The Pakistan Credit Rating Agency Limited

Rating Report

Attock Refinery Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-May-2019	AA	A1+	Stable	Maintain	-
07-Dec-2018	AA	A1+	Stable	Maintain	-
31-May-2018	AA	A1+	Stable	Maintain	-
23-Jun-2017	AA	A1+	Stable	Maintain	-
13-Oct-2016	AA	A1+	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

The ratings reflect ARL's very strong risk absorption capacity emanating from sizable equity base. ARL's core business remains exposed to the vicissitudes in international crude oil, which in turn, may lead to declining gross refining margins (GRMs). The volatility in the oil prices coupled with deep depreciation in Pak Rupee against dollar led to negative profitability. Gross Refining Margins (GRMs) were also negatively impacted because of the reverse delta between crude oil price and petroleum products especially MS. The recent trend is reflecting a positive relationship, which will augur well for the company. There is a significant contribution from value-added products in ARL's revenue. Post completion of expansion project along with DHDS and isomerization plant, the company is continuously enjoying benefits in sales volume as well as price, except FO which came into limelight due to Government unannounced closure of FO based power plants. Incremental benefits could not be reaped in terms of profitability, emanating from squeezed margins and steep rupee devaluation. Free Cashflows from operations has declined, in turn, coverages, but in the longer horizon, it will remain in the comfort zone. ARL's strategic investments and sizable bank placements, continue to provide support in the form of dividend and interest income, which is ~2.5% of the top-line, to the risk profile of the company and remains a stable source of recurring non-core Income. The Company's association with the country's only integrated oil group - Attock Group (AG) - remains a source of comfort for the ratings.

The ratings remain dependent on ARL's ability to effectively shield its business profile from volatility in international oil prices. ARL's financial profile, in turn, its ratings, could be negatively impacted by the persistent downturn in refining margins, or an unexpected drop in dividend stream. The continuity of deemed duty on Diesel is crucial.

Disclosure	
Name of Rated Entity	Attock 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)
Rating Analysts	Hamza Ghalib | hamza.ghalib@pacra.com | +92-42-35869504

Profile

Legal Structure Attock Refinery Limited (ARL), incorporated as a private limited company in 1978, took over crude oil refining business from Attock Oil Company. It was subsequently converted into a public limited company in 1979.

Background ARL is the pioneer of crude oil refining in the country with its operations dating back to 1922. Backed by a rich experience of more than 90 years of successful operations, ARL's plants have been gradually upgraded/replaced with modern hardware to remain competitive and meet new challenges and requirements.

Operations The company is principally engaged in the refining of crude oil. The company primarily produces LPG, premium motor gasoline, jet fuels, kerosene, high-speed diesel, light diesel oil, furnace fuel oil, Mineral Turpentine oil, Jute batching oil, solvent oil and various grades of bitumen.

Ownership

Ownership Structure Attock group, through Attock Oil Company (~61%) and its group company Attock Petroleum Limited (~APL) (2%) retains the majority stake (~63%), and management control in ARL. Other major shareholders comprise a) Individuals (~16.25%), b) Banks and other Financial Institutions (~10.37%), c) Mutual funds (~2.08%), d) Foreign Investors (~2.05%), e) Joint Stock Companies (~2.7%), and Others (~3.5%).

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

Business Acumen ARL is a member of Attock Group of Companies, a fully integrated group covering all segments of oil and gas industry from exploration, production, and refining to marketing of a wide range of petroleum products besides also engaged in manufacturing and trading of cement, information technology. Sponsors have Industry-specific working knowledge and strategic thinking capability.

Financial Strength The Pharaon Group, the principal stakeholder of the Attock Group, is engaged internationally in diversified activities, which include hotels, oil exploration, production and refining, chemicals, cement, and real estate. The Pharaon Commercial Investment Group (PCIG) is the ultimate parent of AOC and overseas investment of Attock Group in Pakistan

Governance

Board Structure ARL's Board of Directors comprises seven members. Board consists of five non-executive members and two independent non-executive directors.

Members' Profile The Chairman of the BoD, Mr. Shuaib A. Malik, is also CEO of Attock Oil Group. Mr. Shuaib A. Malik has been associated with Attock Group of Companies for around 4 decades. ARL's board comprises of highly qualified board members, is composed of professionals with considerable experience in the oil and gas sector. Experience profile of board is rich.

Board Effectiveness During FY18, the board held five meetings, four meetings to approve financial results and one to review the annual budget. Participation of members in board meetings also remained satisfactory. The board has constituted three committees to maintain effective oversight and efficient functioning. These comprise: a) Audit Committee, b) Technical and Finance Committee and C) HR & Remuneration Committee.

Financial Transparency A. F. Fergusons & Co. Chartered Accountants, a member firm of the PwC network, is the auditor of the company, they have expressed an unqualified opinion on ARL's financial statements for FY18. 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 ARL's organization is structured around the effective functioning of nine major departments. Each department is headed by an experienced professional, reporting directly to the CEO. The departments comprise: a) Technical Services, b) Operations, c) Commercial & Material Management, d) Finance & Corporate Affairs, e) Human Resource & Administration, f) Maintenance, g) Engineering, h) Health, Safety, Environment & Quality, & i) Business Review & Assurance.

Management Team Mr. Adil Khattak, the CEO, has been associated with the company since last 39 years, has extensive experience in the petroleum sector. Mr. Assad Abbas is the CFO of the company, a fellow chartered accountant, has been associated with the company for five years. All management team is well qualified which has demonstrated stability over time. Most of the senior management has been linked with the company since long.

Effectiveness Over the years ARL'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 the robustness of control systems is considered positive.

MIS The Company generates MIS reports on daily, fortnightly and monthly basis. These mainly include daily cash position, daily production report, saleable stock position, Treasury and Accounts section MIS, monthly debtors aging, monthly management accounts, quarterly budget vs. expense report.

Control Environment ARL has employed ERP Oracle Financials – developed by Oracle and CMMS (Maximo) – developed by IBM and HRMS system. Primavera software has been deployed to monitor developments on the expansion projects. Moreover, the company has obtained several prestigious international certifications for its quality, environment, occupational health and safety management systems.

Business Risk

Industry Dynamics Pakistan consumed a total of ~18mln metric tons (MT) of petroleum products (White Oil) in FY18 (FY17: ~16 mln MT), an increase of ~9%. This increase is mainly seen due to an increase in the consumption of MOGAS and HSD due to growth in the transport sector. Growth is a given factor in the domestic market, yet the relevant proportion of domestic Vs import may face a 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 input sources for electricity generation 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 are essential. Two refineries namely PARCO and Byco retain a large chunk of the market share of ~55%, while Pakistan refinery, National refinery, and Attock refinery contribute ~45% to the total domestic supply.

Revenues Attock Refinery witnessed the considerable growth of ~47% in 9MFY19 and generated net revenue of PKR ~130,858mln (9MFY19: PKR ~89,002mln). This increase is seen mainly due to increase in PoL product prices.

Margins Gross margins of the company have turned negative in 9MFY19 and stood at ~-2.3% (9MFY18: ~0.6%). This is mainly due to i) declining gross refining margins ii) higher operating cost due to increase in the price of raw material iii) decline in the pricing of Motor Gasoline, which is traded in the international market at a price lower than the crude iv) reduction in the pricing of furnace oil due to its depressed demand which led to a build-up of inventory levels and shift of electricity generation on RLNG. Pre-Tax profit margins of the company have also spun into negative zone in (9MFY19: ~-3.3%, FY18: ~0.8%, FY17: ~5.3%) attributed to rupee depreciation against US dollar that has swept away ~PKR 2,560mln (9MFY18: PKR 841mln) from the profitability.

Sustainability Going forward, management of the company is underway to set up a state-of-the-art continuous Catalyst regeneration (CCR) unit for further improvement of motor gasoline specifications, hydrocracker, delayed coker and additional reactor at DHDS unit. These upgradation plans will further help the company to achieve better performance in futurity.

Financial Risk

Working Capital ARL's working capital requirement emanates from its need to finance its inventory and circular debt, which usually results in a net receivable position to the company. During 9MFY19, trade receivables of the company stood at PKR ~17,111mln (FY18: PKR ~15,748mln). ARL's average gross working capital days are ~57 days while average trade creditor days are ~57 days. Therefore, ARL meets its working capital requirements through internal cash generation whereas reliance on short-term borrowings is nill.

Coverages FCFO [9MFY19: PKR -2,099mln, FY18: PKR 265mln) of the company has turned negative owing to the loss incurred during the period. Interest expense of the company has also increased due to the higher interest rate environment. Negative free cash flows and the surge in interest expense have turned coverages in red [Interest coverage: 9MFY19: -1.5x, FY18: 0.2x].

Capitalization ARL has a robust capital structure with debt to equity ratio clocked in at ~24% as at end-Mar19 (end-Jun18: ~27%).

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Financial Summary
PKR mln

Attock Refinery Limited Refinery	Mar-19 9M	Jun-18 12M	Jun-17 12M	Jun-16 12M
A BALANCE SHEET				
1 Non-Current Assets	34,704	34,586	35,885	35,641
2 Investments	-	986	-	-
3 Related Party Exposure	13,265	13,265	14,840	14,642
4 Current Assets	51,184	52,269	40,482	25,337
a Inventories	*12,038*	*9,789*	*5,712*	*6,708*
b Trade Receivables	*17,111*	*15,748*	*10,679*	*6,889*
5 Total Assets	99,153	101,106	91,207	75,619
6 Current Liabilities	51,322	46,945	31,954	27,266
a Trade Payables	*26,684*	*26,882*	*17,405*	*14,405*
7 Borrowings	11,588	14,843	19,872	15,164
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	-	-	-	-
10 Net Assets	36,243	39,318	39,381	33,190
11 Shareholders' Equity	36,243	39,318	39,381	33,190
B INCOME STATEMENT				
1 Sales	130,858	129,597	101,412	66,565
a Cost of Good Sold	*(133,884)*	*(130,675)*	*(97,079)*	*(67,467)*
2 Gross Porfit	(3,026)	(1,079)	4,333	(902)
a Operating Expenses	(553)	(695)	(644)	(571)
3 Operating Profit	(3,578)	(1,774)	3,689	(1,473)
a Non Operating Income	*638*	*2,279*	*2,946*	*2,441*
4 Profit or (Loss) before Interest and Tax	(2,940)	505	6,635	968
a Total Finance Cost	*(1,414)*	*(1,529)*	*(1,263)*	*(157)*
b Taxation	*1,279*	*1,603*	*42*	*5*
6 Net Income Or (Loss)	(3,075)	579	5,414	816
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*(2,099)*	*265*	*5,315*	*(1,642)*
b Net Cash from Operating Activities before Working Capital Changes	*(3,029)*	*377*	*6,796*	*(646)*
c Changes in Working Capital	*22*	*7,088*	*1,842*	*(1,085)*
1 Net Cash provided by Operating Activities	(3,007)	7,466	8,638	(1,731)
2 Net Cash (Used in) or Available From Investing Activities	902	(1,438)	(949)	(2,488)
3 Net Cash (Used in) or Available From Financing Activities	(3,642)	(5,703)	4,258	3,207
4 Net Cash generated or (Used) during the period	(5,747)	324	11,947	(1,013)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	34.6%	27.8%	52.4%	--
b Gross Profit Margin	-2.3%	-0.8%	4.3%	-1.4%
c Net Profit Margin	-2.3%	0.4%	5.3%	1.2%
d Cash Conversion Efficiency (EBITDA/Sales)	-1.1%	0.8%	5.9%	-1.7%
e Return on Equity (ROE)	-10.9%	1.5%	14.9%	2.5%
2 Working Capital Management				
a Gross Working Capital (Average Days)	57	59	54	98
b Net Working Capital (Average Days)	1	-3	-3	-5
c Current Ratio (Total Current Assets/Total Current Liabilities)	1.0	1.1	1.3	0.9
3 Coverages				
a EBITDA / Finance Cost	-1.1	0.7	4.7	-7.1
b FCFO / Finance Cost+CMLTB+Excess STB	-0.7	0.1	1.5	-0.6
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	-2.5	-11.7	4.9	-9.5
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Short-Term Borrowings / Total Borrowings	24.2%	27.4%	33.5%	31.4%

Rating Scale

Credit Rating Scale & Definitions

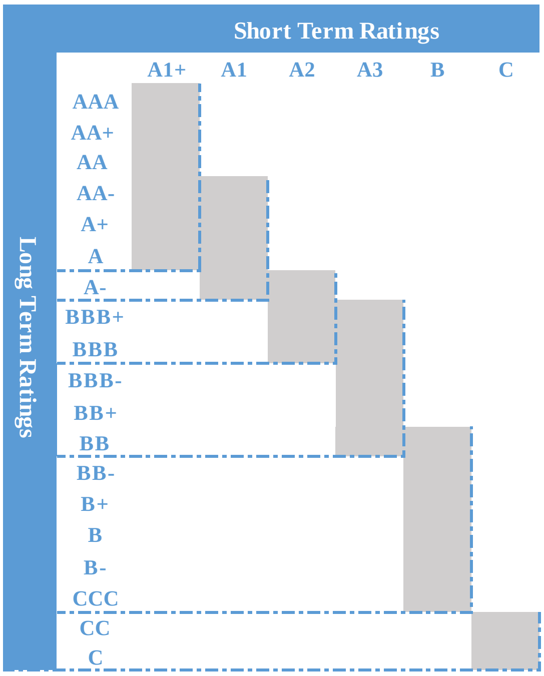
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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.



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)
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