RATING REPORT

Ittehad Chemicals Limited (ICL)

REPORT DATE:
March 30, 2023

RATING ANALYSTS:
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RATING DETAILS				
Rating Category	**Latest Rating**		**Previous Rating**	
	Long-term	**Short-term**	**Long-term**	**Short-term**
Entity	A-	A-2	A-	A-2
Rating Date	*March 30, 2023*		*February 25, 2022*	
Rating Outlook	Stable		Positive	
Rating Action	Maintained		Reaffirmed	

COMPANY INFORMATION	
Incorporated in 1991	**External Auditors:** M/s BDO Ebrahim & Co. Chartered Accountants
Listed Public Limited Company	**Chairman of the Board:** Mr. Mohammad Siddique Khatri
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Abdul Sattar Khatri
Mr. Muhammad Siddique Khatri – 13.5%	

APPLICABLE METHODOLOGY
VIS Entity Rating Criteria: Corporates (August 2021) ***https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf***

RATING RATIONALE

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. Mohammad 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 on the Boards of Ittehad Developers and Chemi Dyestuffs Industries (Pvt.) Limited.

Ittehad Chemicals Limited ('ICL' or 'the Company') was incorporated on September 28, 1991, under the repealed Companies Ordinance, 1984 (now Companies Act, 2017), to take over the assets of Ittehad Chemicals (IC) and Ittehad Pesticides (IP) under a Scheme of Arrangement dated June 18, 1992. The Company was privatized on July 03, 1995. The Company is listed on Pakistan Stock Exchange (PSX) and is principally engaged in the business of manufacturing and selling caustic soda and other allied chemicals. The registered office of the Company is situated at 39, Empress Road, Lahore. The manufacturing facility of the Company is located at G.T Road Kala Shah Kaku District Sheikhupura.

ICL holds 100% shares of Ittehad Salt Processing (Private) Limited ('ISPL' or 'subsidiary company'), which was incorporated on December 3, 2019. The subsidiary company is engaged in the business of exploring, operating, and working on mines and quarries.

Sector Update

- Chemical industry constitutes just 2.55% of weight in large-scale manufacturing (LSM) as of Nov'22. Presently, Pakistan meets only ~10% of chemical needs through local production hence imports of chemicals account for ~18% of total imports, second largest after fuel imports, which is indicative of room for further growth.

- VIS classifies the business risk of the chemical segment as 'Medium to Low', characterized by 'Medium' cyclicality, 'Low' competition, 'High to Medium' capital intensity and 'Medium' energy sensitivity. Given that part of the raw materials are imported, the industry does depict sensitivity to exchange risk. Also, as a large proportion of chemical demand is imported, making the industry susceptible to dumping, albeit the Government of Pakistan has put in place protectionist duties for local industry, which are regularly reviewed.

- Demand in the chemical sector of Pakistan originates from industries such as plastics, paints, paper and leather, wherein the respective chemicals form an integral part of input costs.

- As per Pakistan Bureau of Statistics (PBS), the industry produced 405,123 MT of caustic soda in FY22 as compared to 394,122 MT in the preceding year. Going forward, given the macroeconomic conditions and weakening in textile sector, the industry is likely to face growth challenges.

Business Update – ICL:

Table 1: Production Capacity

(Quantity in Metric Tons)	*Installed Capacity*		*Actual Production*		*Capacity Utilization*	
	FY21	**FY22**	**FY21**	**FY22**	**FY21**	**FY22**
Caustic Soda Liquid	150,000	150,000	95,795	100,175	63.9%	66.8%
Caustic Sada Flakes	10,000	10,000	5,569	5,330	55.7%	53.3%
LABSA/SLES	24,000	70,000	18,899	22,165	78.7%	31.7%
Liquid Chlorine	13,200	13,200	7,943	8,911	60.2%	67.5%
Hydrochloric Acid	250,000	250,000	215,297	222,176	86.1%	88.9%
Sodium Hypochlorite	49,500	49,500	25,125	30,388	50.8%	61.4%
Zinc Sulphate	600	600	90	89	15.0%	14.8%
Sodium Sulphate (Anhydrous)	4,000	4,000	1,532	2,090	38.3%	52.3%
Calcium Chloride Prills	30,000	30,000	19,138	12,744	63.8%	42.5%
Humic Acid	120	120	22	-	18.3%	0.0%

- In May 2022, the Company increased its LABSA/SLES capacity by 46,000 M.T per annum, bringing the total capacity to 70,000 M.T per annum.

- Apart from calcium chloride prills, caustic soda flakes and humic acid, production in all other categories was recorded higher in FY22.
- Actual production of LBSA/SLES was recorded higher while capacity utilization decreased due to increase in installed capacity which came online in the month of May, 2022 i.e. only for a month during FY22.
- Due to the high RLNG cost to power 30MW captive power plant, the Company fulfilled majority (~90%) of the energy requirements through the national grid for FY22 and in Q1’FY23 it has almost entirely (~99%) relied on the national grid.

Sales Mix

Table 2:Product wise Sales Breakup

	FY21	**FY22**	**H1’FY23**
Total Sales (rs. In m)	**11,124**	**15,681**	**12,019**
- Caustic Soda Liquid	45.8%	45.2%	34.2%
- Caustic Soda Flakes	3.9%	3.8%	6.4%
- LABSA	30.4%	30.6%	35.1%
- SLES	2.6%	5.1%	5.4%
- Chlorine Liquid	2.2%	1.9%	1.0%
- Hydrochloric Acid	4.9%	4.7%	3.6%
- Sodium Hypochlorite	4.8%	4.5%	5.3%
- Zinc Sulphate	0.0%	0.0%	0.0%
- Ittehad Humate	0.0%	0.0%	0.0%
- Calcium Chloride	4.8%	3.4%	8.8%
- Other	0.5%	0.7%	0.2%

- Sales mix shows that more than 3/4th of the sales is contributed by caustic soda liquid, LABSA and SLES for the past 2½ period (FY21-H1’FY23).
- The topline growth in FY22 was largely attributable to pricing increase, a trend that has continued in the ongoing year. The growth in quantitative offtake contributed merely a fifth of the uptick in topline.
- Sales concentration as measured by top ten customers has increased over the year, reaching 40.7% in H1’FY23. (FY22: 36.2%; FY21: 33.6%)

Profitability & Cash Flow Coverage

Table 3:P&L (Extract)

Rs. In Million.	**FY21**	**FY22**	**H1’FY22**	**H1’FY23**
Sales – Net	**11,124**	**15,681**	**6,798**	**12,019**
Gross Profit	**1,886**	**2,065**	**829**	**2,200**
Gross Margin	*17.0%*	*13.2%*	*12.2%*	*18.3%*
Operating Margin	*10.0%*	*6.3%*	*5.8%*	*11.0%*
Other Expenses	(108)	(81)	(24)	(76)
Other Income	92	60	33	74
Fair Value gain on investment	113	101	-	-
EBIT	**1,093**	**993**	**403**	**1,320**
Finance Cost	(225)	(330)	(136)	(323)
PBT	**980**	**764**	**267**	**997**
PAT	**657**	**415**	**183**	**755**
Net Margin	*5.9%*	*2.6%*	*2.7%*	*6.3%*

- The Company posted strong topline growth of 41.0% during FY22, a trend which continued in H1’FY23, wherein revenues were higher by 76.8% vis-à-vis SPLY. Revenue growth in FY22 was achieved mainly on the back of pricing increase as discussed above.
- The decline in gross margin during FY22 was attributable to increase in raw material costs, triggered by PKR depreciation and higher fuel costs, which the Company was unable to pass on

to customers promptly. Nevertheless, during H1'FY23, gross margin posted notable improvement as average prices were adjusted to account for the increase in input costs.

- The Company's net margin contracted during FY22, mainly on account of lower gross margin and higher taxation charge, given super tax imposition in FY22 that translated in effective tax rate of 45.7% (FY21: 33.0%).
- For FY23, ICL's topline and bottom line is projected at Rs. ~20b and Rs. 1b respectively.
- Going forward, amidst sensitivity to increasing energy costs, coupled with withdrawal of relief package, prices of coal, exchange rate, interest rate increase and import restrictions, maintaining gross margins is likely to be a challenging task.

Table 4:Cash Flow Coverage Indictors

Rs. In Million.	**FY21**	**FY22**	**H1'FY23**
FFO	1,264	1,011	894
FFO to Total Debt (x)	0.43	0.27	0.51*
FFO to Long term Debt (x)	0.70	0.52	0.92*
DSCR (x)	4.33	1.58	1.95*
Current Ratio (x)	1.04	0.99	1.08
Trade debts & Stock in Trade to ST Debt	1.97	2.21	2.79

** Annualized*

- Funds from Operations (FFO) decreased in FY22, due to lower profitability. As a result, the Company's cash flow coverage indicators came under stress, with both the cash flow coverage of debt and the debt service coverage ratio (DSCR) contracting during the period.
- Current ratio decreased slightly while the coverage of short-term borrowings via trade debts and stock in trade improved as of Jun'22.
- On an annualized basis, cash flow coverage indicators depicted improvement in H1'FY23, given improved margins and stronger topline growth. DSCR is projected to remain at comfortable level as financing is limited to running finance lines, while there are no plans to raise additional long term debt during the rating horizon.
- We have noted an uptick in inventory levels, which used to constitute 10.6% of asset base as of Jun'21, to 16.9% and 15.9% as of Jun'22 and Dec'22 respectively. Given the uptick in inventory holdings, the days inventory outstanding has increased as of Jun'22, as illustrated in the table below. Nevertheless cash conversion cycle of the Company stands on the lower side.

Table 5: Cash Conversion Cycle

	FY21	**FY22**	**H1'FY23**
Cash Conversion Cycle	***7***	***10***	***4***
Days Inventory Outstanding	*36*	*44*	*41*
Days Receivable Outstanding	*32*	*34*	*30*
Days Payable Outstanding	*61*	*69*	*67*

Financial Risk Profile

Table 6: Balance Sheet (Extract)

Rs. M.	**Jun'21**	**Jun'22**	**Dec'22**
Total Asset	**10,310**	**12,865**	**14,057**
Equity	**3,482**	**3,789**	**4,444**
Total Liabilities	**5,435**	**7,684**	**8,221**
Total Debt	**2,963**	**3,745**	**3,537**
- *LT Financing*	1,802	1,954	*1,952*
- *ST Financing*	1,161	1,791	*1,585*
Gearing (x)	***0.85***	***0.99***	***0.80***
Leverage (x)	***1.56***	***2.03***	***1.85***

- Equity base of the Company has improved on account of internal capital generation, growing at a CAGR of 44.2% during the 1½ year period (Jun'21-Dec'22).

- During the year FY22, the Company has reduced dividend payout from 30% in FY21 to 24% in FY22, in view of the prevailing liquidity challenges, which may arise from increasing input and financial costs.
- Effective cost of debt (Calculated on two-point average) has increased to 17.7% for H1'FY22 (FY22: 9.9%). The cost of debt remains relatively on the lower side, mainly as part (~12%) of the debt comprises financings under SBP's concessionary financing schemes.
- Financial risk profile is expected to remain moderate, with gearing and leverage expected to remain below 1x and 2x respectively, through the rating horizon.

Key Rating Driver:

Ratings take into account ICL's market position and longstanding track record of sponsors

The ratings assigned to Ittehad Chemicals Limited (ICL) take into account its eminent position in the Chlor-alkali sector with sizable market share of ~30% and ample experience of sponsors in the industry.

Ratings take into account business risk of the sector and ICL's performance

VIS classifies the business risk of the chemical segment as 'Medium to Low', characterized by 'Medium' cyclicality, 'Low' competition, 'High to Medium' capital intensity and 'Medium' energy sensitivity. Given that part of the raw materials are imported, the industry does depict sensitivity to exchange risk. Also, as a large proportion of chemical demand is imported, making the industry susceptible to dumping, albeit the Government of Pakistan has put in place protectionist duties for local industry, which are regularly reviewed.

The ratings are underpinned by ICL's topline growth and profitability performance. Growth in topline is primarily backed by higher pricing of caustic soda and LABSA in tandem with overall industrial growth in the country, albeit about a fifth of the growth emanated from increase in quantitative offtake. Diversification in LABSA has provided impetus to the topline over the years and accounted for nearly one-third of the sales mix. Profit margins have improved notably in the ongoing year, as higher cost was passed on to the consumers.

Ratings take into account moderate financial risk profile of ICL

Ratings also derive comfort from adequate liquidity and comfortable leverage indicators. The capacity enhancement in LABSA, came online in FY22. However, the Company is still in the process of upgrading captive gas fired engines, which has been delayed on account of import restrictions. Given higher fuel costs, the Company has switched from using captive power plants to the national grid for now. The rising electricity cost and escalation in RLNG remain key challenges for the industry. The ratings remain sensitive to sustainability of margins along with keeping leverage indicators at comfortable level.

Ratings incorporate ICL's status as a listed entity

The assigned ratings incorporate status of ICL as a listed entity, which requires ICL to comply with more stringent Corporate Governance guidelines.

BALANCE SHEET		Jun'21	Jun'22	Dec'22
Property, Plant and Equipment		6,140	6,694	6,724
Investment Property		308	409	409
Store, Spares and Loose Tools		443	496	553
Stock-in-Trade		1,121	2,169	2,239
Trade Debts		1,168	1,787	2,187
Loans and Advances		105	279	112
Tax Refunds due from Government		529	529	845
Cash & Bank Balances		339	195	736
Other Assets		157	307	252
Total Assets		10,310	12,865	14,057
Trade and Other Payables		1,903	3,232	3,996
Long Term Debt (including current marturity)		1,802	1,954	1,952
Short Term Debt		1,161	1,791	1,585
Total Debt		2,963	3,745	3,537
Other Liabilities		569	707	688
Total Liabilities		5,435	7,684	8,221
Paid Up Capital		847	1,000	1,000
Total Equity		4,874	5,181	5,836
Tier-1 Equity		3,482	3,789	4,444
INCOME STATEMENT	FY21	FY22	H1'FY22	H1'FY23
Net Sales	11,124	15,681	6,798	12,019
Gross Profit	1,886	2,065	829	2,200
Operating Profit	1,093	992	403	1,321
Profit Before Tax	980	764	267	997
Profit After Tax	657	415	183	755
RATIO ANALYSIS		Jun'21	Jun'22	Dec'22
Gross Margin (%)		17.0%	13.2%	18.3%
Net Margins (%)		5.9%	2.6%	6.3%
Current Ratio (x)		1.04	0.99	1.08
Net Working Capital		166	(68)	518
Funds from Operations (FFO)		1,264	1,011	894
FFO to Total Debt (x)		0.43	0.27	0.51*
FFO to Long Term Debt (x)		0.70	0.53	0.92*
Gearing (x)		0.85	0.98	0.80
Debt Leverage (x)		1.56	2.03	1.85
Debt Servicing Coverage Ratio (x)		4.33	1.58	1.95*
ROAA (%)		6.7%	3.5%	11.2%*
ROAE (%)		20.0%	11.4%	36.7%*
(Stock in Trade+ Trade Debt) to Short- term Borrowing Ratio		1.97	2.21	2.79

**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 Ratings
Rating History	see table below

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
03/30/2023	A-	A-2	Stable	Maintained
02/25/2022	A-	A-2	Positive	Reaffirmed
11/19/2020	A-	A-2	Positive	Reaffirmed
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

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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Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Muhammad Asif Khan	Chief Financial Officer	February 03, 2023
Mr. Shahbaz Ali	Unit Manager Budget	