The Pakistan Credit Rating Agency Limited

Rating Report

Sitara Petroleum Service (Pvt.) Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
16-May-2019	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect the strong business profile of Sitara Petroleum Service (Private) Limited. Sponsors have been engaged in the business for over three decades and reflect grips on the dynamics of the industry. The company is primarily engaged in two business segments namely i) Trading and distribution of diesel, petrol, related products. This segment is further split into retail and bulk units. Under the retail side, the company operates a network of ~27 retail stations which is mainly spread out in the Punjab region whereas, under the bulk segment the company provides PoL product directly to customers ii) Furnishing fleet logistic services (Carriage income) to various OMCs. The sponsor’s long association with these business lines is being considered positive. Company’s prime profits are being generated from the fleet logistic business. It carries ~70% share in the gross profit, followed by retail (~21%) and bulk business segments (~9%). Over the years share of profit from the fleet logistic division is soaring while retail and bulk segments are also supplementing the profitability. In most segments, Sitara’s margins are regulated not negotiated. Company’s fleet logistic revenue is primarily (~90%) coming from Gas and Oil Company (GO) which is a group company. This is considered a plus. The Company’s financial risk profile is characterized by adequate leveraged capital structure. This along with improved cashflows help manage the financial risk. Adequate coverages lend support to financial profile. Management, being cognizant of the current industry situation, is embarking on functionalizing an Oil Marketing company to augment and diversify its revenue stream. The company is planning a debt instrument in a bid to build a depot at Port Qasim, Karachi; this, in turn, may lead to upping in the leverage capital structure, which remains aligned with the assigned rating. The CAPEX will be cushioned by internal cash generation. Of late, the company has refined its control and governance structure. ‘Category A’ auditor - on the panel of auditors maintained by SECP - has been appointed. The finance team has been strengthened. The overall governance framework is also being augmented.

The ratings are dependent on the management's ability to sustain its business volumes while holding the margins. With the new debt to be acquired, maintenance of coverages would remain important. Sustaining the business and financial profile along with effective changes in governance framework would be beneficial for the ratings. Meanwhile, financial transparency is considered important.

Disclosure

Name of Rated Entity	Sitara Petroleum Service (Pvt.) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-18),Methodology | Criteria | Rating Modifier(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	Hamza Ghalib | hamza.ghalib@pacra.com | +92-42-35869504

Profile

Legal Structure Sitara Petroleum (Pvt.) Limited was incorporated in Jul'12. The office of the company is situated at Tufail Shaheed road near PSO depot, Sahiwal.

Background Initially, there were two companies i) lalpur carriage: which was involved in the business of providing logistics facilities to oil marketing companies (OMCs) ii) Sitara Petroleum: was involved in the business of trading and distribution of PoL products through the medium of retail as well as through direct sales. Afterward, it was decided by the management to give proper structure to these entities under the umbrella of one company. This is how Sitara petroleum Service Private Limited came into being.

Operations Sitara Petroleum Service Private Limited is mainly engaged in the business of trading and distribution of diesel, petrol, and lubricants. The company is also providing fleet logistic services (Carriage income) to OMCs in the country namely GO, PSO and Total PARCO.

Ownership

Ownership Structure The company is 94% owned by Mr. Tahir Iqbal, 4% by Mr. Muhammad Akram, while Mr. Muhammad Javed and Mr. Muhammad Hassan Javed own 1% each.

Stability The Business has been governed and managed by individuals who have solid experience in the Oil sector of Pakistan. Mr. Khalid Riaz, brother of Mr. Tahir Iqbal, has no direct ownership in Sitara, however, he bears stronghold in the strategic decision making of the company, in case the company needs it. Though ownership of the company is clearly defined however succession planning is not well-documented.

Business Acumen Sitara's sponsors have strong business skills which have helped the company to achieve sustainable success over a period of years. Sponsors have Industry-specific working knowledge and strategic thinking capability.

Financial Strength Sponsors financial strength is subject to the successful functioning of the Sitara Petroleum Service (Private) Limited.

Governance

Board Structure The company has a four-member board (including CEO). Board comprises two executives and two independent directors.

Members' Profile The BoD has diversified experience and knowledge of the industry which is considered good.

Board Effectiveness The chairman of the board and CEO of the company is the same person, which is not considered good governance practice. Hence, the effectiveness of the board with respect to this seems lacking. To improve the governance profile of the company, the post of the chairman and CEO is expected to bifurcate by end-Dec19. The board has formulated two committees, i) Board Audit Committee and ii) Board Human Resource & Remuneration Committee.

Financial Transparency M/S Mudassar Ehtisham & Co. is the external Auditor of the company. They have expressed an unqualified opinion on the company's financial statement as at end-Jun18. To improve financial transparency, the company has engaged RSM Avais Hyder Liaquat Nauman for the audit assignment. An engagement letter is signed while the audit assignment is expected to complete by the end-Jun19. The firm having satisfactory QCR Rating from the Institute of Chartered Accountants of Pakistan and classified in category "B" on the panel of auditors maintained by the State Bank of Pakistan.

Management

Organizational Structure The company has an adequate organizational structure. The operations of the company have been bifurcated into four broad functional areas which comprise: i) Operations, ii) Finance and iii) Sales, iv) Transport.

Management Team Mr. Tahir Iqbal is the CEO of Sitara Petroleum Service (Pvt.) Ltd. He has done bachelors in Civil Engineering from University of Engineering & Technology Lahore. He is a veteran of the retail & oil transportation sector with rich experience in the field spanning more than 30 years. Mr. Shaheer Junaid is the CFO of the company, an Associate Chartered Accountant by profession and has over 8 years of professional experience in his portfolio. Most of the senior management is associated with the company since long and have sufficient experience to take strategic decisions

Effectiveness Sitara has constituted two committees comprising members of the management team namely i) Procurement and ii) Retail Development Committee.

MIS The Company uses ERP Software designed & developed by Vision Plus. It is developed by using Oracle RDBMS. It has a variety of information analysis and various modules including general ledger, sales & receivables, purchase & payables, inventory control, carriage & freight, and transport & monitoring.

Control Environment The company is using a fleet management system to keep a track on the movement of tank Lorries and vehicles on the move. This is done through the tracker system. A special structure is designed in the system to track all the trips that are system logged. Sitara has internal audit department which adds value and improvement to the organization's operations.

Business Risk

Industry Dynamics Pakistan consumed a total of ~25.1mln (MT) of POL products in FY18 (FY17: 25.9mln MT), ~3% lower than the same period last year. This decline is seen mainly owing to decrease in the sales of Furnace oil by ~23% to ~7.3mln MT (FY17: ~9.6mln MT), as the government of Pakistan plans to gradually reduce reliance on oil-based power plants to other power sources i.e. LNG & coal. MOGAS, FO, and HSD are three major products that are widely used because of their immense consumption in the country.

Relative Position During FY18, the segment of trading and distribution of Pol products, the company has a market share of ~1.3% and ~1.6% in PMG and HSD, respectively. While in the PoL transportation business the company adds ~15% to the domestic supply. One of the key players in the industry, PAPCO, solely deals in High-Speed diesel transportation. However, in the near future, along with HSD, the company would be transporting MOGAS through an existing network. Because of this, relative positioning, in turn, the market share of the carriage companies will change.

Revenues Topline of the company can be bifurcated into i) PoL Retail Sales ii) PoL bulk sales and iii) Carriage income. During FY18, retail sales yielded ~69% in the total revenue mix, while Bulk sale and carriage income contribute ~29% and ~2% respectively. During FY18, total sales of the company stood at PKR 26,817mln (FY17: PKR 27,327mln), a decline by ~2%. This is because of the plummeting sales volumes of PoL products. During 1HFY19, the top line of the company stood at PKR 12,768mln (1HFY18: PKR 12,696mln), an increase of ~0.56%.

Margins During FY18, the company's prime profits are being generated from the transportation business. It carries ~70% share in the gross profit, followed by ~21% in retail and ~9% in the bulk segment. Over the years share of profit from the fleet logistic division is soaring while retail and bulk segments are also supporting. In most segments, Sitara's margins are regulated not negotiated. During FY18, the total gross profit of the company stood at ~PKR 623mln (FY17: ~PKR 499mln).

Sustainability Going forward, Sitara is intended to increase its retail outlet all over the cities of Pakistan as well as in remote areas by installing pumps. Additionally, the company also intends to grow in the segment of carriage income by growing its number of fleets. Management, being cognizant of the current industry situation is embarking on functionalizing an Oil Marketing company to augment and diversify its revenue stream, in addition to current business. of late, OMC license has been acquired while financing arrangements are being analyzed.

Financial Risk

Working Capital Sitara's working capital requirement emanates from its need to finance its trade debts and stock in trade. For this company resorts to short-term borrowings. During FY18, short-term financing of the company has augmented by ~32% (FY18: PKR 646mln, FY17: PKR 489mln). Trade debts of the company have increased by ~76% to PKR 271mln (FY17: PKR 154mln). The company has been managing its working capital requirements efficiently which is clearly evident from its net cash cycle days (FY18: ~7 days, FY17: ~6 days).

Coverages During FY18, the company has generated cash flow (FCFO) of ~PKR 616mln (FY17: ~PKR 503mln). This is on account of improved profitability during the period. However, the use of the excess debt level resulted in higher interest expense incurred during the period. This has cumulated in the declining coverages [Debt Coverage: FY18: ~1.5x, FY17: ~2.3x).

Capitalization Company's long-term loan consists of demand finance and lease finance. These loans were obtained for the acquisition of commercial vehicles. Sitara has a leveraged capital structure of ~49% (FY17: ~35%). This increase is because of the surge in short-term loans as well as long-term borrowings. Going forward with the new debt to be acquired for expansion, this may intensify the capital structure.

Sitara Petroleum Service Private Limited

BALANCE SHEET	30-Dec-18	30-Jun-18	30-Jun-17	30-Jun-16
Amounts in PKR mln	6M	FY18	FY17	FY16
Non-Current Assets	**2,501**	**2,162**	**1,245**	**1,129**
Investments (Incl. Associates)	-	-	-	-
Current Assets	**1,195**	**1,500**	**1,052**	**751**
Inventory	299	252	262	155
Trade Receivables	305	271	154	68
Others	591	977	636	528
Total Assets	**3,695**	**3,662**	**2,297**	**1,880**
Debt/Borrowings	**1,577**	**1,729**	**786**	**696**
Short-Term	651	646	489	199
Long-Term (Incl. Current Maturity of Long-Term Debt)	927	1,083	297	498
Other Short-Term Liabilities	95	124	83	76
Other Long-Term Liabilities	-	-	-	-
Shareholder's Equity	**2,023**	**1,809**	**1,428**	**1,108**
Total Liabilities & Equity	**3,695**	**3,662**	**2,297**	**1,880**

INCOME STATEMENT				
Turnover	**12,769**	**26,617**	**27,327**	**25,472**
Gross Profit	436	623	499	414
Net Other Income	-	3	-	-
Financial Charges	(78)	(82)	(65)	(30)
Net Income	**214**	**381**	**319**	**282**

CASH FLOW STATEMENT				
Free Cash Flow from Operations (FCFO)	377	616	503	404
Total Cashflows (TCF)	377	616	503	404
Net Cash changes in Working Capital	119	(480)	(309)	(43)
Net Cash from Operating Activities	418	55	129	334
Net Cash from InvestingActivities	(423)	(25)	(234)	(55)
Net Cash from Financing Activities	(151)	(102)	89	(19)

Ratio Analysis				
Performance				
Turnover Growth (vs SPLY)	0.6%	-2.6%	7.3%	-12.6%
Gross Margin	3.4%	2.3%	1.8%	1.6%
Net Margin	1.7%	1.4%	1.2%	1.1%
ROE	21.2%	21.1%	22.4%	25.5%
Coverages				
Interest Coverage (FCFO/Gross Interest)	4.8x	7.5x	7.7x	13.6x
Core: (FCFO/Gross Interest+CMLTD+Uncovered Total STB)	1.7x	1.5x	2.3x	1.9x
Total: (TCF) / (Gross Interest+CMLTD+Uncovered Total STB)	1.7x	1.5x	2.3x	1.9x
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	8.6	7.2	5.6	3.2
Capital Structure (Total Debt/Total Debt+Equity)	44%	49%	36%	39%

Rating Scale

Credit Rating Scale & Definitions

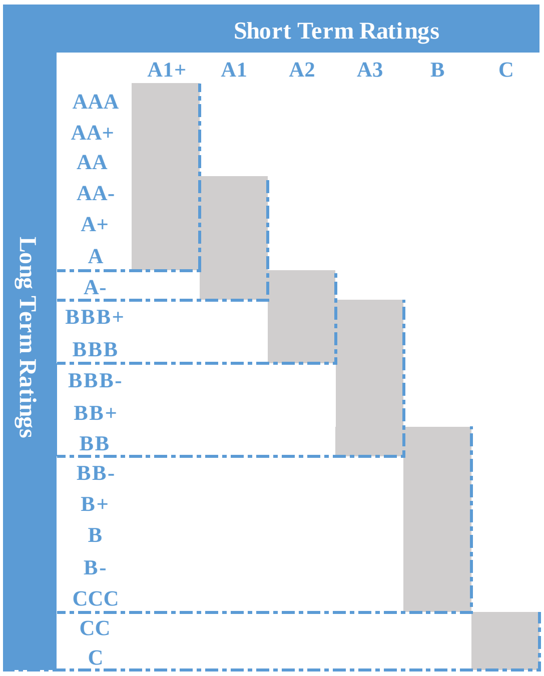
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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.



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.

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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**

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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

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(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)

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(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)

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