RATING REPORT

Hi-Tech Lubricants Limited (HTL)

REPORT DATE:

December 03, 2021

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	Positive		Stable	
Rating Date	*December 03, '21*		*December 30,'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 Methodology – Industrial Corporates (August 2021)
https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

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).

Primary activity of HTL involves production and distribution of lubricants and petroleum products. In Jan'20, the company commenced marketing and sale of petroleum products as an OMC under the brand name of HTL Fuel Stations. The company imports lubricants 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.

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 (around 6% in the overall lubricants market and 25% market share for passenger cars segment) in the lubricant sector. The assigned ratings incorporate moderate business risk profile of the company underpinned by relatively favorable competitive landscape of the sector post recovery in international oil prices and gradual improvement in the overall macroeconomic environment. Ratings also factor in multipronged revenue stream owing to initiation of operations of oil marketing company (OMC).

The ratings draw comfort from shift in business model with majority of product procurement transferred to subsidiary- Hi-Tech Blending (Pvt) Limited (HTBL) leading to cost rationalization reduced import dependence, mitigation of foreign exchange risk and improved cash conversion cycle. Moreover, during FY21 the company has franchised its Express Centers in Lahore, Karachi and Rawalpindi and earns rental income on the same.

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 also invested in a wholly owned subsidiary, HTBL that operates a state of the art blending plant since 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. HTBL operates at a capacity utilization of around 80%. Ratio of imported to local lubricants manufacturing was 60:40 during the outgoing year. HTBL also plans to further increase its capacity in HTBL to 51,000MT per annum through installation of 1 filling line, 3 blow molding machines and 1 injection molding machines. Expected commencement of the same is by Jan'22. Furthermore, in order to avail new business opportunities, HTBL also plans to venture in the manufacturing of plastic products for external customers and third parties.

Diversification in revenue base noted in FY21 with commencement of OMC operations.

The Oil Marketing Company (OMC) business started commercial operations from Jan'20. By the end of FY21, Hi-Tech had 23 fuel stations, all in the Punjab region (26 fuel stations as on November 16, 2021, with 24 operational) with planned increment to around 40-45 by end-FY22. The company currently has storage capacity of 2,130 MT of PMG and 1,859 MT of HSD at Sahiwal. The company has recently developed a storage terminal in Nowshehra, with the aim of establishing its presence in the KPK region subject to approvals from OGRA. The storage capacity at the KPK depot is 1,401 MT of PMG and 1,550 MT of HSD. The plan includes opening of around 35 fuel stations in KPK by end-FY22. Going forward, the entity aims to develop additional storage facilities in Shikarpur (Sindh) and Machike (Punjab), with projected capital expenditure of Rs. 400m and Rs. 500m in FY23 and FY24, respectively.

More than 70% of oil is imported, which offers the benefit of avoiding Ex-refinery fixed price. From the local refineries, stock of no more than 7 days is purchased, helping to avoid any significant inventory losses. Due to the rising prices of petroleum products in Q1FY22, the company was able to enjoy an unprecedented gross margin of up to Rs. 10 per liter. In FY21, there was a huge increase in the revenue generated from the OMC segment (FY21: Rs. 2.4b, FY20: Rs. 349m) because of an increase in the scale of operations, and the growth is expected to continue in near future, as more fuel stations are successfully established across the country.

Dynamics of the Lubricant Segment

The product portfolio includes diesel, gasoline, and motor cycle engine oil. In addition, HTL also caters to the requirement for industrial oils, greases, hydraulics, gear oils, brake fluids, and coolants. These products are further classified into two categories i.e. top-tier (synthetic) and mid-tier (semi-synthetic). Adoption of a new handler model in FY20 to ensure timely supply of lubricants to the distributors across Pakistan along with passing over the carrying risk of inventory to the handlers along with minimizing credit risk exposure has been noted positively in the ratings review. The current sales system encompasses 6 handlers with each dealing with 10-15 distributors 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.

In the lubricants segment, there are agreements in place with DFSK (M/s Regal Automobiles), Hyundai Pakistan, Pak Suzuki Motor Company Limited, and Kia Pakistan. As part of the operations, 85% of base oil is imported from SK Lubricants in South Korea, which is processed and filled in bottles at Hi-Tech's blending plant and supplied to distributors. The rest is purchased from local refineries and requires a certain type of additives to meet the desired quality standard. This segment also experienced a significant growth in FY21 with revenue increasing to Rs. 8.2b (FY20: Rs.5.3b). Given price improvement in the ongoing year gross margins of the segment mounted to 27% in 1QFY22 from 21.3% (FY20: 21.5%) in FY21.

On the international front, the company recently entered into an agreement with M/S Osman Ghani Limited to export its lubricants to Afghanistan. However, uncertainty remains due to the ongoing political situation. Going forward, the management will be receptive to other such opportunities. Considering the increasing demand for motor vehicles in the country and HTL's market presence, the segment's performance is expected to improve further in the coming years.

Company returned to profitability during FY21, as revenue escalated.

Sales revenue depicted a significant improvement and was reported at Rs.10.6b during FY21 (FY20: Rs. 5.6b, FY19: Rs. 9.4b). Sale from petroleum products grew by 6.9x over the period, whereas the revenue from lubricants went up by 55%. The growth was a function of recovery of economic activity post COVID-19, which has continued in Q1FY22. Contrary to the revenue, gross margin for FY21 fell to 16.9% (FY20: 20%, FY19: 13.7%), as the devaluation of the currency raised the cost of imported lubricants. However, the company has now finalized the transition of its sales model that was in process for the last two years. With this change, cost of carrying inventory was transferred to the handlers; consequently requiring lower financing requirements reducing finance costs. The improved operational efficiency, offered by the re-designed supply chain enabled the company to earn a profit of Rs. 300m (FY20: loss of Rs. 40m, FY19 loss of Rs. 435m) in FY21, with a net margin of 2.8% (FY20: -0.7%, FY19: -4.6%). The company reported a net profit of Rs. 342m in 1QFY22 bolstered by a one-off dividend income of Rs. 260m from HTBL. Going forward, profit levels are expected to increase in line with projected expansion in scale of operations.

Improvement exhibited in liquidity profile being a function of high profitability levels and shift in business model reducing cash conversion cycle.

Liquidity position of the company improved substantially on the back of a profitable outgoing financial year. FFO for FY21 increased to Rs. 562m (FY20: -Rs.138m, FY19: -Rs.499m), providing sufficient coverage for debt obligations. Debt service coverage ratio (DSCR), FFO to long term debt and FFO to total debt improved to 3.75x (FY20: 0.19, FY19: -1.12), 103% (FY20: -42%, FY19: -502%), and 56% (FY20: -12%, FY19: -24%), respectively. At end-FY21, short-term debt coverage was also more than 200% and the current ratio remained around 1, all of which highlights a healthy position for the company. Short-term investments in the equity market and mutual funds to the tune of Rs. 220m (FY21: Rs. 446m, FY20: Rs. 723m) at end-Sep'21 provides additional liquidity cushion. However, with gradual utilization of IPO proceeds for expansion in storage capacities, investment portfolio is projected to decline. Going forward, liquidity indicators are expected to improve further because of the expected rise in profit levels.

Sound Capitalization Indicators. Going forward, despite additional debt drawn planned to finance capex in Shikarpur and Machine Depots along with higher working capital needs in view of increase in scale of operations, leverage indicators are expected to remain within manageable levels given consequent growth in equity base through profit retention.

The equity base of the company remained at a similar level at end-FY21 despite a profit of Rs. 300m for the period. This is due to the higher dividend payment to share-holders. Additional long-term debt was raised under the SBP Refinance Scheme for the payment of wages and salaries, but at the same time short-term debt reduced by Rs. 305m. In line with these changes, gearing ratio slightly improved to 0.32x (FY20: 0.35, FY19: 0.64), whereas the leverage ratio went up to 0.77 (FY20: 0.58, FY19: 0.90). Going forward, despite additional debt drawn planned to finance capex in Shikarpur and Machine Depots along with higher working capital needs in view of increase in scale of operations, leverage indicators are expected to remain within manageable levels given consequent growth in equity base through profit retention.

Hi-Tech Lubricants Limited Appendix I

Financial Summary - Unconsolidated (Rs. in m)				
Balance Sheet	**FY19**	**FY20**	**FY21**	**1QFY22**
PPE	1,584	1,694	1,834	1,876
Long Term Investments (including investment property)	1,300	1,300	1,362	1,362
Stock-in-Trade	802	447	879	717
Trade Debts	1,189	78	103	156
Short term ivestments	882	723	446	220
Cash and Bank Balances	159	124	265	462
Total Assets	6,116	4,995	5,586	5,758
Trade and other Payables	739	704	1,385	875
Long Term Debt	99	337	545	541
Short Term Debt	1,975	766	461	808
Total Debt	2,074	1,103	1,006	1,349
Paid Up Capital	1,160	1,160	1,160	1,160
Total Equity	3,227	3,158	3,151	3,493
Income Statement				
Revenue	9,431	5,629	10,589	3,080
Gross Profit	1,294	1,125	1,787	555
Profit Before Tax	(197)	(51)	443	380
Profit After Tax	(435)	(40)	300	342
Ratio Analysis				
Gross Margin	13.7%	20.0%	16.9%	18.0%
Net Margin	-4.6%	-0.7%	2.8%	11.1%
Net Working Capital	299	19	(93)	251
FFO	(499)	(138)	562	140
FFO To Total Debt (%)	-24%	-12%	56%	41%
FFO to Long Term Debt (%)	-502%	-41%	103%	103%
Debt Servicing Coverage Ratio (%)	(1.12)	0.19	3.75	2.48
Gearing (x)	0.64	0.35	0.32	0.39
Leverage (x)	0.90	0.58	0.77	0.65
Current Ratio (x)	1.10	1.01	0.95	1.13
STD Coverage (%)	101%	69%	213%	108%
ROAA (%)	-7%	-1%	6%	24%
ROAE (%)	-13%	-1%	10%	41%
(Cash+Short term investments)/Payables	141%	120%	51%	78%
DSO (days)	46.03	41.10	3.13	3.85
DIO (days)	35.98	50.63	27.49	28.83
DPO (days)	33.15	58.49	43.32	40.83
CC (days)	48.85	33.24	(12.70)	(8.15)

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

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
Dec 03, 2021	A	A-2	Positive	Maintained
Dec 30, 2020	A	A-2	Stable	Maintained
Apr 21, 2020	A	A-2	Rating Watch - Negative	Maintained
Sep 12, 2019	A	A-2	Stable	Downgrade
Feb 22, 2018	A	A-1	Stable	Initial

Instrument Structure	N/A
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
Hisham Iqbal	Senior Manager Financials	09-Nov-21
Hamza Iqbal	Manager Financials	09-Nov-21