RATING REPORT

Fatima Fertilizer Company Limited (FATIMA)

REPORT DATE:
August 30, 2019

RATING ANALYSTS:
Syed Fahim Haider Shah
fahim.haider@vis.com.pk

Maimoon Rasheed
maimoon@vis.com.pk

RATING DETAILS

	Latest Rating		Previous Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	AA-	A-1	AA-	A-1
Rating Outlook	*Stable*		*Stable*	
Rating Date	*August 26, '19*		*December 22, '17*	
Rating Action	*Reaffirmed*		*Reaffirmed*	

COMPANY INFORMATION

Incorporated in 2003	**External auditors:** Deloitte Yousuf Adil Saleem & Co. Chartered Accountants
Public Limited Company	**Chairman of the Board:** Mr. Arif Habib **Chief Executive Officer:** Mr. Fawad Ahmed Mukhtar
Key Shareholders (with stake 5% or more):	
Arif Habib Corporation Limited – 15.2%	
Fatima Holding Limited – 22.9%	
Mr. Arif Habib – 7.1%	
Mr. Faisal Ahmed Mukhtar – 6.3%	

APPLICABLE METHODOLOGY

VIS Entity Rating Criteria *Industrial Corporate (May 2019)*
http://www.vis.com.pk/kc-meth.aspx

Fatima Fertilizer Company Limited (FATIMA)

OVERVIEW OF THE INSTITUTION

Fatima Fertilizer Company Limited (FATIMA) was established in 2003 as a public limited company. The company is involved in manufacturing and sale of fertilizers. The plant is located in Sadiqabad, having production capacities of 500,000 M.T. Urea, 420,000 M.T. CAN, and 360,000 M.T. NP.

Profile of Chairman
Mr. Arif Habib is the chairman with a diversified experience. He is the CEO of Arif Habib Corporation Limited. He is the chairman of Pakarab Fertilizers Limited (Pakarab), Aisha Steel Mills Limited, Javedan Corporation Limited and director of Pakarab Energy Limited.

Profile of CEO
Mr. Fawad Ahmed Mukhtar is the CEO and director of the company. He has broad experience in manufacturing and industrial management. He is also the chairman of Reliance Weaving Mills Limited, Fatima Energy Limited, Reliance Commodities Private Limited, Fatima Sugar Mills Limited and CEO of Pakarab Fertilizers Limited and Fatima Cement Limited as well.

Financial Snapshot
Total Equity: end-1QFY19: Rs. 65.9b; end-FY18: Rs. 62.3b; end-FY17: Rs. 53.7b

Assets: end-1QFY19: Rs. 114.0b; end-FY18: Rs. 110.0b; end-FY17: Rs. 99.3b

Profit After Tax: end-1QFY19: Rs. 3.6b; end-FY18: Rs. 13.3b; end-FY17: Rs. 10.6b

RATING RATIONALE

Fatima Fertilizer Company Limited (FATIMA) is one of the key players in the fertilizer industry of Pakistan. The assigned ratings take into account strong sponsorship profile as majority of the shareholding of the company is held by Fatima Group (FG) and Arif Habib Group (AHG) through their group companies and individual representatives. The business risk profile of FATIMA is also underpinned by well-diversified product portfolio. The company is involved in manufacturing and supply of Urea, Nitrogen Phosphate (NP), and Calcium Ammonium Nitrate (CAN) fertilizers through a dealer network of 4,863 retailers in 61 districts of Pakistan. The ratings also factor in positive earnings trajectory, improving cash flows generation, and decline in leverage indicators on a timeline basis. The ratings draw comfort from access to concessionary gas, which provides a cushion against the increasing gas prices.

Ratings Rationale

Production Update
With overall capacity utilization of 110% (FY17: 101%; FY16: 108%), the company produced 502.3k tons of Urea (FY17: 474.8k tons), followed by 475.0k tons of CAN (FY17: 444.8k tons) and 429.3k tons of NP (FY17: 372.9k tons) in FY18. Higher production was due to upgradation and debottlenecking of production plant. Urea off-take increased to 555.1k tons during FY18 (FY17: 525.6k tons), however, CAN and NP off-take decreased to 499.6k tons (FY17: 538.5k tons) and 377.7k tons (FY17: 413.0k tons), respectively. The company commenced turnaround activity in March'19, and hence, overall production volumes remained 13% lower during 1QFY19. Likewise, overall volumes remained 12% lower due to absence of exports, with largest decrease recorded in NP off-take.

The total market size of CAN and NP stands at 609k tons and 391k tons, of which FATIMA holds 82% and 97% market share, respectively. As per the management, the amalgamation of Fatimafert into FATIMA and acquisition of major plants of Pakarab is under regulatory approval and is expected to be completed by end-FY19. After the proposed asset deal, the overall nameplate capacity of FATIMA will increase to 2.57m tons per annum. The availability of concessionary feed gas has benefited FATIMA, leading to highest margins amongst its peers. The margins are expected to shrink after the expiry of concessionary price agreement in 2021, though may still remain on the higher side owing to presence of relatively high margins products in the portfolio. The financial close of Midwest Fertilizer Company (MFC) is expected in 2Q FY20, with a total estimated project cost of around US$ 2.4b. As per the management, FATIMA shall be subscribing up to 35% of total equity.

Asset Mix
Asset base of the company augmented to Rs. 114.0b by end-1QFY19 (FY18: Rs. 110.0b; FY17: Rs. 99.3b) on account of capex and increase in current assets. Property, plant & equipment amounted to Rs. 79.4b (FY18: Rs. 78.3b; FY17: Rs. 73.0b) with the increase in capital work in process to Rs. 8.0b (FY18: Rs. 6.7b; FY17: Rs. 2.8b) related to upgradation and debottlenecking project. Long-term investment in and long-term loan to associated companies remained unchanged at Rs. 2.2b (FY18: Rs. 2.2b; FY17: Rs. 2.2b) and 2.0b (FY18: Rs. 2.0b; FY17: Rs. 3.0b), respectively. Long-term loan is provided to Pakarab that carries a markup of 6-month KIBOR plus 2.12% per annum. Fixed assets represented 74% of overall asset mix at end-1QFY19 (FY18: 75%; FY17: 79%).

Stock in trade stood at Rs. 5.1b (FY18: Rs. 5.0b; FY17: Rs. 3.8b) with higher NP inventory and lower Urea and CAN inventory. Meanwhile, stores and spares increased to Rs. 5.9b (FY18: Rs. 5.1b; FY17: Rs. 4.7b) owing to turnaround activity during the period. Given the nature of business model of the company, trade debts remained lower at Rs. 2.0b (FY18: Rs. 2.4b; FY17: Rs. 1.8b). Short-term loans to associated companies, including Fatimafert Limited, Reliance Commodities (Pvt.) Limited, and Pakarab, increased on a timeline basis to Rs. 7.2b (FY18: Rs. 6.1b; FY17: Rs. 4.0b), carrying a markup of 6-month KIBOR plus 2.12% per annum. Advances, deposits, prepayments and other receivables stood higher at Rs. 8.6b at end-1QFY19 (FY18: Rs. 7.4b; FY17: Rs. 5.6b) mainly on account of increase in receivable from government against advance sales tax. Short-term investments in financial instruments through profit & loss and available-for-sale increased to Rs. 727m (FY18: Rs. 623m; FY17: Rs. 198m) while cash & bank balance decreased slightly to Rs. 515m (FY18: Rs. 538m; FY17: Rs. 810m).

Sales growth emanated from favorable prices despite lower fertilizer off-take

Net sales of the company increased to 46.0b during FY18 (FY17: Rs. 37.6b; FY16: Rs. 33.8b) as the impact of a slight decline in fertilizer off-take was offset by higher selling prices. The share of NP in overall sales mix improved to 38.5% (FY17: 36.6%) despite lower volume sales of 377.7k tons (FY17: 413.0k tons), followed by Urea 34.8% (FY17: 34.8% with volume sales of 555.1k tons (FY17: 525.6k tons), and CAN 25.8% (FY17: 27.5%) with volume sales of 499.6k tons (FY17: 538.5k tons). Cost of sales amounted to Rs. 19.5b (FY17: Rs. 17.3b; FY16: Rs. 15.8b) with largest increase witnessed in feed and fuel stock cost, chemicals & catalysts, repair & maintenance, and depreciation expenses. Gross profit improved to Rs. 26.5b (FY17: Rs. 20.3b; FY16: Rs. 18.0b) as the margin strengthened to 57.6% (FY17: 54.1%; FY16: 53.3%) owing to higher fertilizer prices and continued availability of concessionary gas.

Despite lower dispatches, overall distribution expenses increased slightly to Rs. 3.6b during FY18 (FY17: Rs. 3.5b; FY17: Rs. 2.4b) partially due to increase in fee marketing and distribution services fee paid to Fatima Agri Sales & Services (Pvt.) Limited (FASSL). The principal activity of FASSL is to carry on business as sellers, marketers, importers, exporters, wholesalers, retailers, and dealers in all type of agri-inputs. Administrative expenses increased to Rs. 2.1b (FY17: Rs. 1.5b; FY16: Rs. 1.3b) mainly on account of higher staff salaries, wages & other benefits as well as increase in depreciation and charity & donation expenses. Other operating expenses stood at Rs. 1.7b (FY17: Rs. 913m; FY16: Rs. 631m) with the increase in workers' profit participation fund and exchange loss of Rs. 389m mainly due to revaluation of ECA facility at a higher exchange rate. (FY17: Rs. 94m). Other income amounted to Rs. 915m (FY17: Rs. 527m; FY16: Rs. 703m) as profit on loan to related parties increased to Rs. 822m (FY17: Rs. 495m). Finance cost decreased to Rs. 1.5b (FY17: Rs. 2.2b; FY16: Rs. 2.7b) on account of lower average utilization of debt financing. Accounting for taxation, the company reported net profit of Rs. 13.3b during FY18 (FY17: Rs. 10.6b; FY16: Rs. 9.8b) with healthy net margin of 28.9% (FY17: 28.1%; FY16: 29.0%).

Growth in net sales during 1QFY19 mainly emanated from higher selling prices despite decrease in volumetric sales due to absence of export sales and commencement of turnaround activity. The company registered some improvement in Urea off-take during 1QFY19 while CAN and NP off-take remained under pressure. With higher sales, improved gross margin, and increase in other income, the company recorded net profit of Rs. 3.64b (1QFY18: Rs. 2.89b) during 1QFY19.

Liquidity position supported by augmented cash flows

Liquidity position of the company is underpinned by healthy cash flow generation. In line with the higher profits, funds from operations (FFO) increased to Rs. 17.6b during FY18 (FY17: Rs. 12.3b; FY16: Rs. 12.8b). Resultantly, FFO to total debt and debt service coverage ratios improved to 1.0x (FY17: 0.7x; FY16: 0.4x) and 2.6x (FY17: 1.9x; FY16: 0.8x), respectively. Current ratio remained largely unchanged at 1.1x (FY17: 1.1x; FY16: 1.0x) while net working capital increased to Rs. 2.2b (FY17: Rs. 2.0b; FY16: Rs. 1.1b). Trade debt as a percentage of sales remained unchanged 5% (FY17: 5%; FY16: 6%) due to the company's conservative credit policy that is in line with industry practice. This strategy not only helps mitigate the bad debts risk but also supports the liquidity profile. The company mostly meets its working capital requirements with a mix of internally generated capital and short-term borrowings as depicted by inventory plus receivables to short-term borrowings ratio of 1.5x (FY17: 3.3x; FY16: 1.0x).

Deleveraging Balance Sheet

Equity base of the company augmented to Rs. 65.9b by end-1QFY19 (FY18: 62.3b; FY17: Rs. 53.7b) with the continued retention of profits, whereas total liabilities increased slightly to Rs. 48.1b (FY18: Rs. 47.7b; FY17: Rs. 45.6b) mainly due to higher trade and other payables and deferred liabilities. Total borrowings decreased to Rs. 16.6b at end-1QFY19 (FY18: Rs. 17.9b; FY17: Rs. 18.2b) on account of scheduled repayment of long-term borrowings and lower utilization of short-term borrowings. Resultantly, gearing and debt leverage indicators improved to 0.25x (FY18: 0.29x; FY17: 0.34x) and 0.73x (FY18: 0.77x; FY17: 0.85x), respectively, by end-1QFY19.

Fatima Fertilizer Company Limited (FATIMA) Annexure I

Financial Statement (*Amount in Million)*

BALANCE SHEET	FY16	FY17	FY18	1QFY19
Property, Plant & Equipment	72,941	72,990	78,262	79,405
Long-term Investments	2,238	2,238	2,240	2,240
Long-term Loan to Associated Company	2,999	2,999	1,999	1,999
Stock in Trade	6,243	3,814	5,028	5,081
Trade Debts	2,116	1,796	2,397	1,954
Short-term Loan to Associated Company	2,449	3,967	6,073	7,184
Cash & Bank Balances	11,100	810	538	515
Other Assets	10,511	10,722	13,413	15,572
Total Assets	**110,597**	**99,336**	**109,951**	**113,950**
Trade and Other Payables	17,399	11,435	13,688	14,806
Short Term Borrowings	8,011	1,726	4,822	3,736
Long-Term Borrowings *(Inc. current matur)*	21,861	16,426	13,030	12,900
Deferred Liabilities	15,642	15,764	15,807	15,909
Other Liabilities	310	244	342	699
Total Liabilities	63,223	45,595	47,690	48,050
Tier-1 & Total Equity	47,374	53,742	62,261	65,900
INCOME STATEMENT	FY16	FY17	FY18	1QFY19
Net Sales	33,765	37,612	45,964	13,347
Gross Profit	17,985	20,337	26,481	7,887
Operating Profit	14,366	14,935	19,961	5,772
Profit After Tax	9,782	10,576	13,272	3,638
FFO	12,802	12,346	17,620	5,256
RATIO ANALYSIS	FY16	FY17	FY18	1QFY19
Gross Margin (%)	53.3	54.1	57.6	59.1
Net Margin (%)	29.0	28.1	28.9	27.3
FFO to Long-Term Debt	0.59	0.75	1.35	1.63*
FFO to Total Debt	0.43	0.68	0.99	1.26*
Debt Servicing Coverage Ratio (x)	0.84	1.87	2.60	16.2
ROAA (%)	9.5	10.1	12.7	13.0*
ROAE (%)	22.3	20.9	22.9	22.7*
Gearing (x)	0.63	0.34	0.29	0.25
Debt Leverage (x)	1.33	0.85	0.77	0.73
Current Ratio	1.03	1.10	1.09	1.18
Inventory + Receivables/Short-term Borrowings	1.04	3.25	1.54	1.88

**Annualized*

ISSUE/ISSUER RATING SCALE & DEFINITIONS Annexure III

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	Annexure IV
Name of Rated Entity	**Fatima Fertilizer Company Limited**
Sector	Fertilizer
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	
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
08/26/2019	AA-	A-1	Stable	Reaffirmed
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