RATING REPORT

Hascol Petroleum Limited

REPORT DATE:
April 26, 2019

RATING ANALYSTS:

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RATING DETAILS				
Rating Category	**Latest Rating**		**Previous Rating**	
	Long-term	**Short-term**	**Long-term**	**Short-term**
Entity	AA-	A-1	AA-	A-1
Sukuk 1	AA		AA	
Rating Outlook	Negative		Stable	
Rating Date	*April 24, 2019*		*Nov 1, 2017*	

COMPANY INFORMATION	
Incorporated in March 2001	External auditors: **Grant Thornton Anjum Rahman & Co. Chartered Accountants**
Public Limited Company	Chairman of the Board: **Mr. Mumtaz Hasan Khan**
Key Shareholders (with stake 5% or more):	Chief Executive Officer: **Mr. Saleem Butt**
Vitol Dubai Limited – 27.46%	
Mr. Mumtaz Hasan Khan – 18.84%	
Fossil Energy (Private) Limited – 10.66%	
Marshal Gas (Pvt.) Limited – 6.44%	

APPLICABLE METHODOLOGY(IES)

Applicable Rating Criteria:
Oil & Gas Industry (November 2016) https://www.vis.com.pk/kc-meth.aspx
Industrial Corporates (May 2016) https://www.vis.com.pk/kc-meth.aspx

Hascol Petroleum Limited

RATING RATIONALE

Hascol Petroleum Limited (HPL) is engaged in procurement, storage and marketing of petroleum and related products; the company obtained oil marketing license from Ministry of Petroleum and Natural Resources in 2005.

Rating Drivers:

Sharp decline witnessed in industry volumes in 9MFY19. As anticipated, decrease was more pronounced in Furnace Oil (FO) segment, followed by HSD with lowest reduction noted in Motor Spirit (MS) segment

Oil sales volumes decreased by 27% in 9MFY19 primarily on account of decrease in sales of Furnace Oil (FO). Availability of cheaper substitutes such as RLNG and coal has contributed to reduction in sales of FO. Excluding FO, volumes witnessed a reduction of 13%, with second largest decline observed in High Speed Diesel (HSD). HSD sales declined on account of slowdown in economy particularly in transport & Large Scale Manufacturing activities. Going forward, industry sales are expected to remain under pressure due to further reduction expected in FO off-take.

Industry Sales (000 tons)		
	9MFY19	**YoY change**
Furnace Oil (FO)	2,171	-60%
High Speed Diesel (HSD)	5,405	-21%
Motor Spirit (MS)	5,524	1%
Others	526	-46%
Total	13,626	-27%

Sizeable investment in infrastructure over the last two years

In line with the business plan, continuous expansion has been witnessed in storage capacity, retail foot print and supply-chain network of the company since 2016:

- **Storage facilities:** With addition of new depots in Punjab and Sindh, total storage capacity increased by 117% by end-9MCY18 in comparison to end-2016. Total leased capacity represented 69% (2017: 61%; 2016: 71%) of the overall capacity. Leased capacity more than doubled in 9M18. Going forward, the pace of expansion in storage facilities is expected to remain subdued given that room for improvement exists in current capacity utilization, which remains on the lower side.

- **Retail network:** HPL continued to increase its footprint to 541 outlets as at end-9MCY18, depicting a healthy growth of 45% vis-à-vis end-2016. In line with the trend witnessed in previous years, the growth has been largely concentrated in Punjab and Sindh. Expansion in retail footprint is planned to continue with focus more towards urban outlets.

OVERVIEW OF THE INSTITUTION

Hascol Petroleum Limited (HPL) was incorporated in March, 2001 under the Companies Ordinance, 1984. Primary business activities involve procurement, storage and marketing of petroleum & related products. The company is listed on Pakistan Stock Exchange (PSX) and its head office is located in Karachi.

Profile of Chairman
Mr. Mumtaz Hasan Khan has over 54 years of experience in the oil industry. He started his career from Burmah Shell Oil Storage and Distribution Company where he served for almost 13 years. In 1980, he started his own oil trading company (Hascombe Limited) in London. He is also on the Board of Pakistan Refinery Limited (PRL)

Profile of CEO
Mr. Saleem Butt possesses 25 years of diverse work experience in the OMC sector. He has been associated with HPL for over 9 years. Previously, he has worked with Shell Pakistan Limited and Emaar Properties in various leadership roles. Mr. Butt is fellow member of the Institute of Chartered Accountants of Pakistan (ICAP).

- **Supply chain network:** Majority of the oil transportation trucks in the company's fleet are outsourced to registered contractors. With increased focus on safety regulations, the management has setup its own in-house supply chain infrastructure including fleet of tank lorries (Volvo trucks) which aggregated to approximately 200 at end-9MCY18.

Growth momentum in market share continued during CY18. However, market share in retail fuels has depicted noticeable decline in recent months while FO market share has increased.

Volumetric growth in sales of HPL outweighed the growth in industry volumes, with off-take increasing by 34.1% (FY17: 43.9%), whereas the overall industry volumes remained stagnant in FY18. Resultantly, market share of HPL increased to 11.4% (FY17: 8.5%), making the company the second largest Oil marketing Company (OMC) operating in Pakistan. In 9MFY19, the overall market share of HPL has trended upwards to approximately 12% (9MFY18: 11%).

In terms of product-wise market share, HPL has gained market share in FO (9MFY19: 15.2%; 9MFY18: 8.4%) owing to higher off-take vis-à-vis industry. On the other hand, market share in retail fuels (MS & HSD) decreased. Decline in market share is partly attributable to a conscious strategy to minimize losses given significant fluctuation in foreign currency. Over the long-term, HPL expects to increase market share as macroeconomic indicators stabilize.

Market share of HPL (%)				
Products	**9MFY19**	**9MFY18**	**FY18**	**FY17**
MS	10.1	12.7	12.6	9.6
HSD	13.0	14.3	14.5	10.6
FO	15.2	8.4	8.4	6.2

Diversification initiatives to contribute significantly to company's bottom-line over the medium term

In a bid to diversify the operations and enhance profitability of the company, the management has undertaken following initiatives:

- **Lubricants**: Management is establishing a lube oil blending plant with a total capacity of 40,000 tons. The project is in final stages of completion and is expected to come online in HY2019.

- **Liquefied Petroleum Gas:** HPL completed acquisition of LPG plant from Marshal (Gas) Private Limited in 2018 and has also initiated sales of LPG at few retail pumps and in the form of cylinders to retail customers.

- **Specialized fuels/Chemicals:** During 2017, the company had commenced importing bulk chemicals and supplying to end users. In terms of volumes, sales of this segment more than doubled during 2018.

- **Liquefied Natural Gas (LNG) and other initiatives:** In March 2017, HPL in partnership with Vitol formed a new company, VAS LNG (Private) Limited, that will deal with the activities relating to the LNG sector. Sales are expected to materialize from this venture going forward. Furthermore, management is planning to undertake coal related initiatives in future.

Import based model remains a key risk to profitability given the country's macro-economic indicators

In line with most players operating in the OMC space, HPL operates via an imports based model, whereby on average 85% of fuel is imported. Resultantly, the company will have to bear a sizeable exchange loss in case of rupee devaluation. Given the sizeable current account deficit and significant external debt servicing requirements over the next three years, VIS expects the same to remain a key risk area to profitability, going forward.

Topline continues to witness sizeable growth; however, translation of increase in topline into growth in bottom-line remained constrained. Enhanced focus on high margin business and cost rationalization through efficiencies in operations planned to improve profitability

Net Sales of the company increased to Rs. 185.7b (2017: 173.7b; 2016: 99.5b) in 9MCY18. Growth in topline was a function of both increase in average selling prices and volumes. As gross margins of MS and HSD are fixed in monetary terms per liter, increase in average selling prices translated into lower gross margins in 2017 (2017: 4.3%; 2016: 5.2%). Moreover, the management had procured inventory at cheaper rates in 2016, resulting in higher margins in that period. In 9MCY18, gross margins have depicted improvement to 4.5% on account of linking of HSD and MS margins to Consumer Price Index (CPI) and inventory gains. Overheads witnessed sizeable growth with increase being in tandem with overall revenue growth. Given the expansion in retail and storage network, headcount of the organization stood higher at 963 at end-Nov'2018 (2017: 755; 2016: 519), culminating in an increase in salaries and wages expenses. Significant exchange losses and higher finance cost translated into profit before tax increasing by a mere 5% while revenues increased by 45% during 9MCY18.

Sizeable debt funded capital expenditure and lower cash flow generation has resulted in pressure on liquidity profile. Slowdown in capital expenditure and improvement in cash flows would be important for liquidity profile going forward

In order to fund expansion, HPL incurred sizeable capital expenditure amounting to Rs. 5.3b (2017: Rs. 5.7b; 2016: Rs. 2.9b) in 9MCY18. The capital expenditure has been primarily financed through acquisition of additional debt with some funding undertaken through a rights issue in 2017. Funds from Operations (FFO) amounted to Rs. 1.3b (2018: Rs. 2.8b; 2017: Rs. 2.3b) in 9MCY18 and is expected to remain significantly lower in 2018 vis-à-vis the preceding year due to decrease in profitability. Given the increase in overall debt, FFO in relation to total debt and debt servicing coverage ratio (DSCR) have decreased on timeline basis. In light of existing scenario and prevailing macro-economic uncertainty, management has revised expansion plans pertaining to storage facilities and retail network. Reduction in the quantum of capex and positive working cycle is expected to provide support to liquidity profile going forward.

Gearing and leverage indicators have increased on timeline basis and is an area of concern given benchmark for the assigned ratings. Reduction in short-term borrowings planned through improved working capital management

Despite high dividend payout ratio (2018: 65.4%; 2017: 74.4%), total adjusted equity base (excluding revaluation surplus on investments) of the company has grown on timeline basis (9MCY18: Rs. 9.5b; 2017: Rs. 9.2b; 2016: Rs. 5.0b) on account of internal capital generation and rights issue of 20% in 2017. Total debt (adjusted for off balance sheet liabilities) carried on balance sheet increased to Rs. 18.8b (2017: Rs. 13.6b; 2016: Rs. 9.4b) at end-9MCY18; short term borrowings were the major reason for increase in total debt. In addition to meet working capital requirements, short term borrowings were also utilized to fund a portion of Capex. Going forward, the management plans to substitute short term borrowings with a fresh Sukuk. As growth in adjusted debt has outweighed the growth in adjusted equity, adjusted gearing and adjusted leverage ratios have increased to 2.0x (2017: 1.5x; 2016: 2.2x) and 6.4x (2017: 5.4x; 2016: 8.9x) at end-9MCY18. Going forward, leverage indicators are expected to remain at elevated levels vis-à-vis the benchmark for the assigned ratings.

Hascol Petroleum Limited — Appendix I

FINANCIAL SUMMARY[1]			*(amounts in PKR millions)*
BALANCE SHEET	**9MCY18**	**2017**	**2016**
Fixed Assets	22,399.6	13,680.3	8,688.9
Stock-in-Trade	25,098.8	18,557.1	16,477.7
Trade Debts	12,268.1	11,518.2	7,871.3
Cash & Bank Balances	10,267.4	9,628.1	7,821.1
Total Assets	75,622.5	58,095.2	44,650.0
Trade and Other Payables	43,462.5	34,321.4	29,822.8
Long Term Debt	9,116.6	6,621.7	5,510.7
Short Term Debt	9,728.6	6,944.7	3,889.6
Adjusted Equity	9,533.2	8,917.7	4,337.2
INCOME STATEMENT	**9MCY18**	**2017**	**2016**
Sales-Net of Sales Tax	183,689.0	173,739.2	99,508.2
Gross Profit	8,212.9	7,389.0	5,130.1
Operating Profit	5,251.3	4,528.4	3,078.1
Profit Before Tax	1,951.3	2,658.7	1,968.0
Profit After Tax	1,507.1	1,401.2	1,215.6
RATIO ANALYSIS	**9MCY18**	**2017**	**2016**
Gross Margin (%)	4.5%	4.3%	5.2%
Net Working Capital	(5,187.0)	(1,614.5)	(1,324.7)
FFO	1,277.1	2,837.0	2,283.4
FFO to Total Debt	9.0%	20.9%	24.3%
FFO to Long Term Debt	18.7%	42.8%	41.4%
Adjusted Gearing (x)	2.0	1.5	2.2
Adjusted Leverage (x)	6.4	5.4	8.9
Debt Servicing Coverage Ratio (x)	1.1	2.3	2.9
ROAA (%)	3.0%	2.7%	3.4%
ROAE (%)	21.8%	19.7%	29.7%

[1] For debt and its ratios, commitments have been accounted for.

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.vis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details.www.vis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES — Appendix III

Name of Rated Entity	Hascol Petroleum Limited
Sector	Oil & Gas
Type of Relationship	Solicited
Purpose of Rating	Entity & Sukuk Rating

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
24-Apr-19	AA-	A-1	Negative	Maintained
1-Nov-17	AA-	A-1	Stable	Upgrade
02-Nov-16	A+	A-1	Stable	Reaffirmed
07-Jul-15	A+	A-1	Stable	Reaffirmed
31-Mar-14	A+	A-1	Stable	Upgrade
28-Jun-13	A-	A-2	Stable	Reaffirmed
28-Dec-12	A-	A-2	Stable	Initial

Rating Date	Medium to Long Term	Rating Outlook	Rating Action
RATING TYPE: SUKUK			
24-Apr-19	AA	Negative	Maintained
1-Nov-17	AA	Stable	Upgrade
02-Nov-16	AA-	Stable	Reaffirmed
08-Jan-16	AA-	Stable	Final
06-Nov-15	AA-	Stable	Preliminary

Instrument Structure	Sukuk of Rs. 2.0b carries profit rate of 3months KIBOR plus 1.5% per annum that is payable quarterly. Security structure of the Sukuk entails formation of a debt payment mechanism to progressively retain upcoming installment in an escrow account. Security structure also includes first pari passu charge over specific depots and retail outlets of the company inclusive of a margin of 25%.
Statement by the Rating Team	VIS, 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(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
Probability of Default	VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.
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