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
30-May-2020	AA+	A1+	Negative	Maintain	-
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 and petroleum products' (POL) prices, which in turn, steer the gross refining margins (GRMs) of the company. The country's refinery sector has been going through significant challenges for an extended period, majorly pertaining to upgradation of the refining complexes and management of furnace oil (FO) produce. The FO offtake has further obstacles on the export avenue as IMO 2020 came into play, since Jan'20. Depressed crude and POL prices in the International market coupled with the underlying issues of the sector had hampered the performance indicators of the industry players in FY19. Adding to the woes, the global oil market was further struck by widespread uncertainty due to the outbreak of the COVID-19 pandemic. This severely weakened the International Oil dynamics, creating a manifold impact on the domestic economy as well as the local refinery industry. Inventory accumulation, NRV adjustments and POL demand slide pressurized the GRMs and profitability margins of the sector players drastically. Nonetheless, the concerns are expected to reverse, going forward, as global prices move towards a stabilized trajectory and demand takes a gradual uptick, on account of ease in lockdown. Having said this, uncertainty still prevails as to the timeliness of complete restoration and recovery of losses that the Industry has absorbed, under the current situation. Likewise, NRL's financial risk profile exhibited a tightened position with persistent bottomline losses, increased short term funding to cater working capital needs and reduced equity. The outlook of the ratings reflects on the same and captures the need to regain improved results in due course of time. Meanwhile, the company's utilization of FO as feed for the lubes domain is considered positive in tackling the FO offtake challenge.

The ratings are dependent upon 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.

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),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria | Rating Modifier(Jun-19)
Related Research	Sector Study | Refineries(Nov-19)
Rating Analysts	Jibran Cheema | jibran.cheema@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 2003, the Government of Pakistan decided to include NRL in its privatization program. The sale of 51% equity and transfer of management control to a strategic investor had been proposed accordingly. After competitive bidding, NRL was acquired by the 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 AG retains the majority stake (~51%), through its group companies; Attock Refinery Limited (~25%), Pakistan Oilfields Limited (~25%) and Attock Petroleum Limited (~1%), along with the 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 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 comprises; the chief executive and five representatives of the AG (including two members of the Pharaon family). The other two members are independent directors, including one nominee representing the Islamic Development Bank.

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 more than 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.

Financial Transparency 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 for FY19 and 6MFY20. The State Bank of Pakistan categorizes the firm, in the A category of auditing firms.

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. He has been serving as the chief executive officer from Nov'18. 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 ~10 years.

Effectiveness The company has an Executive Committee in place, comprising the CEO along with the General Manager Commercial and Procurement. 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 a daily, fortnightly and monthly basis. These mainly include daily cash position, daily production report, saleable stock position, treasury and accounts section MIS, 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 The country consumed a total of ~13.1mln metric tons (MT) of refined petroleum products in 9MFY20 (9MFY19: ~14.9mln MT), depicting a fall of ~12% compared to the corresponding period. This decrease is mainly seen due to a fall in the consumption of MOGAS and HSD as a result of a lack of growth in the transport sector. A further fall in demand because of the nationwide lockdown due to Covid-19 has added to the problems within the industry. Additionally, consumption of black oil has plunged due to declining demand of Furnace Oil (FO), as the government is gradually reducing reliance on oil-based power plants in favor of 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 ~52%, while Pakistan Refinery, National Refinery, and Attock Refinery, contribute ~48% to the total domestic supply of POL products.

Revenues A declining trend in the turnover was noted, with the net revenue amounting to PKR~107,479mln in 9MFY20 (9MFY19: PKR~116,747mln), depicting a fall of 8% compared to the corresponding period. This is attributed, in part, to the decrease in off take of Furnace Oil from Power Plants during the first two quarters of FY20, owing to the availability of alternate energy i.e. RLNG. Demand for all products was significantly hampered by the nationwide lock down, imposed in March 2020, as a result of Covid-19. Consequently, facing severe ullage constraints and no demand for products in sight, the refinery was temporarily closed down.

Margins Net profit margins stayed negative in 9MFY20, standing at -7.6% (9MFY19: -4.4%). Fuel segment incurred a significant net loss of PKR~9,036mln (9MFY19: PKR~6,369mln) due to continuity of low/negative gross refinery margins. The segment remained under pressure, as a result of IMO 2020, which triggered a declining price trend of FO. Subsequently, the outbreak of Covid-19 severely impacted the demand for petroleum products and resultantly the oil prices. NRL incurred a significant inventory loss during the period under review. Lube segment, however, earned a profit of PKR~907mln (9MFY19: PKR~1,183mln).

Sustainability The refinery sector has been going through an existential crisis, as a result of the government's demand for environment friendly fuel. The issue of low FO offtake has been compounded by the introduction of the IMO 2020, which necessitates the use of low sulphur FO by the marine sector. Due to the substantial investment needed for the required upgrades to the refineries, the developments in this regard, have reached an impasse. A slump in demand of petroleum products, due to the lockdown in light of Covid-19, has put the industry players under further pressure.

Financial Risk

Working Capital NRL's working capital requirement emanates from import of raw materials 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 the recent overall decline in demand of all petroleum products. With a surge in inventory levels, NRL's average gross working capital days during 9MFY20, took a hit, rising to 74 days (9MFY19: 65 days). The same trend was noted in the average net working capital days (9MFY20: 47 days, 9MFY19: 26 days). This is where the company requires short-term borrowing to bridge its liquidity needs.

Coverages Free Cash Flows from Operations (FCFO) during 9MFY20 amounted to PKR ~-2,894mln (9MFY19: PKR ~-2,848mln). FCFO stayed negative, owing to the heavy losses incurred during the period. Interest expense of the company also suffered a hike, compared to the corresponding period. Consequently, the coverages remained in a precarious position with the ratio FCFO-to-Finance Cost, clocking in at -1.7x (9MFY19: -4.1x).

Capitalization The debt-to-equity ratio, as at End-9MFY20, clocked in at 45.6% (End-FY19: 42.5%), depicting a highly leveraged structure. Short-term loans constitute 100% of the total borrowings. Equity erosion as a result of consistent losses is a major concern.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

National Refinery Limited	Mar-20	Jun-19	Jun-18	Jun-17
Refineries	9M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	41,395	38,665	38,266	38,634
2 Investments	13	13	-	-
3 Related Party Exposure	-	-	-	3
4 Current Assets	28,469	37,489	27,548	22,747
a Inventories	*22,089*	*25,669*	*12,628*	*10,931*
b Trade Receivables	*2,572*	*7,499*	*7,986*	*6,033*
5 Total Assets	69,877	76,168	65,814	61,385
6 Current Liabilities	22,206	16,994	20,789	16,607
a Trade Payables	*10,493*	*10,290*	*13,952*	*8,732*
7 Borrowings	21,557	25,008	1,430	766
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	370	293	344	673
10 Net Assets	25,744	33,873	43,252	43,339
11 Shareholders' Equity	25,744	33,873	43,252	43,339
B INCOME STATEMENT				
1 Sales	107,479	160,906	136,985	107,447
a Cost of Good Sold	*(115,467)*	*(165,355)*	*(133,173)*	*(97,648)*
2 Gross Profit	(7,987)	(4,449)	3,812	9,800
a Operating Expenses	(1,282)	(1,646)	(1,620)	(1,576)
3 Operating Profit	(9,270)	(6,095)	2,192	8,224
a Non Operating Income or (Expense)	*152*	*(3,735)*	*(1,211)*	*128*
4 Profit or (Loss) before Interest and Tax	(9,118)	(9,830)	981	8,351
a Total Finance Cost	*(1,714)*	*(1,199)*	*(74)*	*(36)*
b Taxation	*2,703*	*2,337*	*863*	*(269)*
6 Net Income Or (Loss)	(8,129)	(8,692)	1,771	8,046
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*(2,894)*	*(5,185)*	*4,205*	*5,965*
b Net Cash from Operating Activities before Working Capital Changes	*(4,452)*	*(6,001)*	*4,345*	*6,379*
c Changes in Working Capital	*9,657*	*(14,828)*	*(2,978)*	*435*
1 Net Cash provided by Operating Activities	5,205	(20,830)	1,367	6,815
2 Net Cash (Used in) or Available From Investing Activities	(1,652)	(1,517)	(2,469)	(15,093)
3 Net Cash (Used in) or Available From Financing Activities	(3,664)	22,783	(1,126)	(823)
4 Net Cash generated or (Used) during the period	(111)	437	(2,228)	(9,101)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	-10.9%	17.5%	27.5%	14.6%
b Gross Profit Margin	-7.4%	-2.8%	2.8%	9.1%
c Net Profit Margin	-7.6%	-5.4%	1.3%	7.5%
d Cash Conversion Efficiency (EBITDA/Sales)	-6.0%	-3.9%	3.1%	8.1%
e Return on Equity (ROE)	-36.4%	-22.5%	4.1%	20.1%
2 Working Capital Management				
a Gross Working Capital (Average Days)	74	61	50	57
b Net Working Capital (Average Days)	47	34	20	29
c Current Ratio (Total Current Assets/Total Current Liabilities)	1.3	2.2	1.3	1.4
3 Coverages				
a EBITDA / Finance Cost	-3.7	-5.2	57.1	240.1
b FCFO / Finance Cost+CMLTB+Excess STB	-0.2	-0.9	28.0	52.9
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	-2.5	-0.7	0.0	0.1
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	45.6%	42.5%	3.2%	1.7%
b Interest or Markup Payable (Days)	79.2	111.1	167.5	98.6
c Average Borrowing Rate	9.8%	9.1%	6.7%	4.7%

Rating Scale | Corporate

2019

Credit Rating Scale & Definitions

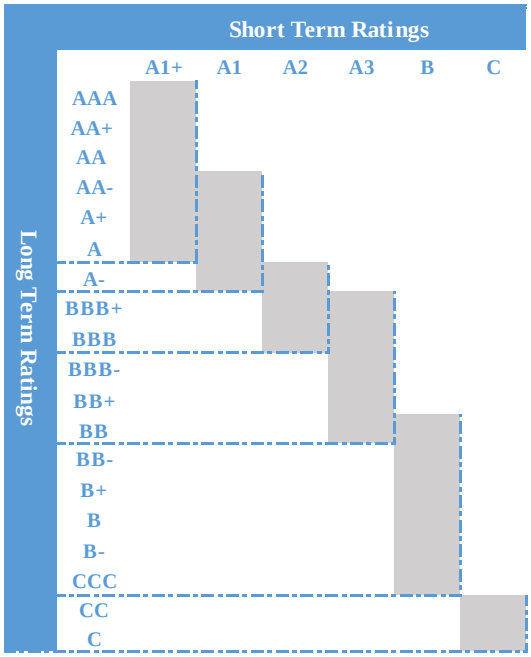
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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.

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