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-2024	A	A1	Stable	Maintain	-
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. POL possesses the largest footprint and customer outreach in the oligopolistic Industrial and Medical gases industry. The electrodes market comprises Tier-I, Tier-II & Tier-III segments. POL is the leader in the Tier-I category besides having a prominent presence in the other two primarily unorganized segments. During CY23, The country faced numerous macroeconomic challenges resulting in stagnation in GDP growth, high inflation, and elevated interest rates that engulfed the growth trajectory of many industrial sectors. Resultantly, the demand from the steel, automotive, and shipbreaking industries remained weak. However, POL recorded ~18% growth in the topline contributed by price adjustment and an incline in the sales in the healthcare, industrial gases, and hard goods segments signifying POL’s broad customer base across a wide spectrum of industries. The massive hike in energy prices remains one of the key challenges to the industry as it constitutes a significant portion of COGS. To cater to this, the Company has successfully commissioned its new state-of-the-art 270TPD Air Separation Unit (ASU) and a new electrode plant of 11TPS to meet the demand for industrial/medical gases and all tiers of the electrode market segments, respectively with better specific power consumption technology. Improved efficiencies from the new plants have also contributed towards the improvement in the profitability matrix of the company as reflected by the GP margin of ~25.9% during 1QCY24 (~18.2%, CY23: 18.2%, CY22) considering an exorbitant increase in the energy costs during the year. An improvement in the Net Profit Margin was observed during 1QCY24 as it was recorded at ~6.5% after a significant dilution to ~1.7% during CY23 owing to a significant increase of ~229% in the finance costs of the company. POL benefits from a strong governance structure which Is augmented by skilled and professional management. The financial risk profile of the Company is characterized by a slightly stretched working capital cycle and adequate coverages. The Capital structure is leveraged where borrowings are dominated by LTBs to facilitate capacity expansion and BMR the Company has also availed a subsidized long-term borrowing facility (TERF). Going forward, the Company is expected to benefit from the reduction in interest rates and its efforts to increase its cost efficiency and export portfolio.

The ratings are dependent on the Company's ability to sustain its market share by effectively utilizing its production capacity. At the same time, sustainability in the growth trajectory and profitability matrix along with the efficient 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(Jul-23),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jul-23),Methodology | Rating Modifiers(Apr-24)
Related Research	Sector Study | Industrial Gases(Nov-23)
Rating Analysts	Sohail Ahmed Qureshi | sohail.ahmed@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 the Pakistan Stock Exchange in 1958.

Background The Company was initially incorporated under the name of Pakistan Oxygen and Acetylene Company (Pvt.) 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: industrial gases, healthcare, packaged gas products (PGP), and pipeline. The Company currently has four Air Separation Units (ASU) with an installed capacity of about 533 tons per day of Air Gases.

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 ~ 77% of the total shareholding. Mr. Siraj Dadabhoy is the major beneficial shareholder.

Stability The Company 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. The Company's Board Chairman, Mr. Waqar A. Malik, is a highly qualified professional with vast experience spanning over 03 decades. He is the former CEO of ICI Pakistan Ltd and also the former Chairman and CEO of Lotte Pakistan (formerly Pakistan PTA Ltd). He also served as the MD & CEO of Fauji Foundation, exhibiting strong business acumen.

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 the Hilton family and Soorty Enterprises (Private) Limited had ample net assets at the time of the acquisition of the Company in 2018.

Governance

Board Structure There are ten members on the Board of Directors, out of which four are Independent Directors and six are Non-Executive directors including the Chairman.

Members’ Profile The board is composed of a sufficient number of Independent and Non-Executive Directors possessing core competencies, diversity, requisite skills, knowledge, and experience deemed pertinent in the context of the Company's operations.

Board Effectiveness The Board and its committees meet regularly with high attendance to exercise their governance roles. The Board and its committees have in place a formal process for annual self-evaluation to ensure performance of the Board. The Board has formed four committees to assist the Board: i) Board Audit Committee, ii) Board Human Resource Remuneration & Nomination Committee, iii) Board Strategy Committee, and iv) Share Transfer Committee. 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.

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'23, the firm expressed an unqualified opinion on the annual financial statements.

Management

Organizational Structure The Company's organizational 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 2 decades of multi-functional and business experience with leadership roles in MNC and local Company environment. The senior management team has been strengthened with the addition of COO, Mr. Zubair Siddiqui who possesses over 20 years of relevant experience in ASU industry (10+ years international experience at senior management level in the world leading gases company, Linde plc) with strong technical knowledge of the Company’s plant operations and its various business segments.

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 The industrial gases segment is heavily reliant on the performance of LSMs as the majority of the demand emanates from the LSM and healthcare sectors. In FY23, many industries across multiple sectors were impacted by import restrictions and overall economic slowdown which impacted the performance of the industrial gases segment. The overall production capacity of the sector stands at 1,300TPD with a revenue of PKR 18bln in FY23. The majority of the market share (~69%) is held by two players i.e. Pakistan Oxygen Ltd and Ghani Chemicals Ltd having production capacities of 533TPD and 435 TPD respectively. The demand for industrial gases is expected to grow in line with the rebound in economic activity and growth of the LSM sector.

Relative Position Pakistan Oxygen currently holds the leading position in the industrial gases industry with a market share of ~37%, whereas Ghani Chemicals follows with a share of ~32%. 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 18% during CY23 on a YoY basis and recorded at PKR 8,589mln. Gases contributed ~80% to the topline while ~20% was contributed by the welding & hardgoods segment. During the year, the demand from industries remained hampered owing to macroeconomic challenges. However, during 1QCY24, the Company’s revenue grew by 27% and clocked in at PKR 2,727mln, owing to a mix of price adjustments and a rise in demand of some products.

Margins During CY23, the company’s GP Margin remained at ~18.2% (CY22, 18.2%). However, the Net profitability diluted significantly owing to a hefty increase of ~229% in the finance costs of the company. However, the company’s overall margins improved in 1QCY24, as the company recorded a GP Margin of ~26% and an NP Margin of ~6.5% primarily attributable to efficiency in production costs on the back of the induction of a new energy-efficient plant and price adjustments.

Sustainability Pakistan Oxygen is one of the largest manufacturers of industrial and medical gases in Pakistan. The newly commissioned state-of-the-art 270 TPD ASU plant, and 11 TPS electrode plant, driven by world-class technology, brings cost-efficiencies and a competitive edge to the Company as 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 increased during 3MCY24: 75 days (CY23, 73 days: CY22: 69 days) mainly on the back of a decrease in payable days.

Coverages The Company's free cash flow from operations (FCFO) stood at PKR 1,277mln during CY23 (CY22: PKR~858mln). The interest coverage ratio; is 2.6x in 3MCY24 (2.1x, CY23: CY22 5.2x). The hike in finance costs has affected its coverages.

Capitalization Long-term borrowings of the Company in 3MCY24 stood at PKR~4,846mln (CY23, 4,979mln: CY22, PKR 4,678mln). Short-term borrowings constitute PKR 2,746mln in total borrowings of PKR 7,592mln as of 3MCY24. The Company has a leveraged capital structure as the total debt-to-capital ratio of the Company is 46.3% in 3MCY24 (CY23, 47.8%: CY22: ~48.0%).

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Financial Summary
PKR mln

Pakistan Oxygen Limited	Mar-24	Dec-23	Dec-22	Dec-21
Industrial gases	3M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	13,531	13,650	12,188	6,019
2 Investments	-	-	-	-
3 Related Party Exposure	0	0	0	0
4 Current Assets	5,085	5,002	5,243	3,788
a Inventories	*998*	*1,030*	*1,317*	*1,041*
b Trade Receivables	*1,639*	*1,338*	*827*	*654*
5 Total Assets	18,616	18,652	17,431	9,807
6 Current Liabilities	1,782	1,712	2,080	1,437
a Trade Payables	*245*	*297*	*770*	*312*
7 Borrowings	7,592	7,910	7,155	2,893
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	425	390	431	484
10 Net Assets	8,817	8,639	7,764	4,993
11 Shareholders' Equity	8,817	8,639	7,764	4,993
B INCOME STATEMENT				
1 Sales	2,727	8,589	7,296	7,005
a Cost of Good Sold	*(2,020)*	*(7,028)*	*(5,972)*	*(5,645)*
2 Gross Profit	707	1,561	1,324	1,360
a Operating Expenses	(174)	(688)	(625)	(568)
3 Operating Profit	533	873	700	793
a Non Operating Income or (Expense)	*36*	*19*	*(15)*	*(40)*
4 Profit or (Loss) before Interest and Tax	569	892	684	753
a Total Finance Cost	*(270)*	*(687)*	*(209)*	*(119)*
b Taxation	*(120)*	*(61)*	*(55)*	*(182)*
6 Net Income Or (Loss)	178	145	420	451
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*653*	*1,277*	*858*	*1,023*
b Net Cash from Operating Activities before Working Capital Changes	*398*	*689*	*750*	*914*
c Changes in Working Capital	*(152)*	*(329)*	*(758)*	*(484)*
1 Net Cash provided by Operating Activities	245	360	(8)	430
2 Net Cash (Used in) or Available From Investing Activities	6	(1,984)	(4,131)	(1,798)
3 Net Cash (Used in) or Available From Financing Activities	(319)	1,484	4,256	1,578
4 Net Cash generated or (Used) during the period	(68)	(140)	117	210
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	27.0%	17.7%	4.2%	26.3%
b Gross Profit Margin	25.9%	18.2%	18.2%	19.4%
c Net Profit Margin	6.5%	1.7%	5.8%	6.4%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	18.4%	11.0%	1.4%	7.7%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	8.2%	1.8%	6.6%	9.0%
2 Working Capital Management				
a Gross Working Capital (Average Days)	84	96	96	88
b Net Working Capital (Average Days)	75	73	69	72
c Current Ratio (Current Assets / Current Liabilities)	2.9	2.9	2.5	2.6
3 Coverages				
a EBITDA / Finance Cost	2.6	2.1	5.2	9.8
b FCFO / Finance Cost+CMLTB+Excess STB	1.7	1.2	1.8	4.5
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	3.1	8.1	7.0	1.6
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	46.3%	47.8%	48.0%	36.7%
b Interest or Markup Payable (Days)	111.1	168.9	392.9	116.9
c Entity Average Borrowing Rate	13.7%	8.7%	4.3%	4.0%

Credit Rating

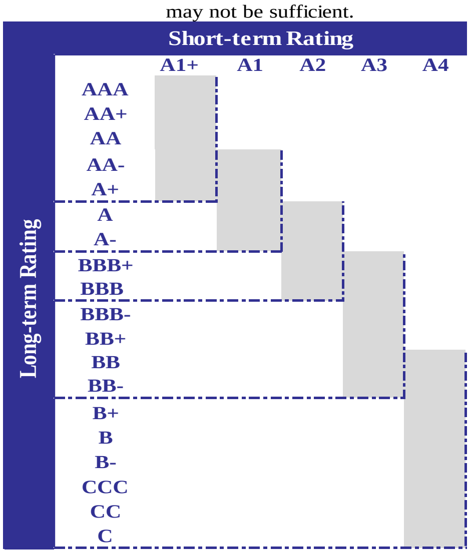
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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 | 17-(a)
(19) PACRA reviews all the outstanding ratings periodically, on annual basis; Provided that public dissemination of annual review and, in an instance of change in rating will be made; | Chapter III | 17-(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 | 17-(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 | 17-(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 | 14-3(f)(vii)
Proprietary Information