



The Pakistan Credit Rating Agency Limited

Rating Report

Pak-Arab Pipeline Company Limited

Report Contents

1. Rating Analysis
2. Financial Information
3. Rating Scale
4. Regulatory and Supplementary Disclosure

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
10-Jun-2020	AAA	A1+	Stable	Maintain	-
23-Nov-2019	AAA	A1+	Stable	Maintain	-
24-May-2019	AAA	A1+	Stable	Maintain	-
23-Nov-2018	AAA	A1+	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings are a reflection of PAPCO's distinctive business model deriving its strength from a tariff based return structure. PAPCO operates a 786 Km pipeline network dedicated for White Oil Pipeline (WOP). The tariff follows a pre-defined pattern, determined in US\$ by the GoP, providing sustainability to the company's profit base and certain cushion against exchange rate volatility. PAPCO has been operating its WOP for High Speed Diesel (HSD) at a capacity utilisation of ~39% in 9MFY20 (9MFY19: ~43%) - which is expected to increase as soon as MOGAS project comes to play. The Company's envisaged pipeline up-gradation plan for the transportation of Motor Gasoline (MOGAS) was initially expected to be completed by Dec'19. However, on account of inevitable factors and unprecedented situation of Covid-19 outbreak, the commencement of the project is now projected to stretch beyond FY20. The expansion is debt driven; from syndicate local debt and foreign borrowings. Leveraging has, therefore, taken an uptick as foreign currency loan of USD 25mln was availed in Dec 2019. The ratings, however, draw comfort from the sizable short term investment book on the balance sheet, mitigating liquidity risk and providing ample room to keep the debt coverages strong. Tariff assigned for MOGAS project is also determined in US\$; which is now set to be operational by 2HCY20. This will also create strategic advantage for the country. The cash flows of the company remain persistently strong, stemming from formidable profitability margins. As market for petroleum products (POL) turned highly unstable at the close of 3QFY20 owing to lockdown restrictions in the country, business volumes of PAPCO also displayed a similar trend. Following 3QFY20, revival in demand is, however, witnessed on the backdrop of diesel offtake for crop harvest season and easing up of lockdown restrictions. Management is also confident that business volumes will grow substantially in the coming periods on the back of MOGAS project. The pipeline capacity to transport is 8mln tons of the commodity/annum, which is being increased up to 12mln tons/annum, considered to be sufficient to meet the upcountry's demand. The company's governance structure derives full benefit from its association with PARCO, which also deposes its functionaries in PAPCO, with Shell Pakistan Limited nominating the CFO.

The ratings are dependent on sustained business model and its share in the overall country's petroleum movement. Sustainability in system share remains vital for the ratings. Completion of the MOGAS project and execution thereof is also important. Meanwhile, adherence to strong performance indicators is imperative.

Disclosure

Name of Rated Entity	Pak-Arab Pipeline Company Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Corporate Ratings(Jun-19),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria Rating Modifier(Jun-19)
Related Research	Sector Study Pipeline Networks(May-19)
Rating Analysts	Bazahtul Qamar bazahtul.qamar@pacra.com +92-42-35869504

Profile

Legal Structure Incorporated in the year 2000, Pakarab Pipeline Company Limited (PAPCO) is a registered public unlisted company.

Background A benchmark laid in the form of Public-Private partnership between top OMCs of the country: Shell Pakistan Limited, PSO and TOTAL PARCO Marketing Limited (formerly known as Chevron Pakistan Limited) and PARCO, to build a US\$ 480 million pipeline system for transporting High Speed Diesel from Karachi ports to upcountry locations.

Operations PAPCO operates a state-of-the-art cross-country pipeline system, White Oil Pipeline Project (WOPP), to transport refined High Speed Diesel from Karachi ports to up-country. Pipeline was commissioned in 2005, comprising 786 Km of 26" dia cross-country pipeline, storage tanks, pumps and other allied facilities. The pipeline network is entirely underground except where there are water streams.

Ownership

Ownership Structure PAPCO's majority holding lies in the hands of PARCO - 51% (which is majorly owned by GoP) while remaining by Shell Pakistan Limited (26%), PSO (12%) and Total PARCO Marketing Limited (11%).

Stability Prolific backing of its sponsors denotes strong foothold in the oil transportation market.

Business Acumen PARCO's holding in PAPCO is part of its strategic alliance whereas, the entire operational efficacy flows collectively from its partners.

Financial Strength Profound ownership flows from its main sponsor – PARCO, anchoring as a backbone for PAPCO.

Governance

Board Structure Company's overall control is overseen by ten-member board of directors (BoD), representing all the shareholders. Mr. Mian Asad Hayaud Din, Secretary Petroleum Division, is the Chairman of the board, nominated by PARCO.

Members' Profile Resilient practices adhered to, Mr. Tariq Rizavi, Managing Director (MD) of PARCO is a representative on PAPCO's Board. Mr. Rizavi, a chemical engineer by profession, has been associated with the company for 40 years and has served at various managerial positions.

Board Effectiveness Having audit committee as part of the Company's board, keeps an oversight on overall business. The company conducted four board meetings witnessing good level of attendance.

Financial Transparency PAPCO's Auditor, Ernst & Young Company 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 of end-Jun'19.

Management

Organizational Structure PAPCO follows a regime of formal well-defined organizational structure with the flare of segregated departments.

Management Team PAPCO has maintained a high profile decorum of its management. Mr. Shujauddin Ahmed, Chief Executive Officer(CEO), is a qualified Engineer with more than four decades of experience in related field. He took charge as the Chief Executive PAPCO in early 2017 and has been aptly deploying his expertise since then.

Effectiveness The entire quorum of management is well-qualified, having long ties with the group. To affirm effectiveness, all reporting lines falls to CEO.

MIS PAPCO maintains sophisticated IT infrastructure throughout its operational lines, with three types of software's including ERP.

Control Environment PAPCO enjoys the supremacy of possessing expertise from its entire group. Quality control reports are generated on regular basis and reviewed by senior engineers on daily basis as well as on weekly/monthly basis.

Business Risk

Industry Dynamics Presently in Pakistan, road transport accounts for ~59% of the cumulative movement of petroleum, oil and lubricant products, pipeline's share is ~38% and use of railways for refined products stand at 3.6%. Currently, the entire supply of MOGAS is carried through oil tankers by road. Under Pakistan's entire universe of petroleum products, MOGAS constitutes ~40% of the total demand. The demand of overall petroleum products have decelerated in 2019 due to economic slowdown in the country. Decline in country's economic activities has affected the demand chart for both products, HSD & MOGAS. During FY19 and onward - to date, demand for HSD has been continuously receding due to its dependence on the construction and transport sector under the LSM segment, which has been affected by political and economic instability as well as due to the outbreak of current pandemic COVID-19.

Relative Position PAPCO bags the title of sole HSD transporter through pipeline in the country. The company has a pivotal geographical presence in Pakistan's high speed diesel (HSD) supply chain business, by providing strategic infrastructure to transport HSD from Karachi to Shikarpur & Mahmoodkot. However, PAPCO's system share for HSD has fallen with a lower proportion (~9%) as compared to the dip in industry (~16%). The Company is all set to transport MOGAS via White Oil Pipeline (WOP) in near future. The multi-grade pipeline will eventually be reducing OMCs' dependence on road transport, hence becoming the preferred choice of transporting HSD & MOGAS through WOP.

Revenues In line with the petroleum industry's performance, PAPCO throughput for 3QFY20 decreased to ~2.4mln MT as compared to 2.6mln MT in 9MFY19 and capacity utilization was limited to ~39% (9MFY19: ~43%) lower by ~4%, as HSD demand continued to fall due to the under-performance of LSM sector. Henceforth, Company's turnover for 9MFY20 clocked in at PKR 4.9bln (9MFY19: PKR 4.7bln), which is slightly better than last year. The company's topline is expected to improve through the introduction of MOGAS revenues.

Margins During the period under review 9MFY20, overall margins of PAPCO were impacted as the dip in topline, gross margins; ~65% (9MFY19:~69%). The bottom line is largely supported by the non-core income which is derived from liquid investments short term and long term. Net margins has maintained its pace at sanguine level; ~62.5% which is much increased from previous year (9MFY19: 54%)

Sustainability In a bid for sustainable yet distinctive business model, PAPCO is introducing its much awaited MOGAS project. A value addition to company's present product portfolio. The project is anticipated to be operational as soon as current country situation stabilises, which was initially planned to be operative by mid-19. The pipeline capacity to transport is 8mln tons of the commodity/annum, which is being increased to 12mln tons/annum, considered to be sufficient to meet the upcountry's demand.

Financial Risk

Working Capital Working capital requirements of the company are dominated by payables days 9MFY20: 44days (FY19: 36days). As the storage tanks of PAPCO merely holds inventory for their customers, there exists small inventory holding period. Over the years, PAPCO has a negligible net working capital days. Working capital requirement is fulfilled sufficiently by company's internal cash. Keeping in view of its requisites, there are no short term borrowings at the end of 3QFY20.

Coverages Company ably generates sufficient free cashflows from its operations; PKR 3.2bln in 9MFY20 (FY19 PKR~4.3bln). Interest coverage 3QFY20: ~980x (FY19: ~113x), mainly attributed to reduced interest cost and strong FCFO.

Capitalization PAPCO has aptly managed its capital structure in past years by keeping its leveraging in comfortable zone (FY17: ~7.5%, FY16: ~11.1%). However, from FY18 onward, leveraging took up an upward pace (~28.3%) and it witnessed a further hike during 9MFY20 i.e. (46%), as the foreign currency loan of USD 25mln from SCB-UK has been fully drawdown in Dec 19, which carries a markup rate of 3L+ 2.7%, payable in 12 equal installments commencing from Dec21. The draw-downs of PKR loan facility has poured in by PKR ~11.8bln till Mar 20, representing ~100% of the total facility, which is exclusively obtained for the MOGAS project. The loan has markup rate of 3K+0.09% and the repayments are scheduled as quarterly instalments starting from June 20.



The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Pak Arab Pipeline Company Limited Pipeline Network	Mar-20 9M	Jun-19 12M	Jun-18 12M	Jun-17 12M
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A BALANCE SHEET

1 Non-Current Assets	20,762	17,487	11,063	11,116
2 Investments	17,416	10,592	9,961	6,852
3 Related Party Exposure	-	-	-	-
4 Current Assets	6,945	6,896	7,427	6,149
a Inventories	-	-	-	-
b Trade Receivables	310	523	337	190
5 Total Assets	45,122	34,975	28,451	24,117
6 Current Liabilities	8,995	8,342	6,231	4,999
a Trade Payables	712	866	364	69
7 Borrowings	15,903	7,000	2,730	1,164
8 Related Party Exposure	154	130	122	115
9 Non-Current Liabilities	1,323	1,439	1,743	2,106
10 Net Assets	18,748	18,064	17,625	15,733
11 Shareholders' Equity	18,748	18,064	17,625	15,733

B INCOME STATEMENT

1 Sales	4,869	6,304	6,735	6,040
a Cost of Good Sold	(1,703)	(2,044)	(1,878)	(1,803)
2 Gross Profit	3,165	4,260	4,857	4,237
a Operating Expenses	(145)	(187)	(161)	(150)
3 Operating Profit	3,021	4,073	4,696	4,087
a Non Operating Income or (Expense)	1,260	873	901	247
4 Profit or (Loss) before Interest and Tax	4,281	4,946	5,597	4,334
a Total Finance Cost	(3)	(40)	(61)	(79)
b Taxation	(1,233)	(1,663)	(1,639)	(1,389)
6 Net Income Or (Loss)	3,045	3,243	3,898	2,865

C CASH FLOW STATEMENT

a Free Cash Flows from Operations (FCFO)	3,264	4,373	5,199	4,243
b Net Cash from Operating Activities before Working Capital Changes	3,264	4,355	5,145	4,168
c Changes in Working Capital	280	1,047	(952)	304
1 Net Cash provided by Operating Activities	3,544	5,403	4,193	4,472
2 Net Cash (Used in) or Available From Investing Activities	(16,684)	(8,765)	(3,876)	(3,665)
3 Net Cash (Used in) or Available From Financing Activities	6,543	1,993	(583)	(2,266)
4 Net Cash generated or (Used) during the period	(6,596)	(1,369)	(266)	(1,459)

D RATIO ANALYSIS

1 Performance				
a Sales Growth (for the period)	3.0%	-6.4%	11.5%	6.8%
b Gross Profit Margin	65.0%	67.6%	72.1%	70.1%
c Net Profit Margin	62.5%	51.4%	57.9%	47.4%
d Cash Conversion Efficiency (EBITDA/Sales)	77.0%	80.5%	91.4%	80.8%
e Return on Equity (ROE)	22.1%	18.2%	23.4%	18.9%
2 Working Capital Management				
a Gross Working Capital (Average Days)	23	25	14	16
b Net Working Capital (Average Days)	-21	-11	3	11
c Current Ratio (Total Current Assets/Total Current Liabilities)	0.8	0.8	1.2	1.2
3 Coverages				
a EBITDA / Finance Cost	1124.9	131.2	102.3	62.0
b FCFO / Finance Cost+CMLTB+Excess STB	4.1	113.1	7.8	7.0
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	3.7	1.6	0.5	0.3
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	46.1%	28.3%	13.9%	7.5%
b Interest or Markup Payable (Days)	5012.2	0.0	0.0	0.0
c Average Borrowing Rate	0.0%	0.8%	2.9%	5.1%

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		Short Term Ratings	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
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.	A1	A strong capacity for timely repayment.
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.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial 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.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
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.	C	An inadequate capacity to ensure timely repayment.
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.		



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 surveil the opinion due to lack of requisite information.

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

Disclaimer: PACRA's ratings are an assessment of the credit standing of entities/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA's opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security's market price or suitability for a particular investor.

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)

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- (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)

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