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
12-Dec-2018	A-	A2	Stable	Maintain	-
31-May-2018	A-	A2	Stable	Maintain	-
29-Jun-2017	A-	A2	Stable	Maintain	-
29-Jun-2016	A-	A2	Stable	Maintain	-
30-Jun-2015	A-	A2	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

The ratings reflect the resilient business profile of PRL emanating from its sustainable operational history, strong demand for its products and its strategic importance in the domestic context. PRL's core business remains exposed to the vicissitudes in international crude oil, which in turn, may lead to reduced gross refining margins (GRMs). In the recent period, PRL's refining margins have suffered deterioration due to unfavorable prices of Crude Oil and Petroleum Products heightened by Exchange loss. The design of PRLs' plant offers relatively limited flexibility; in turn, low margin and high exposure to the volatile dynamics of international crude oil and refinery product pricing. The respite is provided by the commissioned Isomerization plant, providing volumetric growth in petrol - a high-margin product. Additionally, margins are squeezed on account of HSD pricing, due to high Sulphur content, as the company did not install DHDS unit for making euro II compliant HSD, which in turn, affecting the profitability of the company.

The ratings could be impacted by prolonged constrain in refining margins and/or adverse changes in the existing regulatory framework leading to depressed core cash flows. Adequacy of cashflows viz-a-viz debt servicing remains critical for the ratings. Prudent management of financial matrix amidst new borrowing requirement is important.

Disclosure

Name of Rated Entity	Pakistan Refinery 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 | Refineries(Dec-18)
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Profile

Legal Structure Pakistan Refinery Limited is a public company incorporated in Pakistan in 1960. 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.

Background In October 1959 the plant came into operation, two months ahead of schedule. The design capacity of the Refinery was to process 1 million tons of crude oil annually. The additional capacity came online in October 1962. PRL, since inception, has been one of the principal producer and supplier of petroleum products to the domestic market.

Operations PRL, a hydroskimming refinery, designed to process various 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 Fuels (JP-1 & JP-8), HSD, Furnace Oil, and Naphtha. The major customers of the refinery include all the major oil marketing companies operating in the country.

Ownership

Ownership Structure Pakistan Refinery is majorly owned by Shell Petroleum Company Limited (~4%), Pakistan State Oil Company Limited (~53%), Hascol Petroleum (~15%), and Chevron Global Energy (~1%). Other major shareholders comprise financial institutions (~3%) and the general public (~20%).

Stability The Business has been governed and administered by entities who have distinguished name in the Oil sector of Pakistan. Therefore, stability factor is considered strong.

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

Financial Strength Company's sponsors have the ability and showed the willingness to support the entity both on a continuing basis, and support in times of crisis.

Governance

Board Structure The Company has eleven member board at end-Jun18. Board comprises eight non-executive members, two independent members and one executive member.

Members' Profile Syed Asad Ali Shah is the chairman of the board, a qualified chartered accountant, with more than ~30 years of experience in audit, assurance, consulting and governance related advisory services. PRL's board comprises of highly qualified board members, is composed of professionals with considerable foreign and local experience in the oil and gas sector. Few of the board members have engineering background while some are qualified in the domain of Finance and Arts. Moreover, diversification in terms of knowledge and experience is considered good. A fair number of board members have related experience, which is positive.

Board Effectiveness During FY18, the board held five meetings to address the strategic decisions of the company. A fair number of board members attended more than ~90% of the board meetings. The BoD has constituted five committees to maintain strategic oversight over the management namely i) Audit committee ii) Human resource and remuneration committee iii) Board technical committee iv) Board strategic committee v) share transfer committee. The TORs of all the committees are formally defined and they maintain a strong control environment over the organization.

Financial Transparency During the year, PRL's auditors, A. F. Fergusons & Co Chartered Accountants., a member firm of the PwC network, ranked as "A" category auditor by SBP expressed an unqualified opinion on the company's financial statements as at end-Jun18. Because of the listing status, financial transparency is considered strong as the company has to comply with the disclosures requirements of the regulators. Additionally, the company has a well-maintained website as well where financial disclosures are made public to maintain transparency.

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) Engineering, b) Refinery Upgrade Project, c) Technology & Inspection, d) Finance, e) Human Resources, f) Security, g) Commercial, h) Operations & ISEQ. Internal audit & Company Secretary reports to MD indirectly.

Management Team Mr. Aftab Husain, the Managing Director and CEO of PRL, is a Chemical Engineer by profession and has a master's degree in Public Administration (MPA). He has been associated with the company for over three decades. He is supported by a team of qualified and competent individuals. Mr. Imran Ahmad Mirza is the CFO of the company, a qualified chartered accountant and been associated with the PRL for more than ten years.

Effectiveness Over the years PRL's effective management played a significant role in empowering the organization through its progressive results. Additionally, management's effective decision-making cause processes more systematic while robustness of control systems is considered a reflection of strong management, which is considered positive.

MIS PRL implemented SAP ERP since 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 PRL, focusing on optimization of refining capacity and improving efficiency, has completed the installation of an Isomerization Unit (ISOM). The unit is responsible to convert Naptha into Motor gasoline (MOGAS). Completion of the isomerization unit has resulted in a production increase of MOGAS - a high margin product. The company is undertaking a major up-gradation project by installing a Hydro-desulphurization Unit (DHDS) in order to produce Euro-II compliant High-Speed Diesel.

Business Risk

Industry Dynamics Pakistan consumed a total of ~18mln metric tons (MT) of petroleum products (POL) in FY18 (FY17: ~16 mln MT), an increase by ~9%. This increase is mainly seen due to an increase in the consumption of MOGAS and HSD due to solid growth in the transport sector. Growth is a given factor in the domestic market, yet the relevant proportion of domestic Vs import may face transition. Consumption of black oil has been decreasing due to declining consumption of FO, 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 The relative positioning of the players in the premium products (HSD and MOGAS); efficiency and utilization of available capacity is essential. Two refineries namely PARCO and Byco retain a large chunk of market share of ~55%, while Pakistan refinery, National refinery, and Attock refinery contribute ~45% to the total domestic supply.

Revenues Pakistan refinery witnessed the considerable growth of ~32% and generated a turnover of ~PKR 92,229mln in FY18 (FY17: ~PKR 69,929mln). This increase is seen mainly due to i) increase in volumetric sales of ~3% and, ii) a considerable increase of PoL product prices.

Margins Gross margins of the company have declined in FY18 to ~1.1% (FY17: ~3.6%) owing to i) declining gross refining margins MoM basis ii) higher operating cost due to increase in the price of raw material iii) rupee depreciation against US dollar that has resulted to loss of ~PKR 1,284mln during the year (FY17: ~PKR 108mln).

Sustainability For the purpose of smooth and efficient operations, the company has installed a water tube boiler equipped with the independent for efficient utilization of fuel. This will not only augment the existing three boilers which are in service since 1962 but will also meet future operational requirements. Additionally, management of the company is near to complete work on a 4.5 MW Power Plant. This will reduce operational and maintenance costs as well as increases the Plant's safety and reliability.

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 FY18, gross working capital days have increased to ~58days (FY17: ~55days). This is primarily due to an increase in the receivables (FY18: ~PKR 7,265mln, FY17: ~PKR 4,471mln). In order to meet working capital requirements, PRL resorts to short-term borrowings. During FY18, total available financing facility is ~PKR 53,810mln of which ~75% is unutilized.

Coverages During FY18, coverages of the company have slightly shown a declining trend [Interest coverage: FY18: ~3.4x, FY17: ~4.9x) owing to reduced profitability which translated into the reduction in FCFO (FY18: ~PKR 1,998mln, FY17: ~PKR 2,985mln).

Capitalization PRL has a leverage capital structure, clocked in at ~70% (FY17: ~71%). Short-term borrowings constitute ~43% of the total borrowings.

PKR mln

Pakistan Refinery Limited

BALANCE SHEET	30-Jun-18	30-Jun-17	30-Jun-16	30-Jun-15
	FY18	FY17	FY16	FY15
Non-Current Assets	**13,500**	**12,306**	**12,390**	**12,601**
Investments (Incl. associates)	**71**	**84**	**85**	**91**
Equity	71	84	85	91
Current Assets	**16,947**	**13,535**	**12,302**	**18,061**
Inventory	7,478	6,128	5,090	5,516
Trade Receivables	7,265	4,471	5,211	6,231
Others	2,203	2,936	2,001	6,314
Total Assets	**30,518**	**25,925**	**24,777**	**30,753**
Debt	**9,319**	**7,557**	**10,561**	**11,316**
Short-term	3,990	5,322	6,594	7,194
Long-term (Inlc. Current Maturity of long-term debt)	5,329	2,234	3,967	4,123
Other shortterm liabilities	16,779	14,942	11,787	17,514
Other Longterm Liabilities	357	325	261	138
Shareholder's Equity	**4,063**	**3,101**	**2,167**	**1,785**
Total Liabilities & Equity	**30,518**	**25,925**	**24,777**	**30,753**
INCOME STATEMENT				
Turnover	**92,229**	**69,929**	**64,733**	**91,175**
Gross Profit	1,045	2,510	1,990	(677)
Net Other Income	965	74	(140)	187
Financial Charges	(591)	(604)	(909)	(707)
Net Income	**504**	**1,060**	**283**	**(1,182)**
Cashflow Statement				
Free Cashflow from Operations (FCFO)	1,998	2,985	2,050	(1,017)
Net Cash changes in Working Capital	(1,888)	1,923	(2,059)	2,021
Net Cash from Operating Activities	(398)	4,452	(1,071)	(56)
Net Cash from InvestingActivities	(1,502)	(1,223)	(520)	(4,616)
Net Cash from Financing Activities	1,763	(3,104)	(637)	5,195
Ratio Analysis				
Performance				
Turnover Growth	31.9%	8.0%	-29.0%	-35.9%
Gross Margin	1.1%	3.6%	3.1%	-0.7%
Net Margin	0.5%	1.5%	0.4%	-1.3%
ROE	12.4%	34.2%	13.1%	-66.2%
Coverages				
Interest Coverage (FCFO/Gross Interest)	3.4	4.9	2.3	-1.4
Core: (FCFO/Gross Interest+CMLTD+Uncovered Total STB)	0.4	0.4	0.2	-0.1
Total: (TCF) / (Gross Interest+CMLTD+Uncovered Total STB)	0.4	0.4	0.2	-0.1
Debt Payback (Total LT Debt Incl. Uncovered Total STBs) / (FCFO-Gross Int.)	6.5	3.8	8.8	-6.2
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	20	11	18	-9
Capital Structure (Total Debt/Total Debt+Equity)	69.6%	70.9%	83.0%	86.4%

Rating Scale

Credit Rating Scale & Definitions

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

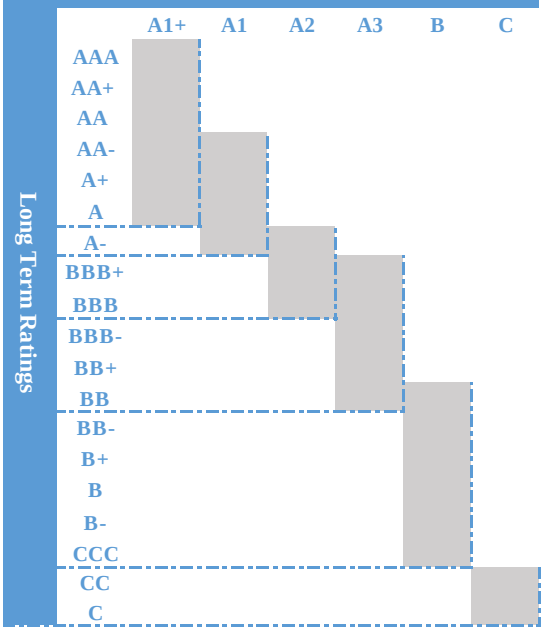
Long Term Ratings

AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short Term Ratings

A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
C	An inadequate capacity to ensure timely repayment.

Short Term Ratings



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

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

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

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

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

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

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

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

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

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

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