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
29-Jul-2020	A	A1	Stable	Maintain	-
30-Jul-2019	A	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect eminent position of Pakistan Oxygen Limited in industrial and medical gases, healthcare solutions, hardgoods & welding segment. The industry largely possesses oligopolistic structure, benefiting the players. Slower demand for industrial gases especially from large scale manufacturers on account of economic slowdown coupled with COVID-19 outbreak and subsequent lockdown kept the product demand depressed, eventually resulting in subdued Company's profitability. 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 serves 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 investment plan to set-up the largest and most efficient air separation unit in Pakistan, the process stands at a preliminary stage. The incumbent sponsors have added energy to the company and are eyeing expansion, of which the related modalities including funding requirement and mix, being negotiated with relevant institutions. Where existing COVID-19 pandemic has hampered almost all the industrial segments of the country - on the other hand - it has shifted the focus towards the self well-being, healthcare and medical engineering segments, which may result in an increased demand. Reversal of key economy driven challenges; interest rate, inflation will strengthen the financial risk appetite of the Company.

The ratings are dependent on the company's ability to effectively utilize its existing capacity and management of financial risk particularly the debt coverages, wherein any significant dilution would be imperative 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 has been ably catering to a market more than its production capacity. Maintaining strong coverages and sustained market share with better profitability will remain vital.

Disclosure	
Name of Rated Entity	Pakistan Oxygen 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)
Related Research	Sector Study | Industrial Gases(Oct-19)
Rating Analysts	Raniya Tanawar | raniya.tanawar@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 was 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 business segments: bulk gases, healthcare, packaged gas products (PGP), and tonnage, while recently distribution segment has been added to this list. The company currently 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, Hilton Pharma (Private) Limited, Soorty Enterprises (Private) Limited and Mr. Shahid Umerani are the major shareholders of the company, together holding ~ 76% of the total shareholding. Mr. Siraj Dadabhoy is the major beneficial shareholder.

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

Business Acumen Adira Capital Holdings (Private) Limited, the majority shareholder, is a semi private equity company. Company's Board Chairman, Mr. Waqar A. Malik, is a highly qualified professional with vast experience profile, spanning over 28 years. He has been associated with a renowned conglomerate Imperial Chemical Industries Plc. group based in UK, this exhibits strong business acumen of the company.

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 There are eleven members in the Board, out of which four are independent directors. Mr. Waqar Ahmed Malik is the Chairman of the Board. Recently, Mr. Mohammad Younus Dagha has been appointed as an Independent Directors on the board in place of Mr Atif Riaz Bokhari.

Members' Profile Members of the board are thorough professionals and well experienced in managing business affairs. Mr. Waqar A. Malik also holds directorship in other companies which include Mari Petroleum Company Limited, Fauji Cement, FFC & FFBL, Adira Capital Holdings (Private) Limited and positioned as CEO/MD of Fauji Foundation. Mr. Younus Dagha, who recently joined the board, possesses a strong portfolio of civil services since 1985 in various fields, including Energy, Finance & Commerce. Mr. Dagha had also served as Federal Secretary Water and Power.

Board Effectiveness Board meetings are held regularly with high attendance of directors. An internal audit function is also in place, outsourced to M/s EY Ford Rhodes, Chartered Accountants, which is supervised by the Head of Internal Audit who reports to the Board Audit committee. Four committees are also in place to assist the Board: i)Audit Committee, ii)HR and Remuneration Committee, iii)Share Transfer Committee and iv) Board Strategy Committee.

Financial Transparency BDO Ebrahim & Co. Chartered Accountants having satisfactory QCR ratings and categorised 'A' in the list of SBP approved auditors are the external auditor of the Company. For year end-Dec'19, the firm expressed an unqualified opinion pertaining to annual financial statements.

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. The senior management team has been reasonably expanded, with addition of new heads of sales, operation, distribution, planning and finance etc.

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 an established SAP version; EHP-8 having modules for Sales (SD), Material Management(MM), Finance(FI), Plant Maintenance(PM), AXON, & Procurement.

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 Pakistan's overall production capacity for industrial gases currently stands at ~825TPD, with the major capacity lying with Ghani Chemicals and Pakistan Oxygen (formerly Linde Pakistan). While Ghani Chemicals recently undertook expansion with its third plant, Pakistan Oxygen has announced its capacity expansion in coming years. Meanwhile, demand for industrial gases remains sluggish as industrial activity has been curbed in line with the overall economic slowdown. This trend is expected to continue in the short-term, at least, and may put pressure on the margins of industry players.

Relative Position Pakistan Oxygen currently holds the leading position in industrial gases' industry with a market share of ~45%, whereas Ghani Chemicals follows with a share of ~37%. Ghani Chemicals' share might increase once its new plant becomes operational. Other players have much lower capacity and hence lower market share.

Revenues The company's topline clocked in at ~PKR 4,667mln (CY18: PKR 4,860mln) depicting a decrease of ~4% YoY. The dip in revenue base came from the declining industrial segments falling in LSM. ~90% of revenue is generated from the Industrial gas' segment and rest from 'welding' segment'. The topline for 3MCY20 slightly improved and stood at PKR 1,195mln as compared to PKR 1,144mln in the SPLY on account of improved tonnage and healthcare business.

Margins Double digit inflation along with the impact of provisioning kept the Company's profitability subdued; PBIT was recorded at PKR 570mln, lower by 13% compared to the last year. Finance costs increased by 49% mainly due to increase in interest rates. As a consequence, the Company posted a profit after tax of PKR 301mln versus last year's profit after tax of PKR 399mln. The declining trend continued as the business witnessed a significant dip in the period ending 3MCY20 and stood at PKR 17mln (3MCY19: PKR 95mln).

Sustainability Pakistan Oxygen is one of the largest manufacturers of industrial and medical gases in Pakistan. A state-of-the-art plant, with approx 250TPD capacity, driven by world class technology, would provide cost effectiveness and competitive edge to the company. 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. Currently, the expansion plan is at a preliminary stage as the process was delayed due to COVID-19 driven lockdown worldwide.

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 and short term borrowings. Average inventory days of the company stood at ~40 days during CY19 (CY18: ~25 days). In line with the industry, net working capital days of the company increased to ~77 days, (3MCY20: 87 days) as compared to ~49 days in CY18, owing to continuous decrease in trade payable days; 22 days in CY19 as compared to 27 in CY18, while on the other hand, receivable days increased notably as well.

Coverages Company's free Cash Flow from operations (FCFO) decreased to PKR 769mln (CY18: PKR~790mln), yet remained healthy. The decrease is due to lower profits and higher finance cost during the period. Hence, interest coverage ratio reduced to 4.5 (CY18: 7.0). As the profits declined FCFO of the company came down to PKR 124mln during 3MCY20

Capitalization Total Debt of the company in CY19 stood at PKR~1,363mln (CY18: PKR~1,249mln). Out of total debt, PKR~1,331mln is short term. The total debt to equity ratio of the company has remained largely the same at ~25%(CY18: 24.3%). During 3MCY20, capital structure remained largely the same as the year end-Dec'19

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Pakistan Oxygen Limited Industrial Gases	Mar-20 3M	Dec-19 12M	Dec-18 12M	Dec-17 12M
A BALANCE SHEET				
1 Non-Current Assets	4,536	4,576	4,662	3,031
2 Investments	-	-	-	-
3 Related Party Exposure	0	0	0	31
4 Current Assets	2,615	2,487	2,035	2,026
a Inventories	*603*	*604*	*406*	*265*
b Trade Receivables	*887*	*839*	*675*	*667*
5 Total Assets	7,151	7,063	6,697	5,087
6 Current Liabilities	1,121	1,069	1,047	1,182
a Trade Payables	*320*	*305*	*246*	*468*
7 Borrowings	1,402	1,363	1,249	1,395
8 Related Party Exposure	-	11	-	-
9 Non-Current Liabilities	468	476	503	543
10 Net Assets	4,160	4,144	3,899	1,967
11 Shareholders' Equity	4,160	4,144	3,899	1,967
B INCOME STATEMENT				
1 Sales	1,196	4,667	4,860	4,413
a Cost of Good Sold	*(985)*	*(3,601)*	*(3,751)*	*(3,421)*
2 Gross Profit	211	1,066	1,110	992
a Operating Expenses	(127)	(478)	(415)	(521)
3 Operating Profit	85	588	694	471
a Non Operating Income or (Expense)	*(4)*	*(18)*	*(40)*	*(36)*
4 Profit or (Loss) before Interest and Tax	80	570	655	435
a Total Finance Cost	*(56)*	*(173)*	*(116)*	*(95)*
b Taxation	*(8)*	*(96)*	*(140)*	*(100)*
6 Net Income Or (Loss)	17	301	399	240
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*124*	*769*	*790*	*713*
b Net Cash from Operating Activities before Working Capital Changes	*86*	*626*	*686*	*617*
c Changes in Working Capital	*(73)*	*(538)*	*(375)*	*(306)*
1 Net Cash provided by Operating Activities	14	89	311	310
2 Net Cash (Used in) or Available From Investing Activities	(49)	(239)	(197)	(167)
3 Net Cash (Used in) or Available From Financing Activities	(1)	(328)	(642)	(470)
4 Net Cash generated or (Used) during the period	(37)	(478)	(528)	(326)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	2.5%	-4.0%	10.1%	11.6%
b Gross Profit Margin	17.7%	22.8%	22.8%	22.5%
c Net Profit Margin	1.4%	6.4%	8.2%	5.4%
d Cash Conversion Efficiency (EBITDA/Sales)	14.3%	19.5%	20.9%	17.6%
e Return on Equity (ROE)	1.6%	7.5%	13.6%	12.7%
2 Working Capital Management				
a Gross Working Capital (Average Days)	112	99	76	75
b Net Working Capital (Average Days)	88	77	49	24
c Current Ratio (Total Current Assets/Total Current Liabilities)	2.3	2.3	1.9	1.7
3 Coverages				
a EBITDA / Finance Cost	3.1	5.3	9.0	8.2
b FCFO / Finance Cost+CMLTB+Excess STB	2.2	4.4	2.1	1.5
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.1	0.1	0.4	1.1
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	25.2%	24.8%	24.3%	41.5%
b Interest or Markup Payable (Days)	89.1	111.0	79.5	45.8
c Average Borrowing Rate	16.0%	13.1%	8.5%	7.5%

#	Notes
D	***Quarterly figures are being annualised for ratio calculations where required**
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Credit Rating

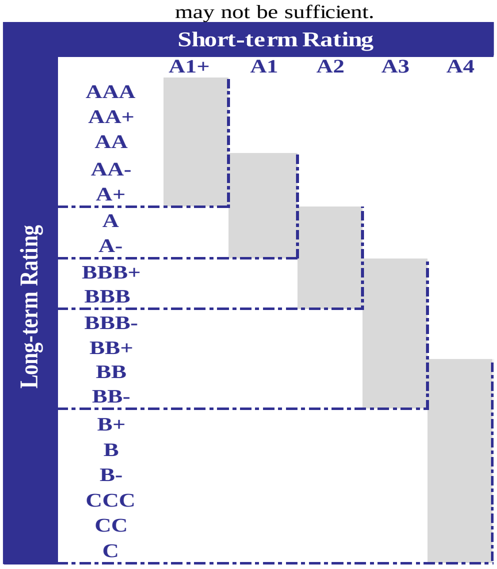
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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