RATING REPORT

Hascol Petroleum Limited

REPORT DATE:
April 17, 2020

RATING ANALYSTS:

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RATING DETAILS				
Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	BB+	A-3	BBB	A-3
Sukuk 1	BBB-		BBB+	
Rating Outlook	Negative		Negative	
Rating Date	*April 17, 2020*		*September 04, 2019*	

COMPANY INFORMATION	
Incorporated in March 2001	External auditors: **Grant Thornton Anjum Rahman & Co. Chartered Accountants**
Public Limited Company	Chairman of the Board: **Mr. Alan Duncan**
Key Shareholders:	Chief Executive Officer: **Mr. Aqeel Ahmed Khan**
Vitol Dubai Limited	
Mr. Mumtaz Hasan Khan	

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

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.

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 FY19 and in the ongoing year.
Industry sales volumes after declining by 22% in FY19 reduced further by 11% during 9MCY20. Macroeconomic slowdown along with availability of cheaper substitutes such as re-gasified LNG (RLNG) and coal in addition to increase in smuggled products from a neighboring country has contributed to reduction in industry volumes. Going forward, industry sales are expected to depict a sharp decline (particularly for white oil business) due to lower industrial and transportation activity. Pressure in industry off-take along with existing players competing for market share is expected to result in increased competitive intensity in the OMC sector.

Figure: Product wise growth/decline

(000 metric tonnes)	9MFY20	9MFY19	% change	FY19	FY18	% change
FO	1,586	2,157	-26%	3,004	7,118	-58%
HSD	4,577	5,392	-15%	7,189	8,965	-20%
MOGAS	5,480	5,503	-0.1%	7,351	7,351	0%
Total	12,162	13,629	-11%	17,544	23,434	-25%

High capital expenditure continued despite curtailment plans.
After incurring a capital expenditure of Rs. 11.8b during FY17 and FY18, the company undertook sizeable debt funded capital expenditure to the tune of Rs. 12.95b in 9MCY19 despite communicated plans to reduce the same. The capital expenditure pertains to storage facility, retail pumps and supply chain infrastructure.

Significant attrition in market share in 9MFY20
HPL's overall market share declined to 6.5% in 9MFY20 from 11.7% in 9MFY19. This is also evident from HPL's volumes declining by 50% during 9MFY20 vis-à-vis industry volumes declining by 11% during the period. Overall capacity utilization in terms of storage capacities are significantly on the lower side.

Diversification initiatives to only contribute 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 has established a lube oil blending plant with a total capacity of 40,000 tons.

- **Liquefied Petroleum Gas:** HPL completed acquisition of LPG plant from Marshal (Gas)

Private Limited in 2018 and has also initiated sales of LPG at 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 but remain low.

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 exposing the Company to exchange losses in case of rupee devaluation. The company has incurred a sizeable exchange loss in 2019. With current account deficits witnessing a sharp decline, along with strong support from IMF and multilateral agencies and debt relief, risk of rupee devaluation is considered manageable in the short-term. However, over the long-term import based model will continue to be a risk given significant foreign currency debt repayments over the rating horizon.

Coronavirus to have a negative impact on industry dynamics

Coronavirus is expected to result in sharp fall in industry volumes (due to partial lockdowns to prevent coronavirus outbreak) which alongwith steep decline in oil prices (resulting in inventory losses) and exchange rate devaluation is expected to adversely impact financial profile of Oil Marketing Companies in the near term.

HPL incurred a sizeable loss during 9MCY19 due to inventory & exchange loss and jump in finance cost. Profitability in CY20 is expected to remain under pressure given the decline in volumes, elevated finance cost despite sharp interest rate reduction and inventory losses.

Net Sales of the company decreased to Rs. 111.4b (9MCY18: Rs. 183.7b) in 9MCY19 due to lower volumetric sales. Overall profitability was impacted by sizeable expenses including a loss amounting to Rs. 6.3b due to fluctuation in the international oil prices and devaluation of rupee causing an increase in product cost. Regulated eventual selling prices versus the product cost resulted in the reported loss. Despite the dip in volumes, overheads witnessed sizeable growth during the period. Expenses included Rs. 838m due to impairment on trade debts (expected credit losses) on account of implementation of IFRS-9. Given the higher borrowings and increase in interest rates, finance cost jumped to Rs. 5b (9MCY18: Rs. 782.6m) during 9MCY19. Resultantly, the company incurred a loss before tax of Rs. 18.74b (9MCY18: Rs. 1.95b) during 9MCY19. Going forward, decline in finance cost due to 425bps cut in discount rate over the last 1 month is expected to provide some respite to profitability. Nevertheless, profitability in CY20 is expected to remain under pressure given the decline in volumes, elevated finance cost despite sharp interest rate reduction and inventory losses

Weak capitalization indicators and liquidity profile.

In order to fund expansion, HPL incurred sizeable capital expenditure of Rs. 12.9b (2018: Rs. 6.1b; 2017: Rs. 5.7b; 2016: Rs. 2.9b) in 9MCY19. The capital expenditure has largely been financed through acquisition of additional debt. Higher debt levels and erosion in equity base has translated into weak leverage indicators. Negative cash flows also translated into weak liquidity profile. The company has completed rights issue in order to strengthen equity base. Despite the equity injection, capital base remains low given the size of operations due to sizeable losses incurred. Ratings depend upon and incorporate strategic investment of Vitol Dubai Limited (VDL) in HPL, a significant international player in the oil sector; shareholding of VDL in HPL has increased to 40.8% as at end-January 2020. Continued sponsor support would remain critical given the challenging operating environment.

Hascol Petroleum Limited — Appendix I

FINANCIAL SUMMARY *(amounts in PKR millions)*

BALANCE SHEET	2016	2017	2018	9MCY19
Fixed Assets	8,688.9	13,680.3	22,563.2	34,006
Stock-in-Trade	16,477.7	18,557.1	22,615.3	17,276
Trade Debts	7,871.3	11,518.2	13,552.2	11,090
Cash & Bank Balances	7,821.1	9,628.1	8,799.4	4,669
Total Assets	44,650.0	58,095.2	73,932.7	78,435
Trade and Other Payables	29,822.8	34,321.4	34,531.1	28,838
Long Term Debt	5,510.7	6,621.7	10,108.1	10,686
Short Term Debt	3,889.6	6,944.7	18,877.5	42,979
Paid-up-Capital	1,206.8	1,448.2	1,810.2	1,991.2
Adjusted Equity (excluding revaluation surplus)	4,337.2	8,917.7	8,312.8	(5,972)
INCOME STATEMENT	**2016**	**2017**	**2018**	**9MCY19**
Sales-Net of Sales Tax	99,508.2	173,739.2	233,607.4	111,973.3
Gross Profit	5,130.1	7,389.0	10,276.6	168.3.8
Operating Profit/(loss)	3,078.1	4,528.4	5,995.9	(10,909.4)
Profit/(Loss) Before Tax	1,968.0	2,658.7	651.9	(18,436.1)
Profit/(Loss) After Tax	1,215.6	1,401.2	207.1	(13,877.0)
RATIO ANALYSIS	**2016**	**2017**	**2018**	**9MCY19**
Gross Margin (%)	5.2%	4.3%	4.4%	0.15%
Current Ratio (x)	0.97	0.96	0.87	0.5
FFO to Total Debt	24.3%	20.9%	-5.1%	-28.7%
FFO to Long Term Debt	41.4%	42.8%	-14.7%	-144%
Adjusted Gearing (x)	2.2	1.5	3.5	N/a
Adjusted Leverage (x)	8.9	5.4	7.4	N/a
Debt Servicing Coverage Ratio (x)	2.9	2.3	(0.15)	N/a
ROAA (%)	3.4%	2.7%	0.3%	-24.3%
ROAE (%)	29.7%	19.7%	1.8%	-15.8%

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				
17-Apr-20	BB+	A-3	Negative	Downgrade
04-Sep-19	BBB	A-3	Negative	Downgrade
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			
17-Apr-20	BBB-	Negative	Downgrade
04-Sep-19	BBB+	Negative	Downgrade
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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