The Pakistan Credit Rating Agency Limited

Rating Report

National Refinery Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
07-Dec-2018	AA+	A1+	Stable	Maintain	-
30-May-2018	AA+	A1+	Stable	Maintain	-
23-Jun-2017	AA+	A1+	Stable	Maintain	-
22-Sep-2016	AA+	A1+	Stable	Maintain	-
30-Sep-2015	AA+	A1+	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

The rating incorporates NRL's association with only integrated oil group – Attock Group (AG). Key character of AG is a low leveraged capital structure with sound cash flow generation ability; ably replicated to NRL too. The company predominantly financed its upgradation projects, including desulphurization unit and ISOM, through internally generated funds; capitalized in Jun'17 and Oct'17, respectively. This translated into accelerated growth in topline FY18. In spite oil prices have been increasing, GRMs remains in comfortable range all through FY18. Higher operation cost, including depreciation, from new units, dented the gross profit. Exchange loss amounting to ~PKR 1.7bln due to the significant devaluation of Pakistani rupee against US dollar further impacted the profitability. Additionally, management is pushing the government for an upward revision of deemed duty (from 7.5% to 9%) to address the issue; actual outcome remains to be seen. Nevertheless, the size of the free cash flows from operations (FCFO) remains in a comfortable zone on annual basis. During FY18, healthy coverages and low leveraged capital structure improve the financial risk profile of the company.

The ratings are dependent upon the sustained market position of the company, herein continuous growth in revenue is important. Prudent management of financial matrix while keeping optimal capital structure would remain critical. A prolonged downturn in gross profit thereby translating in significantly lower cash flows would impact the ratings.

Disclosure

Name of Rated Entity	National 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 Faizan Arif | faizan.sufi@pacra.com | +92-42-35869504

Profile

Legal Structure National Refinery Limited (NRL), listed on the Pakistan Stock Exchange since 1963. The government of Pakistan took over the management of NRL under the Economic Reforms Order, 1972 under the Ministry of Production, which was exercising control through its shareholding in State Petroleum Refining and Petrochemical Corporation (PERAC).

Background In Jun03 the Government of Pakistan decided to include NRL in its privatization programme. The selling of 51% equity and transfer of management control to a strategic investor had been proposed accordingly. After competitive bidding NRL was acquired by Attock Group in July 2005.

Operations NRL is engaged in the manufacturing, production, and sale of a large range of petroleum products. The refinery complex of the Company comprises three refineries, consisting of two lube refineries and one fuel refinery.

Ownership

Ownership Structure Attock Group, through Attock refinery limited (25%), its group company Pakistan Oilfields Limited (POL) (25%) and Attock Petroleum Limited (APL) (1%) retains the majority stake (51%), and management control in NRL. Other major shareholders include; Islamic Development Bank (~15%), Public sector companies (~6.18%) and NIT & ICP (~2.98%). The remaining stake rests with the general public Joint Stock Companies and Foreign investors.

Stability The Group has governed and administered by of AG, a distinguished name in the Oil sector of Pakistan. Therefore, Stability factor is considered strong.

Business Acumen The Pharaon Group is the principal stakeholder of the AG and is engaged internationally in diversified activities, which include hotels, oil exploration, production and refining, chemicals, cement, and real estate.

Financial Strength NRL is a member of Attock Group (AG) 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.

Governance

Board Structure The company's seven-member board of directors includes five representatives of the AG - including two members of the Pharaon family. The remaining two members are independent directors including one nominee representing IDB.

Members' Profile Mr. Shuaib A. Malik, recently appointed as a chairman of the board after serving several years as deputy chairman & chief executive officer. He has been associated with the company for ~35 years, is a veteran of the oil business. A fair number of board members have related experience, which is positive.

Board Effectiveness The board has constituted two committees to maintain effective oversight and efficient functioning. These comprise a) Audit Committee and b) HR & Remuneration Committee. Both committees comprise of three members. The audit committee is headed by Tariq Iqbal Khan and HR & recommendation committee is headed by Mr. Abdus Sattar.

Financial Transparency During FY18, NRL's auditors, A. F. Fergusons & Co Chartered Accountants, a member firm of the PwC network, expressed an unqualified opinion on the company's financial statements. The state bank of Pakistan categorizes A. F. Fergusons & Co Chartered Accountants A (highest category).

Management

Organizational Structure The company operates through five divisions namely: a) Special Projects, b) Operations, c) HR & Admin, d) Commercial and Procurement, and e) Finance & Corporate Affairs. The Special Projects division oversees new projects being undertaken by the company. All divisional heads report to the Deputy Managing Director. The DMD reports to the MD/CEO of the company.

Management Team The CEO, Mr. Jamil A. khan, has been associated with the company since 2005, served as deputy managing director since 2009. He has been elevated as the chief executive officer effective November 03, 2018. He is also serving on the board of director of ARL since January 2017. He is supported by an experienced management team. Mr. Anwar A. Shaik is the CFO of the company, a fellow chartered accountant, has been associated with the company for thirty years and two years at the current position.

Effectiveness The Company has an Executive Committee, comprising CEO, DMD, and General Manager Commercial and procurement, in place. The committee meets on a need basis and ensures smooth refinery operations as well as formulates new strategies to deal with developments in the refinery sector.

MIS MIS presented to the board is strong and shared on a quarterly basis. NRL has employed ERP ECC-6 – developed by SAP. 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 NRL has developed an in-house system – Crude Oil Management System (CMS) for recording functions pertaining to oil movements and purchases of crude oil. NRL uses ERP's automation system in balancing crude oil inventory which was achieved manually before. Meanwhile, NRL has established a Disaster Recovery Site equipped with latest technology ensuring smooth functionality in case of any natural disaster.

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 NRL witnessed the considerable growth of ~27% and generated a turnover of PKR ~136,985mln in FY18 (FY17: PKR ~107,447mln). This increase is seen mainly due to i) meager increase in volumetric sales of ~0.3% and, ii) considerable increase of PoL product prices.

Margins Gross margins of the company have declined in FY18 to ~2.8% (FY17: ~9.1%) owing to i) declining gross refining margins MoM basis ii) higher operating cost including depreciation amounting to PKR 2.75bln on account of newly added Diesel Hydro Desulphurization (DHDS) and Naphtha Isomerization (ISOM) units. Moreover, Pre-Tax profit margins of the company have also reduced (FY18: ~0.7%, FY17: ~7.7%) attributed to higher exchange loss amounting to PKR 1.7bln due to the significant devaluation of Pakistani rupee against US dollar.

Sustainability Going forward, NRL is considering to install a topping Unit and a Reformer Unit. Both these units will lead to an increase in the volumetric growth of Motor Gasoline - a high margin product, which in turn, will culminate to increase in the top line and hence, better profitability. Additionally, the company will also be undertaking the turnaround of its Lube-I Refinery towards the end of FY19. This will result in continuous production at optimum level without frequent maintenance.

Financial Risk

Working Capital NRL's working capital requirement emanates from imports of raw material and remains a function of fluctuating crude oil prices in international markets. During FY18, trade debts amounting to ~PKR 7,986mln (FY17: PKR 6,033mln), of which ~62% are due to the related party. There are no trade receivables from the related party that are past due or impaired. NRL's gross working capital days are ~117 days while payable days are ~66 days. This is where the company requires short-term borrowing to bridge its short-term liquidity needs. During FY18, total available financing facility is ~PKR 8,090mln of which ~16% has been utilized.

Coverages During FY18, coverages of the company have deteriorated owing to i) FCFO of the company has reduced owing to a reduction in the profitability. FCFO of the company stood at ~PKR 4,205mln (FY17: ~PKR 5,965mln), reduced by ~29% ii) interest expense of the company has also increased to ~PKR 74mln (FY17: ~PKR 36mln) owing to rise in the short-term borrowings during the period. Reduced FCFO and surge in interest expense have culminated to slid in coverages. The trend is continued in Sep'18.

Capitalization NRL has a robust capital structure with debt to equity ratio clocked in at 3.2% at end-Jun18. Despite, recent expansion projects, leveraging is very low due to the equity base.

National Refinery Limited

BALANCE SHEET	30-Sep-18	30-Jun-18	30-Jun-17	30-Jun-16
	3M	FY18	FY17	FY16
Non-Current Assets	**37,964**	**38,266**	**38,634**	**23,704**
Current Assets	**30,980**	**27,548**	**22,751**	**29,956**
Inventory	16,888	12,628	10,931	11,253
Trade Receivables	9,482	7,986	6,033	5,297
Others	4,610	6,934	5,787	13,406
Total Assets	**68,944**	**65,814**	**61,385**	**53,660**
Debt	**3,478**	**1,430**	**766**	**-**
Short-term	3,478	1,340	-	-
Long-term (Inlc. Current Maturity of long-term debt)	-	89	766	-
Other shortterm liabilities	22,903	20,789	16,607	16,241
Other Longterm Liabilities	377	344	673	598
Shareholder's Equity	**42,185**	**43,252**	**43,339**	**36,822**
Total Liabilities & Equity	**68,944**	**65,814**	**61,385**	**53,661**
INCOME STATEMENT				
Turnover	**41,259**	**136,985**	**107,447**	**93,788**
Gross Profit	(521)	3,812	9,800	11,043
Other Income	(295)	(1,211)	128	499
Financial Charges	(87)	(74)	(36)	(15)
Net Income	**(1,066)**	**1,771**	**8,046**	**7,688**
Cashflow Statement				
Free Cashflow from Operations (FCFO)	(215)	4,205	5,965	6,939
Net Cash changes in Working Capital	(1,464)	(2,978)	435	3,044
Net Cash from Operating Activities	(1,700)	1,367	6,815	11,174
Net Cash from InvestingActivities	(316)	(2,469)	(15,093)	(15,904)
Net Cash from Financing Activities	2,047	(1,126)	(823)	(795)
Ratio Analysis				
Performance				
Turnover Growth	37.9%	27.5%	14.6%	-36.8%
Gross Margin	-1.3%	2.8%	9.1%	11.8%
Net Margin	-2.6%	1.3%	7.5%	8.2%
ROE	-3.4%	4.1%	18.6%	20.9%
Coverages				
Interest Coverage (FCFO/Gross Interest)	-2.5	57.1	165.3	458.1
Core: (FCFO/Gross Interest+CMLTD+Uncovered Total STB)	-2.5	28.0	52.9	458.1
Total: (TCF) / (Gross Interest+CMLTD+Uncovered Total STB)	-2.3	29.3	56.6	536.7
Debt Payback (Total LT Debt Including UnCovered Total STBs) / (FCFO- Gross Inte	0.1	0.0	0.1	0.1
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	51.1	17.8	28.0	34.1
Capital Structure (Total Debt/Total Debt+Equity)	7.6%	3.2%	1.7%	0.0%

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.

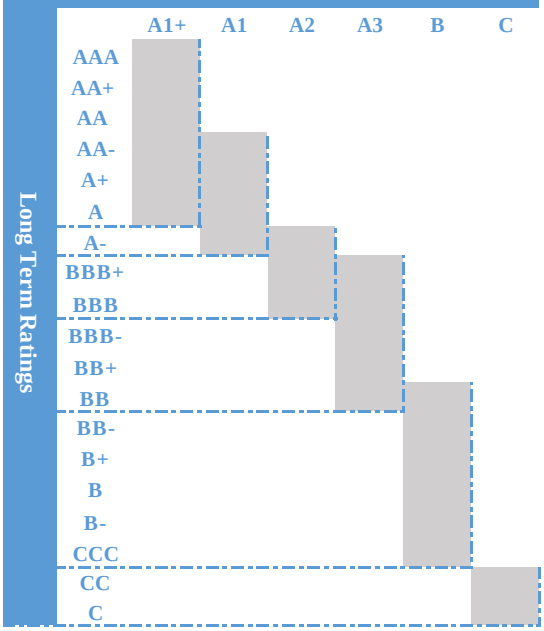
Long Term Ratings

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