The Pakistan Credit Rating Agency Limited

Rating Report

Fatima Fertilizer Company Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
20-Jan-2023	AA+	A1+	Stable	Upgrade	-
25-Jan-2022	AA	A1+	Stable	Upgrade	-
30-Jul-2021	AA-	A1+	Stable	Maintain	-
19-Aug-2020	AA-	A1+	Stable	Maintain	-
21-Aug-2019	AA-	A1+	Stable	Maintain	-
19-Feb-2019	AA-	A1+	Stable	Maintain	-
01-Nov-2018	AA-	A1+	Stable	Maintain	-
08-Aug-2017	AA-	A1+	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

The Country's total fertilizer production capacity stands at around ~ 7.1mln MT of Urea and CAN and ~ 1.7mln MT of DAP, NP, and NPK. Heavy monsoon spell observed in Jul-22 / Aug-22 resulted in inundation of areas in Sindh, Baluchistan and Southern Punjab damaging 4.5mln acres of agricultural land. In 9MCY22, despite floods the nitrogen (primarily Urea) industry in Pakistan has grown by ~ 2% whereas the phosphates industry has declined by ~ 43%. The year observed delayed buying for DAP as demand only materialized in Dec-22 owing to an increase in the support price of wheat and resulted in DAP offtake being plunged by 36% YoY. Despite the increase in gas prices, overall margins of the industry remained healthy mainly due to the increase in prices of fertilizer products. In the international market, prices of Urea and DAP witnessed an upward trend supported by increased demand.
The ratings reflect Fatima Fertilizer Company Limited's ('Fatima' or 'the Company') association with strong business Groups, Fatima Group and Arif Habib Group. The Company holds the highest market share in NP and CAN fertilizers. Furthermore, during the ongoing amalgamation of Pakarab Fertilizer Limited and its plants (Ammonia, Urea, Nitric Acid, Nitro Phosphate, Calcium Ammonium Nitrate, Clean Development Mechanism, LCO2) with and into the Company; the Company has increased its overall market standing and strategic importance. The Company has the highest nameplate capacity (2.57mln MT), in the fertilizer sector of the country. The Company's topline comprising mainly of Urea, NP, and CAN has witnessed phenomenal growth driven by increased prices of fertilizer products during 9MCY22. The Company has maintained healthy margins over the years owing to efficient operations and having a dedicated gas supply line from Mari fields. The latest agreement of fertilizer manufactures with Mari Petroleum to maintain gas pressures further enhances the business risk profile. Subsequent to the Company's sterling financial performance, the management is evaluating investment opportunities and materialization of the projects is anticipated to amplify the Company's prime position in the fertilizer sector. The Company has continuously invested in optimizing its production plants and reaps the benefits of having increased utilization and higher run time of its production facilities. Moreover, income from the trading portfolio provides limited support to the Company's bottom line. The Company’s financial profile is characterized by modestly leveraged capital structure, very strong coverages, and efficient management of working capital. Ratings draw comfort from business acumen from the sponsors and strong governance framework.

The ratings are dependent on the Company's ability to sustain its margins and healthy coverages while maintaining cushion and adherence to strong financial discipline. Substantial deterioration in margins and profitability would adversely impact the ratings.

Disclosure

Name of Rated Entity	Fatima Fertilizer Company Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating(Jun-22),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jun-22),Methodology | Rating Modifiers(Jun-22)
Related Research	Sector Study | Fertilizer(Jan-22)
Rating Analysts	Ahmad Faraz Arif | ahmad.faraz@pacra.com | +92-42-35869504

Profile

Legal Structure Fatima Fertilizer Company Limited ('Fatima Fertilizer' or 'the Company') was incorporated in Dec-03 as a public company under the repealed Companies Ordinance, 1984 (now Companies Act. 2017). The Company got listed on the Pakistan Stock Exchange (PSX) in 2010.

Background The Company was formed by a joint venture between two major business groups in Pakistan namely, Fatima Group and Arif Habib Group. The Company's first venture, a fully integrated fertilizer production facility, was initiated in 2006 in Sadiqabad, Punjab. The facility commenced operations in 2011. The Company later acquired productions plants in Sheikhupura and Multan.

Operations The Company is primarily involved in manufacturing and selling variants of fertilizers and chemicals. The production facilities are all located in Punjab, Pakistan. The Company mainly produces Urea, CAN, and NP. In 9MCY22, the Company's combined actual production increased by 15% compared to the same period from last year and stood at 2.1 mln MT (9MCY21: 1.8mln MT) and capacity utilization stood at maximum (9MCY21: ~93%).

Ownership

Ownership Structure Fatima Group holds 45% of the total shares through associated companies (23%) and individuals (22%), while Arif Habib Group holds 34% through associated companies (16%) and individuals (18%). Fazal Group holds 11% through associated company (3%) and individuals (8%). The remaining shareholding lies with Financial Institutions (4%) and General Public (6%).

Stability Ownership of the business is stable. The second generation has been inducted into the business as well.

Business Acumen The sponsors have very strong business acumen. Fatima Group is one of the leading corporate groups in Pakistan, engaged in trading of commodities, manufacturing of fertilizers, textiles, sugar, mining and energy. Arif Habib Group ranks amongst the prominent financial services groups and holds interests in financial advisory, investment management, commercial banking, commodities, private equity, cement and fertilizer industries.

Financial Strength The Company's sponsors, Fatima Group and Arif Habib Group, have substantial financial strength.

Governance

Board Structure The Company's Board comprises of seven members. The Board includes two members each from Fatima Group and Arif Habib Group, CEO of the Company and two independent directors.

Members' Profile The Board's Chairman, Mr. Arif Habib, has very strong business acumen and is also the Chief Executive Officer of Arif Habib Corporation Limited, the holding company of Arif Habib Group.

Board Effectiveness The Board is assisted by the Board Audit Committee, Human Resource and Remuneration Committee, and Nomination and Risk Management Committee. The committees meet on need basis and minutes are adequately documented.

Financial Transparency The External Auditors of the Company are Deloitte Yousaf Adil, Chartered Accountants rated 'A' on the SBP panel. They have expressed an unqualified opinion on the financial statements for the year ended Dec-21.

Management

Organizational Structure The organizational structure has been optimized as per the operational needs. The Company operates through eight functions: Production, Finance, Marketing and Sales, Internal Audit, Business Development, Administration, Supply Chain, and Human Resource. All functional managers' report to the Company's CEO except the Head of Audit who reports to the Audit Committee, and HR Director who reports to HR & Remuneration Committee.

Management Team Mr. Fawad Ahmed Mukhtar is the CEO of the Company. He has 30 years of experience in industrial management. He is assisted by a team of experienced professionals. Mr. Asad Murad is the Chief Operating Officer of the Company and has over 23 years of experience.

Effectiveness Management's effectiveness and efficiency is ensured through the presence of Executive Committee, Project Review Committee, and Enterprise Risk Management Committee.

MIS The Company uses an upgraded Oracle based ERP system which has been optimized as per the needs of the business.

Control Environment To ensure operational efficiency, the Company has setup an internal audit function, which implements and monitors the policies and procedures of the Company.

Business Risk

Industry Dynamics Pakistan has an agrarian economy, thus fulfills around ~ 84% of its fertilizer requirement through local production while the remaining is met through imports. The Country's total fertilizer production capacity stands at around ~ 7.1mln MT of Urea and CAN and ~ 1.7mln MT of DAP, NP, and NPK. In 9MCY22, despite floods the nitrogen (primarily Urea) industry in Pakistan has grown by ~ 2% whereas the phosphates industry has declined by ~ 43%. Growth in Urea for demand has been made possible with operation of all the fertilizer plants as domestic Urea production stood at ~ 4.77mln MT as compared to ~ 4.66mln MT produced in same period last year. DAP offtake plunged by 36% YoY to settle at 1.21mln MT. Despite the increase in gas prices, overall margins of the industry remained healthy mainly due to the increase in prices of fertilizer products. Going forward, industry's outlook is expected to remain satisfactory.

Relative Position After the acquisition of the Pakarab Fertilizer's plants, the Company has increased its overall market share to 24% in terms of sales.

Revenues The Company's revenue comprises of Urea (34%), NP (34%), CAN (19%), DAP (12%), and Others (1%). During 9MCY22, the Company's revenue witnessed similar trend and clocked in at PKR 98.9bln, up by ~29%, compared to the same period from the prior year (9MCY21: PKR 76.8bln). The increase is mainly due to increase in the prices of fertilizer products. Going forward, the Company's revenues are expected to further improve owing to the amalgamation of Pak Arab Fertilizers with and into the Company.

Margins During 9MCY22, the Company's gross margin declined to ~41.6% (9MCY21: ~ 43.6%) due to higher gas prices and higher volumes being generated from the Company's RNLG based plant. Operating margin stood at ~32% (9MCY21: ~34.5%) due to increased costs. Similarly, amidst higher costs, the Company's net income dipped and stood at PKR 9.9bln (9MCY21: 14.1bln) and, subsequently, net profit margin stood at 10.0% (9MCY21: 18.4%). Going forward, despite the increase in costs, margins are expected to remain strong owing to the increased prices of fertilizer products.

Sustainability The Company is actively evaluating alternate sources of gas with the GoP to mitigate the risk of depleting reserves.

Financial Risk

Working Capital The Company's inventory days increased to 68 days during 9MCY22 (9MCY21: 50 days) due to increase in production in anticipation of the increased demand. Receivable days witnessed slight increase to 39 days (9MCY21: 32 days) in line with the increase in the revenue. Payable days witnessed similar trend and increased to 43 days (9MCY21: 26 days). Subsequently, the overall net cash cycle of the Company stood at 64 days in 9MCY22 (9MCY21: 56 days). The Company's short-term trade leverage and short-term total leverage stood at ~37% and ~18% as at 9MCY22 indicating room to borrow against trade assets and total current assets, respectively.

Coverages Free cash flows of the Company stood at ~PKR 27.3bln during 9MCY22 (9MCY21: ~PKR 26.2bln) due to increased profits. The Company's finance cost stood at PKR 1.9bln during 9MCY22 (9MCY21: PKR 1.8bln) increasing slightly amidst higher interest rates. Subsequently, the coverages remained strong and increase in free cash flows resulted in improvements in the interest coverage ratio (9MCY22: 20.6x, 9MCY21: 19.2x) and Debt Coverage Ratio (9MCY22: 9.2x, 9MCY21: 6.7x). Moreover, debt payback period stood at 0.4x (9MCY21: 0.3x). Going forward, the Company's higher FCFO combined with relatively lower finance cost is expected to keep the coverages high.

Capitalization The Company has low leveraging with debt-to-debt + equity ratio standing at ~15% as at 9MCY22 (CY20: 20.7%). Total debt of the Company increased to ~PKR 17.8bln as at 9MCY22 (9MCY21: ~PKR 14.0bln). The increase represents an uptick in the short-term borrowings (9MCY22: PKR 5.5bln, 9MCY21: PKR 4.0bln) for working capital requirements amidst increase in production volumes. Going forward, the capital structure of the Company is expected to remain strong owing to high equity-base (9MCY22: PKR 102.7bln, 9MCY21: PKR 96.0bln).

PKR mln

Fatima Fertilizer Company Limited	Sep-22	Dec-21	Sep-21	Dec-20	Dec-19
Fertilizer	9M	12M	9M	12M	12M
A BALANCE SHEET					
1 Non-Current Assets	111,333	109,550	109,850	111,042	106,776
2 Investments	5,166	3,018	2,921	3,280	1,158
3 Related Party Exposure	12,839	10,794	10,353	6,442	6,416
4 Current Assets	84,108	61,531	50,801	36,792	40,767
a Inventories	*30,993*	*18,332*	*14,433*	*13,531*	*11,518*
b Trade Receivables	*18,313*	*9,654*	*13,540*	*4,450*	*7,207*
5 Total Assets	213,446	184,893	173,924	157,557	155,116
6 Current Liabilities	67,047	45,528	40,452	23,363	27,511
a Trade Payables	*18,353*	*12,973*	*8,341*	*6,252*	*13,962*
7 Borrowings	17,834	15,404	13,976	22,804	29,594
8 Related Party Exposure	-	-	-	-	-
9 Non-Current Liabilities	25,827	23,697	23,552	24,288	20,004
10 Net Assets	102,739	100,263	95,944	87,103	78,008
11 Shareholders' Equity	102,739	100,263	95,944	87,103	78,008
B INCOME STATEMENT					
1 Sales	98,920	112,488	76,770	71,267	74,964
a Cost of Good Sold	*(57,743)*	*(69,404)*	*(43,262)*	*(42,473)*	*(47,065)*
2 Gross Profit	41,178	43,084	33,508	28,795	27,899
a Operating Expenses	(9,556)	(8,948)	(7,019)	(7,259)	(6,579)
3 Operating Profit	31,622	34,136	26,489	21,535	21,320
a Non Operating Income or (Expense)	*(3,713)*	*(3,944)*	*(2,222)*	*677*	*(366)*
4 Profit or (Loss) before Interest and Tax	27,909	30,192	24,267	22,212	20,954
a Total Finance Cost	*(1,915)*	*(2,007)*	*(1,776)*	*(3,469)*	*(3,761)*
b Taxation	*(16,095)*	*(9,711)*	*(8,400)*	*(5,468)*	*(5,124)*
6 Net Income Or (Loss)	9,899	18,474	14,092	13,275	12,070
C CASH FLOW STATEMENT					
a Free Cash Flows from Operations (FCFO)	*27,338*	*34,500*	*26,229*	*18,576*	*16,741*
b Net Cash from Operating Activities before Working Capital Changes	*25,610*	*32,537*	*24,411*	*14,841*	*13,582*
c Changes in Working Capital	*(12,795)*	*(6,239)*	*(5,924)*	*1,718*	*(6,704)*
1 Net Cash provided by Operating Activities	12,814	26,299	18,486	16,559	6,879
2 Net Cash (Used in) or Available From Investing Activities	(11,122)	(8,359)	(6,146)	(3,489)	(10,322)
3 Net Cash (Used in) or Available From Financing Activities	(6,752)	(11,153)	(12,523)	(13,029)	3,241
4 Net Cash generated or (Used) during the period	(5,060)	6,787	(182)	41	(203)
D RATIO ANALYSIS					
1 Performance					
a Sales Growth (for the period)	17.3%	57.8%	43.6%	-4.9%	N/A
b Gross Profit Margin	41.6%	38.3%	43.6%	40.4%	37.2%
c Net Profit Margin	10.0%	16.4%	18.4%	18.6%	16.1%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	14.7%	25.1%	26.4%	28.5%	13.4%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	13.0%	19.7%	20.5%	16.1%	15.5%
2 Working Capital Management					
a Gross Working Capital (Average Days)	107	75	82	94	91
b Net Working Capital (Average Days)	64	43	56	42	23
c Current Ratio (Current Assets / Current Liabilities)	1.3	1.4	1.3	1.6	1.5
3 Coverages					
a EBITDA / Finance Cost	25.2	21.5	21.0	7.6	6.8
b FCFO / Finance Cost+CMLTB+Excess STB	9.2	8.5	6.7	2.0	1.3
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.4	0.3	0.3	0.7	1.2
4 Capital Structure					
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	14.8%	13.3%	12.7%	20.7%	27.5%
b Interest or Markup Payable (Days)	80.9	64.0	52.1	53.5	89.5
c Entity Average Borrowing Rate	11.6%	9.9%	8.8%	11.4%	11.5%

Credit Rating

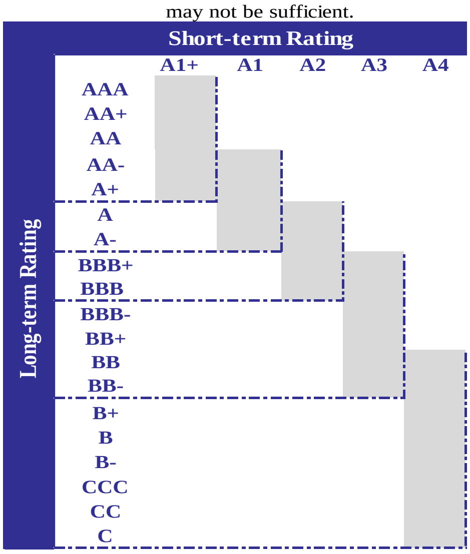
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
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 and in 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.** Substantial 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 Rating

Scale	Definition
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
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

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'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

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, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

a) Broker Entity Rating
b) Corporate Rating
c) Debt Instrument Rating
d) Financial Institution Rating
e) Holding Company Rating
f) Independent Power Producer Rating
g) Microfinance Institution Rating
h) Non-Banking Finance Companies Rating

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2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
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iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term “family members” shall include only those family members who are dependent on the analyst and members of the rating committee

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(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report | Clause 11-(A)(p).
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(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

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(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers’ associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
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(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
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(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

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(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)
Probability of Default
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)
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