The Pakistan Credit Rating Agency Limited

Rating Report

Pakistan Refinery Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
07-Jun-2024	A	A1	Stable	Upgrade	-
09-Jun-2023	A-	A2	Stable	Maintain	Yes
09-Jun-2022	A-	A2	Stable	Maintain	Yes
09-Jun-2021	A-	A2	Stable	Maintain	Yes
09-Jun-2020	A-	A2	Stable	Maintain	Yes
10-Dec-2019	A-	A2	Stable	Maintain	-
10-Jun-2019	A-	A2	Stable	Maintain	-
12-Dec-2018	A-	A2	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

The Ratings of Pakistan Refinery Limited (the Company) draws comfort not only from its association with the state-owned petroleum corporation; Pakistan State Oil (PSO) but also from the fact that a considerable portion of country's petroleum demand is met through the Company. The industry is in dire need of technological upgradation for the same reason, Pakistan Oil Refining Policy for Upgradation of Existing / Brownfield Refineries 2023 has been announced by the Government of Pakistan (GoP) in which incentives are offered for the existing refineries to upgrade and produce environmentally friendly EURO V compliant MS and HSD while cutting down Furnace Oil production. These incentives will be available once the Final Investment Decision (FID) is made. In line with the Country's need the Company has announced the Refinery Expansion and Upgrade Project (REUP) which will double the refinery's crude processing capacity from 50,000 barrels per day to 100,000 barrels per day. Work on Front-End Engineering Design (FEED) of REUP is progressing and is targeted to be completed by September 2024, this will follow by the finalization of the Engineering, Procurement and Construction (EPC) Contract and Financial Close. The Company is also in process of identifying potential investor for the project. The proposed incentives in the refinery policy plays a pivotal role in completion of the REUP. PRL's core business remains exposed to the vicissitudes in international crude oil and products prices, which in turn, steer the gross refining margins (GRMs) of the Company. Spreads between prices of petroleum products and crude oil remained favorable during the period resulting in better margins which was translated into improved performance. During 9MFY24 Gross Profit reported to be PKR 12,942mln (9MFY23: PKR 6,174mln). The profit after tax of the Company during 9MFY24 reported to PKR 5,269mln (9MFY23: PKR 2,531mln). The Company has undergone major turnaround spanning over 38 days in the 3QFY24, resultantly the Company suffered a loss of PKR (1.2bln) as compared to Profit of PKR 1.77bln in the comparative period. The Company reliance on short term financing during the period remains moderate to manage its working capital needs. Going forward leveraging indicators are expected to rise due to the project related loan that the Company will undertake for its upgradation project.

The ratings are reflective of the resilient business profile of Pakistan Refinery Limited (PRL) emanating from its sustainable operational history and its strategic importance in the domestic context. The Ratings are dependent upon PRL's ability to effectively shield its business profile from external vulnerabilities. Revived performance indicators and prudent financial matrix are imperative to uphold the ratings. Furthermore the ratings takes comfort form the refinery policy which will provide support to the REUP and contributes towards the sustainability of operations.

Disclosure

Name of Rated Entity	Pakistan Refinery 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 | Refineries(Nov-23)
Rating Analysts	Andleeb Zahra | andleeb.zahra@pacra.com | +92-42-35869504

Profile

Legal Structure Pakistan Refinery Limited ("PRL") is a Public Limited Company, incorporated in 1960. It is listed on the Pakistan Stock Exchange

Background The plant came into operation, in October 1959. The designed capacity of the refinery was to process one million tons of crude oil annually. Additional capacity was added, subsequently, in October 1962. PRL, since inception, has been one of the principal producers and suppliers of petroleum products in the market.

Operations PRL, a hydroskimming refinery, is designed to process imported and local crude oil to meet the strategic and domestic fuel requirements of the country. Major products of the company comprise; LPG, Motor Gasoline, Kerosene, Jet Fuel (JP-I & JP-8), HSD, Furnace Oil, and Naphtha. The customers of the refinery include all the major oil marketing companies, operating in the country. PRL's refinery is situated at Korangi, while it has a tank terminal to store products, at the Keamari Terminal. In addition to these facilities, there is a network of pipelines connecting the refinery and the terminal to different supply points.

Ownership

Ownership Structure PRL is majorly owned by Pakistan State Oil (PSO) having shareholding of 64%.

Stability The business has been governed and administered by entities, which have a distinguished name in the oil sector. Thus, the stability factor is considered strong.

Business Acumen PRL's sponsors have strong business skills, which has helped the company to achieve sustainable success over a considerable period of time. Sponsors, particularly now with PSO on board, have industry-specific working knowledge and strategic thinking capability.

Financial Strength The company's sponsors have the ability and willingness to support the entity on a continuing basis, and in times of crisis. The sovereign support of the government in the shape of PSO, has further enhanced this notion.

Governance

Board Structure PRL has an eleven member board, including the MD & CEO. The board comprises of six independent directors, four non-executive directors, and one executive member.

Members' Profile Mr. Tariq Kirmani, an MBA, is the Chairman of the Board, with more than 30 years of experience in relevant sector. PRL's board comprises highly qualified members. It is composed of professionals with considerable foreign and local experience in the oil and gas sector. A few of the board members have an engineering background while some are qualified in the domain of finance and arts. Diversification in terms of knowledge and experience is considered good.

Board Effectiveness The BoD has constituted four committees to maintain strategic oversight, namely; i) Board Audit Committee ii) Board Human Resource and Remuneration Committee and iii) Board Project Steering Committee. The TORs of all the committees are formally defined. A strong control environment is maintained.

Financial Transparency PRL's auditor, KPMG Taseer Hadi & Co, has expressed an unqualified opinion on financial statements at end FY23. Because of its listing status, financial transparency of the company is considered strong as it has to comply with the disclosures requirements of the regulators.

Management

Organizational Structure PRL's organizational architecture encompasses a well-built departmental structure comprising established reporting lines. The departments reporting directly to the MD comprise; a) Operations, b) Engineering, c) Refinery Upgrade Project, 4) Finance, 5) Information Technology, 6) Technical and Inspection, 7) Commercial, Contracts and Procurement, 8) Human Resources, 9) HSEQ, 10) Legal & the Company Secretary report to the MD, indirectly.

Management Team Mr. Zahid Mir, the Managing Director and CEO of PRL since August' 19, is a petroleum engineer by profession and has an MBA. He is supported by a team of qualified and competent individuals.

Effectiveness Historically, PRL's effective management has played a major role in empowering the organization through its progressive results. Management's effective decision-making has led to processes becoming more systematic. The robustness of control systems is considered a reflection of strong management.

MIS PRL has implemented SAP ERP, since the year 2000. The SAP software is licensed and undergoes regular up-gradation . The modules implemented at PRL comprise; Finance, Material Management, HR and Plant Maintenance. PRL's IT infrastructure effectively manages all business operations of the company

Control Environment The existence of the Isomerization Unit has resulted in a production increase of Motor Gasoline (MOGAS), a high margin product. The unit is responsible to convert Naphtha into MOGAS.

Business Risk

Industry Dynamics Pakistan consumed a total of ~12.04mln metric tons (MT) of petroleum products (white oil) in 9MFY24 (9MFY23: ~12.3mln MT). This decrease is mainly seen due to decrease in the consumption of MOGAS and HSD due to higher petroleum prices and lower discretionary income. Consumption of black oil has been decreasing over the years mainly due to decline in the consumption of FO by ~ 5% to ~1.8mln MT (FY23: ~2.0mln MT, FY22: ~2.4mln MT), as the government of Pakistan plans to gradually reduce reliance on oil-based power plants to other power sources i.e. LNG & coal.

Relative Position Pakistan's total Refining Capacity stands at ~20mln MTs per annum (FY24), almost equal to the country's POL demand. However, capacity utilization levels remain low on account of the sector's necessity to operate at an optimum level. Demand for Furnace Oil has declined due to the government's policy of reducing reliance on furnace oil for electricity generation.

Revenues During 9MFY24, Pakistan Refinery witnessed a surge of 22% and generated a turnover of -PKR 2,269mln (9MFY23: -PKR 2,531mln). This surge in revenues is due to better product mix and stronger pricing mechanism.

Margins Gross margins of the Company have increased in 9MFY24 to 5.6% (FY23: 2.8%, FY22: 10.6%) owing to i) lower operating cost due to the decrease in the price of raw material ii) reduction in inventory losses. Operating margins (9MFY24: 5.0%) of the Company are also increasing owing to a decrease in the operating expenses during the period under review.

Sustainability The refinery sector has been going through an existential crisis, as a result of the government's demand for environment friendly fuel. The issue of low FO offtake has been compounded by the introduction of the IMO 2020, which necessitates the use of low Sulphur FO by the marine sector. Due to the substantial investment needed for the required upgrades to the refineries, the developments in this regard, have reached an impasse. A slump in demand of petroleum products, has put the industry players under further pressure. Government assistance is imperative, for the sustenance of the sector.

Financial Risk

Working Capital PRL's working capital requirement emanates from its need to finance its inventory and circular debt, which usually results in net receivable position to the company. During 9MFY24 gross working capital days has decreased to 58days (9MFY23: 63 days, 9MFY22: 50 days). This is primarily due to the decrease in trade payables days. In order to meet working capital requirement, PRL resorts to short-term borrowings. During 9MFY24, total short-term borrowings stands at PKR 25bln.

Coverages PRL's cash flow generation ability remains a function of its profitability and working capital requirements. During 9MFY24, coverages of the Company have shown a recovery (Interest coverage: 9MFY24: 3x, FY23: 1.2x FY22: 11.2x) owing to better pricing and profitability translating into lower FCFO. Nevertheless, amidst volatility in crude oil prices, sustaining a level of coverages for upcoming payments commensurate with the company's rating remains pivotal. Going forward, any accumulation of debt for the upcoming expansion and upgradation project may impact the coverages.

Capitalization PRL has a medium term loan of PKR 3bln from Askari Bank Limited. Short term loans of USD 40.26mln and USD 45.69mln from HBL and NBP carry mark up of 3m LIBOR+2.5% and 6m LIBOR +4.44% and are repayable by May 15 and 06, 2024 respectively. The Company leveraging ratio stood at 48% at 9MFY24 (FY23: 56%, FY22: 45%).

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Financial Summary
PKR mln

Pakistan Refinery Ltd. Refinery	Mar-24 9M	Jun-23 12M	Jun-22 12M	Jun-21 12M
A BALANCE SHEET				
1 Non-Current Assets	30,739	28,780	29,176	20,614
2 Investments	11,807	46	56	59
3 Related Party Exposure	16,550	9,853	9,185	7,442
4 Current Assets	69,722	66,792	52,301	16,542
a Inventories	*33,569*	*35,461*	*24,057*	*10,415*
b Trade Receivables	*2,649*	*9,935*	*2,196*	*5,901*
5 Total Assets	128,818	105,472	90,718	44,658
6 Current Liabilities	67,935	47,502	47,430	20,544
a Trade Payables	*53,298*	*35,436*	*46,298*	*14,076*
7 Borrowings	28,541	31,976	19,049	18,020
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	1,214	637	871	382
10 Net Assets	31,129	25,357	23,368	5,711
11 Shareholders' Equity	30,627	25,357	23,596	2,047
B INCOME STATEMENT				
1 Sales	231,644	261,860	191,316	92,084
a Cost of Good Sold	*(218,702)*	*(254,560)*	*(171,044)*	*(88,843)*
2 Gross Profit	12,942	7,301	20,272	3,241
a Operating Expenses	(1,365)	(1,476)	(873)	(745)
3 Operating Profit	11,577	5,825	19,399	2,496
a Non Operating Income or (Expense)	*(307)*	*1,623*	*(1,901)*	*454*
4 Profit or (Loss) before Interest and Tax	11,270	7,448	17,498	2,950
a Total Finance Cost	*(2,963)*	*(4,376)*	*(1,579)*	*(1,311)*
b Taxation	*(3,038)*	*(1,548)*	*(3,345)*	*(702)*
6 Net Income Or (Loss)	5,270	1,524	12,573	937
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*5,828*	*3,065*	*15,649*	*3,311*
b Net Cash from Operating Activities before Working Capital Changes	*2,901*	*(611)*	*14,030*	*1,917*
c Changes in Working Capital	*17,385*	*(19,782)*	*10,386*	*(6,029)*
1 Net Cash provided by Operating Activities	20,285	(20,394)	24,416	(4,112)
2 Net Cash (Used in) or Available From Investing Activities	(11,124)	2,460	(214)	(242)
3 Net Cash (Used in) or Available From Financing Activities	2,472	665	(25,950)	2,237
4 Net Cash generated or (Used) during the period	11,633	(17,268)	(1,748)	(2,117)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	17.9%	36.9%	107.8%	1.7%
b Gross Profit Margin	5.6%	2.8%	10.6%	3.5%
c Net Profit Margin	2.3%	0.6%	6.6%	1.0%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	10.0%	-6.4%	13.6%	-3.0%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	25.1%	6.2%	98.1%	100.0%
2 Working Capital Management				
a Gross Working Capital (Average Days)	48	50	41	57
b Net Working Capital (Average Days)	-4	-7	-17	9
c Current Ratio (Current Assets / Current Liabilities)	1.0	1.4	1.1	0.8
3 Coverages				
a EBITDA / Finance Cost	3.0	1.2	11.2	3.2
b FCFO / Finance Cost+CMLTB+Excess STB	0.5	0.2	1.0	0.1
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	3.9	-10.0	1.0	11.0
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	48.2%	55.8%	44.7%	89.8%
b Interest or Markup Payable (Days)	0.0	0.0	0.0	58.0
c Entity Average Borrowing Rate	13.9%	18.2%	8.6%	7.9%

Credit Rating

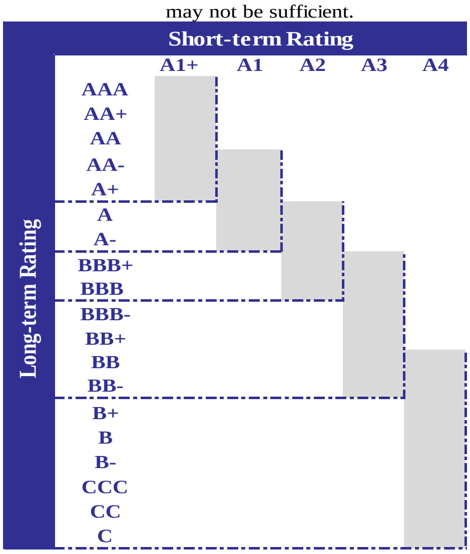
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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