The Pakistan Credit Rating Agency Limited

PAK ARAB REFINERY LIMITED

	NEW [JUN-17]	PREVIOUS [DEC-16]
Long-Term	AAA	AAA
Short-Term	A1+	A1+
Outlook	Stable	Stable

REPORT CONTENTS

JUNE 2017

Profile

- Incorporated in 1974 as an unlisted public limited company
- PARCO is a joint venture between the (GoP) and (EAD).
- With a mid-country refinery of 4.5mln tones per annum, PARCO commenced its refining operations in 2000.
- The company operates a network of crude oil-cum-product pipelines running over 2000 kilometers across the country.

Ownership

- PARCO is 60% owned by the GoP, and 40% by the Abu Dhabi Petroleum Investments LLC (ADPI), a majority owned company of Emirate of Abu Dhabi.

Governance

- Ten member board of directors including chairman and the MD
- Six nominees of the GoP, including Chairman and the Managing Director, while remaining four are EAD and OMV nominees.
- Five committees at the Board level, namely Finance, Technical, Bid Evaluation, HR and Audit committees - headed by board members

Management & Controls

- The company has a well-defined organizational structure with clear segregation of responsibilities.
- The organizational structure of the company is divided into various divisions and departments. All the divisional heads are designated as GM.

Business Risk

- PARCO continued to achieve higher throughput during the year benefitting the company's performance. The company's revenues improved on a YoY basis. The largely stable crude oil process and healthy GRMs resulted in sound gross profits during 9MFY17.
- The sizeable other income supported by interest income and dividend inflow alongwith the reduced finance cost on account of settlement of major long-term and short-term liabilities contributed positively towards the company's profitability.
- Going forward, PARCO is planning to increase the capacity of;
  - The refinery by additional 20,000 barrels per day.
  - MFM Pipeline from 3 million tons to 7 million tons
- Keeping in view the demand/supply situation of refined products, a new refinery project is under evaluation of PARCO.

Financial Risk

- The working capital requirement of the refinery emanates from the need to finance its inventory of crude oil purchases and receivables. The overall working capital cycle improved on the back of low crude oil prices and healthy cash generation.
- PARCO possesses a strong ability to generate cash flow from its operations owing to its sound business model, strategic positioning in the domestic refining sector and high product margin slate. The company's coverages improved during the period under review on account of healthy cash flows and low interest cost and higher other income.
- The company maintains a low leveraged capital structure. The improvement in the company's gearing was due to the settlement of sizeable short-term borrowings during the year.

RATING RATIONALE

The ratings reflect PARCO's ownership structure- owned by the Government of Pakistan (GoP) (60%) and Abu Dhabi Petroleum Investments LLC (40%- a majority owned company of Emirate of Abu Dhabi) (EAD). Additionally, it enjoys strategic importance to the GoP for its socio-economic policies and its quest of reducing the import bill. The company's low business risk emanates from its leading market position, strong demand of its products, and its advanced plant technology. The business fundamentals derive support from high premium product mix and diversified revenue stream. At the same time, the ratings recognize the company's ability to manage its financial profile. Also reflected in the ratings is PARCO's strengthened position in midstream and downstream sector with organic growth and acquisitions.

KEY RATING DRIVERS

Effective management of upcoming projects, favorable regulatory regime especially and consistency in Government policies remain critical for the ratings. The ratings are dependent on sustained competitive positioning of the company.

PKR mln

PARCO

BALANCE SHEET	31-Mar-17	30-Jun-16	30-Mar-16	30-Jun-15
	1QFY17	Annual	Annual	Annual
Non-Current Assets	**21,993**	**21,978**	**22,698**	**25,015**
Investments (Incl. associates)	**40,026**	**40,560**	**71,391**	**39,853**
Equity	39,305	39,515	70,080	38,331
Debt	721	1,045	1,312	1,523
Current Assets	**48,119**	**42,084**	**45,453**	**57,425**
Inventory	23,031	17,832	16,550	24,792
Trade Receivables	13,260	12,519	11,317	14,836
Others	11,828	11,732	17,586	17,797
Total Assets	**125,678**	**125,678**	**148,422**	**126,493**
Debt	**8,598**	**8,598**	**16,079**	**2,514**
Short-term	7,031	7,031	14,248	1
Long-term (Inlc. Current Maturity of long-term debt)	1,568	1,568	1,831	2,513
Other shortterm liabilities	37,513	37,513	36,524	34,381
Other Longterm Liabilities	7,479	7,479	9,447	7,890
Shareholder's Equity	**72,088**	**72,088**	**86,365**	**81,708**
Total Liabilities & Equity	**125,678**	**125,678**	**148,414**	**126,493**
INCOME STATEMENT				
Turnover	**166,406**	**198,099**	**155,943**	**307,285**
Gross Profit	19,272	27,413	21,242	19,927
Other Income	3,152	3,996	1,401	2,664
Financial Charges	(41)	(663)	(344)	(1,009)
Net Income	**14,327**	**18,831**	**17,253**	**13,647**
Cashflow Statement				
Free Cashflow from Operations (FCFO)	15,973	20,974	17,468	14,054
Net Cash changes in Working Capital	1,822	4,324	30,338	5,601
Net Cash from Operating Activities	17,759	24,636	48,841	18,541
Net Cash from InvestingActivities	(1,258)	2,143	(293)	(2,673)
Net Cash from Financing Activities	(7,200)	(14,255)	(10,483)	(11,167)
Ratio Analysis				
Performance				
Turnover Growth	6.7%	-35.5%	-35.5%	-26.4%
Gross Margin	11.6%	13.8%	13.6%	6.5%
Net Margin	8.6%	9.5%	11.1%	4.4%
ROE	16.9%	26.0%	28.8%	15.6%
Coverages				
Interest Coverage (FCFO/Gross Interest)	389.6	11.0	50.8	13.9
Core: (FCFO/Gross Interest+CMLTD+Uncovered Total STB)	52.8	3.3	3.7	7.0
Total: (TCF) / (Gross Interest+CMLTD+Uncovered Total STB)	52.8	0.7	4.0	7.0
Debt Payback (Total LT Debt Including UnCovered Total STBs) / (FCFO- Gross Interest)	0.0	0.3	0.3	0.2
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	16.5	12.3	13.0	17.6
Capital Structure (Total Debt/Total Debt+Equity)	1.5%	10.7%	15.7%	3.0%

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.

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

Regulatory and Supplementary Disclosure

Name of Issuer Pak Arab Refinery Limited
Sector Refining
Type of Relationship Solicited

Purpose of the Rating Independent Risk Assessment

Rating History

Dissemination Date	Long Term	Short Term	Outlook	Action
23-Jun-17	AAA	A1+	Stable	Maintain
30-Dec-16	AAA	A1+	Stable	Maintain
30-Dec-15	AAA	A1+	Stable	Maintain
13-Jan-15	AAA	A1+	Stable	Maintain
15-Jan-14	AAA	A1+	Stable	Maintain
03-Jan-13	AAA	A1+	Stable	Maintain
27-Mar-12	AAA	A1+	Stable	Maintain
29-Nov-10	AAA	A1+	Stable	Maintain

Related Criteria and Research

Rating Methodology Corporate Rating Methodology
Sector Research Refining Sector Review -2016

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Rating Team Statement

Rating Procedure
Rating is an opinion on relative credit worthiness of an entity or debt instrument. It does not constitute recommendation to buy, hold or sell any security. The rating team for this assignment does not have any beneficial interest, direct or indirect in the rated entity/instrument.

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The analysts involved in the rating process do not have any interest in a credit rating or any of its family members has any such interest
The analysts and members of the rating committees including the external member members have disclosed all the conflict of interest, including those of their family members, if any, to the Compliance Officer PACRA
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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 ii) fee mandate - signed with the payer, which can be different from the entity
PACRA ensures that the credit rating assigned to an entity or instrument should 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

Surveillance
PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the rated entity/ issuer, the security arrangement, the industry etc, is disseminated to the market, in a timely and effective manner, after appropriate consultation with the entity/issuer
PACRA reviews all the outstanding ratings on annual basis or as and when required by any stakeholder (including creditor) or upon the occurrence of such an event which requires to do so
PACRA initiates immediate review of the outstanding rating(s) upon becoming aware of any information that may be reasonable be expected to result in any change (including downgrade) in the rating

Reporting of Misconduct
PACRA has framed and implemented whistle-blower policy encouraging all employees to intimate the compliance officer any unethical practice or misconduct relating to the credit rating by another employees of the company that came to his/her knowledge. The Compliance Officer reports to the BoD and SECP

Confidentiality
PACRA has framed a confidentiality policy to prevent abuse of the non-public information by its employees and other persons involved in the rating process, sharing and dissemination of the non-public information by such persons to outside parties
Where feasible and appropriate, prior to issuing or revising a rating, PACRA informs the issuer of the critical information and principal considerations upon which a rating will be based and provide the opportunity to clarify any likely factual misperception or other matter that PACRA would wish to be made aware of in order to produce a fair rating. PACRA duly evaluates the response. Where in a particular circumstance PACRA has not informed the entity/issuer prior to issuing or revising a rating, it informs the entity/issuer as soon as practical thereafter

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Probability of Default (PD)

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