



The Pakistan Credit Rating Agency Limited

Rating Report

Pakistan Refinery Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
10-Dec-2019	A-	A2	Stable	Maintain	-
10-Jun-2019	A-	A2	Stable	Maintain	-
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	-
30-Jun-2014	A-	A2	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

The ratings reflect the resilient business profile of Pakistan Refinery Limited (PRL) emanating from its sustainable operational history and its strategic importance in the domestic context. 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. During FY19, volatile oil prices coupled with a sharp rupee depreciation emerged as one of the key challenges to PRL and the Refinery Sector as a whole. Resultantly, overall refinery margins remained under pressure hampering the profitability of the sector. PRL margins are also impacted on account of low HSD price, due to non-installation of DHDS Unit for producing Euro-II compliant Diesel. Another major issue encountered to the Refining Sector was the declining demand of Furnace Oil (FO), as the Government took steps to shift power sector needs to alternate fuels like LNG and coal. The recent trend, however, is reflecting a revival, as is evident from a stabler rupee and favorable FO prices. This is expected to augur well for the company. The Premium Motor Gasoline (PMG) and crude oil negative delta, which also played a role, has now reversed. With PSO as the main Sponsor on back and an expected stability on the macro-front, PRL now embarks on upgradation project in their refinery complex, being at a very preliminary stage, as of today. This is expected to pitch benefits for the company, when materialized.

The ratings are dependent on improved performance indicators, particularly refining and net margins. Adequacy of cashflows viz-a-viz debt servicing remains critical for the ratings. Meanwhile, prudent financial discipline amidst new funding needs, is imperative.

Disclosure

Name of Rated Entity	Pakistan Refinery Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Corporate Ratings(Jun-19)
Related Research	Sector Study Refineries(Nov-19)
Rating Analysts	Saadat Mirza saadat.mirza@pacra.com +92-42-35869504

Profile

Legal Structure Pakistan Refinery Limited ("PRL" or "the company") 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 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, 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 Fuels (JP-1 & 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, having 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 majority owned by Pakistan State Oil (~52.6%). Other major shareholders as at End-Sept'19 include; Hascol Petroleum (~14.7%) and Shell Petroleum (~3.5%). The general public holds ~18.3% of the ownership.

Stability The business has been governed and administered by entities who have a distinguished name in the oil sector. Therefore, 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 with PSO on board now, have industry-specific working knowledge and strategic thinking capability.

Financial Strength 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 The company has an eleven member board, including the MD & CEO. The board comprises six non-executive, four independent, and one executive member.

Members' Profile Syed Asad Ali Shah, a qualified chartered accountant, is the chairman of the board, with more than ~30 years of experience in audit, assurance, consulting and governance related advisory services. 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. Moreover, diversification in terms of knowledge and experience is considered good.

Board Effectiveness During FY19, the board held five meetings to address the strategic decisions of the company. The BoD has constituted five committees to maintain strategic oversight over the management namely i) Board Audit Committee ii) Board Human Resource and Remuneration Committee iii) Board Technical Committee iv) Board Project Steering Committee v) Board Share Transfer Committee. The TORs of all the committees are formally defined and they maintain a strong control environment.

Financial Transparency During the year, PRL's auditors, A. F. Ferguson & Co Chartered Accountants, ranked as "A" category auditor by SBP, expressed an unqualified opinion on the company's financial statements as at End-Jun19. Because of the listing status, financial transparency is considered strong as the company 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) Engineering, b) Refinery Upgrade Project, c) Technology & Inspection, d) Finance, e) Human Resources, f) Security, g) Commercial, h) Operations & HSEQ. Internal Audit & the Company Secretary report to 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 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 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 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. During FY19, the installation of Diesel Hydro-Desulphurisation Unit (DHDS), to produce EURO II compliant diesel, was approved.

Business Risk

Industry Dynamics Pakistan consumed a total of ~20mln metric tons (MT) of refined petroleum products in FY19 (FY18: ~25mln MT), indicating a decrease of ~20%. This decrease is mainly seen due to a fall in the consumption of MOGAS and HSD due to a lack of growth in the transport sector. Additionally, consumption of black oil has plunged due to declining consumption of Furnace oil, as the government of Pakistan is gradually reducing reliance on oil-based power plants in favor of other input sources for electricity generation i.e. LNG & Coal.

Relative Position With regards to relative positioning of the players in the premium products (HSD and MOGAS); efficiency and utilization of available capacity is essential. PARCO and Byco Petroleum retain a large chunk of the market share of ~54%, while PRL, NRL, and ARL collectively contribute ~46% to the total domestic POL supply.

Revenues PRL witnessed a considerable growth in the topline in FY19 equating to ~25.5%. The turnover in FY19 amounted to PKR ~115,741mln (FY18: PKR ~92,229mln). This increase is seen mainly due to an increase in PoL product prices. A healthy ~23.5% rise (annualized) in the topline was noted in 3MFY20, while generating a turnover of PKR ~35,721mln.

Margins During FY19, the gross refining margins remained under pressure owing to volatile international prices of crude and PoL products. Resultantly, gross profit margins turned negative (FY19: ~-2.7%, FY18: ~-1.1%). Moreover, steep depreciation of PKR further hampered the net profit margins (FY19: ~-5.0%, FY18: ~-0.5%). In 3MFY20, a considerable improvement was noted, with GP margins and NP margins clocking at ~2.8% and ~-0.5% respectively, on the back of a gradual mitigation of the above factors.

Sustainability For the purpose of smooth and efficient operations, the company has installed a water tube boiler equipped with the capabilities for efficient utilization of fuel. This not only augments the existing three boilers, which are in service since 1962, but will also meet future operational requirements. Additionally, management of the company has successfully commissioned the 4.5 MW Power Plant which will reduce O&M costs as well as increase the plant's safety and reliability.

Financial Risk

Working Capital PRL's working capital requirement emanates from its need to finance its inventory and trade receivables. During 3MFY20, gross working capital days stood at an average of 49 days (FY19: 58 days, FY18: 50 days). The improvement is seen mainly due to a recent decrease in the inventory levels. The same trend was noted in the average net working capital days (3MFY20: 20 days, FY19: 26 days, FY18: 14 days).

Coverages FCFO of the company in FY19 turned negative i.e. PKR ~-3,235mln (FY18: PKR ~-1,998mln) owing to losses which translated into the reduction in the coverages of the company (Interest coverage: FY19: -2.2x, FY18: 3.4x). The coverages improved to 2.0x in 3MFY20, as a result of an improved bottomline.

Capitalization The leveraging of PRL has risen in the period under review, clocking at ~75.6% at End-3MFY20 (End-FY19: ~84.4%, End-FY18: ~70%). Short-term borrowings constitute ~60.7% of the total borrowings, required for working capital purposes. The low equity levels, makes the company prone to a highly leveraged capital structure.



The Pakistan Credit Rating Agency Limited

Financial Summary

PKR mln

Pakistan Refinery Limited Refinery	Sep-19 3M	Jun-19 12M	Jun-18 12M	Jun-17 12M
A BALANCE SHEET				
1 Non-Current Assets	19,144	19,022	13,500	12,306
2 Investments	-	-	-	-
3 Related Party Exposure	96	84	71	84
4 Current Assets	18,471	23,775	16,947	13,535
<i>a Inventories</i>	8,159	9,072	7,478	6,128
<i>b Trade Receivables</i>	8,174	13,195	7,265	4,471
5 Total Assets	37,710	42,881	30,518	25,925
6 Current Liabilities	22,197	19,989	16,779	14,942
<i>a Trade Payables</i>	12,275	11,054	9,634	8,452
7 Borrowings	11,441	19,002	9,319	7,557
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	382	380	357	325
10 Net Assets	3,691	3,509	4,063	3,101
11 Shareholders' Equity	3,691	3,509	4,063	3,101
B INCOME STATEMENT				
1 Sales	35,721	115,741	92,229	69,929
<i>a Cost of Good Sold</i>	(34,719)	(118,915)	(91,184)	(67,418)
2 Gross Profit	1,002	(3,174)	1,045	2,510
<i>a Operating Expenses</i>	(157)	(858)	(590)	(540)
3 Operating Profit	846	(4,032)	455	1,970
<i>a Non Operating Income or (Expense)</i>	62	230	965	74
4 Profit or (Loss) before Interest and Tax	908	(3,802)	1,420	2,045
<i>a Total Finance Cost</i>	(454)	(1,443)	(591)	(604)
<i>b Taxation</i>	(273)	(576)	(325)	(381)
6 Net Income Or (Loss)	181	(5,821)	504	1,060
C CASH FLOW STATEMENT				
<i>a Free Cash Flows from Operations (FCFO)</i>	890	(3,235)	1,998	2,985
<i>b Net Cash from Operating Activities before Working Capital Changes</i>	371	(4,264)	1,490	2,529
<i>c Changes in Working Capital</i>	7,411	(4,552)	(1,888)	1,923
1 Net Cash provided by Operating Activities	7,782	(8,816)	(398)	4,452
2 Net Cash (Used in) or Available From Investing Activities	(344)	(1,188)	(1,502)	(1,223)
3 Net Cash (Used in) or Available From Financing Activities	(7,563)	9,682	1,763	(3,104)
4 Net Cash generated or (Used) during the period	(125)	(321)	(138)	125
D RATIO ANALYSIS				
1 Performance				
<i>a Sales Growth (for the period)</i>	23.5%	25.5%	31.9%	8.0%
<i>b Gross Profit Margin</i>	2.8%	-2.7%	1.1%	3.6%
<i>c Net Profit Margin</i>	0.5%	-5.0%	0.5%	1.5%
<i>d Cash Conversion Efficiency (EBITDA/Sales)</i>	3.3%	-2.6%	2.4%	4.5%
<i>e Return on Equity (ROE)</i>	20.1%	-153.8%	14.1%	40.2%
2 Working Capital Management				
<i>a Gross Working Capital (Average Days)</i>	49	58	50	60
<i>b Net Working Capital (Average Days)</i>	20	26	14	19
<i>c Current Ratio (Total Current Assets/Total Current Liabilities)</i>	0.8	1.2	1.0	0.9
3 Coverages				
<i>a EBITDA / Finance Cost</i>	2.6	-2.1	3.8	5.2
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	0.3	-0.3	0.4	0.4
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>	8.7	-3.3	6.5	3.8
4 Capital Structure (Total Debt/Total Debt+Equity)				
<i>a Total Borrowings / Total Borrowings+Equity</i>	75.6%	84.4%	69.6%	70.9%
<i>b Interest or Markup Payable (Days)</i>	61.6	69.8	65.3	82.2
<i>c Average Borrowing Rate</i>	11.9%	10.2%	7.0%	6.6%

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		Short Term Ratings	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
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.	A1	A strong capacity for timely repayment.
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.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial 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.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
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.	C	An inadequate capacity to ensure timely repayment.
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.		



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 surveil 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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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

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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.
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- (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)
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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)
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- (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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