The Pakistan Credit Rating Agency Limited

Rating Report

Pak-Arab Pipeline Company Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
10-Jun-2022	AAA	A1+	Stable	Maintain	-
10-Jun-2021	AAA	A1+	Stable	Maintain	-
10-Jun-2020	AAA	A1+	Stable	Maintain	-
23-Nov-2019	AAA	A1+	Stable	Maintain	-
24-May-2019	AAA	A1+	Stable	Maintain	-
23-Nov-2018	AAA	A1+	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Pak Arab Pipeline Company (PAPCO) operates a 786 KM dedicated White Oil Pipeline (WOP) network. The ratings are reflective of PAPCO's strategic importance to the country and its distinctive business model deriving its strength from a US$ based tariff structure, providing sustainability to the Company's profit and certain cushion against exchange rate fluctuations. The Company's pipeline up-gradation plan for the transportation of Motor Gasoline (MOGAS) has been operationalized and started pumping petrol from Karachi to Mahmoodkot and from there to Machhike, the plan was initially expected to be completed by Dec'19. Tariff assigned for MOGAS project is also determined in US$ which creates an implied hedge to cover exchange rate volatility. The expansion is debt driven; from syndicate local debt and foreign borrowings. The Company has successfully started it repayments as per schedule and going forward leverage is expected to reduce. Market for petroleum products (POL) slightly improved in 1HFY22, business volumes of PAPCO also displayed a similar trend capacity utilization remains at ~50% including 17% for MOGAS in 1HFY22 (1HFY21: ~45%). Low volumes of MOGAS is according to the instructions issued by OGRA. It is projected to be increased further as management is confident that the business volumes will grow substantially in the coming periods owing to the operationalization of MOGAS project. The pipeline capacity to transport is 8mln tons of the commodity/annum, which can be increased up to 12mln tons/annum, considered to be sufficient to meet the upcountry's demand. The liquidity profile of the company is considered as strong due to its sizable short-term investment book on the balance sheet and its cash richness. The cash flows of the company remain persistently strong, stemming from formidable profitability margins. The company's governance structure derives full benefit from its association with PARCO, which also deputes its functionaries in PAPCO, with Shell Pakistan Limited nominating the CFO.

The ratings are dependent on sustained business model and its share in the overall country's petroleum movement. Sustainability in system share remains vital for the ratings. Execution of contracts and timely delivery of products is also important. Meanwhile, adherence to strong performance indicators is imperative.

Disclosure

Name of Rated Entity	Pak-Arab Pipeline Company 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 | Pipeline Networks(Oct-21)
Rating Analysts	Anam Waqas Ghayour | anam.waqas@pacra.com | +92-42-35869504

Profile

Legal Structure Incorporated in the year 2000, Pak Arab Pipeline Company Limited (PAPCO) is a public unlisted Company.

Background A benchmark laid in the form of Public-Private partnership between top OMCs of the country: Shell Pakistan Limited, PSO and TOTAL PARCO Marketing Limited (formerly known as Chevron Pakistan Limited) and PARCO, to build and operate a US$ 480 million cross-country pipeline system for transporting High Speed Diesel from Karachi ports to upcountry locations. Recently, PAPCO has completed the up-gradation of its White Oil Pipeline (WOP). The up-gradation has enabled the pipeline to transport MOGAS along with HSD.

Operations PAPCO operates a state-of- the-art cross-country pipeline system, White Oil Pipeline Project (WOPP), to transport refined High Speed Diesel from Karachi ports to up-country. Pipeline was commissioned in March 2005, comprising 786 Km of 26” dia cross-country pipeline, storage tanks, pumps and other allied facilities. PAPCO is a successful fuel carrier for the country. The pipeline network is entirely underground based except where there are water streams.

Ownership

Ownership Structure PAPCO’s majority holding lies in the hands of PARCO - 62% (which is majorly owned by GoP) while remaining by Shell Pakistan Limited (26%) and PSO (12%). Initially, there was a Signing of Implementation Agreement (IA) between Government of Pakistan and PARCO, PAPCO & Emirate of Abu Dhabi acclaims strong ownership structure for the company.

Stability Prolific backing of it's sponsors denotes strong foothold in the oil transportation market.

Business Acumen PARCO holding in PAPCO is part of its strategic alliance whereas, the entire operational efficacy flows collectively from its partners.

Financial Strength Profound ownership flows from its main sponsors-PARCO, anchoring as the backbone of PAPCO.

Governance

Board Structure Company’s overall control is overseen by ten-member Board of Directors (BoD), representing all the shareholders. Mr. Ali Raza Bhutta, is the new chairman, nominated on Feb 28, 2022.

Members’ Profile Mr. Amr is the Chief Executive Officer and is nominated by PARCO, Mr. Amr holds a bachelors degree in Mechanical Engineering and is also an MBA. He possesses a vast experience of more than three decades and joined PARCO in December 20.

Board Effectiveness Having audit committee as part of the Company's board, keeps an oversight on overall business. The company conducted four board meetings witnessing good level of attendance.

Financial Transparency PAPCO’s external Auditor, Ernst & Young Company are 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 of June 21.

Management

Organizational Structure The Company follows a regime of formal well defined organizational structure with the flare of segregated departments.

Management Team PAPCO has maintained a high profile decorum of its management. Mr. Syed Muhammad Haris, Chief Financial Officer (CFO), possesses more than two decades of experience in related field. He took as the Chief Financial Officer PAPCO in April 21 and has been aptly deploying his expertise since then. He is nominated by Shell.

Effectiveness The entire quorum of management is well-qualified, having ties with the group since long. To affirm effectiveness, all reporting lines fall to CEO.

MIS PAPCO maintains sophisticated IT infrastructure throughout its operational lines, with three types of software including ERP.

Control Environment PAPCO enjoys the supremacy of possessing expertise from its entire group. Quality control reports are generated on regular basis and reviewed by senior engineers on daily basis as well as weekly/monthly basis.

Business Risk

Industry Dynamics In Pakistan, a major portion of oil products is transported through roads. In FY21, ~69% of total oil products were moved by roads followed by pipeline ~29%, and ~2% by railways. Moreover, with the start of MOGAS transport through the pipeline from Nov 21, overall throughput through the pipeline has been improved Under Pakistan’s entire universe of petroleum products, MOGAS constitutes ~40% of the total demand.

Relative Position PAPCO bags the title of being the sole HSD and MOGAS transporter through pipeline network in the country. The company has a pivotal geographic presence in Pakistan’s HSD supply chain business, by providing strategic infrastructure to transport HSD from Karachi to Shikarpur & Mahmoodkot. With the recent expansion, the company also started to supply MOGAS through the pipeline, which will eventually be reducing OMC’ dependence on road transport, hence becoming the preferred choice for transporting HSD & MOGAS through WOP.

Revenues In line with the petroleum industry's performance, PAPCO throughput for 1HFY22 is approximately 2.2mln MT, as compared to 1HFY21, was 2.02mln MT. Henceforth, company's turnover for 1HFY22 clocked in at PKR 3.8bln (1HFY21 PKR 3.3bln). The company's topline is expected to improve further through MOGAS revenue.

Margins During the period under review 1HFY22, overall margins of PAPCO remain stable, gross margins; 58.1% (1HFY21: 63%). The bottom-line is largely supported by on-core income which is derived from short-term liquid investments. Net margins has recorded to be comparatively less than previous period: 47.2% (1HFY21: 60.5%).

Sustainability In a bid for sustainable yet distinctive business model, PAPCO has introduced its much awaited MOGAS project. A value addition to company's present product portfolio. The delivery volumes are introduced to commence from FY22. The pipeline capacity to transport is 8mln tons of the commodity/annum, which can be increased to 12mln tons/annum, considered to be sufficient to meet the country's demand.

Financial Risk

Working Capital Working capital requirements of the company are dominated by payable days 1HFY22: 13 days (1HFY21: 31). As the storage tanks of PAPCO merely holds inventory for their customers, there exists small inventory holding period. Over the years PAPCO has negligible net working days. Net working capital requirements is fulfilled sufficiently by company's internal cash. Keeping in view of its requisites, there are no short-term borrowings for 1HFY22.

Coverages Company is able to generate sufficient free cashflows from operations; PKR 2.2bln in 1HFY22 (1HFY21: 2.1bln). Interest coverage is mainly attributed to reduced interest cost and strong FCFO.

Capitalization PAPCO has aptly managed its capital structure in past years by keeping its leveraging in comfortable zone (1HFY22: 40.7% & 1HFY21: 43.6%). However, from FY18 onward, leveraging took up an upwards pace (28.3%) and it witnessed a further hike during FY20. Foreign currency loan limit is USD 25mln from SCB-UK, which carry a mark-up rate of 3L+2.7%, payable in 12 equal installments commencing from Dec21. The loan facility of PKR 11.8bln has been fully drawn down to date, which is exclusively obtained for the MOGAS project. Therefore, all the local and foreign loan has draw down and repayments have been started to be made. Local currency loan is paid by PKR 3.4bln and foreign currency loan is paid-off by USD 4.1mln.

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Financial Summary
PKR mln

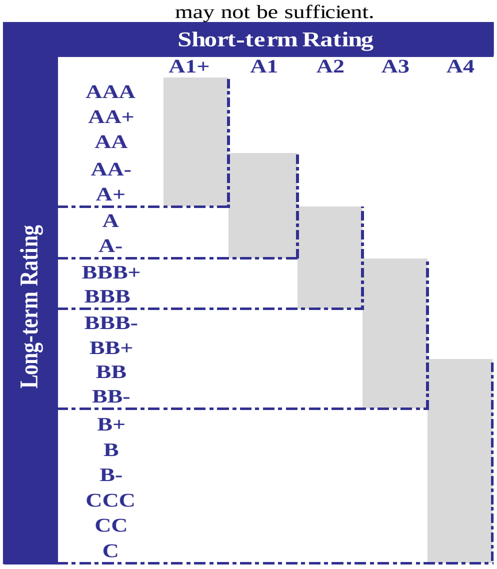
Pak-Arab Pipeline Company Limited	Dec-21	Jun-21	Jun-20	Jun-19
Logistics	6M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	22,523	21,651	21,588	17,487
2 Investments	11,915	14,864	16,308	10,592
3 Related Party Exposure	-	-	-	-
4 Current Assets	7,514	7,360	7,711	6,896
a Inventories	-	-	-	-
b Trade Receivables	*399*	*336*	*435*	*523*
5 Total Assets	41,953	43,875	45,607	34,975
6 Current Liabilities	8,104	8,219	8,738	8,342
a Trade Payables	*306*	*221*	*704*	*866*
7 Borrowings	12,896	13,609	15,532	7,000
8 Related Party Exposure	235	223	156	130
9 Non-Current Liabilities	1,601	1,312	1,299	1,439
10 Net Assets	19,117	20,512	19,882	18,063
11 Shareholders' Equity	19,117	20,512	19,882	18,064
B INCOME STATEMENT				
1 Sales	3,788	6,184	6,709	6,304
a Cost of Good Sold	*(1,587)*	*(2,460)*	*(2,339)*	*(2,044)*
2 Gross Profit	2,200	3,724	4,371	4,260
a Operating Expenses	(225)	(303)	(253)	(187)
3 Operating Profit	1,976	3,420	4,118	4,073
a Non Operating Income or (Expense)	*689*	*1,659*	*1,678*	*873*
4 Profit or (Loss) before Interest and Tax	2,665	5,079	5,795	4,946
a Total Finance Cost	*(163)*	*26*	*9*	*(40)*
b Taxation	*(715)*	*(1,548)*	*(1,626)*	*(1,663)*
6 Net Income Or (Loss)	1,787	3,557	4,178	3,243
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*2,232*	*2,811*	*3,421*	*4,373*
b Net Cash from Operating Activities before Working Capital Changes	*2,154*	*2,796*	*3,420*	*4,355*
c Changes in Working Capital	*(166)*	*(951)*	*368*	*1,047*
1 Net Cash provided by Operating Activities	1,988	1,845	3,788	5,403
2 Net Cash (Used in) or Available From Investing Activities	2,262	8,107	(8,941)	(8,765)
3 Net Cash (Used in) or Available From Financing Activities	(4,000)	(10,848)	6,045	1,993
4 Net Cash generated or (Used) during the period	250	(897)	892	(1,369)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	22.5%	-7.8%	6.4%	-6.4%
b Gross Profit Margin	58.1%	60.2%	65.1%	67.6%
c Net Profit Margin	47.2%	57.5%	62.3%	51.4%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	54.5%	30.1%	56.5%	86.0%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	18.0%	17.6%	22.0%	18.2%
2 Working Capital Management				
a Gross Working Capital (Average Days)	18	23	26	25
b Net Working Capital (Average Days)	5	-5	-17	-11
c Current Ratio (Current Assets / Current Liabilities)	0.9	0.9	0.9	0.8
3 Coverages				
a EBITDA / Finance Cost	15.1	475.9	N/A	131.2
b FCFO / Finance Cost+CMLTB+Excess STB	1.3	1.0	2.0	113.1
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	3.2	4.9	4.6	1.6
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	40.7%	40.3%	44.1%	28.3%
b Interest or Markup Payable (Days)	38.2	977.0	N/A	0.0
c Entity Average Borrowing Rate	2.3%	0.1%	0.0%	0.8%

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