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 |
|---|---|---|---|---|---|
| 31-May-2019 | AA+ | A1+ | Stable | Maintain | - |
| 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 | - |

**Rating Rationale and Key Rating Drivers**

The rating incorporates NRL's association with only integrated oil group – Attock Group (AG). The strength of the company is its base oil business in which the company is supplying a predominant portion of the country's total demand for lubes and lubricants in Pakistan. Generally, it has been observed that Gross Refining Margins (GRMs) are on a higher scale in the lube business when compared to PoL products. The financial strength of the company is also reflected in its low leveraged capital structure. It mostly comprises short-term borrowings related to the working capital needs of the company. 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 has enabled the company to make headway in gaining the market share in high margin products. 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 unprecedentedly MS. The recent trend is reflecting a positive relationship, which will augur well for 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 |

## 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 program. 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 retains the majority stake (51%), through Attock refinery limited (25%), its group company Pakistan Oilfields Limited (POL) (25%) and Attock Petroleum Limited (APL) (1%), and management control in NRL. Other major shareholders include; Islamic Development Bank (~15%), Public sector companies (~5.11%) 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 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 eight-member board of directors includes five representatives of the AG - including two members of the Pharaon family. The other 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 Attock Group for ~40 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. Audit Committee has Three members and HR Committee has Four members.

**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 CEO as the position of DMD is Vacant.

**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. Nouman A Usmani is the CFO of the company, who is associated with NRL for the last 10 years.

**Effectiveness** The Company has an Executive Committee, comprising CEO, 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. Some reports are generated in Excel format too.

**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 in-house reports in balancing crude oil inventory. Meanwhile, NRL has established a Disaster Recovery Site equipped with the 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 (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** National refinery witnessed the considerable growth of ~27% in 9MFY19 and generated net revenue of PKR ~116,747mln (9MFY19: PKR ~92,094mln). 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 ~-2.4% (9MFY18: ~3.6%). This is mainly due to i) declining gross refining margins ii) higher operating cost due to increase in the price of raw material and depreciation amounting to PKR 2,127mln on account of newly added Diesel Hydro Desulphurization (DHDS) and Naphtha Isomerization (ISOM) units. 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: ~-5.6%, FY18: ~0.7%, FY17: ~7.7%) attributed to rupee depreciation against US dollar that has resulted into a loss of ~PKR 2,116mln (9MFY18: PKR 1,035mln)

**Sustainability** Going forward, NRL is in the process of revamping its lube I refinery, whereby the throughput of the refinery would increase from 12,000 bpd to 17,000 bpd. The procurement for revamping has started whereas the revamp would take place at the start of the next calendar year (January and February 2020). The new downstream petroleum policy is under Government's review if the company considers it favorable, Phase II projects including topping unit and reformer unit for growth of Motor gasoline production would be considered.

## 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 9MFY19, trade receivables of the company stood at PKR ~10,049mln (FY18: PKR ~7,986mln), of which ~55% is due to the related party. NRL's average gross working capital days are ~65 days while average trade creditor days are ~39 days. This is where the company requires short-term borrowing to bridge its short-term liquidity needs. During the period under review, the company is heavily relying on short-term borrowings (9MFY19: PKR ~13,004mln, FY18: PKR ~1,340mln) to finance its debt obligations and working capital needs.

**Coverages** FCFO [9MFY19: PKR -2,848mln, FY18: PKR 4,205mln) 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.

**Capitalization** NRL has a robust capital structure with debt to equity ratio clocked in at ~26% as at end-Mar19 (end-Jun18: ~3.2%). The short-term loan consists of ~100% of the total borrowings.

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*Financial Summary*
*PKR mln*

| National Refinery Limited | Mar-19 | Jun-18 | Jun-17 | Jun-16 |
|---|---|---|---|---|
| Refinery | 9M | 12M | 12M | 12M |
| **A BALANCE SHEET** | | | | |
| 1 Non-Current Assets | 38,035 | 38,266 | 38,634 | 23,704 |
| 2 Investments | - | - | - | - |
| 3 Related Party Exposure | - | - | 3 | 11 |
| 4 Current Assets | 39,140 | 27,548 | 22,747 | 29,945 |
| *a Inventories* | *24,735* | *12,628* | *10,931* | *11,253* |
| *b Trade Receivables* | *10,049* | *7,986* | *6,033* | *5,297* |
| **5 Total Assets** | 77,174 | 65,814 | 61,385 | 53,660 |
| 6 Current Liabilities | 26,468 | 20,789 | 16,607 | 16,241 |
| *a Trade Payables* | *18,966* | *13,952* | *8,732* | *7,791* |
| 7 Borrowings | 13,004 | 1,430 | 766 | - |
| 8 Related Party Exposure | - | - | - | - |
| 9 Non-Current Liabilities | 436 | 344 | 673 | 598 |
| **10 Net Assets** | 37,266 | 43,252 | 43,339 | 36,822 |
| **11 Shareholders' Equity** | 37,266 | 43,252 | 43,339 | 36,822 |
| **B INCOME STATEMENT** | | | | |
| **1 Sales** | 116,747 | 136,985 | 107,447 | 93,788 |
| *a Cost of Good Sold* | *(119,521)* | *(133,173)* | *(97,648)* | *(82,745)* |
| **2 Gross Porfit** | (2,775) | 3,812 | 9,800 | 11,043 |
| *a Operating Expenses* | (1,244) | (1,620) | (1,576) | (1,438) |
| **3 Operating Profit** | (4,019) | 2,192 | 8,224 | 9,605 |
| *a Non Operating Income* | *(1,872)* | *(1,211)* | *128* | *499* |
| **4 Profit or (Loss) before Interest and Tax** | (5,891) | 981 | 8,351 | 10,104 |
| *a Total Finance Cost* | *(697)* | *(74)* | *(36)* | *(15)* |
| *b Taxation* | *1,403* | *863* | *(269)* | *(2,401)* |
| **6 Net Income Or (Loss)** | (5,186) | 1,771 | 8,046 | 7,688 |
| **C CASH FLOW STATEMENT** | | | | |
| *a Free Cash Flows from Operations (FCFO)* | *(2,848)* | *4,205* | *5,965* | *6,939* |
| *b Net Cash from Operating Activities before Working Capital Changes* | *(3,272)* | *4,345* | *6,379* | *8,130* |
| *c Changes in Working Capital* | *(6,472)* | *(2,978)* | *435* | *3,044* |
| **1 Net Cash provided by Operating Activities** | (9,744) | 1,367 | 6,815 | 11,174 |
| **2 Net Cash (Used in) or Available From Investing Activities** | (1,019) | (2,469) | (15,093) | (15,904) |
| **3 Net Cash (Used in) or Available From Financing Activities** | 10,781 | (1,126) | (823) | (795) |
| **4 Net Cash generated or (Used) during the period** | 18 | (2,228) | (9,101) | (5,525) |
| **D RATIO ANALYSIS** | | | | |
| **1 Performance** | | | | |
| *a Sales Growth (for the period)* | 13.6% | 27.5% | 14.6% | -- |
| *b Gross Profit Margin* | -2.4% | 2.8% | 9.1% | 11.8% |
| *c Net Profit Margin* | -4.4% | 1.3% | 7.5% | 8.2% |
| *d Cash Conversion Efficiency (EBITDA/Sales)* | -2.7% | 3.1% | 8.1% | 10.0% |
| *e Return on Equity (ROE)* | -17.2% | 4.1% | 20.1% | 23.0% |
| **2 Working Capital Management** | | | | |
| *a Gross Working Capital (Average Days)* | 65 | 50 | 57 | 73 |
| *b Net Working Capital (Average Days)* | 26 | 20 | 29 | 33 |
| *c Current Ratio (Total Current Assets/Total Current Liabilities)* | 1.5 | 1.3 | 1.4 | 1.8 |
| **3 Coverages** | | | | |
| *a EBITDA / Finance Cost* | -4.6 | 57.1 | 240.1 | 618.1 |
| *b FCFO / Finance Cost+CMLTB+Excess STB* | -3.0 | 28.0 | 52.9 | 458.1 |
| *c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)* | -0.1 | 0.0 | 0.1 | 0.0 |
| **4 Capital Structure (Total Debt/Total Debt+Equity)** | | | | |
| *a Short-Term Borrowings / Total Borrowings* | 100.0% | 93.7% | 0.0% | N/A |

# 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.

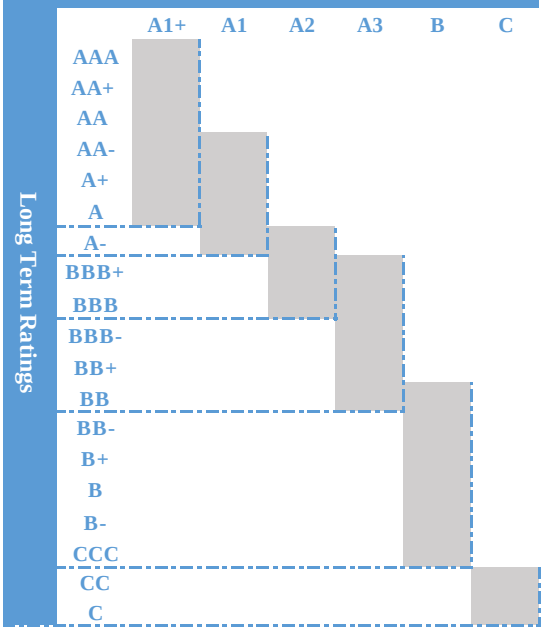
### Long Term Ratings

| | |
|---|---|
| AAA | **Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments |
| AA+<br>AA<br>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+<br>A<br>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+<br>BBB<br>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+<br>BB<br>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+<br>B<br>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<br>CC<br>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**