,099)	(3,203)	(11,592)
Net Cash from Financing Activities	5,306	143	9,210	(33,198)
Net Cash generated during the period	6,798	8,390	(12,542)	(11,839)
Ratio Analysis				
Performance				
Turnover Growth	-4%	-14%	4%	9%
Gross Margin	23%	25%	34%	38%
Net Margin	20%	16%	20%	22%
ROE	35%	89%	59%	79%
Coverages				
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB)	0.1	1.6	2.2	0.8
Interest Coverage (x) (FCFO/Gross Interest)	3.4	3.8	8.8	18.1
Debt Payback (Years) (Total Lt.Debt (excluding Covered Short Term Borrowings) / FCFO-Gross interest)	-18.1	1.7	1.8	1.4
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	56	24	-26	-118
Capital Structure (Total Debt/Total Debt+Equity)	58%	52%	51%	38%

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

Rating	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 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

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
04-Aug-17	AA	A1+	Stable	Maintain
04-Aug-16	AA	A1+	Stable	Initial

Related Criteria and Research

Methodology: Corporate Rating Methodology
Research: Fertilizer Sector - Viewpoint | October - 16

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Rating Team Statement

Rating is an opinion on relative credit worthiness of an entity or debt instrument. It does not constitute recommendation to buy, hold or sell any security. The rating team for this assignment does not have any beneficial interest, direct or indirect in the rated entity/instrument.

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Surveillance

PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the rated entity/ issuer, the security arrangement, the industry etc, is disseminated to the market, in a timely and effective manner, after appropriate consultation with the entity/issuer.
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.

Reporting of Misconduct

PACRA has framed and implemented whistle-blower policy encouraging all employees to intimate the compliance officer any unethical practice or misconduct relating to the credit rating by another employees of the company that came to his/her knowledge. The Compliance Officer reports to the BoD and SECP

Confidentiality

PACRA has framed a confidentiality policy to prevent; abuse of the non-public information by its employees and other persons involved in the rating process, sharing and dissemination of the non-public information by such persons to outside parties
Where feasible and appropriate, prior to issuing or revising a rating, PACRA informs the issuer of the critical information and principal considerations upon which a rating will be based and provide the opportunity to clarify any likely factual misperception or other matter that PACRA would wish to be made aware of in order to produce a fair rating. PACRA duly evaluates the response. Where in a particular circumstance PACRA has not informed the entity/issuer prior to issuing or revising a rating, it informs the entity/issuer as soon as practical thereafter;

Prohibition

Probability of Default (PD)

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 each rating notch. These studies are available at our website (www.pacra.com). However, actual transition of a particular rating may not follow the pattern observed in the past.