The Pakistan Credit Rating Agency Limited

Rating Report

Pak Arab Refinery Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
10-Dec-2019	AAA	A1+	Stable	Maintain	-
10-Jun-2019	AAA	A1+	Stable	Maintain	-
14-Dec-2018	AAA	A1+	Stable	Maintain	-
05-Jun-2018	AAA	A1+	Stable	Maintain	-
23-Jun-2017	AAA	A1+	Stable	Maintain	-
30-Dec-2016	AAA	A1+	Stable	Maintain	-
31-Dec-2015	AAA	A1+	Stable	Maintain	-
13-Jan-2015	AAA	A1+	Stable	Maintain	-
15-Jan-2014	AAA	A1+	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

The ratings reflect PARCO's ownership structure - owned by the Government of Pakistan (GoP) (60%) and Emirates of Abu Dhabi (EAD), through Abu Dhabi Petroleum Investments LLC (40%), a majority owned company of Mubadala. The company is of strategic importance to Pakistan as it operates as an integrated Pipeline, Refinery, and Marketing infrastructure, providing efficient, low-cost, environment-friendly energy solutions. PARCO is also contributing substantially towards socio-economic benefits and Foreign Exchange savings; its low business risk emanates from its leading market position, strong demand of its products and its advanced Refinery Complex technology. During FY19, volatility in International Oil prices coupled with a sharp rupee depreciation emerged as one of the key challenges to the Refinery Sector. The ratings, however, recognize PARCO's aptness and timeliness in subduing challenges on its financial risk profile. Dividend income from subsidiaries and joint venture companies reflect positively on the company's performance. Moreover, strong foreign currency investment returns provide an implied hedge against exchange risk. The ratings also incorporate PARCO's strengthened position in midstream and downstream sector resulting through acquisitions and completion of expansion projects. Market share, though marginally lower in FY19, is expected to remain strong as PARCO enhances its operating capacity from 100,000 barrels per day (bpd) to 120,000 bpd by Jun'20. Additionally, PARCO also embarks on setting a new state-of-the-art 250,000 bpd Coastal Refinery Project which is at a preliminary stage. Strong capital structure and sizable equity has, historically, enabled the company to absorb hefty capital expenditures.

Effective management of upcoming projects, favorable Regulatory Regime, and consistency in Government policies remain critical for the ratings. Meanwhile, sustained competitive positioning is also imperative.

Disclosure	
Name of Rated Entity	Pak Arab Refinery Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-19)
Related Research	Sector Study | Refineries(Nov-19)
Rating Analysts	Saadat Mirza | saadat.mirza@pacra.com | +92-42-35869504

Profile

Legal Structure Established in 1974, Pak-Arab Refinery Ltd (herein referred to as "PARCO" or "the company") is a 60:40 joint venture between the Government of Pakistan (GoP) and Emirates of Abu Dhabi (EAD), through its investment arm, Abu Dhabi Petroleum Investment Company LLC (ADPI).

Background The company was established with the objective of setting up a Mid-Country Refinery (MCR) and an associated pipeline system for the transport of crude oil from Karachi to the refinery site at Mahmood Kot near Multan. The pipeline project was implemented and commissioned in 1981. The refinery, on the other hand, was commissioned in 2000, with a refining capacity of ~4.5mln metric tons per annum (100,000 Barrels per day). It is one of the largest refineries operating in the country.

Operations The company is primarily engaged in the refining, sale, and transportation of petroleum products. The refinery unit of the company produces Liquefied Petroleum Gas, Motor Gas, High Octane Blending Component, Kerosene, Jet Fuel (JP-1 & JP-4), High-Speed Diesel, Light Speed Diesel, Furnace Oil and Sulphur.

Ownership

Ownership Structure PARCO is 60% owned by the GoP, represented by the Ministry of Energy (Petroleum Division) and 40% by the EAD. EAD has made its investment through ADPI - a majority owned company of Mubadala (the state-owned investment vehicle of the Abu Dhabi government).

Stability Considering the strategic importance and sovereign ownership of the company, stability is considered strong.

Business Acumen GoP holds PARCO as its strategically vital asset, whereas further technical knowledge flows in from ADPI. The business acumen of sponsors is considered strong.

Financial Strength Sovereign ownership by two states – Pakistan and Abu Dhabi, provides absolute financial strength to the company. Given the strategic importance of PARCO to the GoP, in terms of its socio-economic policies and its quest of reducing the import bill, the backing of sovereign support, remains high.

Governance

Board Structure The company's ten-member Board of Directors (BoD) includes six nominees of the GoP, including the Chairman and the Managing Director (MD), while the remaining four are Emirate of Abu Dhabi nominees, one of whom is a representative of OMV (an oil exploration and production company, based in Austria).

Members' Profile Mr. Mian Asad Hayaud Din; Secretary, Ministry of Energy (Petroleum Division) is the Chairman of the company and Mr. Khalifa Al Suwaidi, the representative of EAD, is the Vice Chairman of the company with diversified experience of general management. PARCO's board comprises highly qualified members, mostly from renowned institutions. It has a blend of business studies, general management, law, engineering, and finance professionals. Experience profile of the board is rich.

Board Effectiveness During FY19, the board held five meetings, to approve financial results and review progress of ongoing mega projects along with the annual budget. There are three committees at the Board level, namely the Finance, HR, and Audit committees. Each committee is headed by a board member and consists of other non executive board members, with the exception of Mr. Tariq Rizavi, who is the MD of the company.

Financial Transparency PARCO's Auditor, EY Ford Rhodes Chartered Accountants, one of the big four firms, has a satisfactory QCR Rating from the Institute of Chartered Accountants of Pakistan and is classified in the category "A" on the panel of auditors maintained by the State Bank of Pakistan. They have expressed an unqualified opinion on the company's financial statement as at End-Jun19.

Management

Organizational Structure The organizational structure of the company is divided into various divisions and departments. All the divisional heads are designated as General Manager (GM). Despite the GoP's large stake in the ownership structure of PARCO, the company enjoys operational autonomy.

Management Team Mr. Tariq Rizavi took charge as the Managing Director of PARCO , in September 2011. Mr. Rizavi, a chemical engineer by profession, has been associated with the company for over 40 years and has served at various managerial positions. Mr. Shahid Mahmood Khan, a fellow chartered accountant, is the Deputy Managing Director of Finance and Corporate Affairs with an overall experience of ~35 years whereas his association with PARCO spans over 10 years. The management team is well qualified, mostly associated with the company, since long.

Effectiveness Over the years, PARCO's effective management played a significant role in empowering the organization through its progressive results. Additionally, management's effective decision-making has caused the processes to be more systematic. The robustness of control systems is considered a reflection of strong management.

MIS The company generates MIS reports on daily, fortnightly, monthly, and annual basis. These mainly include daily cash position, daily production report, saleable stock position, Treasury and Accounts section MIS, monthly debtors aging, monthly management accounts, and annual financial statements.

Control Environment PARCO has implemented SAP to streamline planning and coordination across business lines, thereby increasing overall efficiency. The implemented modules include Financials, Sales and Distribution, Materials Management, Quality Management, Plant Maintenance Project Systems, and Human Capital Management.

Business Risk

Industry Dynamics Pakistan consumed a total of ~20mln metric tons (MT) of refined petroleum products in FY19 (FY18: ~25mln MT), an decrease of ~20%. This decrease is mainly seen due to a fall in the consumption of MOGAS and HSD due to a lack of growth in the transport sector. Consumption of black oil has been decreasing due to declining consumption of FO, as the government plans to gradually reduce reliance on oil-based power plants to other input sources for electricity generation i.e. LNG & Coal.

Relative Position With regards to relative positioning of the players in the premium products (HSD and MOGAS); efficiency and utilization of available capacity is essential. PARCO and Byco Petroleum retain a large chunk of the market share of ~54%, while Pakistan Refinery, National Refinery, and Attock Refinery collectively contribute ~46% to the total domestic POL supply.

Revenues PARCO witnessed a growth of ~15.3% while generating a turnover of PKR ~316,949mln during FY19 (FY18: PKR ~274,933mln). The trend is seen mainly due to a PoL product price variance. In 1QFY20, the annualized growth in the topline clocked at ~10.5%, with a turnover of PKR ~87,558mln during the period.

Margins Gross profit margins declined in FY19, standing at ~4.1% (FY18: ~8.6%). The trend continued in 1QFY20, where margins remained low at ~3.7%, as compared to ~6.4% in same quarter of FY19. This is mainly due to; declining gross refining margins, increase in the price of raw material, and a decline in the pricing of Motor Gasoline and furnace oil due to its depressed demand, which led to a build-up of inventory levels. As a result of investment in foreign currency TDRs, the company was able to enjoy noteworthy exchange gains (1QFY20: ~1,193mln, FY19: ~4,064mln, FY18: ~1,443mln), in contrast to the industry, where significant pressure was put on the bottom-lines as a result of depreciation of the PKR. This somewhat mitigated the fall in the net profit margins (1QFY20: ~2.0%, FY19: ~3.9%, FY18: ~6.7%).

Sustainability Going forward, PARCO is planning to increase the capacity of its existing 100,000 bpd refinery to 120,000 bpd which is expected to come online by End-FY20. Moreover, PARCO has also initiated the development of the new 250,000 bpd PARCO Coastal Refinery Project, which is expected to come online by ~FY25. With these capacities in the pipeline, the company's sustainable position is expected to further fortify.

Financial Risk

Working Capital PARCO's working capital needs emanate from the need to finance its inventory of crude oil and receivables for which the company mostly relies on internal cash flows. Over the years, PARCO's working capital management has stood strong which is evident from efficient net working capital days (1QFY20: 27days, FY19: 27days, FY18: 21days).

Coverages During FY19, coverages of the company remained strong owing to a reduction in the interest expense, as the average borrowing reduced during the year. Company's cash flows (FCFO) increased owing to improved exchange gain in FY19 (FY19: PKR ~20,994mln, FY18: PKR ~18,639mln). The FCFO suffered in 1QFY20 due to a decrease in profitability.

Capitalization PARCO has an un-leveraged capital structure as at End-1QFY20, with nil borrowings (End-FY19 : 7.9%, End-FY18: ~0.6%).

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Pak Arab Refinery Limited	Sep-19	Jun-19	Jun-18	Jun-17
Refinery	3M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	30,829	30,310	24,641	21,861
2 Investments	47,525	49,492	41,251	45,941
3 Related Party Exposure	12,809	12,272	11,794	11,561
4 Current Assets	60,977	72,328	77,803	44,011
a Inventories	*26,659*	*45,063*	*33,065*	*17,058*
b Trade Receivables	*18,438*	*15,075*	*19,257*	*13,213*
5 Total Assets	152,140	164,401	155,489	123,374
6 Current Liabilities	45,988	51,807	51,549	37,891
a Trade Payables	*22,224*	*32,004*	*33,501*	*16,917*
7 Borrowings	-	8,239	607	1,048
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	8,947	8,920	6,856	6,014
10 Net Assets	97,205	95,436	96,477	78,421
11 Shareholders' Equity	97,205	95,436	96,477	78,421
B INCOME STATEMENT				
1 Sales	87,558	316,949	274,933	225,792
a Cost of Good Sold	*(84,290)*	*(303,843)*	*(251,241)*	*(198,598)*
2 Gross Profit	3,268	13,106	23,691	27,194
a Operating Expenses	(1,417)	(3,908)	(3,365)	(2,679)
3 Operating Profit	1,851	9,198	20,326	24,515
a Non Operating Income or (Expense)	*681*	*8,665*	*6,755*	*3,711*
4 Profit or (Loss) before Interest and Tax	2,532	17,863	27,081	28,226
a Total Finance Cost	*(277)*	*(169)*	*(808)*	*(357)*
b Taxation	*(485)*	*(5,358)*	*(7,756)*	*(8,807)*
6 Net Income Or (Loss)	1,770	12,335	18,517	19,063
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*727*	*20,994*	*18,639*	*17,749*
b Net Cash from Operating Activities before Working Capital Changes	*1,153*	*25,375*	*24,188*	*21,778*
c Changes in Working Capital	*9,815*	*(17,095)*	*(8,343)*	*1,418*
1 Net Cash provided by Operating Activities	10,968	8,280	15,845	23,197
2 Net Cash (Used in) or Available From Investing Activities	645	(15,776)	(2,148)	2,070
3 Net Cash (Used in) or Available From Financing Activities	(8,239)	(4,761)	(5,000)	(21,728)
4 Net Cash generated or (Used) during the period	3,374	(12,257)	8,697	3,538
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	10.5%	15.3%	21.8%	14.0%
b Gross Profit Margin	3.7%	4.1%	8.6%	12.0%
c Net Profit Margin	2.0%	3.9%	6.7%	8.4%
d Cash Conversion Efficiency (EBITDA/Sales)	1.5%	7.5%	8.5%	12.3%
e Return on Equity (ROE)	7.3%	12.9%	21.2%	25.3%
2 Working Capital Management				
a Gross Working Capital (Average Days)	55	65	55	54
b Net Working Capital (Average Days)	27	27	21	27
c Current Ratio (Total Current Assets/Total Current Liabilities)	1.3	1.4	1.5	1.2
3 Coverages				
a EBITDA / Finance Cost	4.9	139.8	28.8	77.8
b FCFO / Finance Cost+CMLTB+Excess STB	2.6	124.0	13.2	20.2
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.0	0.0	0.0	0.1
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	0.0%	7.9%	0.6%	1.3%
b Interest or Markup Payable (Days)	73.2	163.8	1.1	1.0

Rating Scale | Corporate

2019

Credit Rating Scale & Definitions

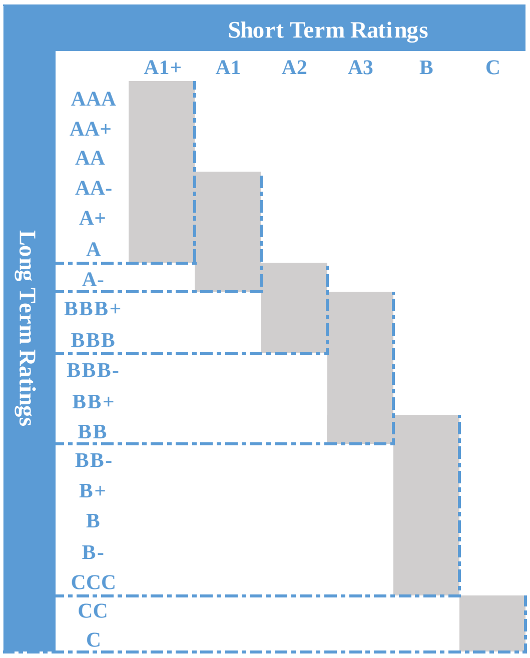
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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.

Regulatory and Supplementary Disclosure
(Credit Rating Companies Regulations,2016)

Rating Team Statements
(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.
(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)

Independence & Conflict of interest
(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 | 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)

Proprietary Information