The Pakistan Credit Rating Agency Limited

Rating Report

Pak-Arab Pipeline Company Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
23-Nov-2018	AAA	A1+	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The rating is a reflection of PAPCO's distinctive business model driving its strength from a tariff based return model. PAPCO operates a 786 Km pipeline network dedicated for White Oil Pipeline (WOP). The tariff follows a pre-defined structure denominated in USD$, providing sustainability to the profits of the company. PAPCO has been operating its WOP for HSD only, at a capacity utilization of 57%. The company has envisaged an expansion plan, which will enhance and further leverage the infrastructure capacity, by way of transporting MOGAS. The expansion is debt driven, wherein interest spread is very much akin to risk free rate. A level of comfort is drawn from the exclusive tariff given for the MOGAS project; all set to be operational by mid of 2019. This will also create strategic advantage for the country. The cash flows of the company are persistently strong, providing sustainable coverages to debt repayments. The business risk is considered low, given stable – indeed growing demand of MOGAS and HSD, in addition to OMCs reliance on PAPCO for oil supply. The company's governance derives benefit from its association with PARCO, which also deputes its functionaries (esp. CEO) in PAPCO, with Shell Pakistan Limited nominating the CFO.

The ratings are dependent on the sustained business operations and industry wide fundamentals. Strong cash flows enabling relevant coverages to its debt repayments is prerequisite

Disclosure

Name of Rated Entity	Pak-Arab Pipeline Company Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-18),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
Related Research	Sector Study | Oil Marketing Companies(Oct-18)
Rating Analysts	Raniya Tanawar | raniya.tanawar@pacra.com | +92-42-35869504

Profile

Legal Structure Incorporated in the year 2000, Pakarab Pipeline Company Limited (PAPCO) is a registered 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 a US$ 480 million pipeline system for transporting High Speed Diesel from Karachi ports to upcountry locations.

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 2005, comprising 786 Km of 26" dia cross-country pipeline, storage tanks, pumps and other allied facilities. The pipeline network is entirely underground except where there are water streams. White Oil Pipeline has the flexibility to receive imported and locally produced petroleum products from multiple sources and to deliver it at different demand centers.

Ownership

Ownership Structure PAPCO's majority holding lies in the hands of PARCO - 51%(which is majorly owned by GoP) while remaining by Shell Pakistan Limited (26%), PSO (12%) and Total PARCO Marketing Limited (11%).

Stability Prolific backing of its sponsors denotes strong foothold in the oil transportation market.

Business Acumen PARCO's 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 sponsor – PARCO, anchoring as a backbone for PAPCO.

Governance

Board Structure Company's overall control is overseen by ten-member board of directors (BoD), representing all the shareholders. The Chairman of the board is nominated by PARCO

Members' Profile Resilient practices adhered to, Mr. Tariq Rizavi, Managing Director (MD) of PARCO is a representative on PAPCO's Board. Mr. Rizavi, a chemical engineer by profession, has been associated with the company for 40 years and has served at various managerial positions.

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 Auditor, Ernst & Young Company 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 of end-Jun18.

Management

Organizational Structure PAPCO 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. Shujauddin Ahmed, Chief Executive Officer(CEO), is a qualified Engineer with more than four decades of experience in related field. He took charge as the Chief Executive PAPCO in early 2017 and has been aptly deploying his expertise since then.

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

MIS PAPCO maintains sophisticated IT infrastructure throughout its operational lines, with three types of software's 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 on weekly/monthly basis.

Business Risk

Industry Dynamics Presently in Pakistan, road transport accounts for ~59% of the cumulative movement of petroleum, oil and lubricant products, pipeline's share is ~38% and use of railways for refined products stand at 3.6%. Country's current fleet of oil tankers comprises 11,198 and the entire supply of MOGAS is carried through oil tankers by road. Under Pakistan's entire universe of petroleum products, MOGAS constitutes ~28% of the total demand. Promising growth in demand is foreseen for MOGAS by 10% from FY17 onwards, while on HSD side, the growth rate is expected to remain conservative at ~2%.

Relative Position PAPCO bags the title of sole HSD transporter through pipeline in the country. Company has a pivotal geographical presence in Pakistan's High speed diesel (HSD) supply chain business, by providing strategic infrastructure to transport HSD from Karachi to Shikarpur & Mahmoodkot. The Company is all set to transport MOGAS via WOPP in near future. The multi-grade pipeline will eventually be reducing OMC's dependence on road transport, hence giving the company an added edge.

Revenues PAPCO product deliveries for FY18 slightly improved to 4,789 MT from 4,517MT while the capacity utilization was limited to 57% which was less than the budgeted estimation, as HSD demand remained conventional. Company's turnover clocked in at PKR ~6.7bln during FY18, which is ~11.5% higher than the same period last year. Higher demand of HSD and hike in global petroleum prices played vital role in improving its margins. Company's topline is expected to further improve as soon as the MOGAS project comes to play.

Margins Gross margins of the company improved (FY18: ~72.1%, FY17: ~70.1%), on account of non-core income and improved turnover. Budgeted transportation revenue for FY19 is PKR ~9,479mln and the 3rd phase of 5years-tariff plan will be applicable in FY19. Finance cost of the company decreased to PKR ~61mln (FY17: PKR ~79mln) as the company has repaid long-term borrowings during the period. As a result the net profit of the company stood at PKR ~3.9bln (FY17: PKR ~2.7bln).

Sustainability In a bid for sustainable yet distinctive business model, PAPCO is introducing its much awaited MOGAS project. A value addition to company's present product portfolio. The project is anticipated to be operational by June 2019 with pipeline capacity to transport 8mln tons of the commodity/annum,can be increased to 12mln tons/annum, which is expected to be sufficient to meet upcountry's demand till 2022. Following a prudent approach PAPCO proactively safeguards its interest through insurance hence securing un-anticipated future damages caused by issues such as political violence. Other projects are also under feasibility review including LNG terminals and strategic storage.

Financial Risk

Working Capital As the storage tanks of PAPCO merely holds inventory for their customers, there exists negligible inventory holding period. Over the years, PAPCO has a précised net working capital days (FY17: 16days, FY16: 19 days) while in FY18 it is almost nil. Working capital requirement is fulfilled sufficiently by company's internal cash. Keeping in view of its requisites, PAPCO has maintained constant level of short term borrowings of PKR ~0.1bln for the past three years.

Coverages Company ably generates sufficient Free cashflows from its operations; PKR~5bln in FY18 (FY17: ~4bln), owing to its sound business model, technical abilities and strategic positioning domestically. Company's coverages continue to stay strong: Interest coverage FY18: ~85.3x, FY17: ~53.4.x, which translates into strong profitability as the company's debt burden is low. Given strong cashflows, financial risk remain comfortable.

Capitalization PAPCO has aptly managed its capital structure in past years by keeping its leveraging in comfortable zone (FY17: ~6.9%, FY16: ~10.4%). However, during FY18 leveraging took up slight upward pace (~13.4%) as the first draw-down episode of PKR~2bln took place, representing ~17% of the total loan facility of PKR ~11.8bln exclusively obtained for MOGAS project. Company's overall leveraging has observed fluctuating trends over the years on account of foreign currency loan; originally amounted USD~50mln arranged by PARCO, from European Investment Bank, which stands at USD~5mln (PKR value ~670mln) as to date. This would be paid off in CY19. Furthermore, by preferring debt finance over equity finance, Company's management decided to finance its MOGAS project through debt finance on significantly low effective rates. PAPCO's strong ability to generate cash from its operations keeps the debt payback capacity in strong position.

The Pakistan Credit Rating Agency Limited

Pak Arab Pipeline Company Limited

PKR (mln)

BALANCE SHEET	30-Jun-18	30-Jun-17	30-Jun-16
	FY18	FY17	FY16
Non-Current Assets	**11,063**	**11,116**	**11,988**
Investments (Incl. associates)	**9,961**	**6,852**	**4,454**
Equity	-	-	-
Debt	-	-	-
Current Assets	**7,427**	**6,149**	**6,283**
Inventory	-	-	-
Trade Receivables	92	64	112
Others	7,335	6,085	6,171
Total Assets	**28,451**	**24,117**	**22,725**
Debt	**2,730**	**1,164**	**1,698**
Short-term	122	115	130
Long-term (Inlc. Current Maturity of long-term debt)	2,608	1,049	1,567
Other shortterm liabilities	6,353	5,115	4,106
Other Longterm Liabilities	1,743	2,106	2,312
Shareholder's Equity	**17,625**	**15,734**	**14,609**
Total Liabilities & Equity	**28,451**	**24,118**	**22,725**
INCOME STATEMENT			
Turnover	**6,735**	**6,040**	**5,655**
Gross Profit	4,857	4,237	3,786
Other Income	901	248	72
Financial Charges	(61)	(79)	(93)
Net Income	**3,895**	**2,866**	**2,488**
Cashflow Statement			
Free Cashflow from Operations (FCFO)	5,199	4,243	3,873
Net Cash changes in Working Capital	(952)	304	353
Net Cash from Operating Activities	4,193	4,473	4,128
Net Cash from InvestingActivities	(2,223)	(3,375)	(1,262)
Net Cash from Financing Activities	(583)	(2,266)	(2,152)
Ratio Analysis			
Performance			
Turnover Growth	11.5%	6.8%	779.5%
Gross Margin	72.1%	70.1%	66.9%
Net Margin	57.8%	47.5%	44.0%
ROE	29.5%	18.2%	17.0%
Coverages			
Interest Coverage (FCFO/Gross Interest)	85.3	53.4	41.5
Core: (FCFO/Gross Interest+CMLTD+Uncovered Total STB)	10.1	7.0	6.3
Total: (TCF) / (Gross Interest+CMLTD+Uncovered Total STB)	10.1	7.0	6.3
Debt Payback (Total LT Debt Including UnCovered Total STBs) / (FCFO- Gross Interest)	0.4	0.3	0.4
Liquidity			
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	0.6	16.2	19.2
Capital Structure (Total Debt/Total Debt+Equity)	13.4%	6.9%	10.4%

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.

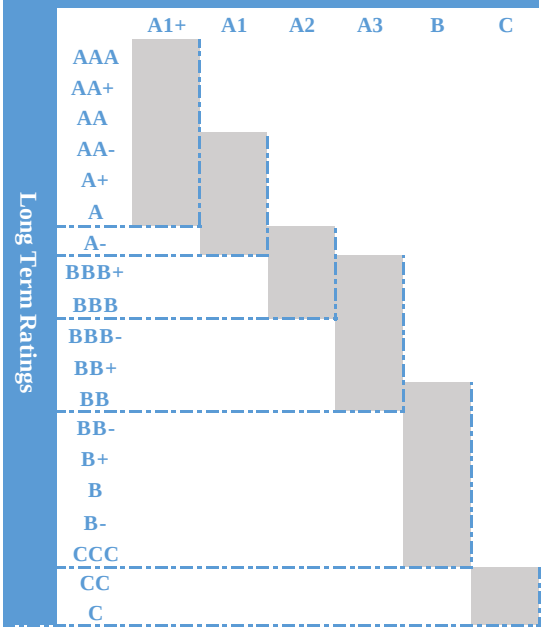
Long Term Ratings

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.

Short Term Ratings



Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Rating Team Statements
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest
(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)
Probability of Default
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)
Proprietary Information