The Pakistan Credit Rating Agency Limited

Rating Report

Pak Arab Refinery Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
05-Jun-2018	AAA	A1+	Stable	Maintain	-
23-Jun-2017	AAA	A1+	Stable	Maintain	-
30-Dec-2016	AAA	A1+	Stable	Maintain	-
31-Dec-2015	AAA	A1+	Stable	Maintain	-
13-Jan-2015	AAA	A1+	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

The ratings reflect PARCO's ownership structure- owned by the Government of Pakistan (GoP) (60%) and Emirates of Abu Dhabi(EAD), through Abu Dhabi Petroleum Investments LLC (40%) - a majority owned company of EAD. The Company is of strategic importance to the Country as it operates as an integrated pipeline, refinery and marketing infrastructure, providing an efficient, low-cost, environment-friendly energy solutions. The company is contributing substantially towards the socio economic benefits and forex saving and its low business risk emanates from its leading market position, strong demand of its products, and its advanced plant technology. The ratings recognize the Company's ability to manage its financial profile. Increasing dividend income from subsidiaries and Joint venture companies and strong investment returns reflect positively on the company's performance. The ratings reflects PARCO's strengthened position in midstream and downstream sector resulting through recent acquisitions and completion of expansion projects. Going forward, PARCO is enhancing capacity of its existing 100,000 bpd refinery to 120,000 bpd through the revamp of existing units and addition of new units which is expected to come online in FY19. PARCO has also initiated the development of the new state-of-the-art 250,000bpd PARCO Coastal Refinery Project, at an estimated project cost of $5bln. The financing structure will be finalized upon completion of FEED study. Strong capital structure and sizeable equity of the company has enabled to absorb financial outflow. With these capacities to come online, bottom line of the company is expected to increase manifold over the time.

Effective management of upcoming projects, favorable regulatory regime, and consistency in Government policies remain critical for the ratings. The ratings are dependent on the sustained competitive positioning of the company.

Disclosure	
Name of Rated Entity	Pak Arab Refinery Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating Methodology(Jul-17),Methodology | Correlation between long-term and short-term rating scale(Jun-17),Methodology | Criteria Modifiers(Jun-17)
Related Research	Sector Study | Refinery(May-18)
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PAK ARAB REFINERY LIMITED (PARCO) - PROFILE	
Incorporated	1974
Major Products	LPG, Motor Gasoline, Kerosene, Jet Fuels (JP-1 & JP-8), HSD, Furnace Oil etc.
Legal status	unlisted
Plant Location	Mahmood Kot near Multan
Capacity	4.5 million tons per year

INDUSTRY SNAPSHOT

- Pakistan's refining production is ~13.7 million tons per year.
- Refining industry achieved capacity utilization of over ~69% during FY17.
- Presently, all petroleum products are deregulated except kerosene.
- Import price of Pakistan State Oil for previous month acts as benchmark for the ex-refinery prices of underlying products

OWNERSHIP

- PARCO is 60% owned by the Government of Pakistan, represented by the Ministry of Petroleum and Natural Resources (MPNR) and 40% by Emirate of Abu Dhabi. Emirate of Abu Dhabi has made an investment under the name of Abu Dhabi Petroleum Investments LLC (ADPI) - a majority owned company of Emirate of Abu Dhabi.
- Sovereign ownership by two states – Pakistan and Abu Dhabi, provides absolute financial strength to the company. Given the strategic importance of PARCO to the Country, in terms of its socio-economic benefits and forex saving, the probability of sovereign support, in case the company requires it, remains high.

GOVERNANCE

- The Company's Ten-member Board of Directors (BoD) includes six nominees of the GoP, including the Chairman and the Managing Director (MD), while the remaining four are EAD nominees, one of whom is an OMV representative.
- Mohammed Jalal Sikandar Sultan; Secretary Petroleum is the Chairman of the Company with overall experience of 22 years and Mr. Khalifa Al Suwaidi, a representative of EAD, is the Vice Chairman of the company with overall experience of ~18yrs and a foreign university graduate. During FY17, the board held four meeting, to approve financial results, review progress of ongoing mega projects and to review annual budget.
- PARCO's Auditor, KPMG Taseer Hadi & Co Chartered Accountants, is one of the big four firms, having satisfactory QCR Rating from the Institute of Chartered Accountants of Pakistan. They have expressed an unqualified opinion on the company's financial statement as of June 30, 2017.

MANAGEMENT AND CONTROLS

- The organizational structure of the company is divided into various divisions and departments. All the divisional heads are designated as General Manager (GM). The top management comprises seasoned professionals with strong track records in their respective fields.
- Mr. Tariq Rizavi took charge of PARCO as the Managing Director in September 2011. Mr. Rizavi, a chemical engineer by profession, has been associated with the company for over 40 years and has served at various managerial positions in the Company.
- PARCO has implemented – SAP – Enterprise Resource Planning (ERP) solution, to streamline planning and coordination across business lines, thereby increasing overall efficiency. The implemented modules include Financials, Sales and Distribution, Materials Management, Quality Management, Plant Maintenance Project Systems and Human Capital Management.
- The Company generates MIS reports on daily, fortnightly, monthly and annual basis. These mainly include daily cash position, daily production report, saleable stock position, monthly debtors ageing, monthly management reports, monthly budget vs. expense report etc.

BUSINESS RISK

- During FY17, PARCO achieved throughput of ~104% (FY16: ~101%). Company's turnover increased by ~14% YoY to PKR ~225bln in comparison to PKR ~198bln. This increase has been led by increase in prices of international crude oil and hence product prices, whereas meagre increase in the volumes is also observed (FY17: ~4.5mln MT, FY16: ~4.3mln MT).
- On the flip side, cost of crude consumed increased by higher proportion (~12%) than revenues. Also, increase in price of raw material (~19%) was observed. Resultantly, gross profit of the company slightly reduced (FY17: ~12%, FY16: ~14%). Operating margins of the company were also slightly lower (FY17: ~11%, FY16: ~13%) owing to inflationary increase in administrative expenses.
- Dividend income from Subsidiaries and Joint Venture was of PKR 2,238mln (FY16: PKR 1,921mln) and return on short-term deposits of PKR 1,968mln (FY16: ~PKR 2,622mln) contributed major support to bottom line. Finance cost reduced significantly (FY17: PKR ~356mln, FY16: PKR ~663mln) due to repayment of long-term loans. Accounting for taxation, net profit of the company stood at PKR 19,062mln (FY16: 18,830mln).
- During 1HFY18, company's turnover clocked in at PKR 117bln, ~7% higher than the same period last year (SPLY). This is primarily due to hike in global crude oil prices. Gross profit of the company decreased (1HFY18: ~9%, 1HFY17: ~12%), as cost of the production increased by higher proportion (~11%) than revenues due to oil prices. Finance cost of the company has increased to PKR ~50mln (1HFY17: PKR ~32mln) due to FE-25 loans during the period. Accounting for taxation, net profit of the company stood at PKR ~9,234mln (1HFY17: PKR 9,420mln)
- Going forward, PARCO is planning to increase the capacity of its existing 100,000 bpd refinery to 120,000 bpd which is expected to come online in FY19. Moreover, PARCO has also initiated the development of the new 250,000bpd PARCO Coastal Refinery Project. With these capacities to come online, bottom line of the company is expected to increase manifold over the time.

FINANCIAL RISK

- PARCO's working capital needs emanate from the need to finance its inventory of crude oil purchases and receivables for which the company relies on both internal cash flows as well as short term borrowings (STBs), if needed.
- Over the years, PARCO's working capital management has improved which is evident from controlled net working capital days (end-Dec17: 25days, end-Jun17: 26days, end-Jun16: 15days). The company has arranged short-term running finance facility of PKR 54bln which is unutilized as of Jun17. However, during 1HFY18, ~17% of the arranged facility has been utilized.
- During FY17, the company's cash flows (FCFO) decreased YoY basis (FY17: 17,749mln, FY16: 19,054mln) owing to reduced PBT and investments in different projects. However, coverages of the company remains strong owing to reduced interest cost [Interest coverage: FY17: ~49.8x, FY16: ~28.7x). During 1HFY18, FCFO of the company stood at PKR 7,375mln (FY16: PKR 9,056mln) whereas coverages also remained strong.
- PARCO has moderately leveraged capital structure (end-Jun17: ~1.3%, end Jun16: ~11%). The only long-term loan has been acquired from European Investment Bank which is re-lent to its subsidiary (PAPCO).

PKR mln

PARCO Limited

BALANCE SHEET	30-Dec-17	30-Jun-17	30-Jun-16	30-Jun-15
	6M	FY17	FY16	FY15
Non-Current Assets	**20,968**	**21,861**	**21,978**	**25,015**
Investments (Incl. associates)	**68,264**	**57,502**	**61,616**	**44,053**
Equity	11,561	11,561	10,878	11,356
Debt	56,702	45,941	50,738	32,697
Current Assets	**48,454**	**44,011**	**42,084**	**57,425**
Inventory	22,679	17,058	17,832	24,792
Trade Receivables	12,656	13,213	12,519	14,836
Others	13,119	13,740	11,732	17,797
Total Assets	**137,685**	**123,374**	**125,678**	**126,493**
Debt	**10,237**	**1,048**	**8,598**	**2,514**
Short-term	9,410	-	7,031	1
Long-term (Inlc. Current Maturity of long-term debt)	827	1,048	1,568	2,513
Other shortterm liabilities	33,993	37,891	37,513	34,381
Other Longterm Liabilities	5,800	6,014	7,479	7,890
Shareholder's Equity	**87,656**	**78,421**	**72,088**	**81,708**
Total Liabilities & Equity	**137,685**	**123,374**	**125,678**	**126,493**
INCOME STATEMENT				
Turnover	**117,275**	**225,792**	**198,099**	**307,285**
Gross Profit	10,942	27,194	27,413	19,927
Other Income	3,620	3,711	3,996	2,664
Financial Charges	(50)	(357)	(663)	(1,009)
Net Income	**9,234**	**19,063**	**18,831**	**13,647**
Cashflow Statement				
Free Cashflow from Operations (FCFO)	7,375	17,749	19,054	12,980
Net Cash changes in Working Capital	(6,218)	1,418	4,324	5,601
Net Cash from Operating Activities	4,006	23,197	27,170	21,475
Net Cash from InvestingActivities	(11,691)	2,070	(18,308)	(11,613)
Net Cash from Financing Activities	4,410	(21,728)	(14,255)	(11,167)
Ratio Analysis				
Performance				
Turnover Growth	7.3%	14.0%	-35.5%	-26.4%
Gross Margin	9.3%	12.0%	13.8%	6.5%
Net Margin	7.9%	8.4%	9.5%	4.4%
ROE	21.1%	24.1%	26.0%	16.6%
Coverages				
Interest Coverage (FCFO/Gross Interest)	148.6	49.8	28.7	12.9
Core: (FCFO/Gross Interest+CMLTD+Uncovered Total STB)	22.7	20.2	5.2	6.5
Total: (TCF) / (Gross Interest+CMLTD+Uncovered Total STB)	31.6	24.8	6.4	8.5
Debt Payback (Total LT Debt Including UnCovered Total STBs) / (FCFO- Gross Int	0.1	0.1	0.2	0.2
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	24.9	25.9	15.2	10.5
Capital Structure (Total Debt/Total Debt+Equity)	10.5%	1.3%	10.7%	3.0%

The Pakistan Credit Rating Agency Limited

ENTITY CREDIT RATING SCALE & DEFINITIONS

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity; 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 Ratings

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 or 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.** "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 Ratings

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 conditions.

B: The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.

C: An inadequate capacity to ensure timely repayment.

Rating Watch
Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. Rating Watch may carry designation – Positive (rating may be raised, negative (lowered), or developing (direction is unclear). A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled.

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 or 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'.

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, a suspended rating should be considered withdrawn.

Withdrawn
A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, or e) the entity/issuer defaults.

Rating Team Statements
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

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)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
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

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(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.
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(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)

Independence & Conflict of interest
(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)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(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)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(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)

Monitoring and review
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(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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