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
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	-
31-Dec-2015	AAA	A1+	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

The ratings incorporate PARCO's unique ownership structure - by the Government of Pakistan (GoP) (60%) and the Emirate of Abu Dhabi (EAD) (40%) along with its strategic importance to economy through operations extended to, transportation of petroleum products through integrated Pipelines, Refining, and Marketing, providing efficient, low-cost, and environment-friendly energy solutions. PARCO is also contributing substantially towards socioeconomic benefits and Foreign Exchange savings; its low business risk emanates from its leading market position, strong demand of its products and its advanced Refinery Complex technology. In addition to spike in crude oil prices in International Market, the Country's oil sales in the first quarter of the ongoing fiscal year (1QFY22) posted growth on the back of rising trend in sales of furnace oil (FO), high speed diesel (HSD), MOGAS. In line with industry trend, the Company's topline also increased by 63.4% in 1QFY22. Further, the revenue stream is supported by the return on investments in subsidiaries and associates. Also, Company's investments in dollar-based TDR cover its financial risk profile to a maximum level and also acts as an implied hedge against exchange rate fluctuations. In 1QFY22, the Company earned a net profit after tax of PKR 9.1 billion. PARCO has initiated the development of PARCO Coastal Refinery Limited (PCRL) project, a greenfield 250-350 kbpd integrated refinery-petrochemical project, to be located in the coastal area near Karachi. PARCO also intends to develop an Oil Import Terminal to meet the growing domestic requirements for refined products. Strong capital structure and sizable equity has, historically, enabled the company to absorb hefty capital expenditures.

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-21),Criteria | Correlation Between Long-term & Short-term Rating Scales(Jun-21),Criteria | Rating Modifiers(Jun-21)
Related Research	Sector Study | Refineries(Nov-20)
Rating Analysts	Bazah Tul Qamar | bazahtul.qamar@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 Dr. Arshad Mahmood; Secretary Petroleum is the 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 FY21, the Board held 21 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 the year ended June 30, 2021.

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 ~39 years whereas his association with PARCO is over ~11 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 consumed a total of -13mln metric tons (MT) of petroleum products in 9MFY21 (FY20: ~15mln MT). This decrease is mainly seen due to decrease in the consumption of MOGAS and HSD due to country wide lockdowns and restrictions on public transport. Consumption of black oil has been decreasing over the years mainly due to decline in the consumption of FO by ~ 33% to ~2.9 mln MT (FY19: ~ 3.5mln MT), as the government of Pakistan plans to gradually reduce reliance on oil-based power plants to other power sources i.e. LNG & coal

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 ~58%, while Pakistan Refinery, National Refinery, and Attock Refinery, contribute ~42% to the total domestic supply of POL products.

Revenues During the period under review i.e., Quarter Sep21, PARCO witnessed a growth of 63.4% while generating a turnover of PKR ~138bln during 1QFY22 as against PKR 66bln in 1QFY21. Such a trend is seen mainly due to, volumetric increase in sales and spike in international oil prices as well. Gross profit of the company, following similar trend, escalated to ~8.4% in 1QFY22, and standing at PKR ~11.6 billion (3MFY21: ~4.7% & PKR ~4 billion).

Margins Gross profit margins of the company, significantly increased in 1QFY22, standing at ~8.4% (FY21:~4.7%). This is mainly due to favorable refinery gross margins (GRM) and increased pipeline revenue.

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 net working capital days (1QFY22: 4 days, FY21: 2days).

Coverages During FY21, coverages of the company improved owing to increase in the cashflows and leveraging as borrowings of the company increased.

Capitalization PARCO has a moderately leveraged capital structure as at FY21 and 1QFY22, with debt equity ratio of ~15.6% and ~21.9%.

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Financial Summary
PKR mln

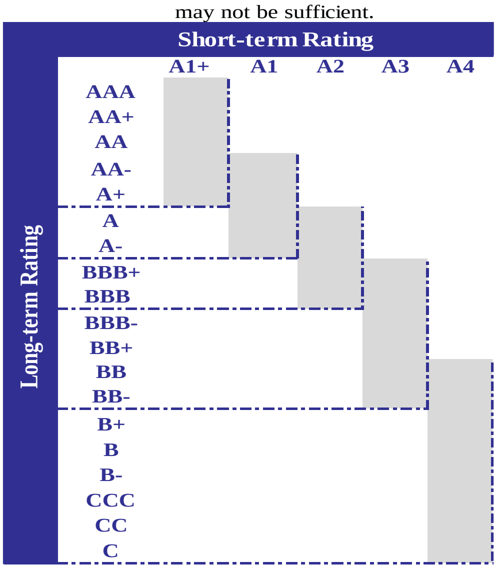
Pak Arab Refinery Limited Refinery	Sep-21 3M	Jun-21 12M	Jun-20 12M	Jun-19 12M
A BALANCE SHEET				
1 Non-Current Assets	37,392	38,037	38,040	30,310
2 Investments	54,459	50,265	53,657	50,319
3 Related Party Exposure	13,359	13,278	13,278	11,641
4 Current Assets	96,210	72,661	33,633	72,326
a Inventories	*57,710*	*33,782*	*12,369*	*45,063*
b Trade Receivables	*27,578*	*28,703*	*11,603*	*15,075*
5 Total Assets	201,420	174,241	138,608	164,596
6 Current Liabilities	74,949	68,676	43,477	51,296
a Trade Payables	*70,220*	*64,856*	*39,406*	*47,666*
7 Borrowings	26,438	15,787	14,227	8,239
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	5,807	4,675	4,046	9,467
10 Net Assets	94,226	85,103	76,859	95,594
11 Shareholders' Equity	94,226	85,103	76,858	95,594
B INCOME STATEMENT				
1 Sales	137,722	337,224	231,608	316,949
a Cost of Good Sold	*(126,112)*	*(321,310)*	*(246,987)*	*(303,843)*
2 Gross Profit	11,611	15,914	(15,379)	13,106
a Operating Expenses	(1,168)	(3,711)	(3,972)	(3,908)
3 Operating Profit	10,443	12,203	(19,351)	9,198
a Non Operating Income or (Expense)	*2,520*	*1,521*	*7,538*	*8,665*
4 Profit or (Loss) before Interest and Tax	12,963	13,724	(11,813)	17,863
a Total Finance Cost	*(487)*	*(1,963)*	*(2,055)*	*(169)*
b Taxation	*(3,353)*	*(3,433)*	*3,821*	*(5,358)*
6 Net Income Or (Loss)	9,123	8,328	(10,046)	12,335
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*10,444*	*10,995*	*(16,288)*	*20,995*
b Net Cash from Operating Activities before Working Capital	*9,905*	*8,692*	*(17,762)*	*20,899*
c Changes in Working Capital	*(18,175)*	*(14,063)*	*29,146*	*(17,095)*
1 Net Cash provided by Operating Activities	(8,270)	(5,371)	11,384	3,804
2 Net Cash (Used in) or Available From Investing Activities	1,698	(5,919)	(5,573)	(2,292)
3 Net Cash (Used in) or Available From Financing Activities	(7)	(21)	(8,620)	(13,000)
4 Net Cash generated or (Used) during the period	(6,579)	(11,311)	(2,809)	(11,488)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	63.4%	45.6%	-26.9%	15.3%
b Gross Profit Margin	8.4%	4.7%	-6.6%	4.1%
c Net Profit Margin	6.6%	2.5%	-4.3%	3.9%
d Cash Conversion Efficiency (FCFO adjusted for Working C	-5.6%	-0.9%	5.6%	1.2%
*e Return on Equity [Net Profit Margin * Asset Turnover * (T*	40.7%	10.3%	-11.7%	12.8%
2 Working Capital Management				
a Gross Working Capital (Average Days)	49	47	66	73
b Net Working Capital (Average Days)	4	-10	-2	27
c Current Ratio (Current Assets / Current Liabilities)	1.3	1.1	0.8	1.4
3 Coverages				
a EBITDA / Finance Cost	23.7	7.1	-6.5	139.8
b FCFO / Finance Cost+CMLTB+Excess STB	21.4	5.6	-8.0	124.0
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Fi	0.0	0.0	0.0	0.0
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equit	21.9%	15.6%	15.6%	7.9%

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.
(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