The Pakistan Credit Rating Agency Limited

Rating Report

Pakistan Oxygen Limited

Report Contents

Rating History					
Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
25-Jul-2023	A	A1	Stable	Maintain	-
26-Jul-2022	A	A1	Stable	Maintain	-
29-Jul-2021	A	A1	Stable	Maintain	-
29-Jul-2020	A	A1	Stable	Maintain	-
30-Jul-2019	A	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect the eminent position of Pakistan Oxygen Limited (“the Company” or “POL”) in the industrial & medical gases, welding, hard goods & Medical Engineering Services (MES) segments. The industrial & medical gases industry largely possesses an oligopolistic structure and the electrodes market comprises of Tier-I, Tier-II & Tier-III segments and POL is the leader in the Tier-I category and prominent presence in the other two segments which are primarily unorganized. OXYMED was launched as an indigenous product line for their MES business vertical. The OXYMED core business is installing the supply sources of medical gases, and pipeline distribution systems with complete associated equipment installation. During Covid-19, the installation of dedicated medical gas capacities in hospitals resulted in a change in the revenue mix and showed considerable growth in the healthcare segment. As of now, the product portfolio has stabilized along the demand yield curve, indicating a more balanced and consistent state in the industry. The demand from the steel, automotive, and shipbreaking industries remained weak due to the country’s macroeconomic challenges. The Company planned to regain their customer base in the industrial gases segment through geographical expansion. POL serves customers across a wide spectrum of industries. The massive hike in energy prices is one of the key challenges to the industry as it constitutes a significant portion of COGS. To cater this, the Company is soon expected to successfully commission its new state of the art 270TPD Air Separation Unit (ASU) and the electrode plant to meet the demand for industrial/medical gases and all tiers of the electrode market segment, respectively with better specific power consumption technology. The top line of the Company has shown a growth of 4.2% YoY basis with an optimal mix of medical and industrial gases. The margins of the Company remained at an adequate level despite a considerable surge in KIBOR, and electricity prices followed by massive PKR devaluation and revoke of sales tax exemption on the sale of medical gases to hospitals. The Company has benefited from a strong governing board and has skilled and professional management. The financial risk profile of the Company is considered adequate with comfortable coverages, cashflows, and working capital cycle. Capital structure is leveraged where borrowings are comprised of short-term and long-term. To facilitate capacity expansions and BMR the Company has a subsidized long-term borrowing facility (TERF).

The ratings are dependent on the Company's ability to sustain its market share by effectively utilizing its production capacity. At the same time, management of financial risk, particularly debt coverages, remains important.

Disclosure	
Name of Rated Entity	Pakistan Oxygen Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating(Jun-22),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jun-22),Methodology | Rating Modifiers(Jun-22)
Related Research	Sector Study | Industrial Gases(Oct-22)
Rating Analysts	Muhammad Harris Ghaffar | harris.ghaffar@pacra.com | +92-42-35869504

Profile

Legal Structure Pakistan Oxygen Limited, formerly Linde Pakistan Limited, (hereinafter referred to as ‘‘the Company’’ or ‘‘Pakistan Oxygen’’) was incorporated in 1949. The Company was listed on Pakistan Stock Exchange in 1958.

Background The Company was initially incorporated under the name of Pakistan Oxygen and Acetylene Company Limited but it was later renamed BOC Pakistan in 1995. In 2011, it was re-branded as Linde Pakistan before being named back to Pakistan Oxygen Limited earlier in 2018 after the acquisition of majority shareholdings of the Company by Adira Capital Holdings (Private) Limited and its Affiliates.

Operations The Company currently operates in four business segments: bulk gases, healthcare, packaged gas products (PGP), and tonnage. The Company currently has three Air Separation Units (ASU) with an installed capacity of about 263 tons per day of Air Gases. This will be increased to 533 tons per day after the commissioning of the 270 TPD plant.

Ownership

Ownership Structure Adira Capital Holdings (Private) Limited, members of the Hilton Pharma family, Soorty Enterprises (Private) Limited and Mr. Shahid Umerani are the major shareholders of the Company, together holding ~ 76% of the total shareholding. Mr. Siraj Dadabhoy is the major beneficial shareholder.

Stability Pakistan Oxygen is majority owned by a consortium of investors under a well-defined share purchase agreement, however, in order to ensure the future prospects of the Company succession planning is the need of the hour.

Business Acumen Adira Capital Holdings (Private) Limited, the majority shareholder, is a semi-private equity Company. Company's Board Chairman, Mr. Waqar A. Malik, is a highly qualified professional with a vast experience profile, spanning over 03 decade. He has been associated with a renowned conglomerate Imperial Chemical Industries Plc. group based in UK, this exhibits strong business acumen of the Company.

Financial Strength The sponsors are commercial-cum-industrial entities consisting of premiere business houses and corporate sector professionals forming a consortium of investors. Members of Hilton family and Soorty Enterprises (Private) Limited had ample net assets at the time of the acquisition of Pakistan Oxygen, in 2017.

Governance

Board Structure There are ten members on the Board, out of which four are independent directors and six are non-executive directors including the chairman. Mr Waqar Ahmed Malik is the Chairman of the Board.

Members’ Profile Members of the board are thorough professionals and well-experienced in managing business affairs. Mr. Waqar A. Malik also holds directorship in other companies which include Mari Petroleum Company Limited, Fauji Cement, FFC & FFBL, Adira Capital Holdings (Private) Limited and positioned as CEO/MD of Fauji Foundation.

Board Effectiveness Board meetings are held regularly with a high attendance of directors. An internal audit function is also in place, outsourced to M/s EY Ford Rhodes, Chartered Accountants, which is supervised by the Head of Internal Audit who reports to the Board Audit Committee. Four committees are also in place to assist the Board: i)Audit Committee, ii)HR Remuneration & Nomination Committee, iii)Share Transfer Committee and iv) Board Strategy Committee.

Financial Transparency BDO Ebrahim & Co. Chartered Accountants with satisfactory QCR ratings and categorized 'A' in the list of SBP-approved auditors are the Company's external auditors. For year-end-Dec'22, the firm expressed an unqualified opinion pertaining to annual financial statements.

Management

Organizational Structure The Company's organisational structure is divided into various functional departments and all the department heads report to the CEO. Within each department, the management hierarchy includes different cadres, enabling the Company to carry out smooth operations.

Management Team The Company's management comprises qualified and experienced professionals with a wide range of skills and diversified experience. Mr. Matin Amjad, the CEO of the Company, brings over 20 years of multi-functional and business experience in an MNC and local Company environment with leadership roles. The senior management team has been reasonably expanded, with the addition of new heads of sales, operation, distribution, planning and finance etc.

Effectiveness The functions of the management are clear and well-defined to achieve its underlying goals and objectives effectively. The system of internal control is in place and has been effectively implemented.

MIS The Company has an established SAP version; ECC6.0, EHP-8 has modules for Sales (SD), Material Management(MM), Finance(FI), Plant Maintenance(PM), AXON, Procurement & Production Planning(PP).

Control Environment The Company maintains a sound internal control system to reasonably assure the efficiency and effectiveness of operations. At the same time, the Board Audit Committee reviews the internal control system based on an assessment of risks and reports to the Board of Directors.

Business Risk

Industry Dynamics Prices of Industrial gases mainly depend on the market forces such as energy costs, oil & natural gas price fluctuation, quality/special gas, customized products etc. Overall production capacity for industrial gases currently stands at ~1,300 TPD, with the significant capacity lying with Ghani Chemicals and Pakistan Oxygen (formerly Linde Pakistan). While Ghani Chemicals recently undertook expansion with its third plant, Pakistan Oxygen has a significant capacity expansion of 270TPD by installing a new ASU plant at Port Qasim. The incremental pandemic effect has almost settled and demand is expected to return to its normal distribution between industry and medical (hospitals).

Relative Position Pakistan Oxygen currently holds the leading position in the industrial gases industry with a market share of ~45%, whereas Ghani Chemicals follows with a share of ~34%. Ghani Chemicals’ share might increase once its new plant becomes operational. Other players have much lower capacity and hence lower market share

Revenues The Company's topline has shown growth of 4.2% YoY basis. Currently, the market enter into a period of over-supply for the short to mid-term when there are imminent challenges of demand contraction due to high inflation amid tightening fiscal and monetary policies and market saturation. During CY22 Company’s topline clocked in at ~PKR 7.3bln (CY21: PKR 7.0bln). The Company's ~77.7% of revenue is generated from the Industrial, medical gas' segment and the rest from the welding' segment.

Margins Massive PKR devaluation, revoke of sales tax exemption on the sale of gases to hospitals and hike in interest rates have effected the Company's profitability and profit margins; PBIT has recorded at CY22: PKR 684mln (CY21: PKR 753mln), with a PBIT margin of 9.4% (CY21: 10.7%). The Company posted a profit after tax of PKR 420mln (CY21: PKR451mln) having a margin of 5.8% in CY22 (CY21: 6.4%).

Sustainability Pakistan Oxygen is one of the largest manufacturers of industrial and medical gases in Pakistan. A state-of-the-art plant, with approx. 270 TPD ASU capacity, 105 TPD ASU Plant and 11 TPS electrode plant, driven by world-class technology, would provide cost-effectiveness and a competitive edge to the Company. As per the POL management presentation, 270 TPD ASU plant commissioning is in progress and expected to be within a few days. Furthermore,11 TPS plant is expected to be commissioned in Q3 2023. These new plants have better specific power consumption (optimal power consumption).

Financial Risk

Working Capital The Company relies on internal cash flows and short-term borrowings to finance its working capital requirements. Net working capital days have shown a slight surge during CY22: 69 days (CY21: 61 days) mainly on the back of a surge in inventory days.

Coverages The Company's free cash flow from operations (FCFO) stood at PKR 858mln (CY21: PKR~1,023mln). The interest coverage ratio; is 5.2x in CY22 (CY21 9.8x). The hike in energy costs and interest rates has moderately affected their coverages as ~48% of long-term borrowings are dominated by TERF.

Capitalization Long-term borrowings of the Company in CY22 stood at PKR~4.32bln (CY21: PKR~1.3bln). this increase is due to the fact that the Company was in the phase of expansion, which has predominately reached its completion level. Short-term borrowings constitute PKR 2.5bln & current maturity of long-term debt of PKR 0.288bln in total borrowings of PKR 7.2bln as of CY22. The Company has a moderately leveraged capital structure as the total debt-to-capital ratio of the Company is 48.0% in CY22 (CY21: ~36.9%).

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Financial Summary
PKR mln

Pakistan Oxygen Limited Industrial gases	Mar-23 3M	Dec-22 12M	Dec-21 12M	Dec-20 12M
A BALANCE SHEET				
1 Non-Current Assets	12,800	12,188	6,019	4,597
2 Investments	-	-	-	-
3 Related Party Exposure	0	0	0	0
4 Current Assets	5,386	5,243	3,788	2,792
a Inventories	*1,545*	*1,317*	*1,041*	*653*
b Trade Receivables	*972*	*827*	*654*	*596*
5 Total Assets	18,186	17,431	9,807	7,389
6 Current Liabilities	2,059	2,080	1,437	1,084
a Trade Payables	*762*	*770*	*312*	*290*
7 Borrowings	7,930	7,176	2,916	1,332
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	400	411	460	471
10 Net Assets	7,797	7,764	4,993	4,502
11 Shareholders' Equity	7,797	7,764	4,993	4,502
B INCOME STATEMENT				
1 Sales	1,815	7,296	7,005	5,545
a Cost of Good Sold	*(1,517)*	*(5,972)*	*(5,645)*	*(4,442)*
2 Gross Profit	298	1,324	1,360	1,104
a Operating Expenses	(168)	(625)	(568)	(495)
3 Operating Profit	130	700	793	608
a Non Operating Income or (Expense)	*(10)*	*(15)*	*(40)*	*8*
4 Profit or (Loss) before Interest and Tax	120	684	753	616
a Total Finance Cost	*(73)*	*(209)*	*(119)*	*(164)*
b Taxation	*(14)*	*(55)*	*(182)*	*(106)*
6 Net Income Or (Loss)	33	420	451	346
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*167*	*858*	*1,023*	*851*
b Net Cash from Operating Activities before Working Capital Changes	*116*	*750*	*914*	*667*
c Changes in Working Capital	*(408)*	*(758)*	*(484)*	*(40)*
1 Net Cash provided by Operating Activities	(292)	(8)	430	626
2 Net Cash (Used in) or Available From Investing Activities	(708)	(4,131)	(1,798)	(399)
3 Net Cash (Used in) or Available From Financing Activities	753	4,256	1,578	(27)
4 Net Cash generated or (Used) during the period	(247)	117	210	201
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	-0.5%	4.2%	26.3%	18.8%
b Gross Profit Margin	16.4%	18.2%	19.4%	19.9%
c Net Profit Margin	1.8%	5.8%	6.4%	6.2%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	-13.3%	1.4%	7.7%	14.6%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	1.7%	6.6%	9.5%	8.0%
2 Working Capital Management				
a Gross Working Capital (Average Days)	117	96	77	89
b Net Working Capital (Average Days)	79	69	61	69
c Current Ratio (Current Assets / Current Liabilities)	2.6	2.5	2.6	2.6
3 Coverages				
a EBITDA / Finance Cost	3.2	5.2	9.8	6.2
b FCFO / Finance Cost+CMLTB+Excess STB	0.9	1.7	4.5	3.1
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	12.2	7.0	1.6	0.4
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	50.4%	48.0%	36.9%	22.8%
b Interest or Markup Payable (Days)	279.9	392.9	116.9	65.5
c Entity Average Borrowing Rate	4.9%	4.3%	5.1%	12.2%

Credit Rating

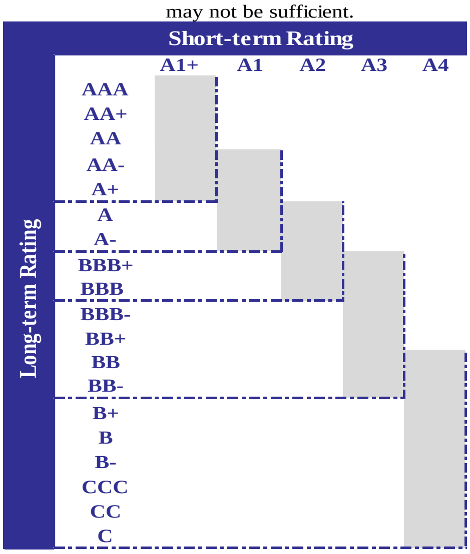
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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):

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

Regulatory and Supplementary Disclosure
(Credit Rating Companies Regulations,2016)

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

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

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

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

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

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