RATING REPORT

Ittehad Chemicals Limited (ICL)

REPORT DATE:
August 26, 2019

RATING ANALYSTS:
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RATING DETAILS				
	Latest Rating		Previous Rating	
Rating Category	Long-term	Short-term	Long-term	Short-term
Entity	A-	A-2	A-	A-2
Rating Date	*August 26, 2019*		*Jan 25, 2018*	
Rating Outlook	Positive		Stable	

COMPANY INFORMATION	
Incorporated in 1991	**External Auditors:** M/s BDO Ebrahim & Co. Chartered Accountants
Public Limited Company	**Chairman of the Board:** Mr. Mohammad Siddique Khatri
Key Shareholders:	**Chief Executive Officer:** Mr. Abdul Sattar Khatri
Sponsoring Family – 27.7% Chemtix Industries Ltd. – 5.5%	

APPLICABLE METHODOLOGY
VIS Entity Rating Criteria: Corporates (May 2019) ***https://www.vis.com.pk/kc-meth.aspx***

OVERVIEW OF THE INSTITUTION

Ittehad Chemicals Limited (ICL) was incorporated as a public limited company in 1991 under the Companies Ordinance, 1984 (now Companies Act, 2017). Privatization of the company took place in 1995. The company is listed on Pakistan Stock Exchange. ICL is engaged in the business of manufacturing and selling caustic soda and other allied chemicals.

Profile of Chairman

Mr. Mohammaed Siddique Khatri has about 30 years of experience in the field of Chemical, Textile Industries, Finance and Corporate Affairs of international and local companies. He is also working as Partner of M/s Ittehad Developers.

Profile of CEO

Mr. Abdul Sattar Khatri has more than 22 years of experience across Chemical Manufacturing, Business Development and Textile Processing Industries. He is also present onthe Boards of Ittehad Developers and Chemi Dyestuffs Industries (Pvt.) Limited.

Core Equity: end-9MFY19: Rs. 3.0b; end-FY18: Rs. 2.7b; end-FY17: Rs. 2.4b

Assets: end-9MFY19: Rs. 8.8b; end-FY18: Rs. 7.7; end-FY17: Rs. 6.6b

Profit After Tax: 9MFY19: Rs. 316m; FY18: Rs. 415m; FY17: Rs. 233m

RATING RATIONALE

The ratings assigned to Ittehad Chemicals Limited (ICL) take into account its prominent and stable position in chlor-alkali sector. The ratings derive strength from positive impetus in profitability supported by volumetric growth in sales along with improvement in gross margins. The ratings draw comfort from adequate coverages and comfortable gearing levels. Further, improvement in production related operational efficiencies and diversification in revenue stream to curtail the impact of increased power and finance cost are conducive to the assigned ratings.

Business and industry risk factors: The chlor-alkali sector is oligopolistic in nature with three players operating in the country. Demand of caustic soda is linked to overall industrial production; there has been an overcapacity situation in the sector. Therefore, overall capacity utilization has remained moderate. The export channel has also been utilized; however, the extent of the same has remained limited on account of higher freight cost as well as storage and handling constraints associated with certain chemicals. Electricity is a major cost component in the manufacturing of caustic soda, which accounts for almost 60% of overall cost of production. Presently, the sector is being impacted by escalated power tariff and charging of higher RLNG price which is further inflated due to Pak Rupee devaluation and increase in oil prices. Nonetheless, ICL's transformation of its entire production technology to the power efficient Ion Exchange Membrane (IEM) plants has enabled it to reduce the impact of the same to a certain extent.

Improvement in production efficiencies emanating from technological modernization: To further improve operational efficiency, ICL has installed IEM Plant – III, with three Electrolizers having production capacity of 37,500 M.T per annum, has started operations in June'18. The installation of fourth Electrolizer for IEM Plant – III, having capacity of 12,500 M.T per annum, has also started operations in November'18. The total installed capacity of liquid caustic soda has increased to 157,500 tons per annum. On account of aforementioned BMR, ICL is now at par among peers in terms of being energy efficient. Production and volumetric sales of caustic soda increased on a timeline basis, keeping in view the market demand dynamics. As per management, presently, IEM-II and IEM-III plants are operational and due to newly installed electrolyzers, these can be operated at 105% capacity. Moreover, IEM-I plant can also be used on need basis.

Augmentation in sales supported by increase in margins: During FY18 net sales of the company stood higher on account of higher prices of all major products along with volumetric growth. Caustic soda has remained the major revenue driver that constituted around 73.3% (FY17: 71.6%) of the total sales mix. Export sales stood higher at Rs. 607.4m (FY17: 338.9m), which constituted sale of calcium chloride and caustic soda. Despite notable increase in power & fuel cost, gross margins have improved slightly, predominantly on back of increase in average sales price per metric ton of caustic soda. Cost of power and fuel as a percentage of total cost stood higher at 59%% (FY17: 57%) mainly due to hike in power tariff. Increase in selling and distribution charges was mainly related to higher freight expenses. Other income (FY18: Rs. 135.7m: FY17: Rs. 49.8m) majorly comprised income from sale of scrap mainly related to defunct DSA plant amounting to Rs. 109.2m (FY17: Rs. 42.2m) during the review period. Increase in sales, some improvement in gross margins, higher other income, lower financial charges and availed tax credit resulted in higher net profit of Rs. 415.5m (FY17: Rs. 233.3m) during FY18.

Annualized sales during 9MFY19 stood higher mainly on account of notable increase in average sales price of caustic soda along with slightly higher annualized volumetric sales. Gross margins improved considerably during 9MFY19 to 22.1% (FY18: 16.8%; FY17 16.4%) primarily on account of higher average prices and commencement of energy efficient operations of IEM-III plant. Revenue emanating from exports during 9MFY19 amounted to Rs. 180m which largly comprised calcium chloride sales to Gulf. Despite notable increase in financial charges, the company was able to sustain profitability during the said period. Going forward, growth in topline is projected to be majorly driven by additional revenue stream generated by LABSA/SLES project along with volumetric increase in sales of caustic soda as well as increase in sales price.

Diversification in revenue stream to retrench the impact of elevated costs related to power and financing: To capitalize into Linear Alkylbenzene Sulphonic Acid and Sodium Lauryl Sulphate market, ICL has executed BMR in LABSA/SLES plant, which will enable the company to reinforce its topline. The plant has started production in June'19. According to the management, there are only two major players producing the aforementioned product in Pakistan and rest of the demand is met through imports (market share: ICL 25%; other players: 55%; imports: 20%). ICL has secured contracts from companies like Proctor & Gamble and Unilever for its sale. As per management, operating at full capacity, LABSA/SLES project may contribute around Rs. 4b to the revenue stream, at a sales price of Rs. 180,000/MT.

In addition, the installation of Sulphate Removal System (SRS)/Sodium Sulphate Anhydrous Plant has also started operations in June'19. SRS is a cost saving project which enhances the efficiency in removing Sulphate from Brine by drastically reducing the consumption of Barium Carbonate during the process. The cost saving emanating from the same is projected to be around Rs. 200m over a period of one year. LABSA is relatively lower margin product (in the range of 15-16%), thereby overall gross margins may not reflect the full impact of operational efficiencies, going forward. The aforesaid projects are envisaged to improve profitability through revenue growth and operational efficiency.

Healthy cash flows in relation to outstanding obligations: Funds from Operations (FFO) stood higher on account of higher profitability. Despite increase in debt, FFO to total debt and FFO to long-term debt have increased slightly on account of higher FFO during FY18. Short-term borrowings have increased to meet higher working capital requirements. As per management, financial charges may double in FY20, on account of higher quantum of short-term and long term borrowings along with higher interest rates. Moreover, a large amount of company's working capital is stuck in tax refunds due from government, which have increased to Rs. 442.6m (FY18: Rs. 408.5m; FY17: Rs. 181.4m) by end-9MFY19. As per management, government has offered promissory notes for encashment of tax refunds and these promissory notes are subject to discount from bank. Debt service coverage ratio (DSCR), though decreased, have remained at comfortable level at 1.24x (FY17: 1.35x), while the same stood higher at 1.57x by end-9MFY19. FFO to total debt and FFO to long-term debt have further improved by end-9MFY19 on back of higher FFO.

Augmentation in equity on back of profit retention: Given increase in un appropriated profits, equity base has strengthened on a timeline basis. Cognizant of the fact that the company has carried out major capex, long-term financing (including current maturity) stood higher at Rs. 1.38b (FY17: Rs. 1.19b) by end-FY18, the same has further increased to Rs. 2.1b by end-9MFY19. Almost three-fourth of the long-term debt procured during 9MFY19 comprised diminishing musharika, the rates on which ranges from 6 months avg. KIBOR *plus* 1.25%-2.50% per annum. Major long-term financing facilities obtained from conventional sources are subject to markup of 3 months avg. KIBOR *plus* 1.40% -1.50%. All of these long-term obligations will be retired by end-FY23.Furthermore, to meet higher working capital requirements emanating from higher scale of operations, short-term borrowings increased to Rs. 1.2b (FY17: Rs. 890.5m) at the end-FY18; the same stood lower at Rs. 760.1m during 9MFY19. Majority of these facilities are secured against charge on present and future current and fixed assets of the company. These facilities are subject to markup of 3 month KIBOR+ 1.25% per annum. Albeit equity base has strengthened on a timeline basis, given elevated levels of short-term and long-term borrowings, gearing and leverage indicators have increased slightly to 0.97x and 1.64x (FY18: 0.93x and 1.47x; FY17: 0.86x and 1.40x), respectively, by end-9MFY19. As major capex has been carried out, the management does not plan to procure any long-term financing in the foreseeable future and also the reliance on short-term borrowings to fund working capital requirements is projected to be curtailed on back of internally generated cash, going forward.

FINANCIAL SUMMARY

(amounts in PKR millions)

BALANCE SHEET	Jun 30, 2016	Jun 30, 2017	Jun 30, 2018	Mar 31, 2019
Fixed Assets	4,235	4,531	5,708	6,498
Store, Spares and Loose Tools	520	477	402	486
Stock-in-Trade	477	392	266	339
Trade Debts	501	551	524	568
Loans and Advances	144	198	198	168
Tax Refunds due from Government	80	181	408	442
Cash & Bank Balances	126	108	94	136
Other Assets	166	157	139	162
Total Assets	6,249	6,596	7,739	8,799
Trade and Other Payables	821	1,006	1,201	1,581
Long Term Debt *(*incl. current maturity)*	1,409	1,188	1,382	2,109
Short Term Debt	949	890	1,176	760
Other Liabilities	291	295	271	409
Total Equity	2,779	3,216	3,710	3,941
Tier-1 Equity	1,985	2,421	2,737	2,968

INCOME STATEMENT	Jun 30, 2016	Jun 30, 2017	Jun 30, 2018	Mar 31, 2019
Net Sales	4,557	4,990	5,743	4,822
Gross Profit	791	820	963	1,066
Operating Profit	372	384	504	603
Profit After Tax	167	233	415	316
Funds from Operations	388	513	669	694

RATIO ANALYSIS	June 30, 2016	Jun 30, 2017	Jun 30, 2018	Mar 31, 2019
Gross Margin (%)	17.4	16.4	16.8	22.1
Net Margins	3.7	4.7	7.2	6.5
Current Ratio	0.95	0.85	0.68	0.83
Net Working Capital	(112)	(370)	(975)	(467)
FFO to Total Debt (x)	0.16	0.25	0.26	0.32*
FFO to Long Term Debt (x)	0.28	0.43	0.48	0.44*
Gearing (x)	1.19	0.86	0.93	0.97
Debt Leverage (x)	1.75	1.40	1.47	1.64
Debt Servicing Coverage Ratio (x)	1.33	1.35	1.24	1.57
ROAA (%)	2.9	3.6	5.8	5.1
ROAE (%)	9.4	10.6	16.1	14.7
(Stock in Trade+Trade Debt) to Short-Term Borrowing Ratio	1.03	1.06	0.67	1.19

**Annualized*

ISSUE/ISSUER RATING SCALE & DEFINITIONS — Appendix II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.vis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details.www.vis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES — Appendix III

Name of Rated Entity	Ittehad Chemicals Limited
Sector	Chlor-alkali (Chemical Sector Sub-set)
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Instrument Structure	N/A
Statement by the Rating Team	VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
Probability of Default	VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.
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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
26/08/2019	**A-**	**A-2**	**Positive**	**Maintained**
01/25/2018	A-	A-2	Stable	Reaffirmed
12/20/2016	A-	A-2	Stable	Reaffirmed
12/22/2015	A-	A-2	Stable	Reaffirmed
12/22/2014	A-	A-2	Stable	Reaffirmed
03/18/2013	A-	A-2	Stable	Reaffirmed