Hascol Petroleum Limited

DEFAULT NOTE

April, 2021

On March 30th 2021, VIS Credit Rating Company Limited (VIS) assigned a 'D' (Default) rating to 6-year (incl. of 1-year grace period) Sukuk (Sukuk-I) of Hascol Petroleum Limited (HPL) due to non-payment of its latest profit payment to Sukuk holders. The Sukuk had previously been assigned a rating of 'BBB-' (Triple B Minus) with 'Negative' outlook.

On December 28th 2012, VIS had assigned initial rating of 'A-/A-2' (Single A Minus/ A-Two) to HPL, with a 'Stable' Outlook. The initial ratings incorporated the operational status of HPL as an Oil Marketing Company (OMC) with a network of around 200 fuel stations with plans to expand its retail network subsequent to the completion of new storage facilities. HPL's rating incorporated the exclusive franchise arrangements with Fuchs Lubricants Germany (FUCHS) to produce and market lubricants as well as greases under the FUCHS brand name in the local market. The initial ratings incorporated the strong growth in HPL's profitability and FFO during FY11-12 period. Gearing had improved on account of fresh equity injection coupled with internal capital generation. Substantial increase in sales of High Sulphur Furnace Oil (HSFO) to independent power producers was noted in FY11 & FY12. Greater reliance on higher margin products i.e. High Speed Diesel (HSD) and Motor Spirit (PMG), mostly sold through the retail channel, was planned over a timeline. The management was cognizant of the fact, and had anticipated a paradigm shift in business dynamics with the completion of its new storage facilities, critical for boosting sales through the retail channel. Timely completion of planned depots was expected to improve competitive position of Hascol in the industry, enabling it to supply petroleum products across the country at competitive rates as well as reducing product delivery time.

On March 31st 2014, the ratings assigned to HPL were upgraded to 'A+/A-1', with a 'Stable' outlook. The upgrade incorporated, improvement in both financial and business risk profile of the company, given that HPL had raised Rs. 1b during the book building process, while Rs. 400m was expected to be generated during the Initial Public Offering (IPO). As a result, availability of credit facilities to HPL was enhanced, which was deemed important in view of the expansion in business operations. Given considerable increase in sales volumes, market share of HPL had strengthened across all major products during FY13. While gross margins declined, higher volumetric sales translated into improved bottom line results. With completion of additional two storage facilities during FY14, the management had projected sales growth trajectory to continue. Liquidity profile of HPL was deemed satisfactory as credit period available from the upstream oil refineries was longer than the credit period offered to downstream customers, thus allowing HPL to effectively manage its cashflows. Quantum of on balance sheet financing was deemed as low.

Table 1: Key Financial Indicators (All Figures in PKR' Millions, except for percentages)

	2012	2013	2014
Sales	25,930	49,820	84,856
Gross Margin	3.14%	2.28%	2.00%
Net Profit	218	392	640
FFO to Debt	15%	22%	32%
DSCR	1.39x	1.28x	2.42x

VIS issued preliminary ratings of Sukuk-I at 'AA-' on November 6th 2015, which were finalized on January 8th 2016. The assigned rating were built on the entity ratings of HPL at 'A+/A-1' (Single A Plus/ A-One) and notched one up on the basis of security structure of the Sukuk which entailed formation of a debt payment mechanism to include monthly retention of amount equivalent to one-third of the quarterly installment in an escrow account by the collection agent from HPL revenues to meet the upcoming installments.

On November 1st 2017, the rating assigned to Sukuk-I was upgraded to AA' (Double A), on the basis of entity rating of HPL being upgraded to 'AA-/A-1' (Double A Minus/A-One). The rating action took into account projected strengthening in capitalization indicators post rights share announcement which was to enhance equity base by 84%. Ratings upgrade also reflected increasing market share, significant ongoing and projected investment in infrastructure (storage, retail footprint & supply chain) which was to facilitate in sustaining growth momentum. Ratings also drew comfort from strategic investment of Vitol Dubai Limited in HPL, a significant international player in the oil sector.

Table 2: Key Financial Indicators (All Figures in PKR' Millions, except for percentages)

	2015	2016	H1'2017
Sales	76,774	99,508	77,531
Gross Margin	3.7%	4.7%	3.9%
Net Profit	1,133	1,216	791
FFO to Debt	26%	19%	23%
DSCR	1.92x	2.41x	2.15x

On September 4th 2019, VIS revised the entity ratings of HPL to 'BBB/A-3' (Triple BBB/A-Three) and Sukuk-I ratings to 'BBB+' (Triple B Plus). The outlook on the assigned rating was revised to 'Negative'. The revision in ratings reflected the significant deterioration in financial risk profile on the back of an unexpected sizeable loss incurred by the Company in H1'2019 resulting in weakening in liquidity profile and risk absorption capacity, as reflected in HPL's company announcement made on August 29th, 2019 on PSX. Ratings downgrade also took into account continued high capital expenditure levels despite plans to reduce the same. Resultantly, borrowings continued to increase on a timeline basis, which along with sizeable equity erosion had translated into weak leverage. The rating action also reflected weakening in industry dynamics and HPL's import-based model, leading to increased market risk which had impacted business risk profile. The revised ratings incorporated strategic investment of Vitol Dubai Limited (VDL) in HPL, a significant international player in the oil sector, which was demonstrated by provision of financing facilities to the tune of $42million to HPL. The assigned ratings were dependent upon management plans to strengthen capitalization levels through rights issue.

On April 17th, 2020 VIS revised the entity ratings of HPL to 'BB+/A-3' (BB Plus/A-Three) and Sukuk-I ratings were revised to 'BBB-' (Triple B Minus). The rating action incorporated further weakening in financial profile of HPL on the back of continued sizeable losses incurred, resulting in weakening of liquidity profile and risk absorption capacity; this, along with significant debt-funded expansion - had adversely impacted the capital structure despite a sizeable equity injection through a rights issue. The rating action also reflected the attrition in market share, which declined sharply in 9M'FY20 (Jun'19 - Mar'20) while volumes of Hascol dropped by 50% vis-à-vis 11% decline in industry volumes during the period. Given the expected volumetric and revenue decline along with very thin margins and substantial debt on the book, the debt servicing ability had been affected, which was incorporated in the rating. Rating action also incorporated the sharp fall expected in industry volumes (due to partial lockdowns to prevent coronavirus outbreak) which along with steep decline in oil prices (resulting in inventory losses) and exchange rate devaluation was projected to adversely impact financial profile of OMCs. Ratings continued to depend upon and incorporate strategic investment of Vitol Dubai Limited (VDL) in HPL, a significant international player in the oil sector, which was demonstrated by VDL increasing its shareholding in HPL to 40.8% as at end-January 2020.

On March 30th, 2021, the ratings assigned to Sukuk-I was revised to 'D' (Defaulted Obligation) on account of non-payment of an installment due. The rating was based on the instrument carrying a debt servicing mechanism to progressively retain upcoming installment in an escrow account under a trustee arrangement, which mechanism had apparently faltered and sponsor support from VDL, which had been incorporated in the assigned rating, also did not materialize. Given weakening in financial risk profile, as reflected by 9M'2020 (Jan'20 - Sep'20) accounts, which were released on PSX on March 29th 2021 wherein equity stood at negative Rs. 33.3b (excluding revaluation surplus). On account of this, and above mentioned instrument default, the debt repayment capacity of HPL had substantially eroded. Accordingly, entity ratings of HPL were revised to 'CC/C' (Double C/Single C) with 'Negative outlook'.

Table 3: Sukuk-I Rating History

Rating Date	Medium to Long term Rating	Rating Outlook	Rating Action Type
11/6/2015	AA-	Stable	Preliminary
1/8/2016	AA-	Stable	Final
11/2/2016	AA-	Stable	Reaffirmed
11/1/2017	AA	Stable	Upgrade
4/24/2019	AA	Negative	Maintained
9/4/2019	BBB+	Negative	Downgrade
4/17/2020	BBB-	Negative	Downgrade
3/30/2021	D	-	Default

Table 4: HPL Entity Rating History

Rating Date	Medium to Long term Rating	Rating Outlook	Rating Action Type
12/28/2012	A-/A-2	Stable	Initial
6/26/2013	A-/A-2	Stable	Reaffirmed
3/31/2014	A+/A-1	Stable	Upgrade
7/7/2015	A+/A-1	Stable	Reaffirmed
11/2/2016	A+/A-1	Stable	Reaffirmed
11/1/2017	AA-/A-1	Stable	Upgrade
4/24/2019	AA-/A-1	Negative	Maintained
9/4/2019	BBB/A-3	Negative	Downgrade
4/17/2020	BB+/A-3	Negative	Downgrade
3/30/2021	CC/C	Negative	Downgrade

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