RATING REPORT

Fatima Fertilizer Company Limited

REPORT DATE:
December 22, 2017

RATING ANALYSTS:
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RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	AA-	A-1	AA-	A-1
Rating Date	*December 22, 2017*		*December 21, 2016*	
Rating Outlook	*Stable*		*Stable*	
Outlook Date	*December 22, 2017*		*December 21, 2016*	

COMPANY INFORMATION

Incorporated in 2003	**External auditors:** Deloitte Yousuf Adil Saleem & Co. Chartered Accountants
Public Limited Company	**Chairman of the Board:** Mr. Arif Habib
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Fawad Ahmed Mukhtar
Arif Habib Corporation Limited – 15.2%	
Fatima Holding Limited – 12.9%	
Reliance Commodities (Private) Limited – 10.0%	
Mr. Arif Habib – 7.6%	
Mr. Faisal Ahmed Mukhtar – 6.3%	

APPLICABLE METHODOLOGY(IES)

JCR-VIS Entity Rating Criteria *Industrial Corporates (May 2016)*
http://www.jcrvis.com.pk/docs/Corporate-Methodology-201605.pdf

Fatima Fertilizer Company Limited (FATIMA)

OVERVIEW OF THE INSTITUTION

FATIMA was incorporated in 2003 as a public limited company under Companies Ordinance, 1984. Primary activities of the company include manufacturing & selling of fertilizers and chemicals. It has a manufacturing facility in Sadiqabad operating with a production capacity of 500,000 MT for Urea, 420,000 MT for CAN and 360,000 MT for NP.

Profile of Chairman

Mr. Arif Habib is a veteran businessman and is CEO of Arif Habib Corporation Limited, director of Pakarab Energy Limited and Chairman of PFL, Aisha Steel Mills Limited and Javedan Corporation Limited.

Profile of CEO

Mr. Fawad Ahmed Mukhtar carries over 30 years of experience in manufacturing and industrial management sector. He is the chairman of Reliance Weaving Mills Limited, Fatima Energy Limited, Reliance Commodities (Private) Limited, Fatima Sugar Mills Limited, Fatima Holding Limited, Air One (Private) Limited and is also CEO of PFL.

RATING RATIONALE

Corporate Profile

In 2003, Fatima Fertilizer Company Limited (FATIMA) was formed as a joint venture between Fatima Group (FG) and Arif Habib Group (AHG). FG is a large business conglomerate engaged in various businesses including fertilizer, textile, energy, sugar, real estate and trading. Apart from FATIMA, group companies of FG include Pakarab Fertilizers Limited (PFL), Fatimafert Limited (Fatimafert), Reliance Weaving Mills Limited, Reliance Commodities (Private) Limited (RCPL), Fatima Sugar Mills Limited, Fatima Energy Limited, Reliance Sacks Limited and Fatima Holding Limited.

Shareholding remained largely unchanged and is mainly vested among FG and AHG through group companies and individuals. There was a single change in Board of Directors composition since last review. Ms. Anja Elisabeth Nielsen was appointed as independent director in place of Mr. Peter Vang Christensen during July 2017.

During 9M2017, Urea remained the lead revenue contributor (36%), followed by Nitrogen Phosphate (NP) (33%) and Calcium Ammonium Nitrate (CAN) (30%). The company also generates revenues from mid-products; however the contribution is minimal at around 1%.

Merger with Fatimafert

The Board has considered and approved merger of FATIMA and its wholly owned subsidiary, Fatimafert from January 01, 2018 in principle. As per management, the merger is expected to add value to consolidated results of the company from the benefits of synergies, cost efficiencies and better use of brands. The proposed merger would be subject to receipt of all requisite corporate & regulatory authorizations, consents and approvals.

Transactions with Related Parties

Short-term loans extended to associate companies amounted to Rs. 2.4b (2015: Rs. 0.5b) at end-2016. This includes loan extended to RCPL of Rs. 1.2b (2015: Rs. 0.5b) and Fatimafert of Rs. 1.3b (2015: nil). FATIMA has also provided long-term loan of Rs. 3.0b (2016: Rs. 3.0b; 2015: Rs. 2.2b) to PFL as at end-9M2017. The company also holds long term investments in wholly owned subsidiaries (at cost); these include exposure in Fatimafert (2016: Rs. 2.2b; 2015: 2.0b).

Business Risk

After a challenging 2016, industry dynamics of urea fertilizer manufacturers have witnessed noticeable improvement due to higher off-take (including exports) and lower production. Resultantly, inventory levels have declined and pricing power has strengthened. JCR-VIS expects prices to increase towards the government set threshold on account of higher demand due to ongoing Rabi season and as inventory returns to normal levels. Moreover, risk of urea imports is considered low given the adequate stock levels.

Urea

- Urea off-take has increased by 12% during 11M2017.
- Exports of 558,912tons of urea against allocated quota of 600,000tons has also facilitated in reducing inventory levels.
- Overall industry urea inventory levels are projected to decline from 1.04m tons at year-end'2016 to slightly below 0.3mtons at year-end'2017 (Sep'2017: 0.73mtons; June'2017: 1m tons; Sep'2016: 1.56mtons) on account of higher urea off-take vis-a-

vis preceding year, lower production and high utilization of export quota. Increase in international urea prices has facilitated players in offloading urea inventory at competitive prices. Recently, international urea prices have witnessed a decline; however, impact on domestic players' profitability of volatility in urea prices is expected to remain limited given that prices are fixed by the government.

Di-ammonium Phosphate

- During 8M2017, Di-ammonium Phosphate (DAP) offtake recorded 16% year-on-year growth.
- Higher seasonal demand along with limited supply has resulted in a significant jump in international prices. Locally, gross margins are projected to witness a significant jump during 4Q17 which is likely to bode well for profitability of Fauji Fertilizer Bin Qasim Limited (FFBL) (only DAP manufacturer) and FATIMA (NP prices linked to DAP rates). Given the significant international capacities coming online in 2H2018, risk of decline in international prices of phosphate based fertilizers remains.

Sales & Profitability

Ratings are supported by diversified product mix of the company. In tandem with management's diversification strategy, sales mix has tilted towards NP and CAN, underpinned by higher volumes during 2016. In 9M2017, topline was further supported by notable growth in CAN and urea offtake, although NP volumes decreased slightly. However, uptick in overall fertilizer sales is expected in 4Q2017 on account of which broad based growth in sales is expected during 2017 as compared to 2016.

Despite some pressure on margins due to increased price competition in nitrogenous fertilizers, FATIMA's bottom line has improved on the back of healthy volumetric growth. Effective tax rate was lower due to tax exemption on subsidy from government. Availability of 110mmcfd[1] feedstock gas supply to FATIMA at concessionary rate of US$ 0.7/mmbtu (concessionary gas available till 3Q2021) has enabled it to maintain better margins in relation to most peers.

Going forward continued focus on enhancing sales is envisaged by management. This, along with normalization of margins is expected to support earnings over the coming years. Moreover, increase in international DAP prices can result in higher profits from phosphate (NP) business.

Capitalization & Liquidity

Despite challenging industry outlook, the company has maintained a conservative financial profile. Loans extended to associates represented 2.7% of asset base at end-2016. Funds from Operations (FFO) have improved on account of better profitability. In line with industry-wide trend, trade debts have increased since 2015; these have been funded through short term borrowings. With growth in total equity and decrease in total borrowings, leverage indicators have declined on a timeline basis. Despite the challenging sector dynamics, financial metrics including cash flows in relation to total debt have largely remained within benchmark limits for the assigned ratings. Impact on financial profile of FATIMA post-merger with Fatimafert with respect to cash flows will continue to be tracked by JCR-VIS.

Operations

In April 2016, FATIMA completed Phase-2 of the Ammonia de-bottlenecking project aimed at improving production efficiencies. Resultantly, production levels increased by

[1] million Cubic Feet per Day

around 30% (annualized) during 2017 and plant turnaround time has improved considerably. FATIMA also undertook an integrated marketing campaign to promote combined usage of NP and CAN instead of conventional fertilizers while also continuing its farmer outreach programs. The company continues its strong focus on educating farmers on yield enhancement methods which will aid in improving their income.

Investment in Midwest Fertilizer Company

FATIMA plans to invest US$ 300m in a US-based fertilizer company, Midwest Fertilizer Company (MFC). To finance the investment, FATIMA plans to issue a foreign currency bond in the international debt market. Subsequent to transaction completion, gearing levels of the company are expected to increase. As a key rating consideration, future trend with respect to leverage indicators will continue to be tracked by JCR-VIS.

Fatima Fertilizer Company Limited (FATIMA) Appendix II

FINANCIAL SUMMARY			*(amounts in PKR millions)*
BALANCE SHEET	**SEP 30, 2017**	**DEC 31, 2016**	**DEC 31, 2015**
Property & Equipment	73,024.8	72,941.7	73,409.1
Investments	5,437.8	5,437.9	4,306.5
Stock-in-Trade	4,578.8	6,242.6	7,002.7
Trade Debts	4,631.1	2,115.6	335.0
Cash & Bank Balances	515.5	11,099.9	295.2
Total Assets	102,261.1	110,597.5	94,789.2
Trade & Other Payables	9,269.0	17,399.0	8,646.0
Long Term Debt *(*incl. current maturity)*	19,002.2	21,860.8	19,980.2
Short Term Debt	7,665.5	8,011.3	10,229.5
Total Equity	49,848.5	47,374.0	40,228.5
INCOME STATEMENT	**SEP 30, 2017***	**DEC 31, 2016**	**DEC 31, 2015**
Net Sales	26,078.4	33,764.6	30,226.0
Gross Profit	13,549.4	17,984.9	17,017.0
Distribution Expenses	2,398.1	2,382.5	1,782.2
Administrative Expenses	1,153.7	1,308.3	1,021.0
Finance Cost	1,607.6	2,739.4	2,379.2
Profit After Tax	6,674.5	9,782.2	9,253.5
RATIO ANALYSIS	**SEP 30, 2017**	**DEC 31, 2016**	**DEC 31, 2015**
Gross Margin (%)	52.0%	53.3%	56.3%
Net Working Capital	815.8	1,082.8	(8,918.9)
FFO to Total Debt (x)	0.44	0.43	0.39
FFO to Long Term Debt (x)	0.62	0.58	0.58
Debt Servicing Coverage Ratio (x)	1.49	1.62	1.59
ROAA (%)	8.4%	9.5%	10.4%
ROAE (%)	18.3%	22.3%	24.0%
*not annualized			

ISSUE/ISSUER RATING SCALE & DEFINITIONS — Appendix III

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: JCR-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.jcrvis.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.jcrvis.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.

'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.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-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 IV
Name of Rated Entity	Fatima Fertilizer Company Limited				
Sector	Fertilizer				
Type of Relationship	Solicited				
Purpose of Rating	Entity Rating				
Rating History	**Rating Date**	**Medium to Long Term**	**Short Term**	**Rating Outlook**	**Rating Action**
			RATING TYPE: ENTITY		
	12/22/2017	AA-	A-1	Stable	Reaffirmed
	12/21/2016	AA-	A-1	Stable	Reaffirmed
	1/7/2016	AA-	A-1	Stable	Reaffirmed
	4/16/2014	AA-	A-1	Stable	Initial
Instrument Structure	N/A				
Statement by the Rating Team	JCR-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	JCR-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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