RATING REPORT

Ittehad Chemicals Limited (ICL)

REPORT DATE:
November 19, 2020

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	*November 19, 2020*		*August 26, 2019*	
Rating Outlook	Positive		Positive	

COMPANY INFORMATION	
Incorporated in 1991	**External Auditors:** M/s BDO Ebrahim & Co. Chartered Accountants
Public Limited Company	**Chairman of the Board:** Mr. Mohammad Siddique Khatri
Key Shareholders:	**Chief Executive Officer:** Mr. Abdul Sattar Khatri
Mr. Muhammad Siddique Khatri – 13.5% Mr. Abdul Sattar Khatri– 6.0%	

APPLICABLE METHODOLOGY
VIS Entity Rating Criteria: Corporates (May 2019) ***https://www.vis.com.pk/kc-meth.aspx***

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. Mohammaed 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 onthe Boards of Ittehad Developers and Chemi Dyestuffs Industries (Pvt.) Limited.

Total Equity: end-1QFY21: Rs. 4.2b; end-FY20: Rs.4.1 end-FY19: Rs. 4.0b

Assets: end-1QFY21: Rs. 9.2b; end-FY20: Rs. 9.1; end-FY19: Rs. 9.5b

Profit After Tax: 1QFY21: Rs. 170m; FY20: Rs.61m; FY19: Rs. 405m

RATING RATIONALE

The ratings assigned to Ittehad Chemicals Limited (ICL) take into account its eminent position in the Chlor-alkali sector with sizable market share of around 29% along with strong sponsor support. The ratings are underpinned by moderate business risk profile manifested by sizable revenues in a highly competitive operating environment. The establishment of multi-pronged revenue stream through product line extensions has given positive impetus to sales. However, margins and profitability position of the company took a dip during the outgoing year owing to depressed economic activity amid ongoing pandemic. The ratings draw comfort from manageable financial risk appetite emanating from its moderately leveraged capital structure, improved capitalization indicators and adequate debt service coverage. Liquidity profile is considered strong given healthy cash flows in relation to outstanding obligations and limited trade debts as majority of the sales are on cash. Receipt of tax refunds due from the GoP further bolstered liquidity profile. However, rupee devaluation and risk of resurgence of COVID-19 till the vaccine is developed remain key challenges.

The ongoing geopolitical scenario, global economic landscape and slowdown in domestic economic activity amidst the COVID-19 pandemic is likely to pose financial risk to the company impacting revenues, profitability, liquidity and debt repayment capacity. Therefore, the ratings incorporate significant dependence of caustic soda manufacturers on textile sector and highly competitive market dynamics. The company's ability to maintain scale of operations, improve profit margins and contain leverage indicators around current levels would be the key ratings sensitivities.

Business and industry risk factors: The chlor-alkali sector is oligopolistic in nature with three players operating in the country. Overall capacity utilization has continued to remain moderate owing to imbalance in the demand and supply of product leading to competition driven market. Moreover, the demand of caustic soda has declined during the outgoing period in line with spread of COVID-19 in export markets and subsequent lockdown in Pakistan. Domestic market is currently under flux and will take firmer direction once spread of COVID-19 is contained, local economic policies, macroeconomic indicators and other key variables have settled. The total volumetric caustic soda sales in local market (liquid and flakes) of the sector were recorded lower around 260,157MT (FY19: 293,253MT); similarly ICL also reported slightly lower quantum sales of 76,866MT (FY19:83,258) during FY20. However, in terms of market share the company's position was slightly improved during the outgoing year with ICL comprising 29.5% (FY19:28.4%) of the county's caustic soda market. While the sector is power intensive, the companies have set up captive power plants to support the production process indigenously. In addition, the differential in the local and import prices of caustic soda due to import duty and freight charges has created a sustainable market for local players. As per the management, the locally produced caustic soda flakes is estimated around Rs.79,500/ton while the imported product is priced at Rs. 100,000/ton. Business prospects of the caustic soda sector in the long run exhibit a positive trend underpinned by growing demand and sound margins; however in the short to medium term caustic soda market may experience some pressure on account of lower textile exports coupled with lower domestic demand. As per the management, the volumetric sale of caustic soda sector including exports expected for FY21 is recorded at 300,000MT out of which ICL plans to capitalize on 90,000 MT.

Onslaught of COVID-19 pandemic resulting in low industry demand and capacity utilization: Given overall sluggishness in the manufacturing sectors and contemplating lower demand amidst COVID-19 pandemic , ICL's production of caustic soda (both liquid and flakes) was reported at 87,139 MT (FY19: 101,135 MT) during FY20. Production of hydrochloric acid was recorded at 182,763 MT (FY19: 200,000 MT) during the same period. Hence, capacity utilization of caustic soda liquid, flakes and hydrochloric acid was reported at 48% (FY19: 56%), 52% (FY19: 60%) and 91% (FY19: 100%) respectively during FY20. However, the trend is expected to be rescued given there is recovery in textile sector exports during the ongoing year. On the contrary, the production of calcium chloride prills increased to 24,283MT (FY19: 12,974MT) leading to an improved capacity utilization of 81% (FY19: 65%) during FY20 on account of its usage in oil and gas sector.

ICL has adjusted its power mix with increased focus on indigenous sources, gas fired captive power plant (30MW) during FY20 produced 74% (FY19: 49%) of total electricity need followed by secondary source of 132 KV LESCO line available producing 26% (FY19:51%) of the total required energy. Further, the upgradation of power plant is likely to improve fuel efficiency resulting in operational efficiencies through cost-rationalization.

Revenue Diversification: The production of Linear Alkylbenzene Sulphonic Acid and Sodium Lauryl Ether Sulphate (LABSA/SLES) increased exponentially to 11,771 MT during FY20 as compared to 1,201MT in the preceding year given the plant became operational in June'19. The plant was operating at 49% (FY19: 5%); however as per the management currently the plant is operational at 85% of its full capacity at end-Oct'20. In line with sound market reception of the product, ICL has planned to enhance the capacity of production facility by 46,000MT; the new facility is expected to begin commercial operations in 1QFY22. The total capex is projected around Rs. 750m out of which Rs. 600m is be financed through commercial funding ; meanwhile the remaining Rs. 150m is to be arranged from company's own resources. The financial close for the same is expected to be achieved by end-Feb'21. For LABSA/SLES the company plans to ink long-term contracts with renowned national and international conglomerates including Unilever, Proctor and Gamble, Olympia etc. to guarantee sale targets; the materialization of the same will be a key rating driver.

Positive momentum in revenues owing to product diversification; profitability slashed sizably owing to decline in margins and finance cost escalation: Over the last three years, sales of the company have grown at a sizable CAGR of around 21%. Further, during the outgoing year the revenues exhibited upward trajectory with annual growth locked at 33%; sales increased to Rs. 8.9b (FY19: Rs. 6.6b) primarily on account of product line extension as LABSA sales contributed incremental revenue of Rs. 2.1b (FY19: Rs. 74.5m) to the top-line during FY20. Caustic soda remains the flagship product of the company accounting for almost 56% (FY19: 77%) of the total revenue base; however the same has subsided in the outgoing year owing to the introduction of new products i.e. LABSA and SLES. The revenues emanating from caustic sale were largely maintained at Rs. 5.0b (FY19: Rs. 5.1b) owing to increase in average retail price of the product; although there was dip in volumetric sales to 76,903MT (FY19: 83,700MT) as a result of onslaught of corona virus pandemic. ICL's export sales amounted to Rs. 566.3m (FY19: Rs. 322.5m) comprising almost 6.4% (FY19: 4.9%) during FY20; majority of export sale is made to Oman and UAE.

The gross margins of the company declined to 13.3% (FY19: 20.8%) during FY20 as a combined impact of increase in average cost of production of caustic flakes coupled with increased contribution of LABSA sales to revenue mix; the gross margins of LABSA are lower at 10% as compared to chlor-alkali products entailing a margin ranging from 18-20%. Further, the increase in cost of production of caustic and allied products was an outcome of higher electricity prices and RLNG tariff Another contributing factor of increased input cost was a change involving costing of RLNG; for 1HFY19 industrial tariff was available at a combination of natural gas and RLNG tariff which was later changed to RLNG only. RLNG is pegged to crude oil prices in US$ resulting in considerable appreciation to input cost of gas during the year under review. Although the average prices of caustic liquid and flakes increased to Rs.63,472MT (FY19: Rs. 59,560MT) and Rs.79,092MT (FY19:Rs. 78,672MT) respectively during FY20 to compensate against the incremental cost of production; however the same could not fully be offset due to prevalent economic conditions of the sector being not conducive enough to warrant such decision.

The distribution cost increased primarily as a result of higher freight expense owing to enhanced scale of operations along with avenues of export availed. Further, administrative expenses were largely rationalized in terms of overall growth in revenues and were recorded at Rs. 208.3m (FY19: Rs. 199.3m) during FY20. The other operating expenses also stood lower at Rs. 60.7m (FY19: Rs. 76.9m) owing to reduced contribution made to workers participation fund. Finance cost has depicted an increasing trend in line with higher average benchmark rate and higher utilization of short-term borrowings. Other income, mainly comprising sale of scrap of fixed assets pertaining to defunct DSA plant, amounted to Rs. 84.4m (FY19: Rs. 65.4m) during the review period. Subsequently despite growth in revenue generation, ICL's bottom line was recorded lower at Rs. 60.8m (FY19: Rs. 405.1m) as an outcome of considerable slash in margins and increased financial charges for the year.

Given the company's plan of revenue diversification through induction of new product lines along with continued BMR on economically efficient operations, the declining trend in revenues and margins is expected to be rectified. ICL reported healthy sales of Rs. 2.4b during the 1QFY21; the management has set a target of Rs. 11.0b for the ongoing year with additional contribution of Rs. 4.0b from LABSA sales. Further, after lifting of lock down in the country, the company has witnessed recovery in the sales of both chlor-alkali and LABSA division. In addition, the declining trend in margins is also expected to be rescued owing to 43% drop in RLNG prices during the ongoing year; moreover, higher contribution of SLES in LABSA segment will reflect positively in company's margins as the former has higher margin cushion of around 14%. As per the management, the RLNG prices have now stabilized at Rs. 1,086/mmbtu from Rs. 1,893/mmbtu; no further dip is expected going forward. As a result, ICL's margin for 1QFY21 exhibited positive momentum at 23.1%; the same is projected to be sustained around 20% for the remaining year. Further, in line with outbreak of COVID-19 pandemic, the government has taken number of measures including reduction in policy interest rate and provision of term loans to industry at subsidized rates to spur economic growth; the same measures have boded well with ICL's investment strategies along with reduction in finance cost.

Albeit slight decline during FY20, liquidity profile and debt service ability exhibited improvement during the ongoing year: Given a considerable slash in margins and hefty increase in finance cost, Funds from Operations (FFO) declined during the outgoing year As a result of decline in FFO, FFO in terms of total debt and long-term debt declined during FY20. Conversely, in line with substantial growth in revenues along with healthy recovery of margins during 1QFY21, FFO to long-term debt improved significantly. Moreover, as a combined outcome of growth in FFO along with lower utilization of short-term financing, FFO to total debt (annualized) improved to 0.58x (FY20: 0.18x; FY19: 0.28x) at end-1QFY21. Debt Service Coverage Ratio (DSCR) has remained adequate during the period under review. Going forward, VIS will continuously monitor improvement in ICL's liquidity position in terms of projected debt obligations materialized during the ongoing year; incapability to maintain the same positive trajectory during the rating horizon may lead to revision in ratings.

Loans and advances majorly comprised advance provided to Sui Northern Pipelines Limited against running bills; the advances do not carry any mark-up charge. The stock in trade carried on the books was largely streamlined in respect to proportion of total revenue; the same has been a conscious effort on part of the management to avoid inventory losses on account of obsolesce coupled with strategy to reduce carryover inventory cost. On the other hand, trade debts were recorded higher during the period under review in line with growth in overall scale of operations. However, aging profile of receivables is satisfactory as around 89% of receivables fall due in less than 90 days bracket. Meanwhile, allowance for bad debts has increased to Rs. 72.5m (FY19: Rs. 64.1m) by end-FY20. Moreover, a large amount of company's working capital is stuck in tax refunds due from government, however the same declined to Rs. 274.7m (FY20: Rs. 419.6m; FY19: Rs. 526.5m) by end-1QFY21. As per management, government has offered promissory notes for encashment of tax refunds and these promissory notes are subject to discount from bank. The company holds investment property amounting to Rs. 195m comprising of freehold land for purpose of of capital appreciation and earning rental incme. The fair value of investment property is estimated to be equivalent to its carrying value. As per the management, ICL will either set up a new business project on the land or dispose it in the medium-term; however no final decision has been reaped on the same yet.

Augmentation in equity on a timeline basis on back of profit retention: Equity base has been fortified in line with profit retention. The surplus on revaluation on property, plant and equipment remained unchanged during the period under review at Rs. 972.7m at end-1QFY21. The company did not pay out dividend for FY19. However, for the year ended-FY20, the company proposed a final cash dividend of 10%. Total borrowings decreased on a timeline basis in line reduced utilization of short-term borrowings. Hence, gearing ratio decreased to 0.82x (FY20: 0.98x; FY19: 1.11x), respectively, by end-1QFY21. The company has unavailed short-term lines of around Rs. 1.3b. Although, the company plans on mobilize additional long-term funding during FY21, leverage and gearing are expected to remain at current levels or just increase slightly owing to sizeable repayments scheduled coupled with internal capital generation, going forward.

Ittehad Chemicals Limited Appendix I

FINANCIAL SUMMARY	*(amounts in PKR millions)*				
BALANCE SHEET	**Jun 30, 2017**	**Jun 30, 2018**	**Jun 30, 2019**	**Jun 30, 2020**	**Sep 30, 2020**
Fixed Assets	4,531	5,708	6,561	6,172	6,124
Store, Spares and Loose Tools	477	402	408	419	441
Stock-in-Trade	392	266	789	685	707
Trade Debts	551	524	665	799	890
Loans and Advances	198	198	217	208	221
Tax Refunds due from Government	181	408	527	420	275
Cash & Bank Balances	108	94	110	135	196
Total Assets	6,596	7,739	9,476	9,141	9,222
Trade and Other Payables	1,006	1,201	1,649	1,202	1,399
Long Term Debt *(*incl. current maturity)*	1,188	1,382	1,986	1,870	1,966
Short Term Debt	890	1,176	1,380	1,139	708
Paid Up Capital	770	770	847	847	847
Total Equity	3,216	3,710	4,004	4,054	4,224
Tier-1 Equity	2,421	2,737	3,031	3,081	3,251
INCOME STATEMENT	**Jun 30, 2017**	**Jun 30, 2018**	**Jun 30, 2019**	**Jun 30, 2020**	**Sep 30, 2020**
Net Sales	4,990	5,743	6,644	8,857	2,395
Gross Profit	820	963	1,379	1,182	554
Operating Profit	384	504	756	496	351
Profit Before Tax	220	361	505	78	282
Profit After Tax	233	415	405	61	170
Funds from Operations	513	669	946	532	385
RATIO ANALYSIS	**Jun 30, 2017**	**Jun 30, 2018**	**Jun 30, 2019**	**Jun 30, 2020**	**Sep 30, 2020**
Gross Margin (%)	16.4	16.8	20.8	13.3	23.1
Net Margins	4.7	7.2	6.1	0.7	7.1
Current Ratio	0.85	0.68	0.84	1.18	1.28
Net Working Capital	(370)	(975)	(546)	460	683
FFO to Total Debt (x)	0.25	0.26	0.28	0.18	0.58*
FFO to Long Term Debt (x)	0.43	0.48	0.48	0.28	0.78*
Gearing (x)	0.86	0.93	1.11	0.98	0.82
Debt Leverage (x)	1.40	1.47	1.81	1.65	1.54
Debt Servicing Coverage Ratio (x)	1.35	1.24	1.63	1.26	4.72
ROAA (%)	3.6	5.8	4.7	0.7	7.4*
ROAE (%)	10.6	16.1	14.0	2.0	21.5*
(Stock in Trade+ Trade Debt) to Short-Term Borrowing Ratio	1.06	0.67	1.05	1.30	2.25

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 Rating
Rating History	see table below
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	see table below

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
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

Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Aamir Shahzad Mughal	CFO	28-Oct-2020
Mr. Shahbaz Ali	Unit Manager Budget	28-Oct-2020