



The Pakistan Credit Rating Agency Limited

Rating Report

National Refinery Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
28-May-2021	AA+	A1+	Negative	Maintain	-
30-May-2020	AA+	A1+	Negative	Maintain	-
29-Nov-2019	AA+	A1+	Stable	Maintain	-
31-May-2019	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 is going through some significant challenges for an extended period, majorly pertaining to up-gradation of the refining complexes. The global oil market was further struck by widespread uncertainty due to outbreak of COVID-19 pandemic. This had severely weakened the International Oil dynamics, creating a manifold impact on the domestic economy as well as the local refinery industry. In order to cater the issues, Working Group constituted by the Government, comprising of the Government officials and representative of refineries, had finalised a draft Refining Policy which envisages certain fiscal and tariff concessions to the refining sector which are likely to improve financial condition of the refineries enabling up-gradation of plants. However the final approval of the Refining Policy and its actual financial impact is yet to be seen. 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 head on a stabilization trajectory and demand takes a gradual uptick on account of eased 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. During the nine months period ended March 31, 2021, the Company's risk profile moderately improved with bottom-line profits. Sales shows growth majorly on the back of increase in sales price although volumes remained steady. The Company's lube segment report profit of PKR 2,666mln in 9MFY21. Meanwhile the Company's utilization of FO as feed for the lubes domain is considered positive.

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-20),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria Rating Modifier(Jun-20)
Related Research	Sector Study Refineries(Nov-20)
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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%), Institutions collectively include Banks, Insurance Companies, NBFIs, Joint Stock Companies, Modarabas, Mutual Funds and Trusts etc. holds (~16.3%). The general public holds ~17.7% of the shareholding.

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 FY20. The State Bank of Pakistan categorizes the firm, in the A category of auditing firms.

Management

Organizational Structure The company primarily operates through four divisions namely: a) Operations, b) HR & Admin c) Commercial and Procurement, and d) Finance & Corporate Affairs. 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 ~12 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 ~19mln metric tons (MT) of refined petroleum products in FY20 (FY19: ~20mln MT), depicting a fall of ~5% 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. Substantial inventory losses were borne by the industry players, due to the recent slump in the global oil prices. Going forward, as global prices head on a stabilization trajectory and demand takes a gradual uptick on account of eased lockdown.

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. While on the other side NRL start producing HSD of EURO-V standard from Jan'21.

Revenues An upward trend in the turnover was noted, with the gross revenue amounting to PKR~145,283mln in 9MFY21 (9MFY20: PKR~144,968mln), due to improved sales volume and increased selling prices. Improvement in domestic economic activity and business sentiments have been witnessed during the period. Consequently the demand for all the products improved nationwide. The increase in petroleum levy during the period, has impacted the net revenues.

Margins Net profit margins turned positive in period under review 9MFY21, standing at 0.9% (9MFY20: -7.6%). Fuel segment incurred a net loss of PKR~1,774mln (9MFY20: PKR~9,036mln) due to less inventory losses and increased sales volume. NRL incurred inventory loss of PKR 227mln during the period under review. Lube segment, report net profit of PKR~2,666mln (9MFY20: PKR~907mln) as margins have improved and throughput increased.

Sustainability The refinery sector has been going through an existential crisis, as a result of the government's demand for environment friendly fuel. Substantial investment needed for the required upgrades to the refineries. Working Group constituted by the Government, comprising of the Government officials and representative of refineries, had finalized a draft Refining Policy which envisages certain fiscal and tariff concessions to the refining sector which are likely to improve financial condition of the refineries enabling up-gradation of plants.

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 demand of all petroleum products improved in FY21, countrywide, so inventory levels shrink. NRL's average gross working capital days during 9MFY21, improved to 63 days (9MFY20: 74 days). The same trend was noted in the average net working capital days (9MFY21: 30 days, 9MFY20: 47 days). This is where the company requires short-term borrowing to bridge its liquidity needs.

Coverages Free Cash Flows from Operations (FCFO) during 9MFY21 amounted to PKR ~5,135mln (9MFY20: PKR ~2,894mln). Interest expense of the company reduced, compared to the corresponding period. Consequently, the coverages ameliorate with the ratio FCFO-to-Finance Cost, clocking in at 0.7x (9MFY20: -0.2x).

Capitalization The debt-to-equity ratio, as at End-9MFY21, clocked in at 37.9% (End-FY20: 36.2%), 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 Refineries	Mar-21 9M	Jun-20 12M	Jun-19 12M	Jun-18 12M
A BALANCE SHEET				
1 Non-Current Assets	40,040	41,954	38,665	38,266
2 Investments	13	13	13	-
3 Related Party Exposure	-	-	-	-
4 Current Assets	34,425	21,346	37,489	27,548
<i>a Inventories</i>	20,453	11,820	25,669	12,628
<i>b Trade Receivables</i>	8,715	4,022	7,499	7,986
5 Total Assets	74,478	63,313	76,168	65,814
6 Current Liabilities	23,944	16,202	16,994	20,789
<i>a Trade Payables</i>	15,734	7,843	10,290	13,952
7 Borrowings	18,745	16,965	25,008	1,430
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	1,060	309	293	344
10 Net Assets	30,729	29,837	33,873	43,252
11 Shareholders' Equity	30,729	29,837	33,873	43,252
B INCOME STATEMENT				
1 Sales	98,105	125,613	160,906	136,985
<i>a Cost of Good Sold</i>	(95,446)	(136,730)	(165,355)	(133,173)
2 Gross Profit	2,660	(11,118)	(4,449)	3,812
<i>a Operating Expenses</i>	(1,250)	(1,598)	(1,646)	(1,620)
3 Operating Profit	1,410	(12,716)	(6,095)	2,192
<i>a Non Operating Income or (Expense)</i>	1,199	97	(3,735)	(1,211)
4 Profit or (Loss) before Interest and Tax	2,609	(12,619)	(9,830)	981
<i>a Total Finance Cost</i>	(1,199)	(2,244)	(1,199)	(74)
<i>b Taxation</i>	(518)	10,799	2,337	863
6 Net Income Or (Loss)	892	(4,064)	(8,692)	1,771
C CASH FLOW STATEMENT				
<i>a Free Cash Flows from Operations (FCFO)</i>	5,136	(5,274)	(5,185)	4,205
<i>b Net Cash from Operating Activities before Working Capital Changes</i>	3,910	(7,539)	(6,001)	4,345
<i>c Changes in Working Capital</i>	(5,074)	17,219	(14,828)	(2,978)
1 Net Cash provided by Operating Activities	(1,164)	9,680	(20,830)	1,367
2 Net Cash (Used in) or Available From Investing Activities	(398)	(1,844)	(1,517)	(2,469)
3 Net Cash (Used in) or Available From Financing Activities	1,759	(8,262)	22,783	(1,126)
4 Net Cash generated or (Used) during the period	197	(426)	437	(2,228)
D RATIO ANALYSIS				
1 Performance				
<i>a Sales Growth (for the period)</i>	4.1%	-21.9%	17.5%	27.5%
<i>b Gross Profit Margin</i>	2.7%	-8.9%	-2.8%	2.8%
<i>c Net Profit Margin</i>	0.9%	-3.2%	-5.4%	1.3%
<i>d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)</i>	0.1%	9.5%	-12.4%	0.9%
<i>e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh</i>	4.2%	-12.4%	-27.5%	4.2%
2 Working Capital Management				
<i>a Gross Working Capital (Average Days)</i>	63	71	61	50
<i>b Net Working Capital (Average Days)</i>	30	45	34	20
<i>c Current Ratio (Current Assets / Current Liabilities)</i>	1.4	1.3	2.2	1.3
3 Coverages				
<i>a EBITDA / Finance Cost</i>	4.4	-4.0	-5.2	57.1
<i>b FCF0 / Finance Cost+CMLTB+Excess STB</i>	0.7	-0.4	-0.9	28.0
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>	1.6	-1.6	-0.7	0.0
4 Capital Structure				
<i>a Total Borrowings / (Total Borrowings+Shareholders' Equity)</i>	37.9%	36.2%	42.5%	3.2%
<i>b Interest or Markup Payable (Days)</i>	59.8	50.6	111.1	167.5
<i>c Entity Average Borrowing Rate</i>	7.7%	11.0%	11.2%	6.9%

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.

Scale	Long-term Rating Definition
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
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.
AA-	
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.
A-	
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.
BBB-	
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.
BB	
BB-	
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.
B-	
CCC	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.
CC	
C	
D	Obligations are currently in default.

Scale	Short-term Rating 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 conditions.
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 surveil 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):

<p>Entities</p> <ul style="list-style-type: none"> 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 	<p>Instruments</p> <ul style="list-style-type: none"> a) Basel III Compliant Debt Instrument Rating b) Debt Instrument Rating c) Sukuk Rating
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(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)

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- 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

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- (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.
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- (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)
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- (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)
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- (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)

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