The Pakistan Credit Rating Agency Limited

Rating Report

Ghani Gases Ltd | Sukuk | Feb-17

Report Contents

Rating History					
Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-Apr-2019	A	-	Developing	Maintain	YES
28-Dec-2018	A	-	Stable	Maintain	-
20-Jun-2018	A	-	Stable	Maintain	-
01-Nov-2017	A	-	Stable	Maintain	-
27-Feb-2017	A	-	Stable	Initial	-
20-Jan-2017	A	-	Stable	Preliminary	-

Rating Rationale and Key Rating Drivers

The ratings recognize Ghani Gases' prominent position in the industrial and medical gases sector. The industry largely possesses oligopolistic structure, benefiting the players. Growth in demand due to increase in industrialization and uptick in economic activity has led the company's revenue to improve. With expectation of continued growth in demand, Ghani Gases is pursuing an expansive strategy to become the market leader by setting up its new ~110TPD plant, GGL-III. Timely completion and subsequent smooth functioning of the new plant is important. Financial risk profile of the Company is stretched on account of recent rise in short-term borrowing, diminishing free cashflows and coverages, though the Company remains moderately leveraged. Given the group's expansionary stance, sustained vigilance and support from sponsors is essential. The sponsoring family has demonstrated support to the company in the past. Presently, the Company is undergoing a scheme of arrangement which aims to restructure Ghani Gases into a holding company which will be renamed to Ghani Global Holdings Limited while the Company's manufacturing undertaking will be transferred to subsidiary: Ghani Chemical Industries Limited. This process is expected to complete during FY20.

The ratings are dependent on the company's ability to effectively utilize enhanced capacities. At the same time, management of financial risk, particularly debt coverages, remains important, wherein any significant dilution would have negative implications for the ratings. Sustained market share and, in turn, better margins would support ratings. Further, considering the ongoing change in ownership structure, PACRA has placed the ratings of Ghani Gases Sukuk | Feb-17 on 'Rating Watch – Developing'.

Disclosure	
Name of Rated Entity	Ghani Gases Ltd | Sukuk | Feb-17
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-18),Methodology | Sukuk(Jun-18),Methodology | Debt Instrument(Jun-18),Methodology | Criteria | Rating Modifier(Jun-18)
Related Research	Sector Study | Industrial Gases(Dec-18)
Rating Analysts	Muhammad Hassan | muhammad.hassan@pacra.com | +92-42-35869504

Profile

Legal Structure Ghani Gases Limited (Ghani Gases) is a listed, public limited concern incorporated in 2007.

Background Ghani Gases was established as a private limited company in 2007 and subsequently converted to public status during 2008. It is a leading company of the Ghani Group and is one of the two market leaders in industrial gas producing industry in Pakistan.

Operations Ghani Gases is engaged in the manufacturing, sale and trading of medical and industrial gases and chemicals including Liquid Nitrogen, Liquid Oxygen, Argon and Calcium Carbide. The Company currently operates with two production facilities for manufacturing of liquid industrial and medical gases with combined capacity of 220TPD and is in the process of setting up a third plant of 110TPD at Kasur, near Lahore.

Ownership

Ownership Structure The Ghani family holds majority stake (~51%) directly in Ghani Gases while the remaining shareholding of the Company rests with financial institutions and public sector companies (~14%) and general public (~35%).

Stability Ghani Gases is part of the Ghani Global Group of Companies. The Group is presently undergoing a restructuring which will result in demerging of Ghani Gases' manufacturing undertaking and transfer it to Ghani Chemical Industries Limited (subsidiary) while Ghani Gases Limited will be renamed to Ghani Global Holdings Limited. Following the restructuring, Ghani Chemical Industries Limited and Ghani Global Glass Limited (associate) will become subsidiaries of Ghani Global Holdings Limited. Further, the sponsor loans of both companies will be transferred to Ghani Global Holdings Limited against issuance of shares at a pre-agreed swap ratio. The scheme was approved by the Lahore High Court in March, 2019, and implementation is in process. Following the restructuring, the stability of the Company is expected to improve.

Business Acumen The sponsors have over five decades of entrepreneurial experience in vastly diversified sectors including industrial gases, engineering, mining, glass, real estate, automobiles and food.

Financial Strength The Ghani Group, which includes Ghani Gases Limited, Ghani Global Glass Limited and Ghani Chemical Industries Limited, had total equity of ~PKR 4bln at end-FY18. The Group has adequate financial muscle and has shown willingness and ability to support the Company through interest-free loans in the past.

Governance

Board Structure The oversight of the Company is entrusted with a nine-member Board of Directors, chaired by Mr. Masroor Ahmad Khan. Recently, two independent directors have been inducted; however, the Board continues to be dominated by the sponsoring family with six members, undermining its mandate as an independent over sight function of the Company.

Members' Profile Mr. Masroor Ahmad Khan has been associated with the family business since 1985. He has over three decades of experience in various managerial and directorial positions in Group companies. Most Directors have been associated with the Board since the inception of the Company and have extensive experience in diversified sectors.

Board Effectiveness Board meetings are held regularly with high attendance of directors. An internal audit function is also in place which is supervised by the Head of Internal Audit who reports to the Board Audit committee. Two committees are also in place to assist the Board: HR and Remuneration Committee and Audit Committee.

Financial Transparency M/s, Rizwan & Co. Chartered Accountants, QCR listed, is the external auditor of the Company. The auditor gave an unqualified opinion on the Company's financial statements for the year ended June 30, 2018 and period ended December 31, 2018.

Management

Organizational Structure The Company's overall operations are segregated into six broad functional divisions with divisional heads reporting directly to the Managing Director – Mr. Hafiz Farooq Ahmad.

Management Team Mr. Atique Ahmad Khan holds the office of CEO. Ghani Gases' management team comprises qualified and experienced professionals with a diversified range of skills related to the industrial gases industry and other sectors.

Effectiveness Ghani Gases maintains adequate IT infrastructure and related controls with regular presentation of reports to senior management. Management committees are in place to attend to relevant matters with documentation of minutes.

MIS The company has deployed Oracle ERP solution recently which is expected to add value to the reporting system of the company, going forward.

Control Environment MIS reports are presented on a regular basis to the senior management including inventory, finance and production. Recent implementation of Oracle technology ensures timely availability of information for efficient decision making.

Business Risk

Industry Dynamics Pakistan's overall production capacity for industrial gases currently stands at ~700TPD. Domestic demand is rising owing to increased industrial activity as well as driven by the healthcare sector while local production is insufficient; thus, a small portion must be imported as well. However, industrial capacity will increase as both major players of the market, Ghani Gases and Pakistan Oxygen, are in the process of expanding their capacity.

Relative Position Pakistan Oxygen currently holds the leading position in industrial gases' industry with a market share of ~45%, whereas Ghani Gases follows with share of ~37%. Other players have much lower capacity and hence lower market share.

Revenues The Company's topline is led by industrial gases, mainly Liquid Oxygen and Liquid Nitrogen, followed by chemicals segment mainly including Calcium Carbide. During 1HFY19, net revenue amounted to ~PKR 1,140mln, a ~24% YoY growth led by an increase in the price of Calcium Carbide and volumetric increase driven by increased demand of Liquid Oxygen by healthcare sector.

Margins The Company's gross margin witnessed a YoY decrease in 1HFY19 to stand at ~32% (1HFY18: ~41%) mainly due to higher cost of importing Calcium Carbide without corresponding increase in selling prices. This translated into lower operating margins (1HFY19: ~17%, 1HFY18: ~23%). Finance cost increased by ~57% YoY on account of higher short-term borrowings. This led to pre-tax profit clocking in at ~100mln against ~PKR 144mln in the corresponding period last year while tax adjustment led to net income of the Company standing ~4% higher YoY at ~PKR 77mln.

Sustainability Keeping in view rising demand in central Punjab, the Company is in the process of setting up its third plant, GGL-III, which arrived in March, 2019, and commissioning is in process. The management expects the plant to become operational during July, 2019. Going forward, the Company is planning to set up another plant in the South with a capacity of 225TPD. This project is yet in the planning stages. Due to the ban imposed by the Punjab government on Calcium Carbide due to health reasons, the Company is also exploring other venues for chemicals.

Financial Risk

Working Capital Ghani Gases' working capital requirements emanate from its need to finance its inventory of imported Calcium Carbide and offering relaxed credit terms to its customers. The Company's cash conversion efficiency improved YoY, depicted in net cash cycle shortening significantly YoY (1HFY19: 80 days, 1HFY18: 103 days). During the year, working capital requirements increased owing to increased cost of importing Calcium Carbide. Recent use of short-term borrowing to repay sponsor loan has also led to depletion of borrowing lines.

Coverages During 1HFY19, the Company's free cash flows stood at PKR ~220mln, a ~5% YoY decline owing to reduced pre-tax profitability. Coverages also showed YoY decline with debt-servicing coverage clocking in at 2.4x (1HFY18: 4.0x) while core coverage stood at 1.0x (FY17: 1.3x) on account of higher finance cost due to increased short-term borrowings. Generation of incremental cash flows from the third plant is critical to avoid further pressure on the Company's coverages.

Capitalization Ghani Gases has maintained a moderately leveraged capital structure with leveraging standing at ~46% at 1HFY19 (1HFY18: ~47%). Long-term debt declined during 1HFY19 owing to repayments of bank borrowings while short-term borrowing showed slight increase to finance working capital requirements. The company plans to finance its new plant partially through debt; thus, leveraging is expected to rise, going forward. The Company issued a rated, privately placed and secured Sukuk in FY17 amounting to PKR 1,300mln at a profit rate of 3M-KIBOR plus 100bps. The Sukuk has a maturity of six years with repayment in quarterly instalments. Outstanding amount at end-Feb19 stood at ~PKR 867mln.

Financials (Summary) in PKR mln
PKR mln

Ghani Gases Limited

Listed Public Limited

BALANCE SHEET	Dec-18	Jun-18	Jun-17	Jun-16
	6M	12M	12M	12M
a Non-Current Assets	**3,204**	**3,127**	**2,997**	**2,831**
b Investments (Incl. Associates)	**593**	**593**	**593**	**1**
Equity Instruments	593	593	593	1
Debt Instruments	-	-	-	-
c Current Assets	**1,656**	**1,607**	**1,375**	**2,071**
Inventory	60	94	38	26
Trade Receivables	572	469	530	406
Others	1,025	1,044	808	1,638
d Total Assets	**5,453**	**5,327**	**4,965**	**4,902**
e Debt/Borrowings	**2,221**	**2,276**	**2,182**	**2,107**
Short-Term	971	956	273	431
Long-Term (Incl. Current Maturity of Long-Term Debt)	1,250	1,320	1,909	1,676
Other Short-Term Liabilities	313	228	153	369
Other Long-Term Liabilities	335	316	281	214
f Shareholder's Equity	**2,584**	**2,507**	**2,349**	**2,212**
g Total Liabilities & Equity	**5,453**	**5,327**	**4,965**	**4,902**

INCOME STATEMENT				
a Turnover	**1,140**	**2,049**	**1,804**	**1,767**
b Gross Profit	366	639	569	576
c Net Other Income	5	(14)	(2)	(4)
d Financial Charges	(91)	(123)	(97)	(118)
e Net Income	**79**	**157**	**136**	**160**

CASH FLOW STATEMENT				
a Free Cash Flow from Operations (FCFO)	220	281	319	391
b Total Cashflows (TCF)	220	281	319	391
c Net Cash changes in Working Capital	43	(90)	(288)	14
d Net Cash from Operating Activities	180	75	(74)	299
e Net Cash from InvestingActivities	(139)	(236)	(856)	(224)
f Net Cash from Financing Activities	(54)	101	75	788
g Net Cash generated during the period	(13)	(61)	(855)	863

RATIO ANALYSIS				
a Performance				
Turnover Growth	24%	14%	2%	3%
Gross Margin	32%	31%	32%	33%
Net Margin	7%	8%	8%	9%
ROE	6%	6%	6%	10%
b Coverages				
Debt Service Coverage (X) (FCFO/Gross Interest+CMLTD+U	1.0	0.8	1.0	0.5
Interest Coverage (X) (FCFO/Gross Interest)	2.4	2.3	3.3	3.4
Debt Payback (Years) (Total Debt (excluding Covered Short T	4.8	8.2	8.6	6.1
c Capital Structure (Total Debt/Total Debt+Equity)				
Net Cash Cycle (Inventory Days + Receivable Days - Payable D	78	89	77	53
d **Capital Structure** (Total Debt/Total Debt+Equity)	46%	48%	48%	49%

Regulatory and Supplementary Disclosure

Sukuk	
Placement	Rated, Secured, Privately Placed Sukuk
Issue size	PKR 1,300mln
Issue date	February 3rd, 2017
Tenor	6 Years from the date of issue
Profit Rate	3Months KIBOR + 1%
Principal Repayment	Twenty-four (24) consecutive quarterly installments
Security	First Pari Passu charge over present and future fixed assets of the company inclusive of a 20% margin to the extent of PKR 1,625mln
Book Value of Security- 30 Sep18	PKR 100,000
Trustee	BankIslami Pakistan Limited

Quarterly Installments	Year	Due Date	Days	Principal	Rent/Profit	Total Installment	Outstanding Balance
					------------PKR 000's ------------		
0	2017	Feb-17	-	-	-	-	1,300,000
1	2017	May-17	89	54,167	37,087	91,254	1,245,833
2	2017	Aug-17	92	54,167	36,740	90,907	1,191,667
3	2017	Nov-17	92	54,167	35,143	89,309	1,137,500
4	2018	Feb-18	92	54,167	33,545	87,712	1,083,333
5	2018	May-18	89	54,167	30,906	85,073	1,029,167
6	2018	Aug-18	92	54,167	30,351	84,517	975,000
7	2018	Nov-18	92	54,167	28,753	82,920	920,833
8	2019	Feb-19	92	54,167	27,156	81,322	866,667
9	2019	May-19	89	54,167	24,725	78,892	812,500
10	2019	Aug-19	92	54,167	23,961	78,128	758,333
11	2019	Nov-19	92	54,167	22,364	76,530	704,167
12	2020	Feb-20	92	54,167	20,766	74,933	650,000
13	2020	May-20	90	54,167	18,752	72,919	595,833
14	2020	Aug-20	92	54,167	17,571	71,738	541,667
15	2020	Nov-20	92	54,167	15,974	70,141	487,500
16	2021	Feb-21	92	54,167	14,377	68,543	433,333
17	2021	May-21	89	54,167	12,362	66,529	379,167
18	2021	Aug-21	92	54,167	11,182	65,348	325,000
19	2021	Nov-21	92	54,167	9,584	63,751	270,833
20	2022	Feb-22	92	54,167	7,987	62,154	216,667
21	2022	May-22	89	54,167	6,181	60,348	162,500
22	2022	Aug-22	92	54,167	4,792	58,959	108,333
23	2022	Nov-22	92	54,167	3,195	57,361	54,167
24	2023	Feb-23	92	54,167	1,597	55,764	(0)

Debt Instrument Rating Scale & Definitions

Debt Instrument 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.

Rating Symbol	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.

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, a) some material identifiable event and/or b) deviation from expected trend. 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 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) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) 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.

Regulatory and Supplementary Disclosure

(Credit Rating Companies Regulations,2016)

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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