The Pakistan Credit Rating Agency Limited

# Rating Report

## Pakistan Oxygen Limited

**Report Contents**



**Rating History**

| Dissemination Date | Long Term Rating | Short Term Rating | Outlook | Action | Rating Watch |
|---|---|---|---|---|---|
| 30-Jul-2019 | A | A1 | Stable | Initial | - |

**Rating Rationale and Key Rating Drivers**

The ratings recognize Pakistan Oxygen's eminent position in the industrial and medical gases, pipeline services and welding solutions. The industry largely possesses oligopolistic structure, benefiting the players. Growth in demand is driven primarily by increased economic activity, booming population, and industrialization. The ratings take comfort from the rich heritage on account of previous ownership of international group with a solid name in the chemical and gases industries globally. Pakistan Oxygen services customers across a wide spectrum of industries ranging from chemical and petrochemical to steel, food and healthcare. Going forward Pakistan Oxygen, with its experienced and professional team and largest footprint across Pakistan, has approved an investment plan to set-up largest air separation unit in Pakistan. The incumbent sponsors have added energy to the company and are eyeing expansion, of which the related modalities including funding requirement and mix are being decided.

The ratings are dependent on the company's ability to effectively utilize enhanced capacities. At the same time, management of financial risk particularly debt coverages, remains important, wherein any significant dilution would have negative implications for the ratings. Debt-Equity mix and repayment plan for the investment would play a pivotal role in determining financial risk profile. The management is deploying a conservative expansion plan with borrowings carrying terms and conditions that the company can conveniently manage. The entity is already catering to a market more than its production capacity. Sustained market share and, in turn, better margins would support ratings.

| Disclosure | |
|---|---|
| **Name of Rated Entity** | Pakistan Oxygen Limited |
| **Type of Relationship** | Solicited |
| **Purpose of the Rating** | Entity Rating |
| **Applicable Criteria** | PACRA_Methodology_Corporate_FY19(Jun-19),PACRA_Crtieria_LT ST Relationship_FY19(Jun-19),PACRA_Criteria_Rating Modifiers_FY19(Jun-19) |
| **Related Research** | Sector Study \| Industrial Gases(Dec-18) |
| **Rating Analysts** | Muhammad Obaid \| muhammad.obaid@pacra.com \| +92-42-35869504 |

## Profile

**Legal Structure** Pakistan Oxygen Limited, formerly Linde Pakistan limited, (hereinafter referred to as ‘‘the Company’’ or ‘‘Pakistan Oxygen’’) was incorporated in 1949. The Company got listed on Pakistan Stock Exchange in 1958.

**Background** The company was initially incorporated under the name of Pakistan Oxygen and Acetylene Company Limited but it was later renamed BOC Pakistan in 1995. In 2011, it was re-branded as Linde Pakistan before being named back to Pakistan Oxygen Limited earlier in 2018 after acquisition of majority shareholdings of the company by Adira Capital Holdings (Private) Limited and its Affiliates.

**Operations** The company currently operates in four businesses: bulk gases, healthcare, packaged gas products (PGP), and tonnage. To service its customers, the company has three Air Separation Units (ASU) with an installed capacity of about 263 tons per day (TPD) of Air Gases.

## Ownership

**Ownership Structure** Adira Capital Holdings (Private) Limited and its Affiliates consisting of Hilton Pharma (Private) Limited, Soorty Enterprises (Private) Limited, Al-Karam Textile Mills (Private) Limited, Mr. Fawad Anwar and Mr. Siraj Dadabhoy are major shareholders of the company together holding ~76%.

**Stability** Pakistan Oxygen is majority owned by a consortium of investors under a well-defined share purchase agreement., however a formal succession planning is required in order to ensure that future prospects are taken care of in the hour of need.

**Business Acumen** Adira Capital Holdings (Private) Limited, the majority shareholder, is a semi private equity company. A key member is the chairman of company, Waqar A. Malik, who has over 27 years of experience with Imperial Chemical Industries Plc. group based in UK. The company posted strong results with PAT increasing by a whopping 50% YoY which exhibits strong business acumen.

**Financial Strength** The sponsors are commercial-cum-industrial entities consisting of premiere business houses and corporate sector professionals forming a consortium of investors. Hilton Pharma (Private) Limited and Soorty Enterprises (Private) Limited had ample net assets at the time of acquisition of Pakistan Oxygen, in 2017.

## Governance

**Board Structure** All nine members of the Boards are non-executive directors, out of which two are independent directors. Mr. Waqar Ahmed Malik is the Chairman of the Board.

**Members' Profile** The Board members are thorough professionals with experiences of managing business affairs in different sectors. Mr. Waqar A. Malik also holds directorship in other companies which include Engro Corporation Limited, TPL Direct Insurance Limited, TPL Life Insurance, Standard Chartered Bank (Pakistan) Limited and Adira Capital Holdings (Private) Limited.

**Board Effectiveness** Board meetings are held regularly with high attendance of directors. An internal audit function is also in place which is supervised by the Head of Internal Audit who reports to the Board Audit committee. Three committees are also in place to assist the Board: i)Audit Committee, ii)HR and Remuneration Committee, and iii)Share Transfer Committee and .

**Financial Transparency** Internal Audit function, outsourced to M/s EY Ford Rhodes, Chartered Accountants, has a functional reporting relationship directly to the Board Audit Committee (BAC). As suggested by BAC, M/s BDO Ebrahim & Co, Chartered Accountants are appointed as auditors for CY19.

## Management

**Organizational Structure** The organizational structure of the company is divided into various functional departments and all the department heads report to CEO. Within each department, the management hierarchy includes various cadres which enables the company to carry out smooth operations.

**Management Team** Management of the company comprises of qualified and experienced professionals with a wide range of skills and diversified experience. Mr. Matin Amjad, the CEO of the company, brings with him over 20 years of multi-functional and business experience in a MNC and local company environment with leadership roles.

**Effectiveness** Functions of the management are clear and well-defined to effectively achieve its underlying goals and objectives. The system of internal control is in place and has been effectively implemented.

**MIS** The company has SAP version EHP-8 having modules for Sales (SD), Material Management(MM), Finance(FI), Plant Maintenance(PM), AXON, Procurement, Special Purpose Ledger (SPL) and Enterprise Controlling Consolidation System(ECCS).

**Control Environment** The company maintains sound internal control system to provide reasonable assurance against efficiency and effectiveness of operations, while the Board Audit Committee reviews the internal control system based on assessment of risks and reports to the Board of Directors.

## Business Risk

**Industry Dynamics** The country's overall production capacity for industrial gases currently stands at ~560 TPD, where installed capacity is 700 TPD. The domestic market is led mainly by two players: Pakistan Oxygen Limited (formerly Linde Pakistan Limited) and Ghani Gases Limited. While domestic demand is rising owing to increased activity led by growing population, local production is insufficient; thus, a small portion has to be imported as well. However, industrial capacity will increase as both Ghani Gases and Pakistan Oxygen are in the process of expanding their capacity.

**Relative Position** Pakistan Oxygen currently holds the leading position in industrial gases' industry with a market share of ~54%, whereas Ghani Gases follows with share of ~37%. Other players have much lower capacity and hence lower market share.

**Revenues** During CY18, the company's topline clocked in at ~PKR 5,483 mln (CY17: PKR 4,995 mln) depicting an increase of ~9.7% YoY. The increase is underpinned by strong performance in the healthcare and the electrode businesses and consolidation in other key business segments. For the 3MCY19, revenue was reported at PKR 1,145 mln.

**Margins** During CY18, operating profit of the company increased by ~50% YoY. This upsurge was led by growth in sales and optimization of costs that resulted in administration and marketing expenses being lower by ~12% and ~27%, respectively. During the period under review, finance cost of the company increased by 22% but is expected to increase further as the domestic interest rates are continually increasing since mid CY17. Accounting for taxation, net profit of the company stood at PKR ~398.6 mln in CY18, which is a whopping ~66% higher, compared to PKR ~240 mln in CY17.

**Sustainability** Pakistan Oxygen is the largest manufacturer of industrial and medical gases in Pakistan. A state-of-the-art plant, with 250TPD capacity, driven by world-class technology, would provide cost effectiveness and competitive edge to the company to enhance market leadership. This expansion would drive increased market share, high product reliability, and would eventually enhance company's strong brand loyalty from the customers. The new plant would improve product availability to grow aggressively across the country.

## Financial Risk

**Working Capital** Company's working capital requirement emanates from financing inventories and trade receivables for which the company relies on both internal cash flows as well as short term borrowings. Average inventory days of the company stood at ~27 days at the end of CY18 (CY17: ~22 days). Net working capital days of the company increased to ~54 days in CY18 as compare to ~15 days in CY17, owing to continuous decrease in trade creditors as trade payable days decreased to 26 days in CY18 as compared to 58 in CY17.

**Coverages** Free Cash Flow from operations of the company increased by PKR~77 mln in CY18 to PKR~790 mln (CY17: PKR~713 mln), and for 3MCY19 FCFO has clocked in at PKR 212 mln. The increase in FCFO was supported by higher profits during the period. Coverage ratios, in turn debt-equity mix and debt servicing plan for the investment would play a pivotal role in determining financial risk profile of the company.

**Capitalization** Total Debt of the company in CY18 stood at PKR~1,249 mln as compared to PKR~1,395 mln in CY17. Out of total debt , PKR~979 mln is short term and the remaining PKR~270 mln in long term shall mature in the current year. Consequently, for 3MCY19 debt reduced to PKR 962 mln. Due to decrease in liabilities over the period and the increase in equity (including reval surplus of PKR 1.8 bln), debt-to-equity ratio of the company decreased to ~24% in CY18 (CY17: ~41%).

## Pakistan Oxygen Limited

| FINANCIAL SUMMARY | 31-Mar-19 | 31-Dec-18 | 31-Dec-17 | 31-Dec-16 | 31-Dec-15 |
|---|---|---|---|---|---|
| *PKR mln* | 3MFY19 | Annual | FY17 | FY16 | FY15 |
| **BALANCE SHEET** | | | | | |
| **Non-Current Assets** | **4,616** | **4,662** | **3,031** | **3,212** | **3,193** |
| **Investments (Incl. Associates)** | **0** | **0** | **0** | **0** | **0** |
| Equity | 0 | 0 | 0 | 0 | 0 |
| Debt | - | - | - | - | - |
| **Current Assets** | **1,891** | **2,035** | **2,057** | **1,725** | **1,472** |
| Inventory | 286 | 406 | 265 | 355 | 299 |
| Trade Receivables | 757 | 675 | 667 | 520 | 439 |
| Others | 848 | 955 | 1,125 | 851 | 734 |
| **Total Assets** | **6,507** | **6,697** | **5,087** | **4,938** | **4,665** |
| | | | | | |
| **Debt** | **962** | **1,249** | **1,125** | **859** | **270** |
| Short-term | 692 | 979 | 740 | 89 | - |
| Long-term (Incl. Current Maturity of Long-Term Debt) | 270 | 270 | 385 | 770 | 270 |
| Other Short-term Liabilities | 1,067 | 1,047 | 1,182 | 1,432 | 1,081 |
| Other Long-term Liabilities | 484 | 503 | 813 | 833 | 1,595 |
| **Shareholder's Equity** | **3,994** | **3,899** | **1,967** | **1,813** | **1,720** |
| **Total Liabilities & Equity** | **6,507** | **6,697** | **5,087** | **4,938** | **4,665** |
| | | | | | |
| **INCOME STATEMENT** | | | | | |
| **Turnover** | **1,145** | **4,860** | **4,413** | **3,955** | **3,914** |
| Gross Profit | 289 | 1,110 | 992 | 896 | 829 |
| Other Income/Expense | 3 | 16 | 7 | 21 | (15) |
| Financial Charges | (35) | (116) | (95) | (111) | (126) |
| **Net Income** | **95** | **399** | **240** | **217** | **141** |
| | | | | | |
| **Cashflow Statement** | | | | | |
| Free Cashflow from Operations (FCFO) | 212 | 790 | 713 | 622 | 512 |
| Net Cash changes in Working Capital | 22 | (375) | (306) | 166 | (181) |
| Net Cash from Operating Activities | 209 | 311 | 310 | 676 | 199 |
| Net Cash from InvestingActivities | (39) | (197) | (167) | (347) | (273) |
| Net Cash from Financing Activities | (2) | (642) | (470) | (402) | 204 |
| Net Cash generated during the period | 168 | (528) | (326) | (73) | 130 |
| | | | | | |
| **Ratio Analysis** | | | | | |
| **Performance** | | | | | |
| Gross Margin | 25.3% | 22.8% | 22.5% | 22.7% | 21.2% |
| Net Margin | 11.0% | 10.9% | 5.4% | 8.4% | 3.6% |
| **Coverages** | | | | | |
| Debt Service Coverage (x) (FCFO/Gross Interest Paid+CMLTD) | 2.1 | 2.0 | 1.5 | 0.7 | 1.3 |
| Interest Coverage (x) (FCFO/Gross Interest) | 0.1 | 6.8 | 7.5 | 5.6 | 4.1 |
| Debt Payback (Years) (Total Lt.Debt / FCFO) | 0.3 | 0.4 | 1.1 | 2.0 | 3.4 |
| **Liquidity** | | | | | |
| Net Cash Cycle (Inventory Days + Receivable Days - Payable Days) | 61.9 | 53.9 | 15.5 | 11.7 | 20.9 |
| **Capital Structure** (Total Debt/Total Debt+Equity) | 19.4% | 24.3% | 41.5% | 38.4% | 43.2% |

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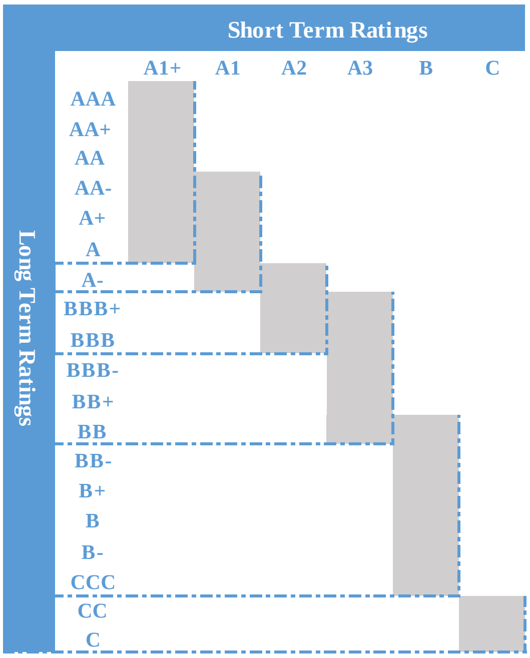
## Credit Rating Scale & Definitions

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+<br>AA<br>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+<br>A<br>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+<br>BBB<br>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+<br>BB<br>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+<br>B<br>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<br>CC<br>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**