

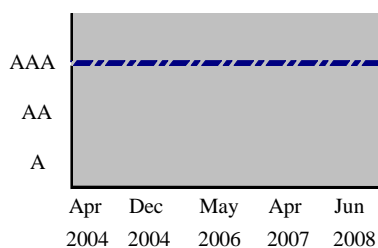
## PAK-ARAB REFINERY LIMITED

### RATINGS (JUNE 2008)

#### PAK-ARAB REFINERY LIMITED

	New	Previous
<b>Entity</b>		
Long Term	AAA	AAA
Short Term	A1+	A1+

### L.T. RATING HISTORY



### FINANCIAL DATA

(PKR mln)

	31-Mar-08 <sup>^</sup>	30-Jun-07	30-Jun-06
Total Assets *	114,320	94,347	94,205
Equity	45,498	39,584	37,167
Operating Profit	19,616	11,664	13,435
Net Income	11,784	8,478	7,625
ROA (%)	14	8.6	7.6
ROE (%)	37.8	23.1	20.9
EBITDA	21,153	14,869	16,557
Net Debt / Equity (%)	14.1	7.1	23.4

<sup>^</sup> Based on 9 months unaudited results

\*Local currency loans secured against

PACRA's foreign currency deposits & USD bonds have been offset.

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### RATING RATIONALE AND KEY DRIVERS

- PARCO's ratings reflect the company's very strong financial profile emanating from a low leveraged capital structure, robust cash flows and healthy coverages. Meanwhile, the company's higher operational flexibility and relatively strong margins – highest in the country's refining sector – largely insulates PARCO from business risk emanating from the cyclical nature of the refining industry. Moreover, the company's strong ownership structure, jointly owned by the Emirate of Abu Dhabi and Government of Pakistan, and established position as a market leader in the local market are also key rating factors.
- The withdrawal of the guaranteed return on refining operations is not expected to affect PARCO's financial strength, as the company has demonstrated strong profit generation capacity in recent years. However, external factors such as any changes in the regulatory framework that would affect refining margins adversely, prolonged downturn in oil prices leading to declining profits and a significant shift towards consumption of alternative energy sources resulting in lower demand for oil based products could impact the ratings. However the likelihood of such occurrences remains low. Meanwhile upholding strong governance and control environment would be critical.

### ASSESSMENT

- PARCO has been a key player in the country's strategic oil supply and logistics. Owing to diversified operations – integrated pipeline, refining, and marketing of petroleum products – the company's revenue stream remains stable. PARCO's refinery operations continued to be the largest contributor towards sales revenue in FY07. During this period, the company showed a nominal turnover growth. At the same time, the throughput of the refinery declined (FY07: 82.7%; FY06: 84.2%) mainly because of maintenance turnaround. The gross margins of the company were also affected due to the lower demand for Mogas and unfavourable fluctuations in oil and oil product prices. Nevertheless, due to PARCO's higher mix of value added products its margins remain higher than its peers. However, oil prices have witnessed an unprecedented hike in the recent period. This trend, alongwith higher demand of value added products has impacted margins positively. However, the impact would be magnified, particularly in performance, had the prices taken a reverse direction. Consequently, the company has posted strong profitability during 3QFY08. The refinery underwent an unplanned shutdown during November 2007 (for a period of three weeks) due to a malfunction in the Continuous Catalyst Regenerating (CRR). The shutdown was purely due to mechanical reasons and the chances of a repeat occurrence remain low.

- Since the completion of the link between the company's Korangi pumping station and Port Qasim, upcountry diesel (HSD) movement has discontinued through KMK segment and has been switched to PAPCO's system. This has resulted in lower capacity utilization of KMK pipeline operations, which is now mainly used for the transportation of crude oil to the company's Mid Country Refinery (MCR). However, since PARCO owns 51% stake in PAPCO, the company would begin to receive dividend income and other charges from PAPCO as its operations gain momentum. The contribution from the marketing segment remained trivial, as there was a reduction in demand for the company's lubricants, which had to compete with cheaper smuggled goods. However, growth is expected in this segment on account of reduction in smuggling.

- Going forward, with the rising trend in oil prices likely to continue, refining margins are expected to remain strong, resulting in high profitability for the company. The management has taken several initiatives to improve its revenue stream through product development and expansion projects. These include setting up an Asphalt production plant and also acquiring stake in another refinery. Asphalt production while helping meet the increasing demand for the product, will also help increase the refinery's throughput. The company is also a partner in setting up of a new refinery, which is expected to have a refining capacity of 250,000 bbl/day. – largest in the country. The refinery is planned to be completed by 2012 and is projected to cost USD 5bln. PARCO will take up 26% shareholdings in the project with the remaining stake belonging to the Emirate of Abu Dhabi. PARCO is also planning to install a Hydro-desulphurization plant in its MCR, which will reduce the sulphur content in diesel as per directives of regulators to achieve compliance with the EURO II standards.

- Over the years, the leveraging of the company has been improving as PARCO has paid off a significant portion of the debt and substituted high cost foreign currency loans with cheaper local borrowing. The financial profile of PARCO strengthened on the back of further reduction in net debt. The cash flows of the company also remained strong, in turn augmenting the coverages. The company manages its working capital requirements effectively as depicted by the low levels of gross and net cash cycle. PARCO also has a very low reliance on short-term running finance. However, rising oil price have significantly increased the inventory costs. This has put pressure on the cash flows, to some extent.

### PROFILE

- PARCO, an unlisted public limited company, was established in 1974 as a joint venture between the Government of Pakistan (60%) and the Emirate of Abu Dhabi (40%). The company owns and operates Pakistan's longest oil pipeline network, extending from Karachi to Mehmood Kot near Multan and onward to Machhike near Lahore spanning 1,228 km. PARCO's MCR, with a capacity of 4.5mln tonnes per annum (tpa), is the largest refining complex representing around 35% of the country's aggregate refining capacity. It enjoys a GOP guaranteed 25% after-tax return on paid-up capital for the initial eight years, ending in December 2008. The company has no plans to seek an extension on the guaranteed return provided by the GOP since both company operations and margins remain strong.
- PARCO markets its products through off-take agreements with Oil Marketing Companies and for lubricants, through its own brand, PEARL. It has a 40% stake in TOTAL PARCO Pakistan Limited (TPPL), a joint venture with Total Fina Elf – a French conglomerate – to market upto 25% of the MCR's production through a rapidly expanding network of TPPL outlets. PARCO also has a 51% stake in the Pak Arab Pipeline Company (PAPCO), which has established a white oil pipeline system to transport refined products from Port Qasim to Mahmood Kot.
- In February 2008, the GOP replaced the chairman of the Board of Directors. The new chairman is a retired army officer of Pakistan. The vice chairman of the company a representative of EAD was also replaced by the division manager for research and business development at the International Petroleum Investment Company (IPIC). The current MD, who took charge in 2006, has been associated with PARCO for over 20 years.