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Research Update:

Pakistan's Azgard Nine Ltd. And Senior Unsecured Notes Assigned 'B+' Rating; Outlook Stable

Primary Credit Analyst:

Wee Lee Cheng, Singapore (65) 6239-6353; weelee_cheng@standardandpoors.com

Secondary Credit Analyst:

Anshukant Taneja, Singapore (65) 6239-6340; anshukant_taneja@standardandpoors.com

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Rationale

On July 3, 2007, Standard & Poor's Ratings Services assigned its 'B+' corporate credit rating to Azgard Nine Ltd. (Azgard), a Pakistani textile and fertilizer manufacturer. The outlook is stable. At the same time, Standard & Poor's assigned its 'B+' issue rating to the proposed long-term senior unsecured senior notes of up to US\$260 million to be issued by Azgard, subject to final documentation. The notes proceeds will be used to refinance about US\$143 million of Azgard's debt obligations. The remainder will be used to refinance debt in Azgard's wholly owned subsidiary, Pak American Fertilizers Ltd. (PAFL), after PAFL has been merged into Azgard. The merger is expected to take place before year-end 2007.

Azgard's textile business is expected to contribute about 60% of its consolidated revenue with the balance from fertilizer, which is undertaken by PAFL. The rating on Azgard reflects its small market position, its highly leveraged financial profile, as well as the highly competitive and fragmented textile industry. This is partly offset by the company's competitive cost advantage, especially in the fertilizer business, and good operating efficiency, which results in higher profitability.

The rating on Azgard is constrained by the following:

- Small market position in textile and fertilizer business. Azgard is one of the smaller players in the global textile apparel industry, which has an estimated global sales value of US\$180 billion. This improved marginally with a 20% increase in Azgard's manufacturing capacity, which came onstream in late 2006. However, the company would continue to be small by international standards. Pakistan's fertilizer industry is dominated by the top player holding about 50% market share, with Azgard accounting for about 7%.
- Exposure to government policies for fertilizers and highly competitive global textile industry. The fertilizer industry is government regulated and is dependent on direct and indirect subsidies from the government. Also, Azgard caters to the global textile and garment market, which is characterized by high competition, especially after the removal of the quota system since January 2005. The industry is highly fragmented with very few integrated players and is distributed across most developing countries such as China and India.
- Highly leveraged financial profile. Standard & Poor's expects the company to have debt of PKR16 billion by year-end 2007, which would result in total debt to EBITDA of 3.5x-4.0x. Also, Standard & Poor's expects Azgard to have FFO to total debt of 10%-15% and EBITDA interest coverage of

2.0x-2.5x by the end of 2007. These ratios are expected to improve with revenue growth, minimal capital expenditure, and partial repayment of debt.

These weaknesses are partially offset by the following strengths:

- Diversified business profile with limited capital expenditure plans. Azgard has business diversity with its presence in fertilizer and textile, allowing it to manage the potential cyclicity of the fertilizer business and the rising competition in the textile business. The company recently completed its textile expansion and does not have any major expansion plans in the medium term for any of its businesses. This avoids any project execution risk and enables Azgard to concentrate on improving productivity.
- Stability of fertilizer and high growth in textile business. Pakistan's economy is agro-based; agriculture accounts for 23% of GDP and 68% of the total employed labor force. However, its cultivable land is deficient in nutrients, resulting in growing demand for fertilizer. Government regulations and support are also needed to maintain adequate supply of fertilizers at reasonable prices. The company has considerable opportunities in textile, given growth in the global textile trade, especially between developed countries and low-cost manufacturers in developing countries.
- Good operating efficiency and profitability. The company's fertilizer business has significant cost and location advantages. It is the only fertilizer plant located in central Punjab, the hub of agricultural activity in Pakistan, and thus has lower cost of distribution. In addition, Azgard has the added advantage of receiving natural gas at almost 60% discount up to 2009. The textile business benefits from easy access to cheap labor and raw material--Pakistan being one of the largest cotton producers in the world. The company is also one of the few integrated textile players in Pakistan that focuses on the denim market.

Liquidity

Azgard's liquidity is adequate with cash and cash equivalents expected to be about PKR1 billion by year-end 2007 after repayment of certain debt. The company is expected to generate PKR2.0 billion-PKR2.5 billion of free operating cash flows over the next few years. After the proposed issue, this should be more than sufficient to meet the scheduled debt maturities of PKR0.7 billion-PKR0.9 billion every year over the medium term. In addition, the company would not have any significant debt maturity in the medium term after the proposed issue.

Outlook

The stable outlook reflects our expectations that Azgard would be able to generate free operating cash flows consistently, given that capital expenditure is expected to be minimal (apart from some debottlenecking plans in the medium term) and its gradual partial debt repayments. The company should be able to effectively manage its textile business risk, given past

experience in working with global clients that are geographically diversified. The business is also well supported by its stable and more profitable fertilizer business. However, any sustained downturn in the denim market or adverse regulatory change in the textile or fertilizer sector could materially affect the company's financial performance. In such a scenario, Standard & Poor's believes that debt to EBITDA of 4.5x or more could result in downward pressure on the rating.

The rating upside is limited in the near future, with its highly leveraged financial profile, small market position, and government's direct and indirect support to the fertilizer industry. Azgard would have to significantly improve its financial profile with FFO to total debt of 30% or more and debt to EBITDA of less than 3x. In addition, the company needs longer contracts with its textile customers to develop a stronger market position. Standard & Poor's also does not expect the company to undertake any major acquisition or shareholder-friendly steps at the detriment of its current financial profile.

Ratings List

New Ratings

Azgard Nine Ltd.

Corporate Credit Rating	B+/Stable/--
Senior Unsecured	
Foreign Currency	B+

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