The Pakistan Credit Rating Agency Limited

ENGRO FERTILIZERS LIMITED (EFERT)

ENTITY & DEBT INSTRUMENT RATING

	NEW [DEC-17]	PREVIOUS [APR-17]
Entity Rating:		
Long-Term	AA-	AA-
Short-Term	A1+	A1+
Outlook	Stable	Stable
Sukuk III	AA-	AA-

DECEMBER 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 three Engro Corp's executives, one DG representatives and four independent directors.
- 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

- In CY16, EFert's topline increased by 17% to ~PKR 47bln (end-Sep16: PKR 41bln); predominately led by higher offtakes as well as exports of 211KT.
- Total domestic sales of urea were observed at 1,231 KT at end-Sep17 ; an increase of 20% (end-Sep16: 1,022KT)
- DAP sales recorded a 11.5% decrease at end-Sep17 to 234KT. This was mainly attributable to decreased price of the product.
- The gross margins of the company witnessed a growth to 31% (end-Sep 16: 26%)
- Subsidy recoverable from GoP stood at PKR 7.1bln, and classified as other income.
- Other income dropped 57% following reduction in urea cash subsidy and replacement of DAP subsidy, along with lower urea sales.
- The finance cost of the company declined by PKR 2.03bln (end-Sep16: PKR 2.386bln) due to re-profiling of long term debt, loan repayments and lower interest rates.
- The company profitability stood at PKR 6.924bln, an increase of 21% over end-Sep16 (PKR 5.745bln)

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. However, the company is increasing the compression by spending an increased amount of PKR 3bln.
- Offtakes kicked off post clarity on subsidy. However, real challenge remains offloading inventory on hand, Govt.'s decision to allow exports is yielding benefits in terms of increased offtakes.
- Reduced parity with international price shall continue to keep local price under check, herein, gas pricing plays critical role to keep margins afloat.
- Company continues to explore new avenues particularly in pestcides and agri farming sectors, these are expected to yield positive results in the long run.

Financial Risk

- The company met the working capital needs of PKR ~12bln, through internal sources
- Free cash flows from operations (FCFO) declined to PKR 13.8bln, in line with reduced profit before tax.
- Debt coverage remained steady to 1.7 times (end-Sep16: 1.8x)
- Debt level remained reduced to PKR 32bln as compared to end-Sep16 (PKR 36bln). The company has 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; the recent approval for the export of excess inventory should help towards supply-demand equilibrium in the market. 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	30-Sep-17	31-Dec-16	31-Dec-15	31-Dec-14
	9MCY17	CY16	CY15	CY14
Non-Current Assets	**73,437**	**74,740**	**72,459**	**75,175**
Investments (Incl. Associates)	**651**	**703**	**16,297**	**25,084**
Equity	560	560	4,383	-
Debt	91	143	11,914	25,084
Current Assets	**30,849**	**26,985**	**16,627**	**11,467**
Inventory	5,991	6,820	6,942	1,101
Trade Receivables	9,392	7,585	2,262	757
Others	15,466	12,580	7,423	9,609
Total Assets	**104,937**	**102,428**	**105,382**	**111,726**
Debt	**31,134**	**34,601**	**36,074**	**44,003**
Long-term (Incl. Current Maturity of Long-Term Debt)	31,134	34,601	36,074	44,003
Other Short-term Liabilities	24,784	18,827	20,164	27,898
Other Long-term Liabilities	7,420	7,718	6,617	5,347
Shareholder's Equity	**41,599**	**41,283**	**42,526**	**34,478**
Total Liabilities & Equity	**104,937**	**102,428**	**105,382**	**111,726**
INCOME STATEMENT				
Turnover	**47,732**	**69,519**	**85,003**	**61,425**
Gross Profit	14,617	17,111	29,568	22,603
Other Income	3,394	6,991	2,506	1,131
Financial Charges	(1,978)	(3,136)	(4,588)	(6,625)
Net Income	**6,696**	**9,025**	**15,028**	**8,208**
Cashflow Statement				
Free Cashflow from Operations (FCFO)	13,811	17,995	26,174	19,493
Net Cash changes in Working Capital	(1,044)	(13,839)	(17,142)	6,661
Net Cash from Operating Activities	10,574	775	4,642	19,063
Net Cash from InvestingActivities	(2,263)	(2,422)	8,165	(5,641)
Net Cash from Financing Activities	(7,537)	(10,748)	(16,384)	(13,692)
Net Cash generated during the period	775	(12,394)	(3,577)	(270)
Ratio Analysis				
Performance				
Turnover Growth	278.7%	-18.2%	430.1%	291.1%
Gross Margin	30.6%	24.6%	34.8%	36.8%
Net Margin	14.0%	13.0%	17.7%	13.4%
Coverages				
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB)	1.7	2.2	1.8	1.5
Interest Coverage (x) (FCFO/Gross Interest)	6.9	5.7	6.0	3.2
Debt Payback (Years) (Total Lt.Debt (excluding Covered Short Term Borrowings) / FCFO)	2.0	2.3	1.6	3.0
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	12.4	9.1	-21.3	-25.2
Capital Structure (Total Debt/Total Debt+Equity)	43.6%	46.7%	45.9%	56.1%

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.