The Pakistan Credit Rating Agency Limited

Rating Report

Pakistan National Shipping Corporation

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
29-Jun-2018	AA	A1+	Stable	Maintain	-
29-Dec-2017	AA	A1+	Stable	Maintain	-
13-Feb-2017	AA	A1+	Stable	Upgrade	-
16-Feb-2016	AA-	A1+	Stable	Maintain	-
17-Feb-2015	AA-	A1+	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

The ratings reflect PNSC's strong ownership - majority owned by Government of Pakistan - and its strategic significance as the country's flag carrier. On a stand-alone basis, PNSC's business profile has gained significant strength in recent years as exhibited by continuous improvement in business margins on account of efficient fleet utilization, better pricing strategy, and cost management measures taken by the management. The company is currently catering increasing business volumes through chartered-hire vessels. Considering the volatility in margins, the company aims to increase its own fleet size by acquiring two vessels. These expansions are expected to result in improved revenue base and higher margins, in turn, further fortification in business profile of the company. The acquisition of new vessels would be majorly financed through debt; thus higher leveraging. This would burden the financial profile; however, improving cash flows from existing business coupled with expectation of additional high margin business to be catered by new vessels is likely to generate commensurate cashflows to support debt service coverages. This, along-with on-balance sheet liquidity, supports overall risk profile of the company. Government's decision to cut furnace oil imports had negative impact on the revenue and margins of PNSC in 9MFY18. Furthermore, continuation of Contract of Affreightment with Pakistan State Oil (PSO) will remain important as PNSC's business with PSO accounts for ~30% of PNSC's topline.

The ratings are dependent on the Corporation's ability to generate envisaged cash flows post-expansion. Meanwhile, proactive management of financial profile while improving coverages remains important.

Disclosure

Name of Rated Entity	Pakistan National Shipping Corporation
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating Methodology(Jul-17),Methodology | Correlation between long-term and short-term rating scale(Jun-17),Methodology | Criteria Modifiers(Jun-17)
Related Research	Sector Study | Shipping(May-18)
Rating Analysts	Muhammad Hassan | muhammad.hassan@pacra.com | +92-42-35869504

PAKISTAN NATIONAL SHIPPING CORPORATION PROFILE	
Incorporated	1979 through an ordinance
Major business lines	Transporting liquid and Dry Cargo through owned and chartered vessels Real Estate
Legal status	Public Sector Entity
Fleet Size	4 Oil Tankers 5 Dry bulk vessels
Head Office	Karachi

INDUSTRY SNAPSHOT

Pakistan's Seaborne trade has shown a rising trend increasing by ~8% in 2017

CPEC under China's One Belt, One Road is expected to increase seaborne trade through Gwadar port.

Pakistan National Shipping Corporation (PNSC) is the only shipping company operating with flag as a national flag carrier.

PNSC had 16% share of total Pakistan's Seaborne trade in 2017

OWNERSHIP

- The Group constitutes PNSC holding company, its nineteen subsidiaries and an associate concern.
- Listed on Pakistan Stock Exchange.
- PNSC is majority owned by the Government of Pakistan (GoP) (86.76%) through the Ministry of Maritime Affairs, followed by PNSC Employee Empowerment Trust.

GOVERNANCE

- Board comprises seven members; five GoP nominees and two elected independent directors.
- The CEO, a GoP nominee, is vested with the authority of Chairman as per the governing Shipping Ordinance.
- For better governance and oversight of the management the board has formed three committees i) Audit Committee ii) Human Resource & Remuneration Committee and iii) Commercial Committee.
- Governance quality bode well owing to diversified experience and technical stature of board members.

MANAGEMENT & CONTROL

- Mr. Rizwan Ahmed – Chairman & CEO, joined PNSC in Dec17. He has worked on various key positions in the federal and provincial governments. He brings with him vast professional experience in administration, finances, management, human resource, law enforcement and public procurement.
- PNSC has tall organizational structure with a professional management team supported by twelve committees.
- PNSC has at its disposal experienced management who have long association with PNSC.
- PNSC deploys Enterprise Resource Planning (ERP) software – "Ship Management Expert System" (SES) – for its MIS reporting. The system provides online link between vessel and head office.
- The Corporation employs 'Purple Finder' – an international satellite system, to track its vessels with the help of equipment trackers that have been installed in the fleet.

BUSINESS RISK

- PNSC's revenues emanate from two main sources as at FY17: (i) Liquid Cargo - Oil (~60%) and (ii) Dry Bulk; it can be sub-divided into Slot Charter (~31%) and Bulk Cargo (~9%). A small proportion of revenue also comes from rental income.
- During 9MFY18, overall revenues witnessed decline primarily on account of decline in liquid business with PSO. (9MFY18: 7,372mln, 9MFY17: 8,994mln)
- PNSC has signed Contract of Affreightment with refineries. Share of revenue from refineries increased during the year (9MFY18: 38%, FY17: 30%, FY16: 35%).
- Decrease in revenue coupled with decrease in business margins (Gross Margins: 9MFY18: 21.7%, 9MFY17: 28.1%, Operating Margins: 9MFY18: 11.5%, 9MFY17: 19.7%) lead to decrease in profitability (9MFY18: 872mln, 9MFY17: 1,380mln).
- Going forward, PNSC is planning to add two new vessels into its fleet. These vessels will be financed through debt to equity ratio of 90:10. Continuity of Contract of Affreightment with PSO will remain important.

FINANCIAL RISK

- PNSC's working capital needs originate mainly from demurrage expenses receivable from the clients. Majority of the demurrage expenses are of PSO. PNSC meets working capital needs from internal cash flow generation.
- FCFO - a function of EBITDA - remained strong though declined owing to lower profitability (9MFY18: 1,950mln, 9MFY17: 2,370mln, FY17: 3,796mln, FY16: 3,505mln).
- Despite decrease in leveraging, lower profitability and cashflows lead to decrease in coverages (Interest Coverage: 9MFY18: 10x, 9MFY17: ~10x, FY17: 11.5x, FY16: 6.3x, Debt Coverage: 9MFY18: 1.8x, 9MFY17: 2x, FY17, 2.5x, FY16: 2x).
- PNSC paid dividend of PKR 250mln during 9MFY18 (FY17: PKR 260mln).
- PNSC has a low leveraged capital structure (end - Mar18: 9.6%). Further loan to expand fleet size would increase leveraging; though likely to remain in comfortable range.

PKR mln

Pakistan National Shipping Corporation Limited

BALANCE SHEET	31-Mar-18	30-Jun-17	30-Jun-16	30-Jun-15
	9M	Annual	Annual	Annual
Non-Current Assets	**22,306**	**23,242**	**24,300**	**25,276**
Investments (Incl. associates)	**51**	**50**	**50**	**54**
Equity	51	50	50	54
Debt				
Current Assets	**7,389**	**7,563**	**6,074**	**7,211**
Trade Receivables	2,870	2,725	1,960	2,282
Others	4,520	4,838	4,115	4,930
Total Assets	**36,748**	**37,652**	**36,538**	**36,270**
Debt	**3,254**	**4,154**	**5,352**	**7,450**
Short-term	-	-	-	-
Long-term (Inlc. Current Maturity of long-term debt)	3,254	4,154	5,352	7,450
Other shortterm liabilities	2,393	3,061	2,991	2,562
Other Longterm Liabilities	631	592	613	852
Shareholder's Equity	**30,470**	**29,845**	**27,582**	**25,407**
Total Liabilities & Equity	**36,748**	**37,652**	**36,538**	**36,270**
INCOME STATEMENT				
Turnover	**7,372**	**12,286**	**12,368**	**15,381**
Gross Profit	1,600	3,455	3,491	3,111
Other Income	450	985	509	810
Financial Charges	(195)	(330)	(559)	(670)
Net Income	**872**	**2,477**	**2,323**	**2,116**
Cashflow Statement				
Free Cashflow from Operations (FCFO)	1,950	3,796	3,505	2,601
Net Cash changes in Working Capital	(721)	(970)	662	123
Net Cash from Operating Activities	1,033	2,502	3,618	2,084
Net Cash from Investing Activities	(187)	(319)	(2,066)	(2,528)
Net Cash from Financing Activities	(1,157)	(1,471)	(2,365)	1,404
Net Cash generated during the period	(312)	712	(812)	960
Ratio Analysis				
Performance				
Turnover Growth	-18.0%	-0.7%	-19.6%	-1.3%
Gross Margin	21.7%	28.1%	28.2%	20.2%
Net Margin	11.8%	20.2%	18.8%	13.8%
ROE	3.8%	8.5%	8.5%	8.8%
Coverages				
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB)	1.8	2.5	2.0	1.1
Interest Coverage (x) (FCFO/Gross Interest)	10.0	11.5	6.3	3.9
Debt Payback-Years (Total Lt.Debt (excluding Covered Short Term Borrowings) / FC	1.4	1.2	1.8	3.9
Liquidity				
Short-term Total Leverage (Net Current Assets - STB) / Current Assets	68%	60%	51%	64%
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	48	50	50	33
Capital Structure (Total Debt/Total Debt+Equity)	9.6%	12.2%	16.3%	22.7%

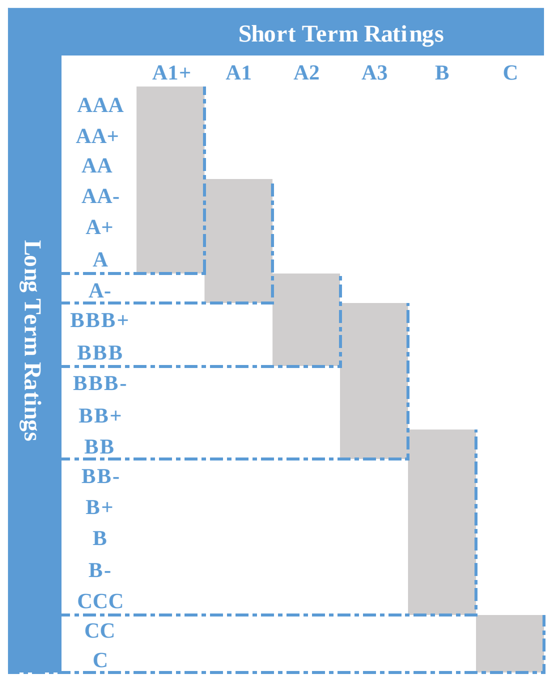
Rating Scale

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+ 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.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

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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**
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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

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(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.
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(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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(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)
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