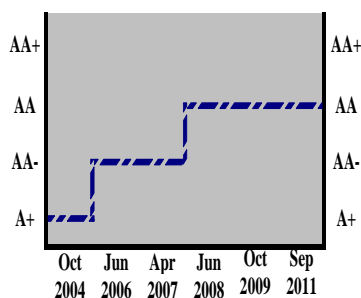


RATINGS (OCTOBER 2011)

ATTOCK REFINERY LIMITED (ARL)

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

LT RATING HISTORY



FINANCIAL DATA

PKR (mln)

	FY11	FY10	FY09
Total Assets	63,694	58,589	44,487
Equity	21,204	12,196	12,070
Turnover	116,397	88,184	77,260
Net Income	2,185	126	1,017
Gross Margin	1.3%	(0.5%)	2.5%
ROE	10.7%	1.1%	16.8%
EBIDTA	2,030	(273)	1,873

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RATING RATIONALE AND KEY DRIVERS

- The ratings reflect ARL's strong risk absorption capacity emanating from a debt-free capital structure, and healthy liquidity, enabling the company to manage circular debt prevailing in the energy chain. Although ARL's core operations remain exposed to vicissitude of the international crude oil and refined products pricing, its sizeable investment book – comprising strategic investments and bank placements – provide a stable, indeed rising source of income. This cushions ARL's core business in times of depressed refining margins. The ratings take into account the benefits emanating from being a part of an integrated oil group - Attock Group.
- The ratings could be impacted by external factors such as unfavorable movements in international oil prices and adverse regulatory changes, leading to prolonged downturn in margins. The company is contemplating major upgrade and expansion of its refining capacity. This would mainly be financed through borrowings. However, this has to be managed carefully as it may impact coverages, in turn, ratings.

ASSESSMENT

- The refining industry in Pakistan, with a total capacity of 13mln tpa, has recently experienced healthy growth in refining margins (ARL: Jul11: \$5.30/bbl; May11: \$4.38/bbl) due to expansion in net spreads across the production slate. During FY11, the government de-regulated the prices of all petroleum products except kerosene oil, introducing a free market mechanism with effect from June 1, 2011. Under the new regime, refineries and OMCs have been allowed to determine the ex-refinery and ex-depot sale prices on monthly basis. Meanwhile, import price of Pakistan State Oil for previous month will act as benchmark for the ex-refinery prices of underlying products. In the case of HSD, refineries are allowed a deemed duty (7.5%) embedded in ex-refinery price. The recent government decision to include incidentals in the pricing formula would have positive impact on the industry players. Furthermore, the Economic Coordination Committee has recently shelved deregulation of Inland Freight Equalization Margin (IFEM) on oil products owing to strong political opposition. Meanwhile, the industry continuing 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 14% of the country's refining capacity. ARL, the only refinery operating entirely on indigenous crude oil, is least exposed to crude oil supply risk. Over the years, ARL's capacity utilization remained one of the highest in the sector (FY10:93%, FY11: 97%). During FY11, ARL managed the impact 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 consumed by group companies, Attock Gen Limited and Attock Petroleum Limited (an OMC), ensuring timely settlement of receivables.
- During FY11, ARL registered positive gross refining margin unlike the corresponding period last year. However, this was attributable to good margin booked by the company in 1QFY11. Subsequently, fluctuation in the international prices of products and crude oil and withdrawal of incidentals from the pricing of regulated products depressed the GRM. Nevertheless, the increased interest income due to enhanced placements in bank deposits and a slight exchange loss, as compared to last year significant loss, supported the company's bottom line. Moreover, higher dividend income from strategic investments further augmented the company's profitability on a YoY basis.
- ARL, being a hydro skimming refinery, lacks the advanced technologies and complex operations such as downstream conversion unity, required to diversify the product mix with value-added products. Resultantly, its margins are on the lower side when compared to its peers. However, ARL remains the only refinery capable of processing heavy crudes produced in Pakistan from which it produces asphalt and related products. This gives ARL the flexibility in processing varied crudes, and produces some products generally not available from a basic refinery. ARL has undertaken several projects to optimize its refining capacity and improve efficiency. An Isomerization Unit (Estimated Cost: USD57mln; Completion Time-line: Jun-14) 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. A Pre-Flash Unit (Estimated Cost: USD18mln; Completion Time-line: Jun-14) upon completion will enhance the refining capacity by 10,400bpd and effectively process various grades of crude oil. Going forward, the company intends to upgrade the refinery, achieving desulphurization of High Speed Diesel to meet EURO II/III standards in the medium term, in line with the stipulated timeline by GoP (Dec-14).
- ARL, due to its association with Attock Group, has made substantial strategic investments in associated companies (Book Value: PKR 13,264mln). ARL holds 1) 25% stake in NRL (the second largest refinery in the country with a monopolistic position in lube segment), 2) around 22% shareholding in Attock Petroleum (an OMC with a 5% 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, enjoys debt-free capital structure. This structure provides financial flexibility and solidifies the company's risk absorption capacity. The management plans to acquire debt to execute above mentioned projects. Effective management of the borrowings maintaining healthy coverages remains critical.

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 downstream segments of the petroleum sector through its exploration companies, refineries, and an OMC.