The Pakistan Credit Rating Agency Limited

Rating Report

Sitara Petroleum Service Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
10-May-2024	A-	A2	Stable	Maintain	-
11-May-2023	A-	A2	Stable	Maintain	-
11-May-2022	A-	A2	Stable	Maintain	-
19-May-2021	A-	A2	Stable	Maintain	-
19-May-2020	A-	A2	Stable	Maintain	-
15-Nov-2019	A-	A2	Stable	Maintain	-
16-May-2019	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Sitara Petroleum Service Limited's (‘Sitara Petroleum’ or ‘the Company’) ratings reflect its affiliation with Gas & Oil Pakistan along with a strong business profile. The Sponsors of the Company have been in the business for over three decades, reflecting their business acumen. The Company is primarily engaged in two business segments namely i) Trading & Distribution of POL products and ii) Fleet Logistic services to various OMCs. The Trading segment is further split into retail and bulk sale units. Under the retail side, the Company sells on cash/fuel cards through a network of 60 retail stations, primarily spread out in the Punjab region (~93%); whereas, under the bulk sale side, the Company provides POL products directly to corporate customers on credit. The latter holds a major portion of the Company's overall sales. The Company owns a fleet of 400 lorries; where vast majority (~95%) of the fleet revenue is generated from its group company, Gas and Oil Pakistan (GO). During 6MFY24, the Company experienced a consistent uptrend in revenues. The Company's prime revenues (~90%) are generated from the trading and distribution business. The Company's management of working capital poses concerns due to the disparity between its receivables (i.e. from bulk POL sale and fleet logistics to group company) and payables (i.e. to group company for POL procurement) cycles. This discrepancy is evident as receivables remain long-tail, in line with the existing 30-day receivables policy, with an average settlement period of 24 days. However, the Company's payable period remains short tail, standing at only 14 days. To address necessitating working capital needs, the Company heavily relies on short-term borrowing, constituting ~77% of its total borrowings. Given the anticipated volume increase, this trend is likely to tighten the working capital cycle further. Thus, during the 6MFY24, the Company acquired a new borrowing facility, leveraging its capital structure (70:30). This resulted in higher finance costs, consequently impacting the Company's coverage ratios and elevating its overall financial risk.

The ratings are dependent on the management's ability to sustain its business volumes while holding the margins. Sustaining the business and financial profile along with improvement in the governance framework would be vital for the ratings. Meanwhile, financial transparency is considered paramount.

Disclosure

Name of Rated Entity	Sitara Petroleum Service Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating(Jul-23),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jul-23),Methodology | Rating Modifiers(Apr-23)
Related Research	Sector Study | POL Distribution - OMCs & Dealers(Nov-23)
Rating Analysts	Faiqa Qamar | faiqa.qamar@pacra.com | +92-42-35869504

POL Distribution - OMCs & Dealers

Profile

Legal Structure Sitara Petroleum Service Limited ("Sitara Petroleum" or "the Company") is a Public Unlisted concern incorporated in July 2012 under the repealed Companies Act 2017.

Background Originally, there existed two distinct firms: Lalpur Carriage, dedicated to supplying logistics services to Oil Marketing Companies (OMCs), and Sitara Petroleum, specializing in wholesale and direct sales of petroleum, oil, and lubricants (POL) goods. The management later consolidated these entities into one organization, Sitara Petroleum Services Limited, to establish a unified structure.

Operations The Company primarily trades and distributes Diesel, Petrol, and Lubricants, while also offering fleet logistics services to OMCs in the country namely GO, PSO and Total PARCO. The Company is currently operating 60 fuel stations and operates a fleet of 400 oil tankers. The registered office is located in Gulberg-II, Lahore.

Ownership

Ownership Structure The majority ownership of the Company rests with Mr. Tahir Iqbal (~97%), while the remaining minority stake is split between Mr. Muhammad Usman Javed, Mr. Muhammad Hassan Javed and Mr. Muhammad Ali.

Stability The Sponsors are inducting the next generation gradually into business. The succession planning however is not formally documented but implied.

Business Acumen The sponsor holds extensive experience and expertise in oil sector. Their strong business skills have helped the Company to achieve sustainable success over the years. Sponsors have Industry-specific working knowledge and strategic thinking capability.

Financial Strength Sitara Petroleum is the sole cash producer entity for the Sponsors.

Governance

Board Structure The Company has a seven-member Board (including CEO). The Board comprises two Executives, two Independent and three Non-Executive Directors.

Members' Profile Mr. Muhammad Azmat is a seasoned businessman running leather tanneries for over 2 decades and has significant experience in imports, exports, strategy and business management. Other Board members are also well-qualified and have been associated with the Company for a reasonable period of time.

Board Effectiveness The roles of the Chairman and the CEO are performed by separate persons. Mr. Tahir Iqbal has been appointed as the CEO of Sitara Petroleum and Mr. Azmat as Chairman. The Board has two committees in place: (i) Audit Committee (ii) Human Resource & Remuneration Committee. The Board meets quarterly and meeting minutes are properly documented.

Financial Transparency The Company has appointed M/s RSM Avais Hyder Liaquat Nauman Chartered Accountants. as its external auditor, listed in the "A" category on the State Bank of Pakistan's panel of auditors. They have expressed unqualified opinion on financial statements FY23.

Management

Organizational Structure A simplified organizational structure exists at the Company. The business profile segregated into four different departments, which are headed by their respective heads resulting in effective control and management.: (i) Operations, (ii) Finance, (iii) Sales, and (iv) Transport. All the heads report to CEO.

Management Team Mr. Tahir Iqbal is the CEO of the Company, a veteran of the Retail & Oil Transportation sector with rich experience of more than 3 decades. Mr. Ejaz Rasool, who serves as the CFO of the company, brings to the role over 12 years of professional experience. Most of the senior management is associated with the Company for a long and has sufficient experience to make strategic decisions.

Effectiveness Sitara Petroleum has constituted two committees comprising members of the management team namely (i) Procurement and (ii) Retail Development Committee. The purpose of the Procurement Committee is to streamline the procurement process, establish effective controls and ensure efficiency in procurement activities while the Retail Development Committee ensures 'Retail Side' of the business is pursuing growth and precise strategies are being devised in the right direction.

MIS The Company has been using an ERP system based on Oracle RDBMS since Jan'12. It operates various modules and generates reports as needed. The IT infrastructure is effectively integrated with all departments, ensuring proper financial and operational control.

Control Environment The Company has an effective in-house internal audit department which helps to improve risk management, control, and governance processes and brings improvement to business practices by forming SOPs.

Business Risk

Industry Dynamics Pakistan relies significantly on imports to meet its energy demand. During FY23, the country consumed ~17.1mln MT of petroleum products (FY22: ~23.1mln MT), a dip of ~25.5% YoY. A decrease in total consumption was due to unstable economic conditions and government policy changes. Currently, there are ~35 registered OMCs. There are five (5) Listed OMCs operating in the country namely (i) Pakistan State Oil (PSO) (ii) Shell Pakistan (SHELL) (iii) Hascol Petroleum (HASCOL) (iv) Hi-Tech Lubricants (HTL) and (v) Attock Petroleum (APL). OMCs generated an aggregate revenue of PKR~5,303bln in FY23 (FY22: ~PKR 4,262bln).

Relative Position During FY23, the Company had a significant market share in PMG and HSD in the Punjab area in the distribution and sale of POL goods.

Revenues The Company primarily generates revenue from its dealership network, with carriage services serving as a secondary source. During FY23, total revenue grew by ~17.3%, reaching PKR 48,695mln (FY22: PKR 41,503mln), mainly due to the rise in POL prices. The sale of oil and diesel accounted for ~88% of the revenue, with the remainder coming from carriage services. During the 6MFY24, the Company's revenue stood at PKR 31,187mln. Continued growth is anticipated in sales, driven by high POL prices and the Company's strategy to expand its network.

Margins Owing to high operational expenses and mismanagement of deployment of resources during FY23 overall margins of the Company took a hit. During FY23 gross profit margin took a hit as they reported at 3.2% (FY22: 3.6%). During 6MFY24 gross profit margin improved to 3.5%. A similar trend was reflected in operating profit margins declining to 3.0% during FY23 (FY22: 3.3%). Operating profit margins improved to 3.3%, during 6MFY24. This impact was trickled down and negatively affected the net profit margin dropping to 1.4% during FY23 (FY22: 1.8%). Net profit margin stood at 1.5% during 6MFY24.

Sustainability Going forward, the Company intends to increase its retail outlet presence all over the cities of Pakistan, as well as in remote areas by installing more pumps. Additionally, the Company also aims to grow in the segment of Carriage Income by growing its number of fleets.

Financial Risk

Working Capital Sitara Petroleum's working capital requirements stem from financing its trade debts and stock in trade, typically covered through short-term borrowings. During FY23, short-term financing decreased by ~31% (FY22: PKR 1,457mln). However, in line with its expansion strategy, during 6MFY24, short-term financing increased by 627%, reaching PKR 7,304mln. Trade debts increased to PKR 3,515mln in FY23 (FY22: PKR 2,999mln), while trade payables decreased to PKR 1,734mln (FY22: PKR 2,000mln). During 6MFY24, trade debts stood at PKR 4,611mln and trade payables at PKR 283mln. Efforts to address working capital issues are evident in improved net working capital days (FY23: 10 days, FY22: 16 days). However, during 6MFY24, net working capital increased to 18 days due to trapped trade debts, reflected in a spike in the current ratio (6MFY24: 17.6x, FY23: 2.6x). The Company reported positive trade leverage of 22% as of 6MFY24. The Company aims to further streamline its working capital cycle moving forward.

Coverages The Company experienced a low net income factoring in the high financing costs. The FCFO of the Company remained stable with a slight growth (FY23: PKR 1,359mln, FY22: PKR 1,319mln). For 6MFY24 the Company reported an FCFO of PKR 817mln. Due to the uptake in the credit facilities availed during the period finance cost grew by ~38% during FY23 and is further expected to increase in line with high borrowing rates. The Company reported a finance cost of PKR 368mln during 6MFY24 (FY23: PKR 401mln, FY22: PKR 291mln). FCFO/Finance Cost coverage declined to 2.2x during 6MFY24 (FY23: 3.4x). In line with the up -rending financing the Finance Cost will increase. Managing healthy coverages remains crucial for the Company.

Capitalization The Company's capital structure has transitioned from being optimal to being leveraged, with a debt-to-equity ratio of 69% in 6MFY24 (FY23: 46%, FY22: 44%). As of 6MFY24, total debt amounted to PKR 9,434mln, with 77% of it concentrated in short-term borrowings. Total equity stood at PKR 4,179mln in 6MFY24 (FY23: PKR 3,722mln, FY22: PKR 3,042mln).

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Financial Summary
PKR mln

Sitara Petroleum Service Limited	Dec-23	Jun-23	Jun-22	Jun-21
POL Distribution - OMCs & Dealers	6M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	4,327	3,541	3,490	3,127
2 Investments	-	-	-	-
3 Related Party Exposure	7	7	-	1,305
4 Current Assets	10,045	5,661	4,850	6,288
a Inventories	*4,497*	*1,249*	*1,024*	*855*
b Trade Receivables	*4,611*	*3,515*	*2,999*	*4,423*
5 Total Assets	14,379	9,208	8,340	10,719
6 Current Liabilities	570	2,181	2,751	2,042
a Trade Payables	*283*	*1,734*	*2,000*	*1,737*
7 Borrowings	9,434	3,134	2,393	4,846
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	196	172	154	124
10 Net Assets	4,179	3,722	3,042	3,707
11 Shareholders' Equity	4,179	3,722	3,042	3,707
B INCOME STATEMENT				
1 Sales	31,187	48,695	41,503	32,584
a Cost of Good Sold	*(30,100)*	*(47,126)*	*(40,017)*	*(31,027)*
2 Gross Profit	1,087	1,569	1,487	1,557
a Operating Expenses	(65)	(127)	(115)	(96)
3 Operating Profit	1,022	1,442	1,371	1,462
a Non Operating Income or (Expense)	*1*	*3*	*1*	*174*
4 Profit or (Loss) before Interest and Tax	1,024	1,445	1,372	1,635
a Total Finance Cost	*(368)*	*(401)*	*(291)*	*(356)*
b Taxation	*(198)*	*(368)*	*(342)*	*(381)*
6 Net Income Or (Loss)	458	676	740	898
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*817*	*1,359*	*1,319*	*1,336*
b Net Cash from Operating Activities before Working Capital Changes	*647*	*973*	*1,044*	*958*
c Changes in Working Capital	*(5,877)*	*(1,354)*	*3,398*	*(888)*
1 Net Cash provided by Operating Activities	(5,230)	(381)	4,441	70
2 Net Cash (Used in) or Available From Investing Activities	(943)	(347)	(335)	9
3 Net Cash (Used in) or Available From Financing Activities	6,201	818	(4,100)	(28)
4 Net Cash generated or (Used) during the period	27	90	6	50
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	28.1%	17.3%	27.4%	-11.8%
b Gross Profit Margin	3.5%	3.2%	3.6%	4.8%
c Net Profit Margin	1.5%	1.4%	1.8%	2.8%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	-16.2%	0.0%	11.4%	1.4%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Shareholders' Equity)]*	23.2%	20.0%	21.9%	27.6%
2 Working Capital Management				
a Gross Working Capital (Average Days)	24	24	33	35
b Net Working Capital (Average Days)	18	10	16	25
c Current Ratio (Current Assets / Current Liabilities)	17.6	2.6	1.8	3.1
3 Coverages				
a EBITDA / Finance Cost	3.3	4.2	5.8	4.9
b FCFO / Finance Cost+CMLTB+Excess STB	1.2	1.5	2.1	1.9
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	2.4	2.2	0.9	1.1
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	69.3%	45.7%	44.0%	56.7%
b Interest or Markup Payable (Days)	44.8	28.7	21.2	0.0
c Entity Average Borrowing Rate	14.8%	15.3%	8.5%	8.1%

Credit Rating

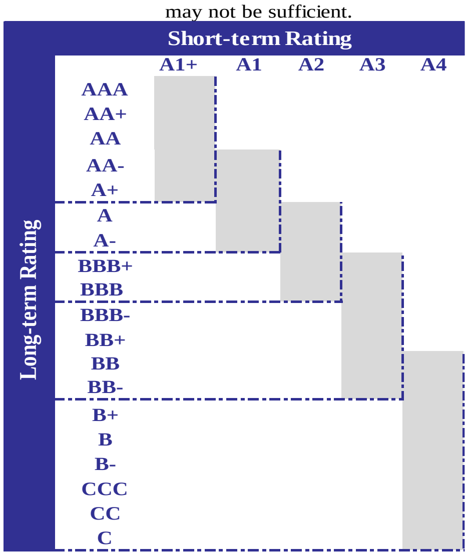
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
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 Rating

Scale	Definition
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
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

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 some material identifiable event with indeterminable rating implications. 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 rating 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) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) 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.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

a) Broker Entity Rating
b) Corporate Rating
c) Debt Instrument Rating
d) Financial Institution Rating
e) Holding Company Rating
f) Independent Power Producer Rating
g) Microfinance Institution Rating
h) Non-Banking Finance Companies Rating

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(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 | Clause 11-(A)(p).
(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)

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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)
(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 | 17-(a)
(19) PACRA reviews all the outstanding ratings periodically, on annual basis; Provided that public dissemination of annual review and, in an instance of change in rating will be made; | Chapter III | 17-(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 | 17-(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 | 17-(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 | 14-3(f)(vii)
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