The Pakistan Credit Rating Agency Limited

# PAKISTAN REFINERY LIMITED

## ENTITY RATINGS REPORT

| | NEW [JUN-16] | PREVIOUS [JUN-15] |
|---|---|---|
| Long-Term | A- | A- |
| Short-Term | A2 | A2 |
| Outlook | Stable | Stable |

REPORT CONTENTS



JUNE 2016

## Profile

- Pakistan Refinery Limited (PRL), having refinery capacity of 2.1mln tons per annum, is operational since Oct'62.Post Chevron exit shareholding in PRL is held by Shell Petroleum Company Limited, UK, (20%) Pakistan State Oil Company Limited (22.5%), and HASCOL (14%) and Chevron (7.5%).
- Chevron intends to sell its entire stock in the company. The transaction is currently under litigation on the basis of shareholder agreement between Class B shareholders.
- Shell has offered 26.67% stake in the company to PSO. The transaction is currently under regulatory approvals. Once concluded, PSO will become major shareholder in the company.

## Governance & Management

- The company has eleven member board (including the CEO) - six class B directors representing sponsoring companies (currently three from PSO, two from Shell and one from Chevron) and four class A directors representing other shareholders.
- Mr. Aftab Husain, PRL's CEO, Chemical Engineer has been associated with PRL for over three decades. He is supported by a team of qualified and competent individuals.

## Performance

- During 9MFY16, PRL witnessed a decline in its turnover on a YoY basis ~30% mainly on account of a sizeable dip in the prices of crude in the international market during most part of the period.
- Marginal increase in the overall operational expenses alongwith the finance cost exerted negatively on the bottomline. However, the positive contribution in GRMs due to ISOM helped in generating healthy profitability on a YoY basis (9MFY16: PKR860mln, 9MFY15: Loss of PKR 2,465mln).

## Business Strategy

- Going forward, the company plans to undertake a major expansion & up-gradation project by installing a Hydro-desulphurization Unit (DHDS) in order to produce Euro II compliant High Speed Diesel. During the year, GoP has given extension for commissioning of DHDS plant till June’17. The company engaged UK based engineering consultant for conducting a feasibility study.

## Working Capital & Cashflows

- PRL resorts to short-term borrowings while stretching its payables to local E&P companies, which comprise 20% in the overall crude procurement. PRL cash cycle has improved as compared to same period last year (FY14: ~33 days, FY15: ~19 days, 9MFY16: ~51 days).
- During 9MFY16, healthy profitability helped in improving the company’s cash flows. The trend in the coverages reversed from negative to positive during the period on account of positive FCFO (Mar16: 1.4, Jun15: -0.4, Jun14: -0.4).

## Capital Structure

- PRL raised its equity during the year through a right issue amounting to PKR 2.6bln. The subscription money was received against the planned right issue of PKR 2.8bln. The remaining amount of PKR 210mln is subject to a restraining order.
- PRL has a long term loan of PKR 2bln obtained for an upgradation project (Isomerization). The said loan will be repayable in ten semi annual payments with a maturity of seven years (inclusive of two year grace period) @ 6MKibor+175bps.

## Debt Instrument

- PRL, issued two TFCs during CY13. TFC I, carrying fixed profit rate of 10.55%, has a tenor of 3 years and will be due for maturity in Dec'16. TFC II, carrying fixed profit rate of 10.75%, has a tenor of 5 years and will be due for maturity in Dec'18.
- the management plans to build a debt payment account from July-2016 for settling the remaining amount of TFC 1 amounting to PKR 1,713mln due in December-2016. The management intends to beef up the account on monthly basis with an amount of ~PKR 285mln for settling the bullet payment for the TFC 1.

## Rating Rationale

The ratings reflects the PRL’s strong business profile emanates from its sound operational history coupled with strong demand of its products line, and its long lasting existence in the domestic market. The ratings incorporates the PRL’s decent operational flexibility and deviation in production to high margin product slate that triggered short-term profitability, however, exposure in volatile dynamics of international crude oil remains critical for PRL’s GRM. At the same time, the company’s prospective capacity expansion & upgradation plans along with construction of DHDS unit are likely to constrain its already thin capital structure as well as coverages. However, the equity injection by means of right issue may help PRL to enhance its equity base. Moving forward stability in global crude prices, execution of equity enhancement plans, further debt accumulation for the DHDS project, and management control of PRL remain critical for the ratings.

## Key Rating Drivers

The ratings could be impacted by prolonged constrain in refining margins and/or adverse changes in the existing regulatory framework leading to depressed core cashflows. The company is pursuing a leveraged up-gradation of its operating platform. Since repayment pattern is aligned to expected cash flows, any completion delay may impact coverages, in turn, ratings.

## Industry Snapshot

The self sufficiency of US coupled with a decrease in its reliance on crude import from OPEC and OPEC’s decision to maintain its current production level at 30mln barrels per day has resulted in an over supplied market. In addition to that, less than expected recovery in the global economy dampened the demand of crude. Resultantly, the oil prices witnessed a steep decline during 9MFY16. Significant developments in the global Shale sector, particularly the related infrastructure in US, exerted further pressure on the global crude prices.

*PKR mln*

# Pakistan Refinery Limited

| BALANCE SHEET | 31-Mar-16 | 30-Jun-15 | 30-Jun-14 | 30-Jun-13 |
|---|---|---|---|---|
| | 9MFY16 | Annual | Annual | Annual |
| **Non-Current Assets** | **12,163** | **12,601** | **7,461** | **5,165** |
| **Investments (Incl. associates)** | **82** | **91** | **90** | **85** |
| Equity | 82 | 91 | 90 | 85 |
| Debt | - | - | - | - |
| **Current Assets** | **22,487** | **18,061** | **21,288** | **22,162** |
| Inventory | 4,378 | 5,516 | 9,673 | 10,979 |
| Trade Receivables | 12,169 | 6,231 | 8,588 | 10,804 |
| Others | 5,941 | 6,314 | 3,027 | 379 |
| **Total Assets** | **34,733** | **30,753** | **28,839** | **27,413** |
| | | | | |
| **Debt** | **20,117** | **11,316** | **8,539** | **7,818** |
| Short-term | 16,129 | 7,194 | 6,110 | 7,818 |
| Long-term (Inlc. Current Maturity of long-term debt) | 3,988 | 4,123 | 2,429 | - |
| Other shortterm liabilities | 11,831 | 17,514 | 19,649 | 18,087 |
| Other Longterm Liabilities | 140 | 138 | 82 | 40 |
| **Shareholder's Equity** | **2,645** | **1,785** | **569** | **1,468** |
| **Total Liabilities & Equity** | **34,733** | **30,753** | **28,839** | **27,413** |
| | | | | |
| **INCOME STATEMENT** | | | | |
| **Turnover** | **49,754** | **91,175** | **142,144** | **132,114** |
| Gross Profit | 1,936 | (677) | (708) | 1,949 |
| Other Income | 83 | 187 | 357 | 101 |
| Financial Charges | (688) | (707) | (87) | (358) |
| **Net Income** | **860** | **(1,182)** | **(864)** | **496** |
| | | | | |
| **Cashflow Statement** | | | | |
| Free Cashflow from Operations (FCFO) | 2,168 | (1,017) | (1,120) | 993 |
| Net Cash changes in Working Capital | (8,931) | 2,021 | 5,087 | (7,556) |
| Net Cash from Operating Activities | (7,384) | (56) | 3,444 | (6,885) |
| Net Cash from InvestingActivities | (266) | (4,616) | (2,168) | (662) |
| Net Cash from Financing Activities | 15,994 | (1,789) | 8,713 | (0) |
| | | | | |
| **Ratio Analysis** | | | | |
| **Performance** | | | | |
| Turnover Growth | -29.7% | -35.9% | 7.6% | -24.4% |
| Gross Margin | 3.9% | -0.7% | -0.5% | 1.5% |
| Net Margin | 1.7% | -1.3% | -0.6% | 0.4% |
| ROE | 33.0% | -68.3% | -155.8% | 21.9% |
| **Coverages** | | | | |
| Interest Coverage (FCFO/Gross Interest) | 3.2 | -1.4 | -12.9 | 2.8 |
| Core: (FCFO/Gross Interest+CMLTD+Uncovered Total STB) | 1.3 | -0.4 | -0.4 | 2.8 |
| Total: (TCF) / (Gross Interest+CMLTD+Uncovered Total STB) | 1.3 | -0.4 | -0.4 | 2.8 |
| Debt Payback (Total LT Debt Including UnCovered Total STBs) / (FCFO- Gross Interest) | 2.7 | -2.4 | -2.0 | 0.0 |
| **Liquidity** | | | | |
| Net Cash Cycle (Inventory Days + Receivable Days - Payable Days) | 17.4 | 7.1 | 4.9 | 67.4 |
| **Capital Structure** (Total Debt/Total Debt+Equity) | 60.1% | 86.4% | 93.8% | 84.2% |

# STANDARD 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. This capacity is highly unlikely to be adversely affected by foreseeable events. |
| **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-** | **Speculative.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic change over time; however, business or financial alternatives may be available to allow financial commitments to be met. |
| **B+ B B-** | **Highly speculative.** Significant 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** | **High default 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.

**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. Rating Watch may carry designation – Positive (rating may be raised, negative (lowered), or developing (direction is unclear). A watch should be resolved with in foreseeable future, but may continue if underlying circumstances are not settled.

**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’.

**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, or e) the entity/issuer defaults.

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## Regulatory and Supplementary Disclosure

Rated Entity

**Name of Rated Entity** Pakistan Refinery Limited
**Sector** Refining
**Type of Relationship** Solicited

**Purpose of the Rating**
Independent Risk Assessment
Regulatory Requirement

**Rating History**

| Dissemination Date | Long Term | Short Term | Outlook | Action |
|---|---|---|---|---|
| 29-Jun-16 | A- | A2 | Stable | Maintain |
| 30-Jun-15 | A- | A2 | Stable | Maintain |
| 30-Jun-14 | A- | A2 | Stable | Maintain |
| 6-May-13 | A- | A2 | Stable | Initial |

**Related Criteria and Research**

Rating Methodology: Corporate Rating Methodology (2005)
Sector Research: Refining Sector study | Sep15

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Rating Team Statement

**Rating Procedure**
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