The Pakistan Credit Rating Agency Limited

Rating Report

National Refinery Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
29-Nov-2019	AA+	A1+	Stable	Maintain	-
31-May-2019	AA+	A1+	Stable	Maintain	-
07-Dec-2018	AA+	A1+	Stable	Maintain	-
30-May-2018	AA+	A1+	Stable	Maintain	-
23-Jun-2017	AA+	A1+	Stable	Maintain	-
22-Sep-2016	AA+	A1+	Stable	Maintain	-
30-Sep-2015	AA+	A1+	Stable	Maintain	-
14-Nov-2014	AA+	A1+	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

The ratings reflect National Refinery Limited's (NRL) association with the integrated oil group – Attock Group (AG). The strength of the company is its base oil business wherein NRL possesses a notable share in meeting the economy's demand for lubricants. NRL's core business remains exposed to the vicissitudes in international crude oil and products prices, which in turn, steer the gross refining margins (GRMs) of the company. During FY19, volatile oil prices coupled with a sharp rupee depreciation emerged as one of the key challenges to NRL and the Refinery Sector as a whole. Resultantly, overall refinery margins remained under pressure hampering the profitability of the sector. Another major issue encountered was the declining demand of Furnace Oil (FO), as the Government took steps to shift power sector needs to alternate fuels like LNG and coal. The recent trend, however, is reflecting a revival, as is evident from a stabler rupee and lower cost of FO, which serves as feed for the lubes domain; this is expected to augur well for the lube segment. The mixed trend of positive and negative delta of PMG and crude oil, also played a role, has now reversed. During FY19, NRL's financial risk profile reflected on a pressured impact as slow offtakes resulted in piled up inventories eventually necessitating funding working capital needs from external sources. Capital structure, therefore, transformed into a leveraged one with borrowings majorly comprising short-term fundings. Historically, the company has predominantly financed its upgradation projects, including desulphurization unit and ISOM, through internally generated funds; capitalized in Jun’17 and Oct’17, respectively. This has enabled the company to advocate its financial strength and maintain its market share in high margin products.

The ratings are dependent on NRL's ability to effectively shield its business profile from external vulnerabilities. Revived performance indicators and prudent financial matrix are imperative to uphold the ratings. Meanwhile, continuity of deemed duty on diesel is also crucial.

Disclosure	
Name of Rated Entity	National Refinery Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-19)
Related Research	Sector Study | Refineries(Nov-19)
Rating Analysts	Saadat Mirza | saadat.mirza@pacra.com | +92-42-35869504

Profile

Legal Structure National Refinery Limited (NRL), is listed on the Pakistan Stock Exchange, since the year 1964. The Government of Pakistan took over the management of NRL as per the Economic Reforms Order, 1972 under the Ministry of Production, which exercised control through its shareholding in State Petroleum Refining and Petrochemical Corporation (PERAC).

Background In June'03, the Government of Pakistan decided to include NRL in its privatization program. The selling of 51% equity and transfer of management control to a strategic investor had been proposed accordingly. After competitive bidding, NRL was acquired by Attock Group (AG) in July 2005.

Operations NRL is engaged in the manufacturing, production, and sale of a large range of petroleum products. The refinery complex of the Company comprises three refineries, consisting of two lube refineries and one fuel refinery.

Ownership

Ownership Structure Attock Group retains the majority stake (~51%), through Attock refinery limited (~25%), its group company Pakistan Oilfields Limited (POL) (~25%) and Attock Petroleum Limited (APL) (~1%), and management control in NRL. Other major shareholders include; Islamic Development Bank (~15%), insurance companies (~6%) and NIT & ICP (~3%). The general public holds ~16% of the shareholding. The remaining stake rests with Joint Stock Companies, Foreign investors and other financial institutions.

Stability The Group is governed and administered by AG, a distinguished name in the Oil sector of Pakistan. Therefore, stability factor is considered strong.

Business Acumen The Pharaon Group is the principal stakeholder of AG and is engaged internationally in diversified activities, which include hotels, oil exploration, production and refining, chemicals, cement, and real estate.

Financial Strength NRL is a member of a conglomerate which is a fully integrated group covering all segments of oil and gas industry from exploration, production, and refining, to marketing of a wide range of petroleum products.

Governance

Board Structure The company’s eight-member board of directors includes five representatives of the AG - including two members of the Pharaon family and the chief executive. The other two members are independent directors including one nominee representing the Islamic Development Bank (IDB).

Members’ Profile Mr. Shuaib A. Malik, was appointed as a chairman of the board after serving several years as deputy chairman & chief executive officer. He has been associated with Attock Group for ~40 years and is a veteran of the oil business. The board members have significant relevant experience.

Board Effectiveness The board has constituted two committees to maintain effective oversight and efficient functioning. These comprise a) Audit Committee and b) HR & Remuneration Committee. Audit Committee has three members and HR Committee has four members.

Financial Transparency For FY19, NRL’s auditors, A. F. Ferguson & Co Chartered Accountants, a member firm of the PwC network, expressed an unqualified opinion on the company’s financial statements. The State Bank of Pakistan categorizes the firm, in the A category.

Management

Organizational Structure The company operates through five divisions namely: a) Operations, b) HR & Admin c) Commercial and Procurement, d) Finance & Corporate Affairs and e) Special Projects. The special project division is temporally established to work on major projects. All divisional heads report to the CEO.

Management Team The CEO, Mr. Jamil A. Khan, has been associated with the company since 2005, serving as deputy managing director since 2009. He has been serving as the chief executive officer from November 2018. He is supported by an experienced management team. Mr. Nouman A Usmani is the CFO of the company, who has been associated with NRL for the last 10 years.

Effectiveness The Company has an Executive Committee, comprising CEO, General Manager Commercial and Procurement, in place. The committee meets on a need basis and ensures smooth refinery operations as well as formulating new strategies to deal with developments in the refinery sector.

MIS MIS presented to the board is strong and shared on a quarterly basis. NRL has employed ERP ECC-6, developed by SAP. The Company generates MIS reports on daily, fortnightly and monthly basis. These mainly include daily cash position, daily production report, saleable stock position, treasury and accounts section MIS, monthly debtors aging, monthly management accounts, quarterly budget and expense reporting. Some reports are generated in Excel format as well.

Control Environment NRL has developed an in-house system – Crude Oil Management System for recording functions pertaining to oil movements and purchases of crude oil. NRL uses in-house reports in balancing crude oil inventory. Meanwhile, the company has established a Disaster Recovery Site equipped with the latest technology ensuring smooth functionality in case of a natural disaster.

Business Risk

Industry Dynamics Pakistan consumed a total of ~20mln metric tons (MT) of refined petroleum products in FY19 (FY18: ~25mln MT), indicating a decrease of ~20%. This decrease is mainly seen due to a fall in the consumption of HSD due to a lack of growth in the transport sector. Consumption of black oil has also been decreasing due to declining consumption of FO, as the government of Pakistan plans to gradually reduce reliance on oil-based power plants to other input sources for electricity generation i.e. LNG & Coal.

Relative Position With respect to the relative positioning of the players in the premium products (HSD and MOGAS); efficiency and utilization of available capacity is essential. Two refineries namely PARCO and Byco Petroleum retain a large chunk of the market share of ~54%, while Pakistan Refinery, National Refinery, and Attock Refinery, contribute ~46% to the total domestic supply of POL products.

Revenues There is a declining trend in the sales growth (~17.5%) in FY19 was noted (FY18: ~27.5%). Generated net revenue in FY19 amounted to PKR ~160,906mln (FY18, PKR ~136,985mln). Moreover, a decline in the turnover of ~2.4% (annualized) was seen in 3MFY20 compared to the prior year. This is majorly attributed to the decrease in demand of Furnace Oil from Power Plants, owing to the availability of alternate energy i.e. RLNG.

Margins Gross margins of the company turned negative in FY19, standing at ~-2.8% (FY18: ~2.8%). This was mainly due to declining gross refining margins, higher operating cost due to increase in the price of raw material and depreciation, decline in the pricing of Motor Gasoline and demand of furnace oil. While remaining negative, an improvement in 3MFY20 was noted, where the gross profit margins rose to ~-0.5%. The same trend was seen in the net profit margins. In 3MFY20 it stood at ~-1.7% (FY19: ~-5.4%, FY18: ~1.3%). Recently, rupee depreciation against US dollar, has exerted significant pressure on the profitability.

Sustainability Going forward, NRL is in the process of revamping its lube I refinery, whereby the throughput of the refinery would increase from 12,000 bpd to 17,000 bpd. The procurement for revamping has started whereas the revamp is expected to commence in Dec'19. The new downstream petroleum policy is under Government's review. If the company considers it favorable, Phase II projects including hydrocracker and reformer would be considered, which will increase production of HSD and Naphtha.

Financial Risk

Working Capital NRL’s working capital requirement emanates from imports of raw material and remains a function of fluctuating crude oil prices in international markets. Moreover, the requirement in refineries also results from operating at low throughput due to lower sales of FO. With a surge in inventory levels, NRL's average gross working capital days took a hit during 3MFY20 rising to 79 days (FY19: 61 days, FY18 50 days). The same trend was noted in the average net working capital days (3MFY20: 47 days, FY19: 34 days, FY18 20 days). This is where the company requires short-term borrowing to bridge its short-term liquidity needs.

Coverages Free Cash Flows from Operations (FCFO) during FY19 amounted to PKR ~-5,185mln (FY18: PKR ~4,205mln). It turned negative owing to the loss incurred during the year. Interest expense of the company significantly rose due to a higher interest rate environment. Consequently, the negative cash flows and the surge in interest expense turned the coverages in red. On the other hand, FCFO in 3MFY20 turned positive to PKR ~1,648mln (3MFY19: PKR ~-215mln), considerably improving the coverages during the period.

Capitalization A recent surge in borrowing is noted, leading to higher leveraging. The debt to equity ratio clocked at ~34.7% (End-FY19: ~42.5%, End-FY18: ~3.2%). Short-term loans constitute 100% of the total borrowings.

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Financial Summary
PKR mln

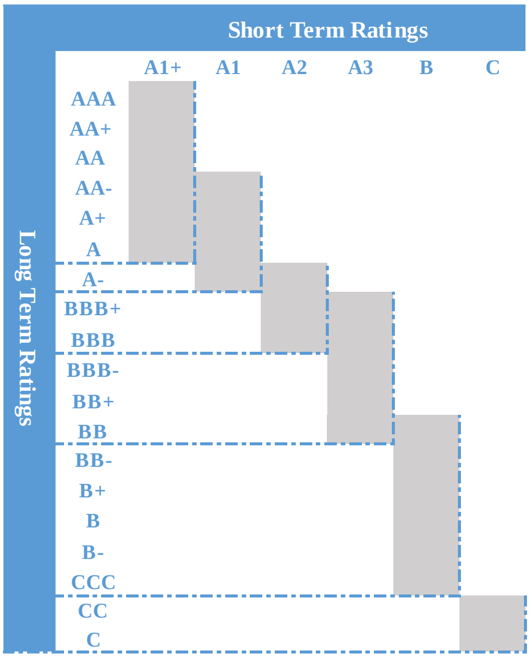
National Refinery Limited	Sep-19	Jun-19	Jun-18	Jun-17
Refinery	3M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	38,938	38,665	38,266	38,634
2 Investments	13	13	-	-
3 Related Party Exposure	-	-	-	3
4 Current Assets	38,724	37,489	27,548	22,747
a Inventories	*24,916*	*25,669*	*12,628*	*10,931*
b Trade Receivables	*9,898*	*7,499*	*7,986*	*6,033*
5 Total Assets	77,675	76,168	65,814	61,385
6 Current Liabilities	26,485	16,994	20,789	16,607
a Trade Payables	*17,310*	*10,290*	*13,952*	*8,732*
7 Borrowings	17,672	25,008	1,430	766
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	324	293	344	673
10 Net Assets	33,195	33,873	43,252	43,339
11 Shareholders' Equity	33,195	33,873	43,252	43,339
B INCOME STATEMENT				
1 Sales	39,268	160,906	136,985	107,447
a Cost of Good Sold	*(39,456)*	*(165,355)*	*(133,173)*	*(97,648)*
2 Gross Profit	(188)	(4,449)	3,812	9,800
a Operating Expenses	(431)	(1,646)	(1,620)	(1,576)
3 Operating Profit	(620)	(6,095)	2,192	8,224
a Non Operating Income or (Expense)	*266*	*(3,735)*	*(1,211)*	*128*
4 Profit or (Loss) before Interest and Tax	(354)	(9,830)	981	8,351
a Total Finance Cost	*(540)*	*(1,199)*	*(74)*	*(36)*
b Taxation	*215*	*2,337*	*863*	*(269)*
6 Net Income Or (Loss)	(679)	(8,692)	1,771	8,046
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*1,648*	*(5,185)*	*4,205*	*5,965*
b Net Cash from Operating Activities before Working Capital Changes	*1,162*	*(6,001)*	*4,345*	*6,379*
c Changes in Working Capital	*6,615*	*(14,828)*	*(2,978)*	*435*
1 Net Cash provided by Operating Activities	7,776	(20,830)	1,367	6,815
2 Net Cash (Used in) or Available From Investing Activities	(451)	(1,517)	(2,469)	(15,093)
3 Net Cash (Used in) or Available From Financing Activities	(7,532)	22,783	(1,126)	(823)
4 Net Cash generated or (Used) during the period	(207)	437	(2,228)	(9,101)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	-2.4%	17.5%	27.5%	14.6%
b Gross Profit Margin	-0.5%	-2.8%	2.8%	9.1%
c Net Profit Margin	-1.7%	-5.4%	1.3%	7.5%
d Cash Conversion Efficiency (EBITDA/Sales)	1.4%	-3.9%	3.1%	8.1%
e Return on Equity (ROE)	-8.1%	-22.5%	4.1%	20.1%
2 Working Capital Management				
a Gross Working Capital (Average Days)	79	61	50	57
b Net Working Capital (Average Days)	47	34	20	29
c Current Ratio (Total Current Assets/Total Current Liabilities)	1.5	2.2	1.3	1.4
3 Coverages				
a EBITDA / Finance Cost	1.0	-5.2	57.1	240.1
b FCFO / Finance Cost+CMLTB+Excess STB	0.9	-0.9	28.0	52.9
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	1.2	-0.7	0.0	0.1
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	34.7%	42.5%	3.2%	1.7%
b Interest or Markup Payable (Days)	69.2	111.1	167.5	98.6
c Average Borrowing Rate	10.1%	9.1%	6.7%	4.7%

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+ 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 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