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-2021	A	A1	Stable	Maintain	-
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, medical gases, healthcare solutions, hard goods & welding segment. The industry largely possesses oligopolistic structure, benefiting the players. Lately, the demand side in case of both industrial and medical gases have gained momentum when the industrial segments gradually resumed to normality post-Covid lockdown and large scale manufacturing showed some respite as well, and to capitalize LSM growth the Company has planned to enhance production capacity of electrodes with a new plant. As it was anticipated, third wave of pandemic pushed up the medical gases consumption to its peak, eventually enabling the market players to earn more revenues including Pakistan Oxygen. The company came forward to serve the community from the forefront when the country had to face capacity limitation and turned to imports in order to combat the looming situation. Since this was a low margin based area, the company’s profitability did not reflect the incremental effect of revenues. Pakistan Oxygen serves customers across a wide spectrum of industries ranging from chemical and petrochemical to steel, food and healthcare. The ratings take comfort from the rich heritage on account of previous ownership of international group (LINDE) with a solid name in the chemical and gases industries globally, which continues to lend support. Pakistan Oxygen, is on its way to set-up the largest and most efficient air separation unit in Pakistan sourced from Linde. Going forward, the process of expansion has expedited which was previously delayed due to COVID-19. The related modalities and funding arrangements has been finalized and will figuratively reflect in coming quarters. The incumbent sponsors have added more investments into the company which are expected to bear fruits in near future, Reversal of key economy driven challenges; interest rate, have strengthened 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-20)
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, sponsoring members of the Hilton Pharma family, 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 29 years. He has been associated with a renowned conglomerate Imperial Chemical Industries Plc. group based in UK. Mr. Siraj Dadabhoy has more than 25 years of experience in real estate and financial industries where he has held a range of leadership roles. He is also the founder and Managing Director of AION Global; an owner. 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. In the year 2020, Ms Tushna D Kandawala joined the Board and Mr. Mohammad Younus Dagha joined in place of Mr Atif Riaz Bokhari as Independent Directors.

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 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 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'20, 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). Both companies are currently in the phase of their respective expansions. Covid-19 has exceptionally raised the consumption of medical oxygen, with figures varying from 300 to 500 TPD in 2020. It is expected that high demand for medical oxygen will continue throughout this year and next, with levels of 300-400 TPD in 2021 and about 200-250 TPD in 2022. During third wave in the country, the industry had to import in order to cater rising demand levels.

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 their new ventures materializes. Other players have much lower capacity and hence lower market share. Once Pakistan Oxygen completes its expansion it will embrace the label of highest capacity holder in industrial, medical gases segment.

Revenues Company's topline continues to grow at a good pace. During CY20 company’s topline clocked in at ~PKR 5.5bln (CY19: PKR 4.7bln) depicting an increase of ~19% YoY. The uptick in revenue base came from high demand in medical, healthcare segment. This year Company's ~90% of revenue is generated from the 'industrial & medical gas and medical engineering' solutions while rest is from 'welding' segment'. The growth trend continued in 1QCY21 as revenue stood at PKR 1.5bln.

Margins Over the past 2/3 years the input cost(s) have increased, keeping profit levels at a subtle pace, PBIT was recorded at PKR 616mln in CY20, increased by 8% compared to the last year CY19. The increasing trend continued during 1QCY21 and stood at PKR 185mln as compared to PKR 8mln in 1QCY20. The Company posted a profit after tax of PKR 108mln versus profit after tax of PKR 17mln in the SPLY.

Sustainability Pakistan Oxygen is one of the largest manufacturers of industrial and medical gases in Pakistan. A state-of-the-art plant, with ~260TPD capacity, driven by world class technology, provides cost effectiveness and competitive edge to the company. The company announced a new investment in new air separation unit. which delayed due to COVID-19 pandemic. It is now expected to come online in 2023 with a new supplier. The plant is superior due to higher capacity, better specific power consumption, product quality, reliability and advanced control system. This will bring efficiency in company's overall performance.

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 ~40days in the past 2 years of period to date. Payable days have remained nearly unchanged for the period and the net working capital days were 59days during 1QCY21 (CY20: 69days, CY19: 77days), denoting adequate management.

Coverages Instilling from better profits, Company's free cash flow from operations (FCFO) increased to PKR 851mln (CY19: PKR~769mln), remained healthy. This also reflects in the interest coverage ratio; 8.9x in 1QCY21 (CY20 5.3x, CY19: 4.5x).

Capitalization Total borrowings of the company in 1QCY21 stood at PKR~1.8bln (CY20: PKR~1.3bln). this increase is due to the fact that company is in its expansion phase, which is gradually reaching to its completion level. Out of its total debt, PKR~1.1bln is short term. The company issued bonus share, which has moved equity base to PKR 4.5bln. The total debt to equity ratio came down to 22% in CY20 (CY19: ~25%, CY18: 24.3%). but it has slightly increased in 1QCY21 (~28%). The expansion is majorly sourced through cheaper financing arrangements.

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Financial Summary
PKR mln

Pakistan Oxygen Limited Industrial Gases	Mar-21 3M	Dec-20 12M	Dec-19 12M	Dec-18 12M
A BALANCE SHEET				
1 Non-Current Assets	5,074	4,597	4,576	4,662
2 Investments	-	-	-	-
3 Related Party Exposure	0	0	0	0
4 Current Assets	2,925	2,792	2,487	2,035
a Inventories	*696*	*653*	*604*	*406*
b Trade Receivables	*632*	*596*	*839*	*675*
5 Total Assets	7,999	7,389	7,063	6,697
6 Current Liabilities	1,132	1,084	1,069	1,047
a Trade Payables	*304*	*290*	*305*	*246*
7 Borrowings	1,792	1,332	1,363	1,249
8 Related Party Exposure	-	-	11	-
9 Non-Current Liabilities	464	471	476	503
10 Net Assets	4,611	4,502	4,144	3,899
11 Shareholders' Equity	4,611	4,502	4,144	3,899
B INCOME STATEMENT				
1 Sales	1,522	5,545	4,667	4,860
a Cost of Good Sold	*(1,212)*	*(4,442)*	*(3,601)*	*(3,751)*
2 Gross Profit	310	1,104	1,066	1,110
a Operating Expenses	(125)	(495)	(478)	(415)
3 Operating Profit	185	608	588	694
a Non Operating Income or (Expense)	*(0)*	*8*	*(18)*	*(40)*
4 Profit or (Loss) before Interest and Tax	185	616	570	655
a Total Finance Cost	*(29)*	*(164)*	*(173)*	*(116)*
b Taxation	*(47)*	*(106)*	*(96)*	*(140)*
6 Net Income Or (Loss)	109	346	301	399
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*256*	*851*	*769*	*790*
b Net Cash from Operating Activities before Working Capital Changes	*230*	*667*	*626*	*686*
c Changes in Working Capital	*(111)*	*(40)*	*(538)*	*(375)*
1 Net Cash provided by Operating Activities	119	626	89	311
2 Net Cash (Used in) or Available From Investing Activities	(572)	(399)	(239)	(197)
3 Net Cash (Used in) or Available From Financing Activities	443	221	(328)	(642)
4 Net Cash generated or (Used) during the period	(9)	449	(478)	(528)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	9.8%	18.8%	-4.0%	10.1%
b Gross Profit Margin	20.4%	19.9%	22.8%	22.8%
c Net Profit Margin	7.1%	6.2%	6.4%	8.2%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	9.5%	14.6%	4.9%	8.5%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	9.8%	7.9%	7.4%	11.6%
2 Working Capital Management				
a Gross Working Capital (Average Days)	77	89	99	76
b Net Working Capital (Average Days)	59	69	77	49
c Current Ratio (Current Assets / Current Liabilities)	2.6	2.6	2.3	1.9
3 Coverages				
a EBITDA / Finance Cost	9.7	6.2	5.3	9.0
b FCFO / Finance Cost+CMLTB+Excess STB	4.6	3.1	4.4	2.1
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.8	0.4	0.1	0.4
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	28.0%	22.8%	24.8%	24.3%
b Interest or Markup Payable (Days)	95.4	65.5	111.0	79.5
c Entity Average Borrowing Rate	8.1%	12.2%	14.1%	8.6%

Credit Rating

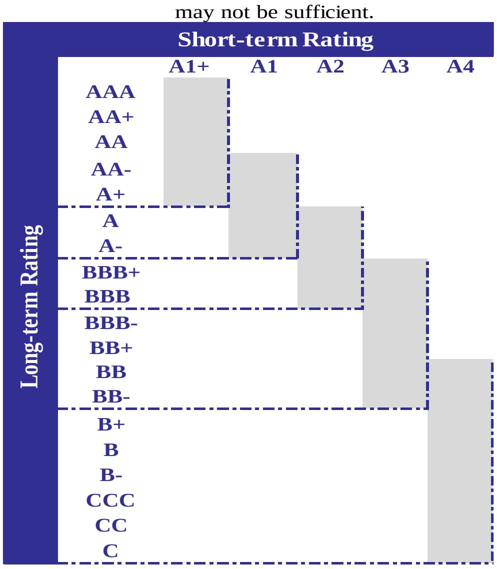
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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

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