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
09-Dec-2022	AAA	A1+	Stable	Maintain	-
10-Dec-2021	AAA	A1+	Stable	Maintain	-
10-Dec-2020	AAA	A1+	Stable	Maintain	-
10-Dec-2019	AAA	A1+	Stable	Maintain	-
10-Jun-2019	AAA	A1+	Stable	Maintain	-
14-Dec-2018	AAA	A1+	Stable	Maintain	-
05-Jun-2018	AAA	A1+	Stable	Maintain	-
23-Jun-2017	AAA	A1+	Stable	Maintain	-
30-Dec-2016	AAA	A1+	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

The ratings incorporate PARCO's unique ownership structure representing the Government of Pakistan (GoP) – (60%) and Abu Dhabi Petroleum Investment Company (ADPI) through Mubadala Investment Company (based in Emirates of Abu Dhabi – UAE) – (40%). The rating also incorporates PARCO’s strategic importance to economy through operations providing efficient, low-cost, and environment-friendly energy solutions through transportation of petroleum products via integrated Pipelines, Refining and Marketing. PARCO is also contributing substantially towards socioeconomic benefits and Foreign Exchange savings for the country. Being the market leader, PARCO retains a large chunk of the market share of ~49% of the total domestic supply of Petroleum products. In addition, PARCO witnessed the revenue growth of 134% during FY22, while a significant increase was observed in 1QFY23 where the sales increased by ~20.8%. The Company has low leveraged structure and operations are generally funded by its own resources. Further, the revenue streams also includes return on investments in subsidiaries and associate. Also, Company's investments in dollar-based funds acts as an implied hedge against exchange rate fluctuations. In line with its strategic vision, PARCO has also initiated an integrated refinery-Petrochemical complex of 250-350kbpd project namely the PARCO Coastal Refinery Project. PARCO has also recently completed a feasibility study for Bottom-of-Barrel upgradation project for its existing refinery in order to produce Euro-V compliant fuel products and minimize the production of Furnace Oil as per the directions of the Government of Pakistan. Through its subsidiary, Pak Arab Pipeline Company Ltd (PAPCO), PARCO has initiated development of an Oil Import Terminal (OIT) to meet the growing domestic requirements for petroleum products and to reduce congestion of existing ports.

Effective management of upcoming projects, consistency in Government policies and technological improvisation will remain critical for the ratings. Meanwhile, sustained competitive positioning is also imperative.

Disclosure	
Name of Rated Entity	Pak Arab Refinery Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating(Jun-22),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jun-22),Methodology | Rating Modifiers(Jun-22)
Related Research	Sector Study | Refineries(Nov-21)
Rating Analysts	Anam Waqas Ghayour | anam.waqas@pacra.com | +92-42-35869504

Profile

Legal Structure Established in 1974, Pak-Arab Refinery Ltd (PARCO) is a 60:40 joint venture between the Government of Pakistan and Emirates of Abu Dhabi (EAD) through its investment arm, Abu Dhabi Petroleum Investments LLC (ADPI).

Background The Company was established with the objective of setting up a Mid-Country Refinery (MCR) and an associated pipeline system for the transport of crude oil from Karachi to the refinery site at Mahmood-Kot near Multan. The pipeline project was implemented and commissioned in 1981. The Mid-Country Refinery was established in 2000, one of the largest refinery operating in the country, has a refining capacity of ~120,000 Barrels per day after successfully completing its revamp project.

Operations The company is primarily engaged in the refining, sale, and transportation of petroleum products. The refinery unit of the company produces Liquefied Petroleum Gas (LPG), Motor Gasoline (MS), High Octane Blending Component (HOBC), Kerosene, Jet Fuel (JP-1 & JP-8), High-Speed Diesel (HSD), Light Diesel Oil (LDO), Furnace Oil (FO), Asphalt and Sulphur.

Ownership

Ownership Structure PARCO is 60% owned by the Government of Pakistan, represented by the Ministry of Energy (Petroleum Division) and 40% by Emirates of Abu Dhabi (EAD). EAD has made investment under the name of Abu Dhabi Petroleum Investments LLC (ADPI) - a majority owned company of Mubadala Investment Company (the state-owned investment vehicle of the Abu Dhabi government).

Stability Considering the strategic importance of the company, stability is considered strong.

Business Acumen GoP holds PARCO as its strategically vital asset, whereas more technical knowledge flows in from ADPI. The business acumen of sponsors of the company is considered strong.

Financial Strength Sovereign ownership by two states – Pakistan and Abu Dhabi, provides absolute financial strength to the company. Given the strategic importance of PARCO to the GoP, in terms of its socio-economic policies and its quest of reducing the import bill, the probability of sovereign support, in case the Company requires it, remains high.

Governance

Board Structure 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's nominees through Mubadala Investment Company.

Members' Profile Mr. Capt. (Retd) Muhammad Mahmood, Additional Secretary In-charge Petroleum Division is the chairman of the Company having more than twenty-seven years of diversified experience. PARCO's board comprises of highly qualified members, mostly from well-renowned institutions. It has a blend of business studies, general management, law, engineering, and finance professionals. Experience profile of the board is rich.

Board Effectiveness During FY22, the Board held multiple meetings, to approve financial results, progress review of ongoing mega projects and to review the annual budget. There are five committees at the Board level, namely the Finance, HR, Audit, Investment and Risk & Compliance committees. Each committee is chaired by a board member and consists of other non-executive board members, with the exception of Mr. Shahid Mahmood Khan, who is the MD of the Company and is part of the HR and Finance Committee.

Financial Transparency PARCO's Auditor, EY Ford Rhodes Chartered Accountants, one of the big four firms, have satisfactory QCR Rating from the Institute of Chartered Accountants of Pakistan and classified in category "A" on the panel of auditors maintained by the State Bank of Pakistan under section 35 of Banking Companies Ordinance, 1962. They have expressed an unqualified opinion on the company's financial statement as at end-Jun22.

Management

Organizational Structure The organizational structure of the company is divided into various divisions and departments. All the divisional heads are designated as General Managers (GM). Despite the GoP's large stake in the ownership structure of PARCO, the Company enjoys operational autonomy.

Management Team Mr. Shahid Mahmood took charge of PARCO as the Managing Director in Aug'20. He is a fellow chartered accountant (FCA) with the overall experience of ~40 years whereas his association with PARCO is over ~12 years. The management team is well qualified, mostly associated with the company since long.

Effectiveness Over the years PARCO's effective management played a significant role in empowering the organization through its progressive results. Additionally, management's effective decision-making cause processes more systematic while the robustness of control systems is considered a reflection of strong management.

MIS The company generates MIS reports on daily, fortnightly, monthly, and annual basis. These mainly include daily cash position, daily production report, saleable stock position, Treasury and Accounts section MIS, monthly debtors aging, monthly management accounts, and Annual Financial Statements.

Control Environment PARCO has implemented – SAP – Enterprise Resource Planning (ERP) solution, to streamline planning and coordination across business lines, thereby increasing overall efficiency.

Business Risk

Industry Dynamics Pakistan relies significantly on imports to meet the demand of its energy products. During FY22, the country consumed ~23.1mln MT of petroleum products (FY21:~20.1mln MT) up ~14.9% YOY of which ~47.0% was produced locally and ~53.0% were imported. Owing to declining local oil reserves amid low new discoveries, the dependence on imported POL products is increasing with each passing year. In FY22, local crude oil production is estimated to be ~3.7mln MT (FY21: ~3.7mln MT). However, as local refineries lack the capabilities to viably refine all grades of locally produced crude, their offtake averages at ~87%, while on average ~9% of locally produced crude (condensates) is exported.

Relative Position With respect to the relative positioning of the players in the premium products (HSD and MOGAS); efficiency and utilization of available capacity is essential. Two refineries namely PARCO and Byco Petroleum retain a large chunk of the market share of ~59%, while Pakistan Refinery, National Refinery, and Attock Refinery, contribute ~42% to the total domestic supply of POL products.

Revenues PARCO witnessed the growth of 134% while generating a turnover of PKR ~790,351mln during FY22 (FY21: PKR 337,224), while a significant increase was observed in 1QFY23 where the sales increased by ~73.2% amounting to PKR 238,597 as compared to PKR 137,722mln in 1QFY22.

Margins Gross profit margins of the company, likewise increased in FY22, standing at ~16.7% (FY21: ~4.7%). This is mainly due to increase in prices of POL. Similarly, in 1QFY23 margins showed a further upward movement and stood at ~17.7%.

Sustainability The refinery sector has been going through an existential crisis, as a result of the government's demand for environment friendly fuel. The issue of low FO offtake has been compounded by the introduction of the IMO 2020, which necessitates the use of low Sulphur FO by the marine sector. Due to the substantial investment needed for the required upgrades to the refineries, the developments in this regard, have reached an impasse. Government assistance is imperative, for the sustenance of the sector.

Financial Risk

Working Capital PARCO's working capital needs emanate from the need to finance its inventory of crude oil purchases and receivables for which the company mostly relies on internal cash flows. Over the years, PARCO's working capital management has stood strong which is evident from efficient net working capital days. (1QFY23: 33 days, FY22: 22 days, FY21: 14 days). However, company has availed short term borrowings in the 1QFY23 amounting to PKR 24,849mln.

Coverages During FY22, coverages of the company increased manifolds owing to a reduction in the interest expense as borrowings of the company have reduced. And in 1QFY23, company's coverages portray the same trend. Further, Company's cash flows (FCFO) have also increased owing to increased profitability.

Capitalization PARCO has the moderately-leveraged capital structure, leveraging stands at 16.6% at end 1QFY23 as compared to only 0.1% at end Jun-22. (3MFY22: 21.9%, FY21: ~15.7%). Debt only constitutes the short-term borrowings. Going forward, with the new refinery project, leveraging is expected to increase but will remain well-managed.

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Financial Summary
PKR mln

PARCO Refinery	Sep-22	Jun-22	Jun-21	Jun-20
	3M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	36,127	36,544	37,968	38,041
2 Investments	75,060	67,113	50,265	53,657
3 Related Party Exposure	11,362	11,338	13,278	13,278
4 Current Assets	182,697	166,955	73,059	33,633
a Inventories	*110,040*	*85,893*	*33,782*	*12,369*
b Trade Receivables	*46,421*	*56,223*	*28,703*	*11,603*
5 Total Assets	305,246	281,951	174,570	138,609
6 Current Liabilities	133,938	121,698	69,561	43,679
a Trade Payables	*61,971*	*66,488*	*43,104*	*18,037*
7 Borrowings	24,954	109	15,847	14,303
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	20,810	18,609	4,058	3,769
10 Net Assets	125,544	141,534	85,104	76,858
11 Shareholders' Equity	125,544	141,534	85,103	76,858
B INCOME STATEMENT				
1 Sales	238,597	790,351	337,224	231,608
a Cost of Good Sold	*(196,469)*	*(658,490)*	*(321,310)*	*(246,987)*
2 Gross Profit	42,128	131,861	15,914	(15,379)
a Operating Expenses	(9,552)	(8,786)	(3,711)	(3,972)
3 Operating Profit	32,576	123,075	12,203	(19,351)
a Non Operating Income or (Expense)	*(2,084)*	*(5,703)*	*1,521*	*7,538*
4 Profit or (Loss) before Interest and Tax	30,492	117,372	13,724	(11,813)
a Total Finance Cost	*(83)*	*(1,948)*	*(1,963)*	*(2,055)*
b Taxation	*(9,698)*	*(46,707)*	*(3,433)*	*3,821*
6 Net Income Or (Loss)	20,711	68,718	8,328	(10,046)
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*18,707*	*99,689*	*10,994*	*(16,287)*
b Net Cash from Operating Activities before Working Capital Changes	*18,506*	*97,637*	*8,691*	*(17,761)*
c Changes in Working Capital	*(14,182)*	*(43,106)*	*(14,063)*	*29,146*
1 Net Cash provided by Operating Activities	4,324	54,531	(5,372)	11,385
2 Net Cash (Used in) or Available From Investing Activities	(31,247)	(31,024)	(5,919)	(5,573)
3 Net Cash (Used in) or Available From Financing Activities	(22,027)	(10,249)	(21)	(8,620)
4 Net Cash generated or (Used) during the period	(48,950)	13,258	(11,312)	(2,808)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	20.8%	134.4%	45.6%	-26.9%
b Gross Profit Margin	17.7%	16.7%	4.7%	-6.6%
c Net Profit Margin	8.7%	8.7%	2.5%	-4.3%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	1.9%	7.2%	-0.9%	5.6%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	62.0%	60.6%	10.3%	-11.7%
2 Working Capital Management				
a Gross Working Capital (Average Days)	57	47	47	66
b Net Working Capital (Average Days)	33	22	14	15
c Current Ratio (Current Assets / Current Liabilities)	1.4	1.4	1.1	0.8
3 Coverages				
a EBITDA / Finance Cost	327.0	64.9	7.1	-6.5
b FCFO / Finance Cost+CMLTB+Excess STB	225.4	53.2	5.6	-8.0
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.0	0.0	0.0	0.0
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	16.6%	0.1%	15.7%	15.7%
b Interest or Markup Payable (Days)	75.9	37.3	56.3	117.4
c Entity Average Borrowing Rate	1.9%	11.9%	9.6%	25.6%

Credit Rating

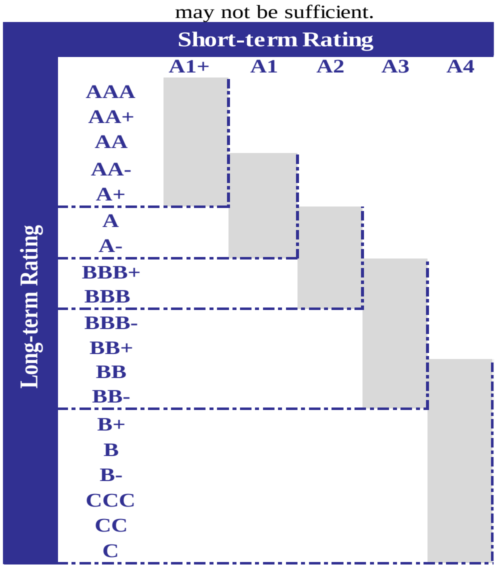
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	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.

Short-term Rating

Scale	Definition
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
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

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 some material identifiable event with indeterminable rating implications. 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 rating 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) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) 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.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

Entities

a) Broker Entity Rating
b) Corporate Rating
c) Financial Institution Rating
d) Holding Company Rating
e) Independent Power Producer Rating
f) Microfinance Institution Rating
g) Non-Banking Finance Companies (NBFCs) Rating

Instruments

a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk Rating

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 | Clause 11-(A)(p).
(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