RATING REPORT

Hi-Tech Lubricants Limited (HTL)

REPORT DATE:

November 28, 2022

RATING ANALYSTS:
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RATING DETAILS				
	Latest Rating		Previous Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	A	A-2	A	A-2
Rating Outlook	Stable		Positive	
Rating Date	*November 28, '22*		*December 03,'21*	

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):	
Directors and their families – 70.54%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria Methodology – Industrial Corporates (August 2021) **https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf**

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,

RATING RATIONALE

About the Company

- Hi-tech Lubricants Limited (HTL) is 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'.
- Lubricants are sold in the domestic market through designated handlers and distributors across Pakistan including Gilgit and Azad J&K.
- Majority of the revenue is generated from the Punjab region.
- Albeit being small in size, HTL has also signed a Non-Exclusive Distribution Agreement with M/S Osman Ghani Limited (an Afghanistan based company) for export of locally blended ZIC Brand products. However, uncertainty remains due to the ongoing political situation.
- In Jan'20, the company commenced marketing and sale of petroleum products as an OMC under the brand name of HTL Fuel Stations in the Punjab Province.
- The company currently has two storage terminals in Sahiwal and Nowshehra, respectively. The one in Sahiwal has storage capacity of 2,040 MT of PMG and 1,860 MT of HSD. Nowshehra's storage capacity stands at 1,401 MT of PMG and 1,550 MT of HSD. In addition to that, Hi-tech uses a terminal in Machike as part of a hospitality arrangement.
- At end-June'22, the company had 27 dealer operated fuel stations in Punjab.
- During FY22, OGRA enhanced limit of HTL fuel stations in Punjab from 26 to 52 based on successful completion of Sahiwal Oil Storage Facility. In view of the enhancement, management plans to open 5-10 additional stations by Dec'22.
- Second storage at Nowshera, KPK has been completed to operate 35 fuel stations in KPK. With delay in receipt of licenses to operate in KPK, the company enhanced its footprint in Punjab.
- Going forward, the entity aims to develop an additional storage facility in Shikarpur (Sindh), work on which has already started.
- The Company provides vehicle maintenance services through its franchise centers called HTL Express Centers. These are located in Lahore, Karachi, Rawalpindi, and generate rental income for the entity. Going forward, management plans to phase out from express centers division gradually.

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. synthetic and semi-synthetic. A handler model was adopted in FY20 to ensure timely supply of lubricants to the distributors across Pakistan, which passes over the carrying risk of inventory to the handlers and minimizes credit risk exposure. 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

GOR-1, and Lahore.

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, around 60 % of lubricants are imported SK Lubricants, most of which are filled in bottles at Hi-Tech's blending plant. For the rest, base oil is procured from local refineries and certain types of additives supplied by the same vendor (SK Lubricants) are mixed into it to meet the quality standards

Going forward, the management plans increase the proportion of lower-tier products (intended for motorcycles) in the overall mix as they offer better margins. With higher planned utilization of local refineries' base oil for manufacturing of the same, exchange rate risk is expected to be mitigated.

Key Rating Factors

Elevated business risk profile amidst weakening in global and local macroeconomic indicators

The ratings assigned to HTL take into account the established footprint of the company entailing adequate brand equity and market share in the lubricant sector. Business risk profile of the company is supported by relatively favorable competitive landscape of the lubricant sector; however with slowdown in overall global oil demand amidst subdued international and local macroeconomic fundamentals and supply constraints due to OPEC's decision on production cuts, risk profile of the oil sector is considered elevated over the next year. Ratings also factor in multipronged revenue stream owing to initiation and subsequent expansion 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.

Wholly owned subsidiary, HTBL 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 was 67.9m MT per annum at end-FY22. Process of manufacturing bottles and filling lubricants is entirely automated. Around 60% of the lubricants are imported, whereas for the remainder base oil is sourced locally from refineries. Furthermore, in order to diversify its business operations, HTBL is in the process of establishing a facility to manufacture a range of plastic products for different types of external customers.

A diversified revenue base

Rs. In m	Lubricants				Petroleum			
	FY21	FY22	1QFY22	1QFY23	FY21	FY22	1QFY22	1QFY23
Sales	8,187	9,800	1,843	1,340	2,410	7,944	1,237	2,602
Proportion in total Sales Mix	77%	55%	60%	34%	23%	45%	40%	66%
Gross Margin	27%	31%	27%	24%	2%	8%	4%	1%
Net Margin	12%	9%	21%	-4%	-5%	4%	-1%	-3%
Net Profit	945	866	395	(59)	(131)	352	(15)	(67)

Revenue generation from the OMC segment (FY22: Rs. 7.9b, FY21: Rs. 2.4b) increased because of an increase in the scale of operations along with higher selling prices. Lubricants segment also experienced a decent growth in FY22 with revenue increasing to Rs. 9.8b (FY21: Rs.8.2b). Given price improvement in the last year, gross margin of the segment to 31.3% (FY21: 27.0%). Meeting projected growth momentum along with improving margins amidst demand slowdown is important from a ratings perspective.

Improved profitability in FY22 supported by double-digit growth in topline and profits achieved in the OMC division. However, with weak macroeconomic environment in the ongoing year, HTL incurred losses. Re-bound in the same is considered important.

Sales revenue depicted a significant improvement and was reported at Rs.17.7b during FY22 (FY21: Rs. 10.6b, FY20: Rs. 5.6b) with sale of petroleum products and lubricants increasing by 3.3x and 20%, respectively. Sales revenue for 1QFY23 was recorded to the tune of Rs. 1.3b declining in correspondence to the preceding year due to stock building industry in the wake of uncertain economic and political environment and impact of floods halting supply of products in the southern part of the country.

Contrary to the revenue, gross margin for FY22 fell to 15.3% (FY21: 16.9%, FY20: 20.0%), which was mainly attributable to a growing share of OMC business in the overall sales mix yielding lower margins as compared to lubricants segment. Growth in operating expenses during FY22 was in line with growth in sales revenue, despite incurrence of exchange loss. Dividend income from subsidiary to the tune of Rs. 283m supported bottom-line of the company in FY22. Consequently, profit margin for the year was reported at 4.2% (FY21: 2.8%, FY20: -0.7%).

Subdued market dynamics across the globe and Pakistan in particular affected the profitability profile in 1QFY23 (lower gross margins and higher finance costs) with the company reporting loss amounting Rs. 101m. Improving the same over the remaining part of the year is considered important in view of extended working capital cycle posing higher burden of financial charges on the books.

Escalated working capital cycle to hold inventory weakened liquidity profile in 1QFY23; which were adequate in FY22

Liquidity position of the company improved in FY22 on the back of higher profits with cash flows providing sufficient coverage for debt obligations. Debt service coverage ratio (DSCR), FFO to long term debt and FFO to total debt improved to 3.55x (FY21: 3.75x, FY20: 0.19), 167% (FY21: 103%, FY20: -41%), and 50% (FY21: 56%, FY20: -12%), respectively at end-FY22. At end-FY22, inventory and trade debts also provided adequate coverage against short-term debt, while current ratio stood at 1.02x.

Management of working capital cycle in the lubricants segment is efficient, considering payments are received in advance from handlers. This enables the company to utilize excess cash for meeting working capital requirements of the OMC segment. Quantum of short-term investments on the balance sheet has fallen to Rs. 227m (FY21: Rs. 446m) at end-June'22 which will be liquidated over time to utilize funds for expansion in the KPK region. Going forward, the planned implementation of the handler model for Zic M (lower tier) products is expected to further improve the cash conversion cycle.

With proportion of OMC segment in the total business operations increasing on a timeline basis, overall cash conversion cycle of the company has extended increasing the utilization of short-term borrowings to carry inventory. In addition to the losses incurred, liquidity profile of the company weakened in the ongoing year. Management of working capital needs and consequent improvement in liquidity profile is important to sustain the ratings.

Sound Capitalization Indicators.

On the back of profit retention, equity base of the entity increased to Rs. 4.1b (FY21: Rs. 3.2b, FY20: 3.2b). However, quantum of short-term debt rose substantially in line with higher working capital requirements. Consequently, capitalization indicators went up, but remained within manageable levels. At end-Sep'23, gearing and leverage ratios were reported at 0.64x (FY22: 0.5x, (FY21: 0.3x) and 0.93x (FY22: 1.2x, FY21 0.8x), respectively. Going forward, drawdown of long-term debt is planned to finance capital expenditure at Shikarpur site and utilization of running finance lines is also expected to follow an upward trajectory due to expansion in operations. Maintaining capitalization profile over the rating horizon will be one of the key rating sensitivities.

Hi-Tech Lubricants Limited Appendix I

Financial Summary - Unconsolidated (Rs. in m)					
Balance Sheet	**FY19**	**FY20**	**FY21**	**FY22**	**1QFY23**
PPE	1,584	1,694	1,834	2,590	2,549
Long Term Investments (including investment property)	1,300	1,300	1,362	1,430	1,430
Stock-in-Trade	802	447	879	2,869	1,255
Trade Debts	1,189	78	103	106	115
Short term ivestments	882	723	446	227	231
Cash and Bank Balances	159	124	265	657	292
Total Assets	6,116	4,995	5,586	9,137	7,813
Trade and other Payables	739	704	1,385	2,726	1,043
Long Term Debt	99	337	545	644	602
Short Term Debt	1,975	766	461	1,494	1,996
Total Debt	2,074	1,103	1,006	2,138	2,598
Paid Up Capital	1,160	1,160	1,160	1,392	1,392
Total Equity	3,227	3,158	3,151	4,143	4,042
Income Statement					
Revenue	9,431	5,629	10,589	17,739	3,942
Gross Profit	1,294	1,125	1,787	2,720	347
Profit Before Tax	(197)	(51)	443	1,014	(126)
Profit After Tax	(435)	(40)	300	737	(101)
Ratio Analysis					
Gross Margin	13.7%	20.0%	16.9%	15.3%	8.8%
Net Margin	-4.6%	-0.7%	2.8%	4.2%	-2.6%
Net Working Capital	299	19	(93)	80	(25)
FFO	(499)	(138)	562	1,077	(143)
FFO To Total Debt (%)	-24%	-12%	56%	50%	-22%
FFO to Long Term Debt (%)	-502%	-41%	103%	167%	-95%
Debt Servicing Coverage Ratio (%)	(1.12)	0.19	3.75	3.55	(0.38)
Gearing (x)	0.64	0.35	0.32	0.52	0.64
Leverage (x)	0.90	0.58	0.77	1.21	0.93
Current Ratio (x)	1.10	1.01	0.95	1.02	0.99
STD Coverage (%)	101%	69%	213%	199%	69%
ROAA (%)	-7%	-1%	6%	10%	-5%
ROAE (%)	-13%	-1%	10%	20%	-10%
(Cash+Short term investments)/Payables	141%	120%	51%	32%	50%
DSO (days)	46.03	41.10	3.13	2.15	2.56
DIO (days)	35.98	50.63	27.49	45.54	52.33
DPO (days)	33.15	58.49	43.32	49.95	47.83
CC (days)	48.85	33.24	(12.70)	(2.26)	7.06

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		
Nov 28, 2022	A	A-2	Stable	
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	26-Oct-22
Hamza Iqbal	Manager Financials	26-Oct-22