RATING REPORT

Hi-Tech Lubricants Limited (HTL)

REPORT DATE:
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RATING ANALYSTS:
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RATING DETAILS

	Latest Rating	
Rating Category	**Long-term**	**Short-term**
Entity	A	A-1
Rating Date	*February 22, 2018*	
Rating Outlook	Stable	
Outlook Date	*February 22, 2018*	

COMPANY INFORMATION

Incorporated in 1997	**External auditors:** M/s Riaz Ahmed & Co., Chartered Accountants
	Chairman of the Board: Mr. Shaukat Hassan
Public Limited Company	**Chief Executive Officer:** Mr. Hassan Tahir
Key Shareholders (with stake 5% or more):	
Shaukat Hassan & family – 31.1%	
Tahir Azam& family – 31.1%	

APPLICABLE METHODOLOGY(IES)

JCR-VIS Entity Rating Criteria: *Industrial Corporates (October 2016)*
http://jcrvis.com.pk/docs/Corporate-Methodology-201605.pdf

Hi-Tech Lubricants Limited

RATING RATIONALE

Hi-tech Lubricants Limited (HTL) has been in the business of trading of lubricants imported from SK Lubricants, South Korea (SKL) for around two decades. HTL sells almost all of its lubricants under the brand name 'ZIC'. The company has also invested in a wholly owned subsidiary, Hi-Tech Blending (Pvt.) Limited (HTBL) to set up a state of the art blending plant which was completed in August'2016. The plant has the facility of blending, producing its own bottles/caps and filling lines for lubricant bulk import. Blending capacity of the plant is 30,000 MT per annum, whereas filling capacity of the plant is 90 bottles per minute. Process of manufacturing bottles and filling lubricants is almost entirely automated.

HTL's product portfolio includes diesel, gasoline and motor cycle engine oil. Product portfolio also caters to Underhoods (industrial oils, greases, hydraulics, gear oils, brake fluids and coolants). These products are further classified into two segments i.e. top-tier (synthetic) and mid-tier (semi-synthetic) segment. Around three-fourth of the company's total sales comprise top-tier (synthetic) oil sales. Gasoline engine oil is the major sales driver in the top-tier range comprising over two-third of total sales, while diesel and motorcycle engine oil represents over 90% sales in mid-tier range. Company's entire sales are made through distributors (over 150 distributors) with negligible institutional sales, an area where room for improvement remains. Concentration in sales in term of top 20 distributors is on the higher side.

Oil Marketing Company (OMC)

HTL is in process of diversifying in the OMC business and expects to start commercial operations in the first half of 2018. The company plans to open 360 fuel stations in the first five year of operations with memorandum of understanding already signed for over 80pumps. The new fuel station will offer full range of services to customers and will be a combination of dealer and mixed financed pumps. The company's existing distributor network for lubricant business will also facilitate in retail footprint expansion. Progress has also been made in terms of expansion of storage infrastructure through 80% completion of storage facility at Sahiwal while Shikarpur, Tarujabba, Gatti and Mehmoodkot are at various feasibility/construction stages. Storage infrastructure is also being enhanced through hospitality arrangements in Punjab and KPK. JCR-VIS believes that the company's brand strength and recognition in lubricant business will facilitate HTL in establishing its footprint in the OMC business. In this regard, strong focus on service quality, as planned by the management, is considered important, particularly post deregulation in High Speed Diesel (HSD) business. Given the increased competitive landscape of the OMC sector with aggressive capex plans of existing (significant storage capacities coming online of Hascol, APL and PSO over the next two years) and new OMCs (Admore), progress against planned initiatives and projected financial targets will be an important rating driver, going forward. While increasing trend in international oil prices and rupee depreciation may partly impact demand growth, JCR-VIS expects demand growth to remain healthy on the back of healthy automobile sales (particularly heavy commercial vehicles) and increased transit activity as CPEC projects near completion.

Sector Dynamics

Lubricant industry in the country is dominated by multinational players, Shell Pakistan Limited (SPL) and Chevron Pakistan Limited (CPL), due to their perceived better product quality. Other major players include Pakistan State Oil Limited and HTL who also enjoy sizeable market share. Cumulatively, these four players represent over two-third of the lubricant market share. Remaining demand is catered to by multiple smaller players and other OMCs including Hascol Petroleum Limited and Total Parco Pakistan Limited. Share of smuggled products has witnessed a declining trend given the crack-down by the government on smuggled products in order to improve revenues. Lubricant business in the country is subject to high taxes and duties including custom duty of 21%, sales tax of 20% besides income tax.

OVERVIEW OF THE INSTITUTION

Hi-Tech Lubricants Limited (HTL) was initially formed as a partnership firm in March, 1997. In 2011, the firm was converted into a private limited company by the name of Hi-Tech Lubricants (Pvt.) Limited and subsequently converted into a public unlisted company in the same year. In 2016, the company was listed on the Pakistan Stock Exchange (PSX).

Primary activity of HTL involves trading of lubricants imported from SK Lubricants, South Korea in Pakistan under the brand name 'ZIC'. Registered office of the company is located at 1-A Danepur Road, GOR-1, and Lahore.

The company association with SK Lubricants, South Korea extends since 1997. The arrangement is for a period of 2 years and is extendable for another 2 years and was last negotiated at the time of the IPO in 2014. Management expects to sign a 10 year agreement with SK lubricants in the ongoing year. SK group is one of the largest conglomerates in South Korea and was ranked 95 in fortune global 500 list of 2017.

Pakistan's lubricant oils market demand is dominated by the transport segment with over four-fifth share, followed by industrial and then power sector. Within transportation segment, heavy duty diesel engine oil represents the major chunk of consumption followed by passenger cars and industrial oils. Lubricant business is deregulated and offers higher margin vis-à-vis conventional fuels (MOGAS and HSD) sold by OMCs

Going forward, demand growth for lubricant business is expected to continue to be driven by the transportation sector. Significant growth in sales of heavy commercial vehicles, motor cycles, passenger cars and tractors is expected to bode well for volumetric off-take. Lower fuel prices have resulted in increased use of automobiles and resultantly increased frequency of lubricant change. However OMCs, as part of the retail expansion strategy are aggressively targeting to increase market share in the lubricant business (through value added services like oil change facilities) resulting in significant price competition. Despite growing demand, JCR-VIS expects margins to witness pressure due to competition for market share. In the backdrop of rupee depreciation, margins of industry players are also expected to witness pressure unless cost increases are passed on to customers.

Profitability

Volumetric sales of the company have grown at a Compounded Annual Growth Rate (CAGR) of 10.5% over the last 5 years (2012-2017). Going forward, management expects increase in sales volume to be significantly higher than historical CAGR based on favorable demand outlook and improved price competitiveness in the diesel and motor cycle oil category. EBITDA margins have averaged 11.4% over the last five years and have increased on a timeline basis in FY16 and FY17. JCR-VIS expects EBITDA margins to be maintained despite increasing competition and rupee depreciation on account of impact of various costs saving initiatives, higher proportion of blended plant in product mix and planned increase in prices. Given the volumetric growth in sales, profitability is projected to depict strong double digit growth over the rating horizon.

Liquidity

Liquidity profile of the company is considered strong on account of healthy cash flows in relation to outstanding obligations (FFO coverage of long term debt is healthy at 1.48x (FY17: 1.74x; FY16: 0.82x). Besides healthy cash flows, liquidity profile is supported by sizeable liquid assets held on balance sheet; although the same is planned to be liquidated and utilized for incurring capital expenditure over the next 2 years. Working capital cycle increased on account of higher inventory accumulated for both finished good and HTBL bulk import. In order to maintain adequate buffer, management expects inventory days to remain on the higher side. Trade debts in relation to sales have remained within manageable levels with majority of company's sales based on cash. Current ratio of the company was reported at 1.8x at end-FY17. Debt servicing coverage ratio is currently strong and is projected to remain adequate (even after accounting for long term debt for OMC project) under realistic stress test scenarios.

Capitalization and Funding

Equity base of the company has grown on account of funds raised through Initial Public Offering and internal capital generation. Dividend payout ratio has ranged between 43%-59% over the last three years. Debt profile of the company is short-term in nature with short-term debt representing around three-fourth of total borrowings. Leveraging of the company has remained conservative as reflected by gearing of 0.38x at end-1QFY18. Going forward, management intends to prepay long-term borrowings pertaining to blending plant during FY18. However, short-term borrowings are projected to increase due to higher working capital requirements. Total capex planned for the OMC project is Rs. 3.8b which will be funded through a mix of debt (50%) and equity (50%). Expansion will initially be funded through liquidating TDRs on balance sheet and internal cash generation. Long-term debt draw down for OMC is planned in FY20. Even after accounting for debt planned to be raised for funding OMC project and higher borrowing to fund working capital requirement, gearing is projected to remain below 1(x) over the rating horizon.

Corporate Governance

Overall corporate governance framework is supported by adequate board composition and oversight. Board composition conforms to best practices with 3 independent and 1 women director (regulatory requirement). Senior management team has largely remained stable with experienced resources hired for successful execution of the OMC project. Internal audit function is outsourced to Ernst and Young Ford Rhodes, Sidat Hyder, Chartered Accountants with an internal HTL team possessing relevant experience also in place for effective liaison. The company uses Oracle based ERP with integrated modules for its IT related needs. Governance framework is supported by strong financial planning process, documented policy & procedural framework along with focus on transparency as evident from detailed governance related disclosures in the annual report which provide important information for stakeholders.

Hi-Tech Lubricants Limited **Appendix III**

FINANCIAL SUMMARY *(amounts in PKR millions)*

BALANCE SHEET	SEP 30, 2017	JUN 30, 2017	JUN 30, 2016
Fixed Assets	2,543.5	2,501.0	1,851.3
Short Term Investments	1,080.4	1,081.1	1,458.6
Stock-in-Trade	1,811.4	2,070.8	752.2
Trade Debts	235.1	179.6	151.1
Cash & Bank Balances	68.8	220.9	187.5
Total Assets	6,524.6	6,619.6	4,657.6
Trade and Other Payables	1,348.4	1,170.8	590.7
Long Term Debt *(*incl. current maturity)*	375.4	409.1	613.3
Short-term Debt	1,034.6	1,236.0	99.0
Total Equity	3,688.6	3,733.2	3,302.4

INCOME STATEMENT	SEP 30, 2017	JUN 30, 2017	JUN 30, 2016
Net Sales	2,037.0	7,328.5	7,014.7
Gross Profit	474.3	1,930.6	2,045.7
Operating Profit	198.0	1,059.6	838.4
Profit After Tax	133.9	744.0	518.1

RATIO ANALYSIS	SEP 30, 2017	JUN 30, 2017	JUN 30, 2016
EBITDA Margin (%)		14%	13.3%
FFO	138.8	711.4	500.2
FFO to Total Debt	0.39	0.43	0.70
FFO to Long-term Debt	1.48	1.74	0.82
Debt Leverage	0.77	0.77	0.41
Gearing	0.38	0.44	0.22
DSCR	2.17	2.57	3.33
Dividend payout	-	48.3%	59.3%
ROAA (%)	8.1	13.2	14.6
ROAE (%)	14.4	21.1	22.9

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix IV

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: JCR-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.jcrvis.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.jcrvis.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.

'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.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-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 V

Name of Rated Entity	Hi-Tech Lubricants Limited
Sector	Oil & Gas
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see table below
Instrument Structure	N/A
Statement by the Rating Team	JCR-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	JCR-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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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
Feb 22, '18	A	A-1	Stable	Initial