The Pakistan Credit Rating Agency Limited

PRESS RELEASE

Rating Action

Lahore : 29-Jun-2016

Analyst

Rai Umar Zafar
(+92-42-35869504)
rai.umar@pacra.com
www.pacra.com

PACRA MAINTAINS RATINGS OF PAKISTAN REFINERY LIMITED

The Pakistan Credit Rating Agency (PACRA) has maintained the long term and short term entity ratings of Pakistan Refinery Limited (PRL) at **'A-'** (Single A Minus) and **'A2'** (A Two) respectively. The rating of TFC I of PKR3,000mln and TFC II of PKR1,000mln have been maintained at **'A'** (Single A). The ratings denote a low expectation of credit risk emanating from a strong capacity for timely payment of financial commitments.

The ratings reflect the strength of the business profile of PRL emanating from its sustainable operational history, strong demand of its products and its strategic importance in the domestic context. The design of PRL's plant offers relatively limited flexibility; in turn, low margin and high exposure to volatile dynamics of international crude oil and refinery product pricing. However, with the successful commissioning of Isomerization plant, the company experienced volumetric growth in high-margin products which boosted profitability. The incremental cashflows are adequate considering size of the related debt obligations. In addition, the stability in oil prices may supplement the profitability and hence cashflows.

The ratings could be impacted by prolonged constrain in refining margins and/or adverse changes in the existing regulatory framework leading to depressed core cashflows.

About the Company:

Pakistan Refinery Limited (PRL), having refinery capacity of 2.1mln tons per annum, is operational since Oct'62. Majority shareholding in PRL is held by Shell Petroleum Company Limited, UK, (30%) Pakistan State Oil Company Limited (22.5%), HASCOL (14%) and Chevron (7.5%). During the year, Shell has decided to reduce its shareholding in PRL. PSO showed its intention to acquire the same. The transaction is in the process of regulatory approvals. Upon completion of the transaction, PSO would be the biggest shareholder of PRL. PRL's DHDS project is still pending (GOP latest extention is till June'17). Given pending change in ownership, clarity as to timeline and funding mix would emerge later. The company is also looking for capacity expansion oppurtunities.

The company has eleven member board (including the CEO) - six class B directors representing sponsoring companies (currently three from PSO, two from Shell and one from Chevron) and four class A directors representing other shareholders.

About the Debt Instruments

PRL, issued two TFCs during FY13. TFC I (outstanding at end Mar-16 PKR 1,732mln), carrying fixed profit rate of 10.55%, has a tenor of 3 years and will be due for maturity in Dec'16. TFC II (outstanding at end Mar-16 PKR 244mln), carrying fixed profit rate of 10.75%, has a tenor of 5 years and will be due for maturity in Dec'18. Although principal repayment is at maturity, these instruments carry perpetual Put option. The TFCs are secured by way of Hypothecation of a) Stocks and Receivables and b) Fixed Assets.

Applicable Criteria and Related Research

- Refining Sector Viewpoint | Sep-15
- Corporate Rating Methodology

The Pakistan Credit Rating Agency Limited

PAKISTAN REFINERY LIMITED (PRL)

ENTITY RATINGS REPORT

	NEW [JUN-15]	PREVIOUS [JUN-14]
Long-Term	A-	A-
Short-Term	A2	A2
Outlook	Stable	Stable

REPORT CONTENTS

JUNE 2015

RATING ANALYSES
(JUNE 2015)
PAKISTAN REFINERY LIMITED (PRL)

RATING RATIONALE
The ratings reflect the strength of the business profile of PRL emanating from its sustainable operational history, strong demand of its products, and its strategic importance in the domestic context. The design of PRL's plant offer relatively limited flexibility; in turn, low margin and high exposure to volatile dynamics of international crude oil and refinery product pricing. However, this is expected to witness beneficial change with soon to commission Isomerization project, changing PRL's product slate favourably. The incremental cashflows are strong considering size of the related debt obligations. In addition, the stability in oil prices may supplement the profitability and hence cashflows. The company's risk absorption capacity is weak on a stand-alone basis. Some respite is in the offing with latest right issue; though further consolidation in the ownership may be more helpful.

KEY RATING DRIVERS
The ratings could be impacted by prolonged constrain in refining margins and/or adverse changes in the existing regulatory framework leading to depressed core cashflows. The company is pursuing a leveraged up-gradation of its operating platform. Since repayment pattern is aligned to expected cash flows, any completion delay may impact coverages, in turn, ratings.

- **Global Refining Industry:** The self sufficiency of US coupled with a decrease in its reliance on crude import from OPEC, and OPEC's decision to maintain its current production level at 30mln barrels per day has resulted in an over supplied market. In addition to that, less than expected recovery in the global economy dampened the demand of crude. Resultantly, the oil prices witnessed a steep decline during FY15. Significant developments in the global Shale sector, particularly the related infrastructure in US, exerted further pressure on the global crude prices. Going forward, the chances of any sharp increase in the oil prices are thin.
- **Performance:** During 9MFY15, PRL witnessed a decline in top line on YoY basis ~ 33% merely on account of sharp decline in prices of the crude in international market during later part of 1HFY15, coupled with extended turnaround period of 38 days (earlier 23 days in 2011). GRM's remains under pressure mainly due to steep decline in crude prices which resulted in huge inventory losses. Furthermore the operating expenses remains largely on the same level however, increase in finance cost has further pushed PRL's profitability in to negative zone. However, improved GRM's on account of stability in crude prices during 3QFY15 helped PRL to book profit before tax of ~ PKR 1.1bln.
- **Working Capital & Cashflows:** PRL's working capital requirement emanate from its need to finance its inventory and receivables. To bridge the funding needs, PRL resorts to short-term borrowings while stretching its payables to local E&P companies. PRL cash cycle has improved significantly as compared to same period last year (9MFY15: ~1.6 days, FY14: ~12 days, 9MFY14: ~20 days).
- PRL's cash flow generation ability remains a function of its profitability and working capital requirements. During 9MFY15, lower profitability constrained the company's cash flows. The fragile coverages of the company turned negative (Mar15: -0.9, Jun14: -0.4, Jun13:0.3) during the period on account of negative FCFO. Nevertheless, amidst inherent volatility in crude oil prices, sustaining a level of coverages for upcoming payments remain pivotal. Going forward, positive cash flow generation ability of the company owing to timely completion of Isomerization would improve the coverages.
- **Business Strategy:** Going forward, the successful commissioning of its Isom project in near term will benefit PRL to enhance its positive margins. Furthermore, execution of right issue coupled with stabilized crude prices will enhance the company's financial risk profile. Execution of DHDS is dependent upon availability of sizeable funds.
- **Capital Structure:** PRL has raised a long term loan of PKR 2bln in 3QFY15 for an up gradation project (Isomerization). The loan will be repayable in ten semi-annual payments having tenor of seven years (including two year grace period) @ 6MKibor+175bps. The capital structure of PRL is highly leveraged as Total Debt/Total Debt + equity ratio is 122% at 9MFY15 (FY14: 94%, FY13: 84%).
- The management has announced to acquire equity finance by means of proposed right issue (PKR2.8bln) from major shareholders. All the major shareholders have shown intent to subscribe the issue and the execution of the proposed issue will take place during the current financial year. The issue will replace the shorter borrowings of the company.
- **Debt Instruments**: PRL, issued two TFCs during CY13. TFC I, carrying fixed profit rate @ 10.55%, has a tenor of 3 years, while TFC II, carrying fixed profit rate @ 10.75%, has a tenor of 5 years. Although principal repayment is at maturity, these instruments carry perpetual Put option.
- **Profile:** Pakistan Refinery Limited (PRL), having refinery capacity of 2.1mln tons per annum, is operational since Oct'62. Majority shareholding in PRL is held by Shell Petroleum Company Limited, UK, (30%) Pakistan State Oil Company Limited (22.5%), and HASCOL (14%) and Cheveron (7.5%).
- **Governance & Management:** The company has eleven member board (including the CEO) - six class B directors representing sponsoring companies (three from PSO, two from Shell and one from Chevron) and four class A directors representing other shareholders. Mr. Aftab Husain, PRL's CEO, Chemical Engineer has been associated with PRL for over three decades. He is supported by a team of qualified and competent individuals.

The Pakistan Credit Rating Agency Limited

PAKISTAN REFINERY LIMITED

PKR mln

BALANCE SHEET	31-Mar-15	30-Jun-14	30-Jun-13	30-Jun-12
	9Months	*Annual*	*Annual*	*Annual*
Non-Current Assets	11,344	7,461	5,165	4,562
Investments	89	90	85	78
Inventories	6,563	9,673	10,979	7,828
Current Assets (Excluding Inventory)	6,486	11,614	11,183	21,743
Total Assets	24,482	28,839	27,413	34,211
Borrowings	2,000	-	-	-
Total Liabilities	24,399	28,270	26,198	33,434
Shareholders' Equity	(1,917)	569	1,215	777
Total Liabilities & Equity	24,482	28,839	27,413	34,211

PROFIT & LOSS ACCOUNT	31-Mar-15	30-Jun-14	30-Jun-13	30-Jun-12
Turnover	70,738	142,144	132,114	127,175
Gross Profit	(1,722)	(202)	1,936	(460)
Interest Income	50	151	46	99
Exchange Gain / (Loss)	26	79	69	-
Net Income	(2,484)	(864)	496	(1,616)

CASHFLOW STATEMENT	31-Mar-15	30-Jun-14	30-Jun-13	30-Jun-12
EBITDA	(1,645)	(663)	1,785	(361)
Free Cashflow from Operations (FCFO)	(1,975)	(1,120)	993	(1,126)
Total Operating Cashflows (TCF)	(1,975)	(1,120)	993	(1,126)
Net Cash available from investing activities	(4,099)	(2,168)	(662)	(196)
Cashflow from financing activities	(4,213)	934	7,326	(1,303)

RATIO ANALYSIS	31-Mar-15	30-Jun-14	30-Jun-13	30-Jun-12
Gross Margin	-2.4%	-0.1%	1.5%	-0.4%
Net Profit Margin	-3.5%	-0.6%	0.4%	-1.3%
Net Cash Cycle (Days)	1.7	12.0	10.9	6.7
Total Debt/Total Debt+Equity	122%	94%	87%	0%

The Pakistan Credit Rating Agency Limited

STANDARD 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. This capacity is highly unlikely to be adversely affected by foreseeable events.
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-**	**Speculative.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic change over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ **B** **B-**	**Highly speculative.** Significant 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**	**High default 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.

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. Rating Watch may carry designation – Positive (rating may be raised, negative (lowered), or developing (direction is unclear). A watch should be resolved with in foreseeable future, but may continue if underlying circumstances are not settled.

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'.

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, or e) the entity/issuer defaults.

Regulatory and Supplementary Disclosure

Rated Entity

Name of Rated Entity Pakistan Refinery Limited
Sector Refining
Type of Relationship Solicited

Purpose of the Rating Independent Risk Assessment
Regulatory Requirement

Rating History

Dissemination Date	Long Term	Short Term	Outlook	Action
30-Jun-14	A-	A2	Stable	Maintain
6-May-13	A-	A2	Stable	Initial

Related Criteria and Research

Rating Methodology Corporate Rating Methodology (2005)
Sector Research Refining Sector study | Oct14

Rating Analysts

Shoaib Afzal
shoaib.afzal@pacra.com
(92-42-35869504)

Rai Umar Zafar
rai.umar@pacra.com
(92-42-35869504)

Rating Team Statement

Rating Procedure
Rating is an opinion on relative credit worthiness of an entity or debt instrument. It does not constitute recommendation to buy, hold or sell any security. The rating team for this assignment does not have any beneficial interest, direct or indirect in the rated entity/instrument.

Disclaimer

Rating Shopping
PACRA maintains principle of integrity in seeking rating business.
PACRA has used due care in preparation of this document. Our information has been obtained directly from the underlying entity and public sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA shall owe no liability whatsoever to any loss or damage caused by or resulting from any error in such information.

Conflict of Interest
PACRA, the analysts involved in the rating process, and members of its rating committee do not have any conflict of interest relating to the credit rating done by them
The analysts involved in the rating process do not have any interest in a credit rating or any of its family members has any such interest
The analysts and members of the rating committees including the external member members have disclosed all the conflict of interest, including those of their family members, if any, to the Compliance Officer PACRA
The analysts or any of its family members do not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This is, however, not applicable on investment in securities through collective investment schemes. PACRA has established appropriate policies governing investments and trading in securities by its employees
PACRA may provide consultancy/advisory services or other services to any of its clients or to any of its clients' associated companies and associated undertakings that is being rated or has been rated by it. In such cases, PACRA has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities
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 ii) fee mandate - signed with the payer, which can be different from the entity
PACRA ensures that the credit rating assigned to an entity or instrument should 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

Surveillance
PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the rated entity/ issuer, the security arrangement, the industry etc, is disseminated to the market, in a timely and effective manner, after appropriate consultation with the entity/issuer
PACRA reviews all the outstanding ratings on annual basis or as and when required by any stakeholder (including creditor) or upon the occurrence of such an event which requires to do so
PACRA initiates immediate review of the outstanding rating(s) upon becoming aware of any information that may be reasonable be expected to result in any change (including downgrade) in the rating

Reporting of Misconduct
PACRA has framed and implemented whistle-blower policy encouraging all employees to intimate the compliance officer any unethical practice or misconduct relating to the credit rating by another employees of the company that came to his/her knowledge. The Compliance Officer reports to the BoD and SECP

Confidentiality
PACRA has framed a confidentiality policy to prevent abuse of the non-public information by its employees and other persons involved in the rating process, sharing and dissemination of the non-public information by such persons to outside parties
Where feasible and appropriate, prior to issuing or revising a rating, PACRA informs the issuer of the critical information and principal considerations upon which a rating will be based and provide the opportunity to clarify any likely factual misperception or other matter that PACRA would wish to be made aware of in order to produce a fair rating. PACRA duly evaluates the response. Where in a particular circumstance PACRA has not informed the entity/issuer prior to issuing or revising a rating, it informs the entity/issuer as soon as practical thereafter

Prohibition
None of the information in this document may be copied or otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without PACRA's written consent. PACRA reports and ratings constitute opinions, not recommendations to buy or to sell

Probability of Default (PD)

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

RATINGS (MAY 2013)
PAKISTAN REFINERY LIMITED (PRL)

	PRELIMINARY
Secured, Listed TFCs	
TFC of PKR 3,000 mln (Including Green Shoe of PKR500mln)	**A**
TFC of PKR 1,000mln	**A**

Instrument	TFC 1
Tenor	36 months
Issue Amount (PKR mln)	3,000
Green shoe option	500
Profit Rate	Fixed Rate: 3 months Kibor + 1.0%
Profit Payment	Quarterly
Principal Redemption (Bullet)	The principal will be repaid in one bullet payment with reserve being accumulated 6 months prior the maturity date
Purpose	To meet the working capital requirements including but not limited to company's CAPEX requirements.
Security	The TFC Issue has been secured by way of a) Hypothecation of Stocks and Receivables and b) Hypothecation of Fixed Assets alongwith a certain margin.
Put Option	Exercisable with a 15days notice, a service charge is applicable

Instrument	TFC 2
Tenor	60 months
Issue Amount (PKR mln)	1,000
Green shoe option	-
Profit Rate	Fixed Rate: 3 months Kibor + 1.20%
Profit Payment	Quarterly
Principal Redemption (Bullet)	The principal will be repaid in one bullet payment with reserve being accumulated 6 months prior the maturity date
Purpose	To meet the working capital requirements including but not limited to company's CAPEX requirements.
Security	The TFC Issue has been secured by way of a) Hypothecation of Stocks and Receivables and b) Hypothecation of Fixed Assets alongwith a certain margin.
Put Option	Exercisable with a 15days notice, a service charge is applicable

ANALYST
Adnan Rasool
+92 42 3586 9504
adnan.rasool@pacra.com

Rai Umar Zafar
+92 42 3586 9504
rai.umar@pacra.com

RATING RATIONALE & KEY RATING DRIVERS

- The rating recognizes the originator's – Pakistan Refinery Limited – sound financial profile emanating from low leveraged capital structure and healthy cashflows. Cognizant of the prevailing inter-corporate debt in the energy chain, PRL has effectively managed its exposure by favourably using commercial credit from domestic E&P companies. The rating draws its strength from underlying structure of the debt instruments, whereby, inter-alia, 1) the requisite funds to ensure timely redemption would be gradually retained/ built-up over a period of six months prior to the payment date and 2) PRL has strong fortnightly cashflows cycle, which alongwith the un-utilized portion of existing running finance lines provides cushion against exercise of put option.
- The rating is dependent on the continued compliance with the defined structure of the instruments. Moreover, any significant deterioration in the performance of PRL owing to volatility in international oil prices and/or changes in existing regulatory framework, adversely impacting its refining margins, in turn cashflow stream would negatively impact the financial profile.

INSTRUMENT STRUCTURE

- PRL, a hydroskimming refinery with a capacity of 2.1mln tpa, for the purpose of meeting its working capital and CAPEX requirements, intends to issue two listed and secured TFCs of PKR 3,000mln (Including a green shoe of PKR500mln) and PKR 1,000mln for a period of 3 and 5 years, respectively. The total size of issues amount to PKR4,000mln.

SECURITY:

- The TFC Issues have been secured by way of a) Hypothecation of Stocks and Receivables and b) Hypothecation of Fixed Assets alongwith a certain margin. The company has emplaced the hypothecation in favour of the Trustee for the benefit of the Investors, by way of a first pari passu charge over the mentioned assets alongwith a certain margin. Meanwhile, the company shall not establish any charge on the charged assets, through the life of the instruments, without prior written approval of the Trustee.

ASSESSMENT:

- **Profile:** Pakistan Refinery Limited's (PRL) foundation stone was laid in May, 1960. PRL with a throughput capacity of 2.1mln tons is the fourth largest oil refinery in the country, contributing ~16% to domestic refining capacity. Majority shareholding is retained by the companies that were involved in setting up the refinery. These companies are: Shell Petroleum Company Limited, UK (30%), Pakistan State Oil Company Limited (18%), and Chevron Texaco Global Energy Incorporated, USA (12%). Being a hydro skimming refinery, PRL lacks the advanced technologies and complex operations such as downstream conversion units, required to diversify the product mix with value-added products. Hence, the product mix – Fuel Oil (32%) & Naphtha (11%) – predominantly comprises negative and low margin products, respectively. Resultantly, the refinery's margins are on the lower side when compared to its peers.
- **Price Risk:** PRL remains a price taker on both the raw material and end-product sides. This inability to control prices at either end of the value addition chain is a key risk for the company exposing the company's GRMs to inherent high volatility in international prices of oil and related petroleum products. Presently the refining sector in Pakistan takes benefit from 7.5% of deemed duty which is embedded in ex-refinery price on sale of HSD. Any unfavourable change in the mentioned pricing regime would undermine the operational viability of the refining sector including PRL.
- **Liquidity Risk:** PRL's exposure to OMCs has made it a part of the circular debt prevailing in the energy chain of the country. The utilization of commercial credit by local E&P companies enabled PRL to manage the quenched liquidity arising due to circular debt. Additionally, the proposed structure of instruments is designed to ensure retention/build up of requisite cashflows over a period of six months (6 months) prior to the principal repayments to avoid pressure on any single month. The GoP is actively engaged in activities related to mop up the re-accumulated debt on quarterly basis. However, it remains a concern for the company and, if unresolved, could adversely impact its cash flows.
- **Redemption Risk:** The option available to investors to pre-maturely redeem the outstanding TFCs or investment from TFCs by providing a written notice of 15 days could result in sizable redemptions exposing the company to significant pressure. However, PRL has strong fortnightly cashflows cycle, which alongwith the un-utilized portion of existing running finance lines provides cushion against exercise of put option thereby mitigating the redemption risk.
- **Interest Rate Risk:** The issues carry fixed interest rate structure, entailing quarterly payment at a predefined rate based on prevailing interest rates in the country. Unanticipated movement in interest rates make the instruments susceptible to interest rate volatility. Considering an increase in interest rate would encourage the investors to exercise the put option available to them. However, the interest rate risk is mitigated by establishing an early redemption service charge, which phases out, throughout the life of the instruments. This is expected to limit the expected outflow of investment on account of interest rate movements over the medium term.