RATING REPORT

Hi-Tech Lubricants Limited (HTL)

REPORT DATE:

December 30, 2020

RATING ANALYSTS:
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RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A	A-2	A	A-2
Rating Outlook	Stable		Rating Watch-Negative	
Rating Date	*Dec 30,'20*		*April 21,'20*	

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)

VIS Entity Rating Criteria: *Industrial Corporates (May 2019)*
https://www.vis.com.pk/kc-meth.aspx

Hi-Tech Lubricants Limited

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).

Profile of Chairman: Mr. Shaukat Hassan holds a master's degree in economics from Punjab University Lahore Mr. Shaukat has a proven track record for his excellent business professionalism and is one of the core partners since the inception of business operations for the Group in 1976. Mr. Shaukat Hassan is also the CEO of MAS Infosoft (Pvt.) Ltd, Director of MAS Associates (Pvt) Ltd and Chairman/Trustee of HTL Employees Provident Fund Trust, Sabira Hamida Trust and MAS Associates Employees Provident Fund Trust.

Financial Snapshot

Core Equity: end-1Q21: Rs. 3.2b; end-FY20: Rs. 3.2b; end-FY19: Rs. 3.3b

Assets: end-1Q21: Rs. 5.1b; end-FY20: Rs. 5.0b; end-FY19: Rs. 6.1b

Net Sales: 1QFY21: Rs.1.8b; FY20: Rs. 5.6b FY19: Rs. 9.4b

Profit After Tax: 1QFY21: Rs 75.3m; FY20: Rs. (40.1m); FY19: Rs. (495.3m)

RATING RATIONALE

The ratings assigned to Hi-tech Lubricants Limited (HTL) take into account the established footprint of the company entailing adequate brand equity and market share in the lubricant sector. The assigned ratings incorporate moderate business risk profile of the company underpinned by relatively favorable competitive landscape of the sector along with multi-pronged revenue stream owing to initiation of operations of oil marketing company (OMC) and establishment of service express centers. The ratings draw comfort from shift in business model with majority of product procurement transferred to subsidiary leading to cost rationalization, reduced import dependence, mitigation of foreign exchange risk and improved cash conversion cycle. In the short to medium-term the demand driven risk is slightly escalated on account of ongoing pandemic as automobile industry has been one of the hardest hit sectors.

The change in the rating outlook factors in improvement in the financial risk profile supported by positive momentum in earnings, improved margins, rescued profitability and liquidity indicators and conservative capital structure. The liquidity position of HTL continues to be aided by investments in liquid avenues. Financial performance of the company is expected to be facilitated by significant decline in debt levels and lower average market interest rates resulting in reduced finance cost as compared to the preceding year. The ratings will remain dependent on improvement of market position, maintenance of leverage and liquidity indicators at around current levels coupled with augmentation of topline on account of materialization of financial prospects with incremental sales generation from OMC operations and hospitality rental services. Key risk to performance in FY21 will be from a prolonged 2nd wave of the corona virus pandemic although risk of the same is considered manageable given that vaccine rollout is expected in the upcoming months.

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 entirely automated.

Revenue Diversification: The Oil Marketing Company (OMC) business started commercial operations from Jan'20. As per the business plan, HTL plans to open 360 fuel stations in the first five-year of operations with memorandum of understanding already signed for multiple pumps. By end-Nov'20, 20 fuel pumps were operational; all the pumps have been opened in the central region. The company has received approval for opening of 26 petrol pumps in Punjab; the same are expected to become operational by end-FY21. The company expects to start marketing and sale of petroleum products in KPK by Jan'21, after completion of Nowshera Oil storage depot and receiving formal approvals from Oil and Gas Regulatory Authority (OGRA). It will lead the company to operate 26 HTL fuel station sin KPK. Further, feasibility study of Mehmoodkot has been completed; once the aforementioned facility is constructed the company will be able to improve its penetration in the Southern market as well. VIS believes that the company's brand strength and recognition in lubricant business will facilitate HTL in establishing its footprint in the OMC business. The OMC setup will further improve market penetration of lube oil of HTL as well by directly catering to the end-

consumers. In this regard, strong focus on service quality, as planned by the management, is considered important. 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. With the onslaught of COVID-19, oil prices have declined the transportation industry has been impacted the most, hence the prospects of OMC becoming profitable in the short-term remain minimal; however the medium to long-term forecast is bright owing to increased transit activity as CPEC projects near completion. In addition, HTL is also outsourcing its terminal facilities' to be used by other OMCs against which the company will charge hospitality service charge; the same is also projected to give boost to revenues.

Industry and Business Dynamics; COVID-19 has considerably impacted transportation industry: The top five players, namely Shell Pakistan Limited, Total PARCO Pakistan Limited, Chevron Pakistan Limited, MAL Pakistan, HTL and Pakistan State Oil Company Limited, account for more than 90% of the lubricant market**.** 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 22%, sales tax of 17% on retail price. The transport segment with over four-fifth share, followed by industrial and then power sector, dominates Pakistan's lubricant oil market demand. 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.

The Pakistani lubricants market is expected to register a CAGR greater than 1%, during from FY19 to FY25 reaching a size of $1.9b at end-FY25. The major contributing factor expected of growth is the augmenting textile production in Pakistan. Lubricants, such as greases, heat transfer fluids, gear oils, compressor oils, transmission, and hydraulic fluids, and anti-static oils are used in the textile industry. On the flip side, the slowdown in the automotive sector owing to significant increase in automobile prices as an outcome depreciation of rupee in terms of dollar is expected to hinder the growth of the sector. The engine oil segment has dominated the industry and is expected to continue its dominance during the forecast period. Recently, policy for promotion of electric vehicles in the country has been approved, which may negatively impact the engine oil market. Overall, the demand for engine oil, in the country from the automotive industry, is expected to increase at a slower rate in comparison to the past decade.

Quantum of loss declined during FY20 despite sharp dip in revenues; however he company revenues and profitability has picked pace during the ongoing year: HTL's net revenues took a sizable plunge declining to Rs. 5.6b in comparison to Rs. 9.4b in the preceding year primarily as an outcome of sizable dip in volumetric sales owing to change in consumer behavior in reaction to exchange rate driven price changes followed by impacts on the supply chain caused by taxation and regulatory changes led by the government. The informal participants in the distribution chain withdrew from the market in response to government documentation drive. In addition, the onslaught of COVID-19 pandemic towards end-3QFY20 brought the transportation segment almost to a standstill hence, escalating the revenue depression already caused by prevailing factors even further. With initiation of OMC operations, HTL has achieved slight revenue diversification with sale of petroleum products contributing 6% to the topline. The contribution is currently marginal; however, the same is expected to grow multifold owing to OMC being operational for full year long coupled with addition in the number HTL fuel stations.

Contrary to revenues, HTL's gross margins improved to 20.0% (FY19: 13.7%) on account of utilization of spare capacity of HTBL; the company shifted around 70% of products to HTBL by end-FY20 resulting in decline in input cost as for product processing now as the base oil is largely procured locally. Further, the high quality base oil was purchased from SKL in bulk quantity to avoid forex losses in the depreciating local currency scenario. Moreover, HTBL also has an indigenous bottling capacity that has contributed positively in the uptick of margins owing to economies of scope. In addition, as per the management, the final price adjustment to fully transfer the impact of rupee devaluation was made in 4QFY19; therefore margins have recovered. The distribution cost in absolute value has declined to Rs. 713.8m (FY19: 834.5m); however the same is a on a higher side relative to sales value. The decline was mainly manifested in employee related expenses owing to decline in staff strength along with cut down in sale advertisements and promotion activities as sales discounts are being reclassified in gross profit against gross sales. Further, the administrative expenses were also recorded lower at Rs. 381.0m (FY19: Rs. 432.4m) owing to salary expenses; the staff strength of permanent employees has declined to 338 at end-FY20 as compared to 381 in the preceding year. The other expenses reduced to 24.5m (FY19: 103.6m) on account of no exchange loss booked during the outgoing year in comparison of loss of Rs. 52.4m booked in FY19. On the other hand, other income stood higher at Rs. 129.7m (FY19: Rs. 113.9m) as a result of exchange gain booked and reversal of expected credit losses.

During FY20, HTL has restructured its sales system with the introduction of six handlers with each handler dealing with 8-10 distributors; the distributors are now merged with handlers. The handlers buy stock from the company in bulk quantities in turn aiding liquidity injection in the company as a result of which HTL's cost of carrying inventory has reduced leading to reduced working capital requirement. The structural shift in the sales system has contributed positively in cost reduction, reinstatement of brand value by transferring promotional discounts to consumers and improving market penetration. Subsequently, in line with lower utilization of short-term borrowings the finance cost declined to Rs. 186.3m (FY19: 235.1m) during FY20. As a combined impact of recovery of margins, reduction in operating expenses and rationalized finance cost, the quantum of loss was recorded lower at 40.1m (FY19: (Rs. 434.8m)) despite a decline of Rs. 3.8 in the top line. The outgoing years' loss incorporates loss of Rs. 18.0m emanating from OMC operations, the same is likely to turned around as only 9 fuel stations were operational by end-FY20; moreover, the same came online in Jan'20 so full year impact has not been taken into accounts.

The profitability indicators of the company exhibited positive trajectory in 1QFY21 with the company reporting profit of Rs. 75.3m from a topline of Rs. 2.3b owing to improvement in margins to 21.5%. The margins improved as import dependency has reduced further with the company procuring 80% of raw material from the company's own wholly owned subsidiary, HTBL, to reduce forex related losses. In additional, operating expenses have been rationalized and were reported lower at Rs. 300.1m during 1QFY21 as opposed to Rs.308.9m in the corresponding period last year. Finance cost has also continued to decline owing to perpetual decline in the short-term borrowings as an outcome of change in sale structure. Going forward, the management expects the company to close the current year at Rs. 9.0b with margins expected to improve to 25.0%. By end-Nov'20, 20 fuel stations were operational and the number is expected to increase to 36 by end-FY21. There is a two-fold increase expected in revenues from the fuel stations as it will not only sell petrol but also aid the sale of HTL's lube oil directly to end-consumers where the margin of lube is considerably high at 40% due to elimination of middle-man in the supply chain. The expected volumetric growth in sales is expected to bode well for profitability over the rating horizon.

Volatility exhibited in liquidity profile; the same has been a function of profitability indicators: Liquidity profile of the company remained weak and could not present a complete recovery during FY20 on account of incurrence of loss, although the quantum of loss declined considerably, given funds flow from operations (FFO) was still negative. However, a

turnaround in the liquidity position was witnessed during 1QFY21 as FFO was reported at Rs. 70.6m in line with improvement in scale of operations along with improvement in margins. Subsequently, FFO to total debt and FFO to long-term debt stood at 0.42x and 0.80x at end-1QFY21. In line with negative FFO, debt servicing coverage ratio (DSCR) was reported low at 0.4x at end-FY20 as opposed to negative in the of preceding year; however, the same stood at healthy 2.3x at end-1QFY21. Further, to support liquidity HTL has maintained 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. Moreover, in line with improved cash generation, the short-term investments are unlikely to be sold to meet any liquidity stress. The company has invested in term deposit receipts amounting to Rs. 472.4m (FY19: Rs. 778.4m) at end-FY20 with maturity ranging between one to six months. The interest receivable on these securities is locked at 5.4% to 12.9% per annum.

In addition, the working capital has decreased owing to change in sales structure where by the company receives large chunks of cash from handlers in advance rather than giving longer period credit to distributors; as a result of the same trade debts have exponentially reduced to Rs. 56.4m (FY20: Rs.76.1m; FY19: Rs. 1.2b) by end-1QFY21. In addition, given the raw material procurement which primarily includes purchase of base oil has been outsourced to HTBL, the company now only keeps stock of finished goods inventory, hence the stock in trade has declined on a timeline basis. Trade payables were recorded higher on timeline basis, majority of them pertained to HTBL in line with procurement of finished goods. Prior to this arrangement, HTL had to either import base oil from SKL or purchase from the local market against which a fair amount had to be paid in advance. Current ratio of the company was reported above 1.0x during the period under review. The company has maintained an investment in its subsidiary, HTBL, worth Rs. 1.3b; given strategic nature of investment the same is expected to remain in company's books in the long-term future.

Conservative Capitalization Structure: The equity base of the company took a slight dent during the outgoing year owing to net loss reported during FY20; however the situation improved during 1QFY21 as a result of positive bottom line. The company paid final cash dividend of Rs. 0.25/ share for FY19 amounting to an aggregate payment Rs. 29.0m during FY20. Meanwhile, dividend for FY20 is announced at Rs.0.9/share. There has been a shift in the debt matrix of the company as the short-term debt now only comprises less than half of the total credit procured as compared to 95% at end-FY18. The shift has been an outcome of change in business model as raw material procurement is now done by HBTL, meanwhile, ith induction of handler, HTL has substantial cash available as handlers inject their own funds for procuring company's products as opposed to huge quantum credit allocation to distributors previously. As a result, the company's cash cycle has improved on both fronts, payment and receivable, leading to slackened demand of short-term funding. In addition, as per the management, HTL plans to arrange long-term debt amounting to around Rs. 350m during FY21 for projected capex on infrastructure development of storage facilities for OMC and fuel pumps. Initially the management's plan was to meet the funding requirement from internal sources; however, owing to significant slash in market interest rates due to pandemic crisis cost of borrowing was rendered cheaper than cost of equity. Leases from banks are secured against charge on the lease assets, personal guarantees' of directors and security deposit of Rs. 9.7m. Going forward, the management does not plan on acquiring any new long-term funding for the next three years. Total capex planned for the OMC project will be funded through a mix of debt (50%) and equity (50%). Expansion of OMC operation sin FY21 is expected to be funded by internal cash generation. Given sizable reduction in the working capital requirement, gearing and leverage indicators have declined considerably on a timeline basis. With successful continuation of shift in business model entailing low working capital requirement along with reinstatement of positive momentum in revenues aiding equity augmentation, the leverage indicators are expected to remain at current levels and well 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. 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 that provide important information for stakeholders.

Hi-Tech Lubricants Limited Appendix I

FINANCIAL SUMMARY *(amounts in PKR millions)*				
BALANCE SHEET	**JUN 30, 2018**	**JUN 30, 2019**	**JUN 30, 2020**	**SEP 30, 2020**
Fixed Assets	1,389.0	1,583.9	1,693.7	1,727.1
Short Term Investments	917.4	882.5	723.3	665.9
Investment in Subsidiary	1,300	1,300	1,300	1,300
Stock-in-Trade	961.2	802.0	447.3	546.2
Trade Debts	236.9	1,189.4	76.1	56.4
Cash & Bank Balances	471.6	158.9	124.2	138.4
Total Assets	5,522.3	6,116.0	4,993.2	5.071.4
Trade and Other Payables	614.0	739.1	704.3	1,145.3
Long Term Debt *(*incl. current maturity)*	155.1	99.4	333.7	351.9
Short-term Debt	707.6	1,974.9	766.3	319.6
Paid up Capital	1,160	1,160	1,160	1,160
Tier-I /Total Equity	3,892.7	3,226.8	3,157.7	3,233.0
INCOME STATEMENT	**JUN 30, 2018**	**JUN 30, 2019**	**JUN 30, 2020**	**SEP 30, 2020**
Net Sales	9,253.6	9,431.2	5,628.7	1,838.9
Gross Profit	1,928.3	1,294.4	1124.9	395.8
Operating Profit/(Loss)	959.1	37.7	135.2	109.5
Profit /(Loss) Before Tax	876.5	(197.3)	(51.1)	89.1
Profit /(Loss) After Tax	554.4	(434.8)	(40.1)	75.3
FFO	612.1	(495.3)	(140.3)	70.6
RATIO ANALYSIS	**JUN 30, 2018**	**JUN 30, 2019**	**JUN 30, 2020**	**SEP 30, 2020**
Gross margin (%)	20.8	13.7	20.0	21.5
FFO to Total Debt	0.71	-0.24	-0.16	0.42
FFO to Long-term Debt	3.90	-5.0	-0.13	0.80
Debt Leverage	0.42	0.90	0.58	0.57
Gearing	0.22	0.64	0.35	0.21
Current Ratio	1.84	1.10	1.01	1.05
DSCR	7.9	-1.3	0.4	2.3
ROAA (%)	9.7	-7.5	-0.7	6.0
ROAE (%)	14.5	-12.2	-1.3	9.4
(Stock in Trade+ Trade Debt) to Short-Term Borrowing	1.69	1.01	0.68	1.89

ISSUE/ISSUER RATING SCALE & DEFINITIONS — Appendix II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

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	Hi-Tech Lubricants Limited
Sector	Oil & Gas
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Instrument Structure	N/A

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
Dec 30, '20	A	A-2	Stable	Maintained
Apr 21, '20	A	A-2	Rating watch Negative	Maintained
Sep 12, '19	A	A-2	Stable	Downgrade
Feb 22, '18	A	A-1	Stable	Initial

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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Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Hisham Iqbal	Manager Accounts and Finance	02-Dec-2020
Mr. Hamza Iqbal	Deputy Manager Finance	02-Dec-2020