RATING REPORT

Hascol Petroleum Limited

REPORT DATE:
September 23, 2019

RATING ANALYSTS:

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RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	BBB	A-3	AA-	A-1
Sukuk 1	BBB+		AA	
Rating Outlook	Negative		Negative	
Rating Date	*September 04, 2019*		*April 24, 2019*	

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

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).

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.

Oil sales volumes decreased by 25% in FY19 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, overall industry volumes witnessed a reduction of around 12% in FY19, with second largest decline observed in High Speed Diesel (HSD). HSD sales declined by around 20% in FY19 on account of slowdown in economy particularly in transport & Large Scale Manufacturing activities. In the absence of any direct substitutes, sharp decline in HSD sales is also attributable to increased smuggling. Going forward, OMC volumes are expected to remain under pressure in FY20.

Figure 3: Product wise growth/decline

(000 metric tonnes)	FY19	FY18	% change
FO	3,004	7,118	-58%
HSD	7,189	8,965	-20%
MOGAS	7,351	7,351	0%
HOBC	80	127	-37%
JP	529	746	-29%
KERO	94	109	-14%
LDO	18	17	6%
Total	18,264	24,433	-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. 12.4b in 1HCY19 despite communicated plans to reduce the same.

- **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 9MCY18. 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.

- **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.

Significant attrition in market share in 8MCY19 with decline in market share being more notable in recent months

HPL's overall market share declined to 8% in 8MCY19 from 13% in 8MCY18. Overall market share decline has been more notable in recent months with market share in July 2019 and August 2019 being reported at 4.4% and 4.9%, respectively. Overall capacity utilization in terms of storage capacities is significantly on the lower side. As per management, decline in market share is partly attributable to a conscious strategy to minimize losses given significant fluctuation in foreign currency and implementation of a revised credit policy. Over the long-term, HPL expects to increase market share as macroeconomic indicators stabilize.

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.

- **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 exposing the Company to exchange losses in case of rupee devaluation. The company has incurred a sizeable exchange loss in the ongoing year. While current account deficit has depicted a notable decline in the ongoing, sizeable gross financing requirements (including significant external debt servicing payments over the next three years) are expected to exert pressure on exchange rates. Resultantly, exchange losses remain a key risk area to profitability of the company, going forward.

HPL incurred a sizeable loss during 1HCY19 due to inventory & exchange loss and jump in finance cost. Profitability to remain under pressure given the decline in volumes and high finance cost.

Net Sales of the company decreased to Rs. 86.4b (1HCY18: Rs. 122.1b) in 1HCY19 due to lower volumetric sales. Overall profitability was impacted by sizeable expenses including a loss amounting to Rs. 6.2b due to fluctuation in the international oil prices and devaluation of rupee causing an increase in product cost. Regulated eventual selling prices verses 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. 2.65b (1HCY18: Rs. 435.2m) during 1HCY19. Resultantly, the company incurred a loss before tax of Rs. 14.7b (1HCY18: Rs. 1.6b).

Weak capitalization indicators and liquidity profile.

In order to fund expansion, HPL incurred sizeable capital expenditure of Rs. 12.4b (2018: Rs. 6.1b; 2017: Rs. 5.7b; 2016: Rs. 2.9b) in 1HCY19. The capital expenditure has largely been financed through acquisition of additional debt. Higher debt levels (Rs. 35.2b) and erosion in equity base (equity was negative at end-1HCY19) has translated into weak leverage indicators. Negative cash flows also translated into weak liquidity profile. The company has announced rights issue amounting to Rs. 6 billion in order to strengthen equity base. Timely raising of funds through rights issue is essential for improving liquidity and capitalization indicators.

Hascol Petroleum Limited Appendix I

FINANCIAL SUMMARY *(amounts in PKR millions)*

BALANCE SHEET	2016	2017	2018	HY19
Fixed Assets	8,688.9	13,680.3	22,563.2	33,833.7
Stock-in-Trade	16,477.7	18,557.1	22,615.3	20,779.0
Trade Debts	7,871.3	11,518.2	13,552.2	12,317.3
Cash & Bank Balances	7,821.1	9,628.1	8,799.4	7,027.6
Total Assets	44,650.0	58,095.2	73,932.7	83,621.1
Trade and Other Payables	29,822.8	34,321.4	34,531.1	48,943.8
Long Term Debt	5,510.7	6,621.7	10,108.1	9,347.2
Short Term Debt	3,889.6	6,944.7	18,877.5	25,857.5
Adjusted Equity	4,337.2	8,917.7	8,312.8	(2,855.5)
INCOME STATEMENT	2016	2017	2018	HY19
Sales-Net of Sales Tax	99,508.2	173,739.2	233,607.4	86,034.8
Gross Profit	5,130.1	7,389.0	10,276.6	107.8
Operating Profit/(loss)	3,078.1	4,528.4	5,995.9	(9,545.0)
Profit/(Loss) Before Tax	1,968.0	2,658.7	651.9	(14,674.8)
Profit/(Loss) After Tax	1,215.6	1,401.2	207.1	(11,168.3)
RATIO ANALYSIS	2016	2017	2018	HY19
Gross Margin (%)	5.2%	4.3%	4.4%	0.1%
Net Working Capital	(1,324.7)	(1,614.5)	(7,389.3)	(34,173.4)
FFO to Total Debt	24.3%	20.9%	-5.1%	-38.8%
FFO to Long Term Debt	41.4%	42.8%	-14.7%	-146.2%
Adjusted Gearing (x)	2.2	1.5	3.5	(12.3)
Adjusted Leverage (x)	8.9	5.4	7.4	(28.9)
Debt Servicing Coverage Ratio (x)	2.9	2.3	(0.15)	(3.4)
ROAA (%)	3.4%	2.7%	0.3%	-28.4%
ROAE (%)	29.7%	19.7%	1.8%	-818.6%

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 TYPE: ENTITY

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
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 TYPE: SUKUK

Rating Date	Medium to Long Term	Rating Outlook	Rating Action
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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