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-2020	AAA	A1+	Stable	Maintain	-
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	-

Rating Rationale and Key Rating Drivers

Rating incorporates the company's strategic importance to economy through its operations extended to, transportation of petroleum products through integrated Pipelines, Refining, and Marketing, providing efficient, low-cost, and 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. Volatility in International Oil prices remained as one of the key challenges along with adversities of COVID-19 Pandemic. The ratings, however, recognize PARCO’s aptness and timeliness in subduing challenges on its financial risk profile. Company investments in dollar based TDR cover its financial risk profile to a maximum level and also acts as an implied hedge against exchange rate fluctuations. In 3MFY21, the Company earned a net profit of ~PKR 3.2bln supported by dividend income from subsidiaries and joint venture company. Moreover, return on investments also reflected positively on the company’s performance. The ratings take into account PARCO’s strengthened position in midstream and downstream sector resulting through acquisitions and completion of expansion projects. The company went through a capacity enhancement phase taking the optimum capacity level from100,000 barrels per day (bpd) to 120,000 bpd, however this expansion is expected to start paying off in near future as the country wide lockdown situation has eased out. 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, consistency in Government policies and technological improvisation will 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-20),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria | Rating Modifier(Jun-20)
Related Research	Sector Study | Refineries(Nov-19)
Rating Analysts	Bazah Tul Qamar | bazahtul.qamar@pacra.com | +92-42-35869504

Profile

Legal Structure Legal Structure Established in 1974, Pak-Arab Refinery Ltd (PARCO) is a 60:40 joint venture between the Government of Pakistan and Emirates of Abu Dhabi (EAD) through its investment arm, Abu Dhabi Petroleum Investments 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 Mid-Country Refinery, one of the largest refinery operating in the country, was commissioned in 2000 with annual refining capacity of ~4.5mln metric tons (100,000 Barrels per day), Recently, the Company went through capacity enhancement from 100,000 Barrels to 120,000 Barrels per day.

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 (LPG), Motor Gasoline (MS), High Octane Blending Component (HOBC), Kerosene, Jet Fuel (JP-1 & JP-8), High-Speed Diesel (HSD), Light Diesel Oil (LDO), Furnace Oil (FO), Asphalt and Sulphur.

Ownership

Ownership Structure PARCO is 60% owned by the Government of Pakistan, represented by the Ministry of Energy (Petroleum Division) and 40% by Emirates of Abu Dhabi (EAD). EAD has made investment under the name of Abu Dhabi Petroleum Investments LLC (ADPI) - a majority owned company of Mubadala Investment Company (the state-owned investment vehicle of the Abu Dhabi government).

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

Business Acumen GoP holds PARCO as its strategically vital asset, whereas more technical knowledge flows in from ADPI. The business acumen of sponsors of the company 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 probability of sovereign support, in case the Company requires it, 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 EAD's nominees, one of whom is the OMV representative (an oil exploration and production company, based in Austria).

Members' Profile Mian Asad Hayaud Din; Secretary Petroleum is the Chairman of the Company and Mr. Ali Al Dhaheri, a representative of Mubadala (EAD), is the Vice Chairman of the Company with diversified experience of general management. PARCO's board comprises of highly qualified members, mostly from well-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 FY20, the Board held five meetings, to approve financial results, progress review of ongoing mega projects and to review 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. Shahid Mahmood Khan, who is the MD of the Company.

Financial Transparency PARCO's Auditor, EY Ford Rhodes Chartered Accountants, one of the big four firms, have satisfactory QCR Rating from the Institute of Chartered Accountants of Pakistan and classified in category "A" on the panel of auditors maintained by the State Bank of Pakistan under section 35 of Banking Companies Ordinance, 1962. They have expressed an unqualified opinion on the company's financial statement as at the year ended June 30, 2020.

Management

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

Management Team Mr. Shahid Mahmood took charge of PARCO as the Managing Director in Aug'20. He is a fellow chartered accountant (FCA) with the overall experience of ~38 years whereas his association with PARCO is 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 cause processes more systematic while 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 – Enterprise Resource Planning (ERP) solution, to streamline planning and coordination across business lines, thereby increasing overall efficiency.

Business Risk

Industry Dynamics The country consumed a total of ~12.0mln metric tons (MT) of refined petroleum products in 8MFY20 (8MFY19: ~13.3mln MT), depicting a fall of ~10% compared to the corresponding period. This decrease is mainly seen due to subdued domestic demand of POL products. A further fall in demand because of the nationwide lockdown due to Covid-19 has added to the problems within the industry. Additionally, consumption of black oil has plunged due to declining demand of Furnace Oil (FO), as the government is gradually reducing reliance on oil-based power plants in favor of other input sources for electricity generation i.e. LNG & Coal. With the introduction of IMO 2020, offtake of FO will continue to be a major challenge.

Relative Position With respect to the relative positioning of the players in the premium products (HSD and MOGAS); efficiency and utilization of available capacity is essential. Two refineries namely PARCO and Byco Petroleum retain a large chunk of the market share of ~56%, while Pakistan Refinery, National Refinery, and Attock Refinery, contribute ~44% to the total domestic supply of POL products.

Revenues PARCO witnessed the growth of 15% while generating a turnover of PKR ~66,514mln during 1QFY21, while a significant decline was observed in FY20 where the sales declined by ~27%. Such a trend is seen mainly due to a lack of demand and also severely impacted due to lockdowns.

Margins Gross profit margins of the company, significantly declined in FY20, standing at ~-6.4% (FY19:~4.1%). This is mainly due to inventory losses suffered by the company due to exchange rate fluctuations and a decline in international prices of crude oil. However as the things settled down in 1QFY21 margins showed an upward movement and stood at ~6%.

Sustainability The refinery sector has been going through an existential crisis, as a result of the government's demand for environment friendly fuel. The issue of low FO offtake has been compounded by the introduction of the IMO 2020, which necessitates the use of low Sulphur FO by the marine sector. Due to the substantial investment needed for the required upgrades to the refineries, the developments in this regard, have reached an impasse. A slump in demand of petroleum products, due to the lockdown in light of Covid-19, has put the industry players under further pressure. Government assistance is imperative, for the sustenance of the sector.

Financial Risk

Working Capital PARCO's working capital needs emanate from the need to finance its inventory of crude oil purchases 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 (1QFY21: 20 days, FY20: 27days, FY19: 27 days).

Coverages During FY20, coverages of the company deteriorated owing to increase in the interest expense as borrowings of the company increased.

Capitalization Capitalization PARCO has a moderately leveraged capital structure as at FY20 and 3MFY21, with debt equity ratio of ~15.8% and 24.3% (FY19: 7.9%).

The Pakistan Credit Rating Agency Limited

nancial Summary
PKR mln

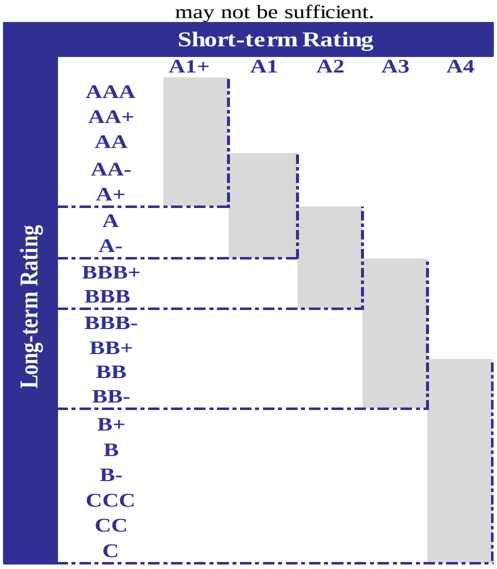
Pak Arab Refinery Limited	Sep-20	Jun-20	Jun-19	Jun-18
Refinery	3M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	38,835	38,078	30,310	24,641
2 Investments	51,992	52,500	49,492	41,251
3 Related Party Exposure	13,910	13,910	12,272	11,794
4 Current Assets	54,585	33,628	72,328	77,803
a Inventories	*29,495*	*12,369*	*45,063*	*33,065*
b Trade Receivables	*15,572*	*11,603*	*15,075*	*19,257*
5 Total Assets	159,322	138,115	164,401	155,489
6 Current Liabilities	49,583	43,637	51,807	51,549
a Trade Payables	*22,307*	*18,037*	*32,004*	*33,501*
7 Borrowings	25,528	14,303	8,239	607
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	4,585	3,769	8,920	6,856
10 Net Assets	79,625	76,406	95,436	96,477
11 Shareholders' Equity	79,625	76,406	95,436	96,477
B INCOME STATEMENT				
1 Sales	66,514	231,608	316,949	274,933
a Cost of Good Sold	*(62,509)*	*(246,353)*	*(303,843)*	*(251,241)*
2 Gross Profit	4,005	(14,745)	13,106	23,691
a Operating Expenses	(935)	(4,586)	(3,908)	(3,365)
3 Operating Profit	3,070	(19,332)	9,198	20,326
a Non Operating Income or (Expense)	*1,632*	*7,150*	*8,665*	*6,755*
4 Profit or (Loss) before Interest and Tax	4,702	(12,181)	17,863	27,081
a Total Finance Cost	*(422)*	*(2,055)*	*(169)*	*(808)*
b Taxation	*(1,061)*	*3,897*	*(5,358)*	*(7,756)*
6 Net Income Or (Loss)	3,219	(10,339)	12,335	18,517
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*2,235*	*(17,925)*	*20,994*	*18,639*
b Net Cash from Operating Activities before Working Capital Changes	*1,526*	*(19,399)*	*25,375*	*24,188*
c Changes in Working Capital	*(14,380)*	*30,842*	*(17,095)*	*(8,343)*
1 Net Cash provided by Operating Activities	(12,854)	11,444	8,280	15,845
2 Net Cash (Used in) or Available From Investing Activities	1,447	(5,935)	(15,776)	(2,148)
3 Net Cash (Used in) or Available From Financing Activities	(12)	(8,620)	(4,761)	(5,000)
4 Net Cash generated or (Used) during the period	(11,419)	(3,112)	(12,257)	8,697
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	14.9%	-26.9%	15.3%	21.8%
b Gross Profit Margin	6.0%	-6.4%	4.1%	8.6%
c Net Profit Margin	4.8%	-4.5%	3.9%	6.7%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	-18.3%	5.6%	1.2%	3.7%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sha*	17.3%	-12.4%	13.3%	21.4%
2 Working Capital Management				
a Gross Working Capital (Average Days)	47	66	65	55
b Net Working Capital (Average Days)	20	27	27	21
c Current Ratio (Current Assets / Current Liabilities)	1.1	0.8	1.4	1.5
3 Coverages				
a EBITDA / Finance Cost	6.6	-7.4	139.8	28.8
b FCFO / Finance Cost+CMLTB+Excess STB	5.3	-8.8	124.0	13.2
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.0	0.0	0.0	0.0
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	24.3%	15.8%	7.9%	0.6%
b Interest or Markup Payable (Days)	77.8	117.4	163.8	1.1

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):

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

Instruments
a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk Rating

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