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
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	-
31-Dec-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 Mubadala. The Company is of strategic importance to the Pakistan 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 for 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 reflect PARCO's strengthened position in midstream and downstream sector resulting through recent acquisitions and completion of expansion projects. Going forward, PARCO is enhancing the capacity of its existing 100,000 bpd refinery to 120,000 bpd which is expected to come online by end-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. Strong capital structure and sizeable equity of the company has enabled to absorb financial outflow. With these capacities to come online, the 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 Ratings(Jun-18),Methodology | Criteria | Rating Modifier(Jun-18),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
Related Research	Sector Study | Refineries(Dec-18)
Rating Analysts	Hamza Ghalib | hamza.ghalib@pacra.com | +92-42-35869504

Profile

Legal Structure Incorporated in 1974 as an unlisted public limited company, Pak-Arab Refinery Limited (PARCO) is a joint venture between the Government of Pakistan (GoP) and the Emirate of Abu Dhabi (EAD).

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 refinery, on the other hand, was commissioned in 2000 and, with a refining capacity of ~4.5mln metric tons (100,000 Barrels per day), is one of the largest refinery operating in the country.

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), High Octane Blending Component (HOBC), Kerosene, Jet Fuel (JP-1 & JP-4), High-Speed Diesel (HSD), Light Speed Diesel (LDO), Furnace Oil (FO) and Sulphur.

Ownership

Ownership Structure 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.

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

Business Acumen GoP hold 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 nominees, one of whom is an OMV representative.

Members' Profile Mr. Mian Asad Hayaud Din; Secretary, Ministry of Energy (Petroleum Division) is the Chairman of the Company and Mr. Khalifa Al Suwaidi, a representative of EAD, is the Vice Chairman of the company with diversified experience of general management. 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 FY18, the board held four meetings, to approve financial results, progress review of ongoing mega projects and to review the annual budget. There are three committees at the Board level, namely the Finance, HR, and Audit committees. Each committee is headed by a board member and consists of other non-executive board members, with the exception of Mr. Tariq Rizavi, who is the MD of the Company.

Financial Transparency PARCO's Auditor, EY Ford Rhodes Chartered Accountants, one of the big four firms, having 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-Jun18.

Management

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

Management Team Mr. Tariq Rizavi took charge of PARCO as the Managing Director during 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. Mr. Shahid Mahmood Khan, a fellow chartered accountant, is the Deputy Managing Director of Finance and Corporate Affairs with the overall experience of ~35 years whereas his association with the PARCO is ~10 years. All 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 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, quarterly budget vs. expense report, 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. The implemented modules include Financials, Sales and Distribution, Materials Management, Quality Management, Plant Maintenance Project Systems, and Human Capital Management.

Business Risk

Industry Dynamics Pakistan consumed a total of ~18mln metric tons (MT) of petroleum products (White Oil) in FY18 (FY17: ~16 mln MT), an increase by ~9%. This increase is mainly seen due to an increase in the consumption of MOGAS and HSD due to growth in the transport sector. Growth is a given factor in the domestic market, yet the relevant proportion of domestic Vs import may face transition. Consumption of black oil has been decreasing due to declining consumption of FO, as the government of Pakistan plans to gradually reduce reliance on oil-based power plants to other input sources for electricity generation i.e. LNG & Coal.

Relative Position 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 retain a large chunk of market share of ~55%, while Pakistan refinery, National refinery, and Attock refinery contribute ~45% to the total domestic supply.

Revenues PARCO witnessed the considerable growth of ~22% and generated a turnover of ~PKR 274,933mln in FY18 (FY17: ~PKR 225,792mln). This increase is seen mainly due to a considerable increase of PoL product prices.

Margins Gross profit of the company has declined in FY18 to ~8.6% (FY17: ~12%) owing to i) declining gross refining margins ii) higher operating cost due to increase in the price of raw material, which also resulted in the reduction of operating profit of the company (FY18: ~7.4%, FY17: ~11%).

Sustainability 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 by end-FY19. Moreover, PARCO has also initiated the development of the new 250,000bpd PARCO Coastal Refinery Project, which is expected to come online in FY23. With these capacities to come online, the bottom line of the company is expected to increase manifold over the time.

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 improved which is evident from efficient net working capital days (FY18: ~12days, FY17:~22days).

Coverages During FY18, coverages (FY18: ~23.0x, FY17: ~49.0x) of the company remained strong owing to a reduction in the interest expense as borrowings of the company have reduced. Company's cash flows (FCFO) increased by ~5% YoY basis (FY18: ~PKR 18,639mln, FY17: ~PKR 17,749mln). This increase is primarily led by a reduction in the outflow of tax that is paid (FY18: ~PKR 4.3bln, FY17: ~PKR 9.8bln).

Capitalization PARCO has the un-leveraged capital structure (end-Jun18: ~0.6%, end-Jun17: ~1.3%). The only long-term loan has been acquired from the European Investment Bank which is re-lent to its subsidiary (PAPCO).

PKR mln

PARCO Limited

BALANCE SHEET	30-Sep-18	30-Jun-18	30-Jun-17	30-Jun-16
	3M	FY18	FY17	FY16
Non-Current Assets	**24,273**	**24,641**	**21,861**	**21,978**
Investments (Incl. associates)	**51,084**	**53,046**	**57,502**	**61,616**
Equity	11,832	11,794	11,561	10,878
Debt	39,252	41,251	45,941	50,738
Current Assets	**89,570**	**77,803**	**44,011**	**42,084**
Inventory	37,175	33,065	17,058	17,832
Trade Receivables	17,525	19,257	13,213	12,519
Others	34,870	25,481	13,740	11,732
Total Assets	**164,927**	**155,489**	**123,374**	**125,678**
Debt	**621**	**607**	**1,048**	**8,598**
Short-term	-	-	-	7,031
Long-term (Inlc. Current Maturity of long-term debt)	621	607	1,048	1,568
Other shortterm liabilities	56,107	51,549	37,891	37,513
Other Longterm Liabilities	6,867	6,856	6,014	7,479
Shareholder's Equity	**101,332**	**96,477**	**78,421**	**72,088**
Total Liabilities & Equity	**164,927**	**155,489**	**123,374**	**125,678**

INCOME STATEMENT				
Turnover	**86,513**	**274,933**	**225,792**	**198,099**
Gross Profit	5,554	23,691	27,194	27,413
Other Income	1,944	6,755	3,711	3,996
Financial Charges	(12)	(808)	(357)	(663)
Net Income	**4,855**	**18,517**	**19,063**	**18,831**

Cashflow Statement				
Free Cashflow from Operations (FCFO)	5,374	18,639	17,749	19,054
Net Cash changes in Working Capital	145	(8,343)	1,418	4,324
Net Cash from Operating Activities	7,268	15,845	23,197	27,170
Net Cash from InvestingActivities	1,569	(2,148)	2,070	(18,308)
Net Cash from Financing Activities	-	(5,000)	(21,728)	(14,255)

Ratio Analysis				
Performance				
Turnover Growth	40.5%	21.8%	14.0%	-35.5%
Gross Margin	6.4%	8.6%	12.0%	13.8%
Net Margin	5.6%	6.7%	8.4%	9.5%
ROE	6.4%	19.2%	24.3%	26.1%
Coverages				
Interest Coverage (FCFO/Gross Interest)	446.0	23.1	49.8	28.7
Core: (FCFO/Gross Interest+CMLTD+Uncovered Total STB)	11.3	13.2	20.2	16.1
Total: (TCF) / (Gross Interest+CMLTD+Uncovered Total STB)	14.9	17.2	24.8	6.4
Debt Payback (Total LT Debt Including UnCovered Total STBs) / (FCFO- Gross	0.1	0.0	0.1	0.2
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	20.7	12.2	21.6	22.6
Capital Structure (Total Debt/Total Debt+Equity)	0.6%	0.6%	1.3%	10.7%

Rating Scale

Credit Rating Scale & Definitions

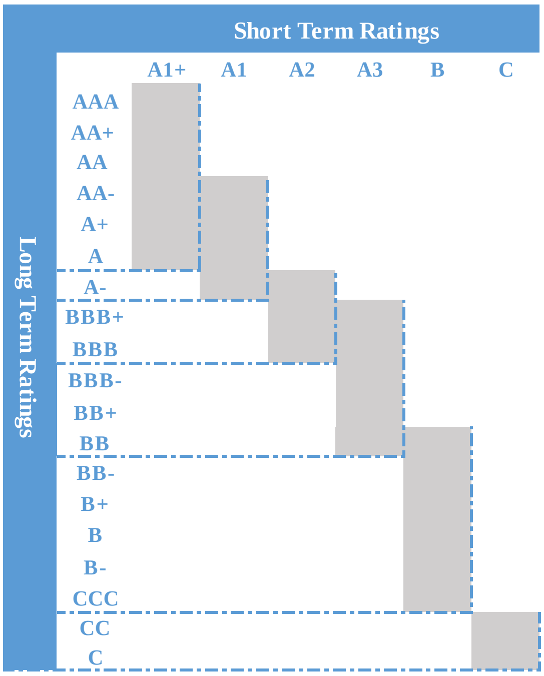
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings

AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ 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 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.

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)
Proprietary Information