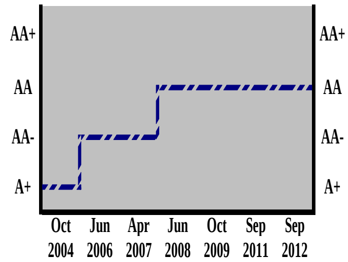
RATINGS (OCTOBER 2012)

ATTOCK REFINERY LIMITED (ARL)

ENTITY	NEW	PREVIOUS
Long Term	AA	AA
Short Term	A1+	A1+

LT RATING HISTORY



FINANCIAL DATA

PKR (mln)

	FY12	FY11	FY10
Total Assets	93,715	63,694	58,589
Equity	23,640	21,204	12,196
Turnover	154,381	116,397	88,184
Net Income	2,735	2,186	126
EBIDTA	2,878	2,031	(273)
Gross Margin	1.3%	1.3%	(0.5%)
ROE	11.9%	20.6%	1.1%

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RATING RATIONALE AND KEY DRIVERS

- The ratings incorporate ARL's strong risk absorption capacity emanating from robust financial profile supported by existing debt-free capital structure, rising cash flows and healthy profitability. Additionally, ARL, due to pre-dominantly local procurement of crude oil and sizeable sales through group companies, has fared better against the menace of circular debt compared to other refineries. ARL's core refining business remains exposed to vicissitude of the international crude oil and refined products pricing. However, ARL's sizeable investment book – comprising strategic investments and bank placements – provide a stable, in fact growing source of income. This enhances the bottom line of the company and forms cushion for ARL's core business in times of depressed refining margins. Moreover, the ratings consider the synergistic alliances originating from the association of the company with an integrated oil group - Attock Group.
- The ratings could be impacted by volatility in international oil prices and adverse changes in the existing regulatory framework leading to depressed refining margins. The company is contemplating major up-gradation and expansion of its refining capacity. The management intends to finance the expansion projects through borrowings. Thereby, effective management of financial profile remains critical as it may impact coverages, in turn, ratings.

ASSESSMENT

- The FY12 started-off with healthy gross refining margins (GRM). However, the crude prices experienced an upward push towards the end of 2012, weakening GRM. This could be attributed to a) fresh US sanctions on Iran and, b) Euro-zone crisis. However, easement in the crude prices (4QFY12), provided respite to the suppressed margins of the global industry. Although current prices remain susceptible to multiple factors, any gradual adjustment – upward or downward – may not have significantly detrimental impact on the industry. Meanwhile, the prevailing inter-corporate debt continues to hamper the liquidity, hence throughput levels of the domestic refineries, as it shows a declining trend on YoY basis.
- The refining industry in Pakistan, with a total capacity of 13.2mln tpa, performed inline with the international trend. During 2012, the Economic Coordination Committee (ECC) in order to align domestic prices with international trends revised the monthly product pricing to be carried out on a weekly basis. The impact of the mentioned initiative on the refining margins and product availability remains to be seen. The competitive landscape of the domestic industry would transform as Byco's 120,000 bpd refinery commences commercial production and achieves stability therein. Meanwhile, the industry continues to face the menace of circular debt, which has constrained the sector's liquidity.
- ARL, with a refining capacity of 1.92mln tpa, currently constitutes around 15% of the country's refining capacity. ARL, the only refinery operating entirely on indigenous crude oil, is comparatively less exposed to crude oil supply risk. The discovery of new oil reserves during the year in the northern region bodes well for the company. Over the years, ARL's capacity utilization has remained one of the highest in the sector (FY12:100%, FY11:96%). This was an outcome of the company's successful management of inter-corporate debt owing to its ability to downstream any delays in payments to oil suppliers. Further, a major portion of the entity's production is marketed by group companies, Attock Gen Limited (an IPP – consuming ~ 70% of FO produced) and Attock Petroleum Limited (an OMC), ensuring timely settlement of receivables.
- During FY12, the company's topline grew owing to stable volumes and a sizeable increase in the product prices on a comparative basis. The company's ability to produce a favorable product mix, with comparatively low proportion of residual fuel, shielded the company from volatility of crude prices. At the same time, the increased interest income due to enhanced placements in bank deposits and substantial dividend income from strategic investments supplemented the company's profits. This was despite the sizeable exchange loss booked during the year due to steep currency devaluation.
- ARL is undertaking several projects to optimize its refining capacity and improve efficiency. An Isomerization Unit will enable the company to produce more environment friendly and higher quantity of Premier Motor Gasoline (PMG), which has recently experienced rising demand in wake of persistent non-availability of compressed natural gas in the country. Moreover, the production of Naphtha, mainly exported, will decline which is a low margin product for ARL. A Pre-Flash Unit upon completion will enhance the refining capacity by 10,400bpd and effectively process various grades of crude oil. These expansion projects have an estimated cost of ~ USD140mln and the time required for completion is 24 months. The management is in the final stages to award the contract and plans to initiate the projects during FY13.
- ARL, due to its association with Attock Group, has made substantial strategic investments in associated companies (Book Value: PKR 13,265mln). ARL holds 1) 25% stake in NRL (the second largest refinery in the country), 2) around 22% shareholding in Attock Petroleum (an OMC with 8% market share), and 3) has 30% share in Attock Gen Limited (an IPP with a capacity of 165 MW).
- ARL, with its strong financial strength emanating from strengthening equity base on the back of rising profitability and reserve accumulation, currently enjoys debt-free capital structure. The debt would be procured over a period of two years and would have cost commensurate to the company's credit profile. While a sizeable grace period would be availed, the principal repayments would be spread over a longer period. This is critical as interest and principal would constitute a considerable sum. The coverage from operational cash flows would reduce though, if liquid investments are added, the cushion is significant. However, the final terms of the loan would be subject to review. Since this would be leveraged expansion, a robust MIS for related coverages would add sanctity to the control framework. The management plans to finance the above mentioned projects with equity to debt ratio of 80:20.

PROFILE

- Attock Oil Company Limited (AOC), incorporated in the UK and a pioneer in oil refining in South Asia, started refining operations in the sub-continent in 1922, at Morgah, near Rawalpindi. ARL, incorporated in 1978 to take over the crude oil refining business from AOC, is listed on all the three stock exchanges of the country. Mr. Adil Khattak, the Chief Executive of ARL, has extensive experience in the petroleum sector and is supported by a senior management team that has expertise in both the upstream and downstream segments of the oil business.
- ARL is sponsored by Attock Group. The group has considerable representation in the upstream and down-stream segments of the petroleum sector through its exploration companies, refineries, and an OMC.