The Pakistan Credit Rating Agency Limited

# Rating Report

# EGAS (Pvt.) Limited

**Report Contents**



**Rating History**

| Dissemination Date | Long Term Rating | Short Term Rating | Outlook | Action | Rating Watch |
|---|---|---|---|---|---|
| 18-Feb-2020 | BBB | A2 | Stable | Maintain | - |
| 31-Aug-2019 | BBB | A2 | Stable | Maintain | - |
| 03-May-2019 | BBB | A2 | Stable | Upgrade | - |
| 05-Nov-2018 | BBB- | A3 | Stable | Maintain | - |
| 04-Apr-2018 | BBB- | A3 | Stable | Initial | - |

## Rating Rationale and Key Rating Drivers

E-Gas (Pvt.) Ltd operates a unique business model of supplying CNG through a virtual pipeline. Overall the industry is dependent on the two major state owned gas distribution companies; E-Gas through its virtual pipeline is capturing a small niche in that market. There is room available in this segment as the gas being distributed is a small fraction of what is being flared into the atmosphere. The demand from the customers is need-driven, which is perpetually increasing, as the energy starved industry doesn't have access to uninterrupted supply or any other viable alternatives.
Success is pivotal on sound supply chain management and fulfilling the ever increasing demand through a well-managed fleet of logistical infrastructure. E-Gas has expanded its fleet size over the last few years. The Company is currently procuring gas from six fields and has enhanced its customer base. Significant portion (72%) of sales emanating from top three customers; further diversification will help address concentration risk. The company has expanded its fleet size over the year; gradual expansion is still underway. Expansion will increase leveraging but is expected to remain within comfortable range supplemented by good cash flows of the Company. Furthermore, strengthened equity base (end Dec-19: PKR 2.4bln, end Dec-18: PKR 1.7bln) over the last few years provide comfort to financial risk matrix. The cost structure is being managed; distribution costs, going forward, should be the main focus of the management. The sponsors have a good understanding of the business along with happenings in the industry. The sponsor support is evident from presence of interest free long term loan and personal guarantees of directors on the book.

The ratings are dependent on sustaining a steady revenue stream and financial risk profile. The ratings would positively benefit from the corporate governance principles, internal control systems and financial strength of E-Gas. Any prolonged dip in subdued business volume and low gas prices can have a detrimental effect.

**Disclosure**

| | |
|---|---|
| **Name of Rated Entity** | EGAS (Pvt.) Limited |
| **Type of Relationship** | Solicited |
| **Purpose of the Rating** | Entity Rating |
| **Applicable Criteria** | Methodology \| Corporate Ratings(Jun-19),Methodology \| Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria \| Rating Modifier(Jun-19) |
| **Related Research** | Sector Study \| Distribution \| Gas(Jun-19) |
| **Rating Analysts** | Abdul Wahab \| abdul.wahab@pacra.com \| +92-42-35869504 |

## Profile

**Legal Structure** E-Gas (Pvt) Limited was established in 2006.

**Background** In 2006, E-Gas had two core business divisions, Alternate Energy Solution and Virtual Gas pipeline. For Alternate Energy Solutions they partnered with Fornovo Gas, a technologically advanced equipment manufacturer to provide CNG equipment and services in Pakistan (discontinued in 2011). Presently, E-Gas' main business revolves around the Virtual Gas Pipeline - Operating as distributors.

**Operations** Operating Virtual Gas pipeline, E-Gas has been supplying CNG to different companies in Pakistan through their huge fleet of High-Pressure Specialized Modules (HPSM). CNG is transported through trucks from a pipeline near a gas field (reservoir) straight to customer location including remote filling stations for CNG fueled vehicles. At production facility, located near the gas field, the gas is compressed, cooled and dehydrated.

## Ownership

**Ownership Structure** The three shareholders; who are brothers, each owns 33% stake in the company. Their father, Mr. Muhammad Raza, is a sleeping partner holding 0.002% of the shares.

**Stability** E-Gas needs to have succession planning to ensure sustainability of the entity's prospects. However the ownership is considered to be stable as no variation is expected.

**Business Acumen** The brothers are keen businessmen with diverse experience from various industries. To name a few, oil & gas, accounting, medicine, auto dealership etc. The sponsors are highly educated and have exposure of dealing with national and international companies on assorted forums.

**Financial Strength** The sponsoring family has two other successful running businesses, 4 fuel stations - one of them in F-7 Islamabad, and a Honda cars dealership in Rawalpindi. In August 2019, the sponsors shared that they're also bringing Hyundai dealership to Pakistan, and now it is currently operational. In case of need, these would provide financial cushion to continue operations efficiently.

## Governance

**Board Structure** The Board comprises of the three brothers as their father isn't involved in the day to day business of the company. Governance structure has room for improvement as all three members have executive roles and there is no independent director at present.

**Members' Profile** The eldest brother, Mr. Yasir Raza is the CEO, an MBA from London Metropolitan University, carries years of experience in the technology and oil & gas sectors - looks after the technical side of the business. Dr. Taimur Raza, the middle brother, holds an MBBS and an MRCP degree from the UK. He has previously worked as a medical professional and is now part of the EGas team spearheading the finance department. Mr. Hassan Raza youngest amongst the three directors holds a MBA degree from Indiana University. He looks after the business development and sales function of E-Gas. All the board members are qualified and experienced individuals.

**Board Effectiveness** The presence of an independent director is integral to ensure effective, transparent and independent oversight. The company would do better if it has its own internal audit function which could report directly to a board audit committee. In addition to this, no board committees are in place.

**Financial Transparency** M/s. Horwath Hussain Chaudhury & Co. Chartered Accountants, are the external auditor of the company. They're SBP's category 'A' auditors and also have a QCR rating. The auditors have expressed an unqualified audit opinion on the financial statements of E-Gas for the year ended June 30, 2019.

## Management

**Organizational Structure** E-Gas has a lean organizational structure with an experienced management team and a balanced mix of professionals

**Management Team** The top management includes four key professionals. Mr. Maj (Retd.) Najmul Hassan, General Manager, holds an MBA and joined E-Gas in FY16. Mr. Muhammad Bin Qasim, CFO, is a chartered accountant and has been with E-Gas for 5 years.

**Effectiveness** All members of management team are qualified and carry adequate experience. E-Gas does not have formal management committee.

**MIS** The company's MIS generates balance sheet, profit and loss, and cash flow statements on a weekly basis for the board including sales reports which are reviewed by the top management daily.

**Control Environment** E-Gas is currently using Intuit QuickBooks Online accounting software. The web-based features include remote access capability, remote payroll assistance etc.

## Business Risk

**Industry Dynamics** Presently, natural gas is contributing nearly 46% to Pakistan's primary energy supply mix. The country produces around 4 BCFD of natural gas against the demand of more than 6 bcfd. Demand gap is presently managed through load shedding and load management by gas utility companies. Currently struggling with the rapidly increasing energy supply/demand gap, efforts are being made by GoP to utilize the existing resources. One potential measure includes the utilization of gaseous hydrocarbons currently being flared and/or vented at oil & gas production and processing facilities mainly due to quality, technical, operational, and economic constraints. There is an excavated potential/scope of utilizing these flared gases which will add up to a sustainable energy source. Currently, 3-4 companies are operating to capture this market segment. Pakistan's volume of total flared gas stands at 363 million cubic meters as of 2019 (2018: 299 million cubic meters).

**Relative Position** E-GAS is the only private sector virtual pipeline company operating in all four provinces of Pakistan. It's competitor, 'Hitech Pipes & Engineering' has licence to only incentivize from gas stations in the Sindh region. Out of the total flared gas emitted in the atmosphere, E-Gas has 45% market share (134.55 million cubic meters).

**Revenues** EGas has witnessed a consistent increase in its revenues as the demand has been robust and upward trending. During FY19, the entity's revenues stood at PKR 1.6bln (FY18: PKR 968mln), a ~69% increase YOY. In 1HFY20, reported revenues was PKR 965mln, showed a growth of ~48% YoY (1HFY20: PKR965mln, 1HFY19: PKR 652mln).

**Margins** During FY19, as topline increased, hike in distribution costs around 37% YOY (FY19: PKR 178mln, FY18: PKR 129mln) resulted in a slight dip in the gross margins (FY19: 62%, FY18: 65%). In 1HFY20, distribution costs further increase to ~58% YOY, and diminished the gross profit margins to 58% in 1HFY20, from 68% in 1HFY19 (IHFY20: PKR 125.2mln, 1HFY19: PKR79mln). In FY19, Admin and general expenses rose by 58% YOY (FY19: PKR 130mln, FY18: PKR 82mln). This trend also followed in 1HFY20 and reported expenses witnessed an increase of ~24% YOY (1HFY20: PKR 79.8mln, 1HFY19: PKR 391mln).PAT also declined by a slight ~5% YOY, standing at PKR 330mln in 1HFY20 and PKR 592mln in FY19.

**Sustainability** During FY20, EGas has planned to add 3-5 new HINO trucks to its fleet and in this regard, negotiations with Habib Bank Limited is in final stage. These trucks are automatic and have the capacity to carry 11,000Kg of CNG. Further they would be able to run on CNG which would lower the cost of Fuel. Total cost savings are estimated to be around PKR 1mln/month. E-Gas recently acquired two new fields -i) Orient Petroleum Limited (Ratana) ,ii) Pakistan Petroleum Limited (Dhok Sultan), and now there are 6 operational gas fields. The contract with PPL was renewed till June 2020 and as of today E-gas is in the negotiation of opening 3 new contracts with them. Negotiations with Mitsui to penetrate into port Qasim's terminal is also on the horizon.

## Financial Risk

**Working Capital** For working capital needs, E-Gas relies on both internal cash flows as well as short term borrowing. In 1HFY20, short term borrowing stood at PKR 90mln (FY19: PKR 90mln). During 1HFY20, net working capital days have decreased, (1HFY20: 46 Days, FY19: 61days), on account of coherent receivables aging - standing at an adequate level.

**Coverages** In FY19, FCFO witnessed a growth of ~70% increase YOY and in 1HFY20, growth stands at ~9% YOY. (IHFY20: PKR 321mln, FY19: PKR 851mln). The major reason behind this decline in growth trend was due to ~54% increase in payment of income taxes in the 1HFY20. (1HFY20: PKR 238mln, FY19 : PKR 155mln). Further added, in 1HFY20, interest coverage ratio deteriorated (1HFY20: 29x, FY19: 35x).

**Capitalization** At end-Dec-19, EGas has a slightly shredded its borrowing book, due to which, capital structure decreased to 8.5% in 1HFY20 (FY19: 12%; FY18: 21%). This is primarily on account of decrease in long-term debt levels (1HFY20: PKR 38mln, FY19: PKR 79mln, FY18: PKR 134mln) - 81% of LTD relates to Finance lease.

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*Financial Summary*
*PKR mln*

| E-Gas Pvt. Limited<br>Distribution \| Gas | Dec-19<br>6M | Jun-19<br>12M | Jun-18<br>12M | Jun-17<br>12M |
|---|---|---|---|---|
| **A BALANCE SHEET** | | | | |
| 1 Non-Current Assets | 2,366 | 2,171 | 1,542 | 1,178 |
| 2 Investments | - | - | - | - |
| 3 Related Party Exposure | - | - | - | - |
| 4 Current Assets | 458 | 491 | 539 | 500 |
| *a Inventories* | *16* | *15* | *28* | *24* |
| *b Trade Receivables* | *207* | *253* | *251* | *230* |
| **5 Total Assets** | 2,824 | 2,662 | 2,081 | 1,677 |
| 6 Current Liabilities | 184 | 295 | 193 | 190 |
| *a Trade Payables* | *49* | *43* | *37* | *47* |
| 7 Borrowings | 223 | 280 | 393 | 287 |
| 8 Related Party Exposure | - | - | 2 | 5 |
| 9 Non-Current Liabilities | - | - | - | - |
| **10 Net Assets** | 2,417 | 2,086 | 1,493 | 1,195 |
| **11 Shareholders' Equity** | 2,417 | 2,086 | 1,493 | 1,195 |
| **B INCOME STATEMENT** | | | | |
| **1 Sales** | 966 | 1,633 | 968 | 886 |
| *a Cost of Good Sold* | *(401)* | *(637)* | *(338)* | *(275)* |
| **2 Gross Profit** | 565 | 996 | 630 | 611 |
| *a Operating Expenses* | (80) | (130) | (83) | (125) |
| **3 Operating Profit** | 485 | 866 | 547 | 486 |
| *a Non Operating Income or (Expense)* | - | *1* | *0* | *1* |
| **4 Profit or (Loss) before Interest and Tax** | 485 | 866 | 548 | 486 |
| *a Total Finance Cost* | *(19)* | *(32)* | *(36)* | *(26)* |
| *b Taxation* | *(135)* | *(242)* | *(154)* | *(143)* |
| **6 Net Income Or (Loss)** | 331 | 593 | 358 | 318 |
| **C CASH FLOW STATEMENT** | | | | |
| *a Free Cash Flows from Operations (FCFO)* | *321* | *851* | *500* | *429* |
| *b Net Cash from Operating Activities before Working Capital Changes* | *300* | *830* | *466* | *406* |
| *c Changes in Working Capital* | *34* | *60* | *(50)* | *(155)* |
| **1 Net Cash provided by Operating Activities** | 334 | 890 | 415 | 251 |
| **2 Net Cash (Used in) or Available From Investing Activities** | (270) | (771) | (464) | (179) |
| **3 Net Cash (Used in) or Available From Financing Activities** | (57) | (122) | 46 | (70) |
| **4 Net Cash generated or (Used) during the period** | 7 | (3) | (3) | 2 |
| **D RATIO ANALYSIS** | | | | |
| **1 Performance** | | | | |
| *a Sales Growth (for the period)* | 18.3% | 68.7% | 9.2% | 9.9% |
| *b Gross Profit Margin* | 58.5% | 61.0% | 65.1% | 69.0% |
| *c Net Profit Margin* | 34.3% | 36.3% | 37.0% | 35.9% |
| *d Cash Conversion Efficiency (EBITDA/Sales)* | 57.9% | 61.6% | 66.4% | 63.5% |
| *e Return on Equity (ROE)* | 29.4% | 33.1% | 26.6% | 28.6% |
| **2 Working Capital Management** | | | | |
| *a Gross Working Capital (Average Days)* | 46 | 61 | 100 | 77 |
| *b Net Working Capital (Average Days)* | 38 | 52 | 85 | 60 |
| *c Current Ratio (Total Current Assets/Total Current Liabilities)* | 2.5 | 1.7 | 2.8 | 2.6 |
| **3 Coverages** | | | | |
| *a EBITDA / Finance Cost* | 29.2 | 34.9 | 20.3 | 22.4 |
| *b FCFO / Finance Cost+CMLTB+Excess STB* | 4.8 | 6.0 | 2.5 | 3.4 |
| *c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)* | 0.2 | 0.2 | 0.7 | 0.5 |
| **4 Capital Structure (Total Debt/Total Debt+Equity)** | | | | |
| *a Total Borrowings / Total Borrowings+Equity* | 8.5% | 11.9% | 20.9% | 19.6% |
| *b Interest or Markup Payable (Days)* | 0.0 | 0.0 | 0.0 | 0.0 |
| *c Average Borrowing Rate* | 15.2% | 8.5% | 9.2% | 9.9% |

# Rating Scale | Corporate

2019

## Credit Rating Scale & Definitions

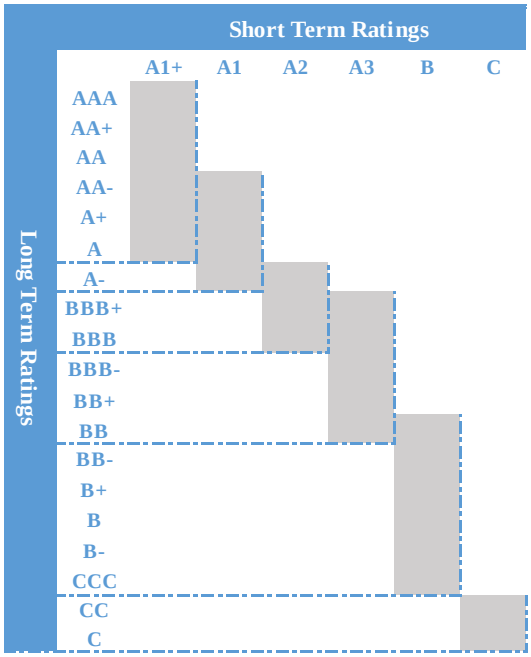
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

### Long Term Ratings

| | |
|---|---|
| AAA | **Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments |
| AA+<br>AA<br>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+<br>A<br>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+<br>BBB<br>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+<br>BB<br>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+<br>B<br>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<br>CC<br>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. |

### 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. |




**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.

**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)
**Proprietary Information**