

## RATINGS (APRIL 2011)

### ENGRO FERTILIZER LIMITED [EFL]

ENTITY	NEW	PREVIOUS
LONG TERM	AA-	AA-
SHORT TERM	A1	A1
<b>Secured, Listed</b>		
TFC II – PKR 4,000MLN	AA	AA
TFC III – PKR 2,000MLN	AA	AA
<b>Secured, Privately Placed</b>		
PKR 4,000MLN	AA	AA
PKR 2,000MLN	AA	AA

## EFL L.T. ENTITY RATING HISTORY

AA		
AA-		
A+		
A-		
	May 2010	April 2011

## FINANCIAL DATA

### PKR (MLN)

	Dec-10	Dec-09 *
Total Assets	98,054	93,709
Equity	13,639	26,888
Long term borrowings	62,660	58,565
Current borrowings	8,672	831
Net Turnover	19,018	30,172
Net Income	3,730	3,957
Gross Margin	46.9 %	23.0 %
ROE	27.3 %	14.7 %
FCFO/ Interest + CMLTD	2.81 x	2.91 x
Net Debt/ Net Debt + Equity	83.2 %	67.7 %

\* Numbers for Engro Chemicals Pakistan Limited

## ANALYSTS

Aahyan Mumtaz  
+92 42 35869504  
aahyan.mumtaz@pacra.com

Jhangeer Hanif  
+92 42 35869504  
jhangeer@pacra.com

## TFCs Issues

The company has 4 rated TFCs. TFCII of PKR 4,000mln issued in Nov-07, with a tenor of 8 years, carrying profit based on 6month KIBOR plus 1.55%. The principal repayment would be in two equal installments commencing from May 2015. PPTFCs of PKR 4,000mln and PKR 2,000mln were issued in Mar-08 at a markup of 6 months KIBOR plus 1.70% and 6month KIBOR plus 1.25% respectively. PPTFCs are perpetual with a five-year call and ten year put option. TFCIII of PKR 2,000mln was issued in Dec09, with a tenor of 7 years, carrying profit based on 6month KIBOR plus 2.40%. The principal repayment will be in 10 semi-annual installments, starting from June 2012. In consideration of the guarantee from ECL, these instruments have been rated one notch higher than entity ratings of EFL; at par with the long term entity rating of its parent guarantor.

## RATING RATIONALE & KEY DRIVERS

- The ratings reflect EFL's relatively low business risk emanating from a stable, indeed growing, urea demand with continuing domestic supply deficit. The ratings take into account the company's well-conceived strategy of fortifying its position through a sizeable urea expansion project (Enven 1.3), nearing commercial production now. The ratings recognize the company's ability to manage its financial profile, though stretched as a result of high borrowings with ensuing cashflows of the new urea capacity and adequate arrangements – public offering & committed debt from parent – to meet upcoming debt payments.
- These ratings are dependent on the successful operation of the urea expansion project without significant hindrances, and gradual deleveraging thereby managing financial risk in the medium term through ensuing internal cash flows. In addition, strengthening the human resource and technological/support infrastructure to supplement expanded operations remains critical.

## ASSESSMENT

- EFL is currently the second largest producer of urea in the country; its base plant's designed capacity is 975,000 MT per annum (~23% market share). In the later part of 2010, EFL, after experiencing a delay, achieved mechanical completion and started trial production of its new plant of 1,300,000 MT – Enven 1.3 – the world's largest single-train urea complex. However, the plant was unable to continue operations as SNGPL commenced a 45-day gas outage during Jan11, as part of a gas load management program. The delays resulted in cost overruns (incremental project costs, interest burden, and opportunity cost of producing and selling urea) of USD 100mln raising the total project cost to USD 1,100mln. Nevertheless, with the resumption of gas supply, the plant has now restarted operations; and commercial production is now expected to commence during May11. To ensure uninterrupted gas supply EFL has obtained an Order from the Honourable Sindh High Court decreeing against the disconnection of EFL's gas supply. The enhanced total capacity with the addition of the plant (2,275,000 Mt p.a.) is expected to increase EFL's market share to ~33%.
- During 2010, EFL's revenue grew 18% YoY due to higher fertilizer prices realized to compensate for curtailed gas supply. The company's urea production stood at 972,000 MT, 2.1% higher than the previous year. This was made possible through continuous plant operation without annual turnaround, maximizing production in 1H2010. Meanwhile, NPK off-take decreased inline with the decline in the phosphate market. Benefiting from higher urea prices, EFL saw an uptick in gross margins on a comparative basis. Although enhanced leverage increased the company's financial cost burden, a major portion of it was capitalised (~PKR 11,319mln as at Dec10). The company realized a one-time gain on the sale of property of PKR 312mln during the year. This helped boost EFL's bottom line for 2010. During 1Q2011, EFL has experienced a sizeable hike in profitability, attributable to price rise despite a slight fall in urea off-take.
- Going forward, fertilizer production is expected to remain a function of gas supply. The current announced gas shortage schedule stands at maximum 20% for the new plant and maximum 12% for the base plant. EFL would continue compensating fall in production due to gas curtailment through price hike. As urea prices have seen unprecedented hike in recent periods, the possibility of heightened gas curtailment, more than current levels, seems remote. In terms of profitability, the contribution of the new plant is expected to remain limited initially due to accelerated depreciation charges. Incremental cash flows are also not expected since repayment of project loans has started in 1H2011. Furthermore, EFL plans to raise fresh capital (~PKR 2bln) through an IPO during 2011.
- Following the corporate restructuring, ECL has irrevocably and unconditionally guaranteed to each secured party, punctual performance by EFL of all its obligations. Engro Corporation is expected to monitor planned outflows and take requisite actions, including injection of requisite liquidity, prior to any contingency.
- EFL has a highly leveraged capital structure (debt-to-equity ratio of 84 : 16 as at Dec10) with most of the debt incurred for the completion of the urea expansion project. However, the company for its lenders' satisfaction and compliance with debt covenants has re-valued its fixed assets. This results in debt-to-equity ratio of 71.4 : 28.6 – lower than the agreed benchmark ratio (73.5 : 26.5). This high debt quantum has restricted the fiscal space of EFL by suppressing the company's coverages. With the start of debt repayment in 2011, debt levels are expected to decrease – albeit gradually over the medium term – for which timely COD announcement of Enven 1.3 to supplement base plant cash flows remains critical.
- Although debt repayments are expected to be made through internally generated cash flows, certain injections by the parent company in the form of subordinated loans are expected. In this regard, ECL is expected to lend PKR 3bln as a subordinated loan to EFL (PKR 1.5bln lent as of Dec10) by Jun11, which will be utilized to replace existing debt and/or to meet future funding requirements of the new urea plant. This, coupled with EFL's already strong cash generating ability from core operations and the corporate guarantee provided by Engro Corporation, largely mitigate the associated risks. The company is also carrying un-utilized short term lines to the tune of PKR 3,900mln as on Mar11. Further, the proceeds from the proposed listing of the company would add to the liquidity profile of the company and supplement capital structure.

## PROFILE

- EFL is a wholly owned subsidiary of Engro Corporation Limited, which in turn is majority (~48%) owned by Dawood Group. The core business of EFL, the second largest producer of urea in the country, is manufacturing and marketing of fertilizers. EFL's current urea plant, with a capacity of 975,000MT p.a., is located at Daharki, whereas NPK plant is situated at Port Qasim. EFL's new urea plant (1,300,000MT p.a.), the country's largest ammonia-urea plant, has recently been completed and is progressing towards achieving commercial production (target: May11).
- The ten member board of EFL comprises four executive directors including the CEO, two from Dawood Group and four independent directors. The CEO, Mr. Khalid Siraj Subhani, is a chemical engineer by qualification and has been associated with the company for long. The chairman, Mr. Asad Umar, an MBA with significant professional experience, is the CEO of the parent company and chairs the board of all Engro subsidiaries.