RATING REPORT

Unity Foods Limited

REPORT DATE:
October 1, 2019

RATING ANALYST:
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RATING DETAILS		
	Initial Ratings	
Rating Category	Long-term	Short-term
Entity	A-	A-2
Rating Outlook	Stable	
Rating Date	*October 1, 2019*	

COMPANY INFORMATION

Incorporated in 1991	**External auditors:** Naveed Zafar Ashfaq Jaffery & Co. Chartered Accountants
Listed Public Limited Company	**Chief Executive Officer:** Muhammad Farrukh
Key Shareholders (with stake 5% or more):	**Chairman:** Abdul Majeed Ghaziani
Unity Wilmar Agro (Private) Limited – 11.0% Sheikh Ali Baakza – 26.1% Muhammad Farrukh(CEO) – 17.5% Abdul Hafeez Ghaziani – 6.2% Abdul Majeed Ghaziani(Chairman) – 6.5% Safdar Sajjad – 6.2% General Public – 26.5%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria - Industrial Corporates (May 2016)
http://www.vis.com.pk/docs/Corporate-Methodology-201605.pdf

Unity Foods Limited

OVERVIEW OF THE INSTITUTION

Unity Foods Limited (UFL) (formerly Taha Spinning Mills) was incorporated as a private limited company and subsequently converted to a public limited company in 1991. The company was listed on Pakistan Stock Exchange (PSX) on February 01, 1994.Taha Spinning Mills was taken over by the current sponsors in 2017 and name of the company was changed to Unity Foods Limited. Since takeover of the Company by new management, the principal business of the company is edible oil extraction, refining and related businesses. Registered office of the company is located in Karachi, Pakistan.

Profile of Chairman

Abdul Majeed Ghaziani is CMA with over 21 years' of experience in the commodity industry. He has also worked as treasurer in the Rice Exporters Association of Pakistan.

Profile of CEO

Muhammad Farrukh has over 17 years of well-rounded and diversified experience. Mr. Farrukh has expertise in exploring and developing previously untapped new export markets and managing group's overall operations and business relationships.

RATING RATIONALE

Based in Karachi, Unity Foods Limited (UFL) is engaged in extraction, refining and marketing of edible oil products, along with animal feed, meal and industrial fats. UFL is majority owned and managed by a group of individual shareholders with remaining shares vested with the general public. Moreover, Unity Wilmar Agro Private Limited (UWA) holds 11.0% stake in UFL. UWA is jointly owned by Wilmar Pakistan Holdings Pte Ltd, a subsidiary of Wilmar International Limited (WIL) (52%) and Unity Enterprises Private Limited (48%). Founded in 1991, WIL is a Singapore-based conglomerate and one of Asia's leading agribusiness groups with net profit of US$ 1.13b in FY18.

UFL is engaged in sale of banaspati and cooking oil for both, retail and industrial customers. The company has positioned its product portfolio, specifically towards the Popular and Discounted categories. It has three major brands namely Dastak, Ehtimam and Zauqeen. Dastak and Ehtimam are targeted towards the Popular segment while Zauqeen is focused on Discounted category. In 9MFY19, 70% of revenue was contributed by edible oil, while 25% emanates from animal feed and 2% from industrial fats. ~10% of UFL's net sales emanate from exports, entirely contributed by animal feed.

Business Strategy

UFL aims to establish itself as a holistic food marketing company with a complete product portfolio and vertically-integrated manufacturing operations. This is intended to support both, sales volumes (presence of diversified product portfolio) as well as margins (efficiency gains from vertical-integration). The company has recently setup a new Crude Palm Oil (CPO) refinery in Port Qasim. The CPO refinery will enable UFL to 1) lower its raw material cost as CPO is cheaper vis-à-vis Refined, Bleached and Deodorized (RBD) palm oil 2) favorable duty structure for CPO 4) manufacture additional products from byproducts, including, but not limited to, industrial fats.

Port Qasim Machinery Addition and Oil Storage Terminal Project

In line with its vision of 1) shifting its product suit from bulk to branded 2) expanding SKUs and undertaking product line extensions 3) catering to all business segments including General Trade, Industrial and Bulk and 4) integrating the business value chain, UFL is currently undertaking an extensive overhaul of its Port Qasim refinery which includes addition of hydrogenation, fractionating, margarine & shortening plants, as well as a chemical refinery. UFL plans to set up an oil storage terminal in Port Qasim as well. Total cost of the project is Rs. 2.9b and it will be funded through internally generated cash. Timely completion of ongoing projects is key rating driver; the same is considered important and progress will be monitored by VIS.

Marketing, Sales & Distribution

The company either supplies its products from 5 self-owned warehouses directly to retailers and points of consumption, or through a network of over 200 distributors covering the country at more than 21,000 retail outlets. Moreover, there are more than 20 industrial customers of the company. Sales team comprises 4 Regional Managers, 3 Zonal Managers, 13 Area Managers, 37 Territory Sales Officers, 4 Sales Operations Officers and 125 Order Bookers. Going forward, the company plans to add new warehouses, increase existing storage space, implement a mobile-based sales management platform, and increase distributor & industrial customer base to over 400 during the ongoing fiscal year.

Operations & Quality Assurance

The assigned ratings derive strength from large scale integrated operations of UFL which are expected to support the operational efficiency of the company. In SITE Area, the company operates a soft oil refinery with annual capacity of 34,500 MT along with a filling facility. In Port Qasim, the company operates a CPO refinery with annual installed capacity of 180,000 MT (500 MT per day); the facility also houses a ghee mill and filling facility. In Kotri, UFL operates a solvent/crushing plant with annual crushing capacity of 165,000 Tons and Pellet Mill with annual capacity of 90,000 Tons. Ratings are also supported by the quality certifications held by UFL. The company holds ISO Quality Management System, Food Safety Management System, HACCP and Halal Food Management System certifications and its products are Pakistan Standards and Quality Control Authority (PSQCA) certified.

Key Rating Drivers:

Substantial experience of sponsors in the edible oil business.

The operating shareholders of UFL have substantial experience in agro-commodity trading business. Moreover, UFL benefits from voluntary technical assistance provided by WIL. In relation to other large players in the edible oil refining industry, UFL is a relatively newer player; therefore, achievement of envisaged business volumes will be tracked by VIS.

Highly fragmented industry characterized by intense competition though supported by favorable demand prospects.

Pakistani edible oil industry is characterized by high competitive intensity due to fragmentation and low barriers of entry which result in limited pricing power and inherently thin profitability. However, several large players have been operating for a long period of time and thus enjoy stronger brand equity in relation to other firms. Pakistan is amongst the leading importers and consumers of edible oil. Current per capita consumption level of Pakistan stands at ~23 kg/year for 2016 compared to global average of ~28.0 kg/year (2015-16). Over the medium to long-term, demand is expected to increase in line with GDP growth which is further supported by positive demographic fundamentals. Nevertheless, changes in raw material prices (resulting in inventory losses) and foreign exchange rate fluctuations are key risk factors resulting in volatility in margins. Ability to manage the same depends on pass through to consumers, which in turn, is linked to degree of competition and operational efficiency.

Revenues have depicted sizeable growth over last two years; business risk profile is supported by diversification into animal feed sales which account for one-fourth of turnover. Bottom line is projected to be driven by higher revenues and improvement in margins.

In 9MFY19, UFL reported net sales of Rs. 12.5b (annualized) vis-à-vis Rs. 2.8b in FY18. Growth in sales was driven by volumes. Business risk profile is supported by diversification into animal feed sales which have gained significant traction and account for ~25% of UFL's revenue. The assigned ratings derive strength from higher projected revenues on the back of additional volumes from the new Port Qasim Refinery and diversification of income streams. Gross margins have increased from 8.9% in FY18 to 9.3% in 9MFY19. Going forward, the following, will enable the company to post improvement in margins.

- Movement in sales mix from bulk to branded sales.
- Increased economies of scale resulting from larger production volume.
- Backward integration supported by seed crushing and solvent extraction plant, establishment of oil storage terminal and CPO refinery.
- New production facilities will enable the company to blend raw materials in various forms to produce different blends. Moreover, the byproducts can be used interchangeably to produce various products including, ghee, margarine and shortening and healthy blends like canola. This will enable the company to offer a diverse range of products/SKUs in line with changing

consumer trends while keeping production costs low and manufacturing speed at a fast pace.

Raw oil constitutes ~90% of UFL's cost of sales. Given the nature of business, majority of raw material is imported. In order to manage inventory loss and rupee depreciation risk, management passes on increase/decrease in input prices to consumers while efficient procurement is also considered important.

With increase in sales, marketing, selling and distribution expenses also increased by 4.4x in 9MFY19 (annualized). Finance cost of the company has depicted a rising trend on account of higher RF utilization and increase in interest rates. Over 9MFY19, UFL reported profit before tax of Rs. 201.6m (FY18: Rs. 97.7m). The company is subject to high taxation regime with 5.5% tax applicable on import of oil and 2.0% tax on locally procured oil consumed. Going forward, the company expects that resulting tax benefits (100% tax credit under 65E) from expansion project will enable to it to lower its tax burden and improve its bottom line.

Despite increase in short term loans, leverage indicators have remained manageable on account of a sizeable equity base.

In FY18, total equity increased to Rs. 1.8b (FY17: Rs. 2.4m) due to completion of right share issuance with proceeds of Rs. 1.65b. At end-9MFY19, total equity increased to Rs. 1.9b on account of internal profit accumulation. In 3QFY19, the company announced 221.83% right issue resulting in issuance of 375m shares at par value (Rs. 10 each). The company raised Rs. 3.75b from the right issue in May 2019. The funds will be deployed in expansion and growth of various projects.

Debt profile entirely comprises short term debt acquired for working capital financing. Stock in trade and receivables represented 297% (FY18: 426%) of outstanding short-term borrowings at end-9MFY19. Borrowing levels have depicted growth due to higher stock levels and increase in trade debts. Adjusting for 2nd rights issue in 2019, gearing levels stand below 0.5x at end-9MFY19. In line with envisaged growth in business volumes, borrowings are projected to increase over the coming years. In order to maintain assigned ratings and accordingly, suitable capitalization indicators, efficient working capital management is considered important over the rating horizon.

Weak liquidity profile on account of negative cash flows resulting from sizeable taxation. However, income tax paid is being accumulated as an asset on the balance sheet and may be recovered/adjusted back at future date.

Liquidity profile was under stress during 9MFY19 on account of negative cash flows (FFO: Minus 104.7m; FY18: Rs. 33.8m). In line with increase in turnover, the amount of trade debts has also increased and stand at 22% (FY18: 41%) in relation to sales as at end-9MFY19. According to the aging schedule, ageing profile of trade debts is considered manageable with all receivables due within three months. Current ratio of the company stood at 1.6x (FY18: 1.3x) at end-9MFY19 and is projected to remain above 1x over the rating horizon. Given projected increase in margins and lower tax burden post expansion, cash flows are expected to improve over the ratings horizon.

Satisfactory governance structure while IT infrastructure has been revamped.

Board of Directors at UFL comprises seven members including four non-executive directors and two independent directors including one female director. In line with best practices, positions of Chairman and Chief Executive Officer (CEO) are segregated. SAP Business One is the business management software (ERP) utilized by UFL It includes modules for administration, financials, sales, inventory and material requirements planning. Financial statements for FY19 were audited by Naveed Zafar Ashfaq Jaffery & Co. Chartered Accountants. The external auditors are placed in category 'A' of SBP's panel of auditors.

Unity Foods Limited **Appendix I**

FINANCIAL SUMMARY	*(amounts in PKR millions)*		
BALANCE SHEET 9MFY19 has been annualized	**FY17**	**FY18**	**9MFY19***
Fixed Assets	-	1,521.8	1,839.8
Stock-in-Trade	-	1,479.3	2,638.5
Trade Debts	-	1,148.2	2,761.2
Cash & Bank Balances	1.8	10.0	26.6
Total Assets	3.0	4,567.2	8,189.4
Trade and Other Payables	0.6	1,744.8	2,004.3
Long Term Debt	-	-	-
Short Term Borrowings	-	616.2	1,818.4
Total Debt	-	616.2	1,818.4
Total Equity (excluding surplus)	2.4	1,773.9	1,876.1
Surplus on Revaluation of Assets - Net			
INCOME STATEMENT	**FY17**	**FY18**	**9MFY19***
Net Sales	-	2,781.9	12,516.8
Gross Profit	-	247.8	1,167.0
Administrative Expense	4.4	55.1	212.4
Marketing, Sales and Distribution Expense	-	55.4	301.9
Finance Cost	0.0	51.8	193.1
Profit (Loss) Before Tax	(4.3)	97.7	268.8
Taxation	-	23.7	(19.8)
Profit (Loss) After Tax	(4.3)	121.4	249.0
RATIO ANALYSIS	**FY17**	**FY18**	**9MFY19***
Gross Margin (%)	n/a	8.9%	9.3%
Net Margin (%)	n/a	4.4%	2.0%
Current Ratio (x)	4.90	1.08	1.00
(Stock in Trade + Trade debt)/ST Borrowings (%)	n/a	426%	297%
FFO	(4.5)	33.8	(139.6)
FFO to Long Term Debt (%)	n/a	n/a	n/a
FFO to Total Debt (%)	n/a	5.5%	-7.7%
Debt Servicing Coverage Ratio (x)	(53.81)	0.80	(1.08)
Gearing (x)	n/a	0.35	0.97
Leverage (x)	0.25	1.57	3.37
ROAA (%)	-88.4%	5.3%	3.9%
ROAE (%)	-95.0%	13.7%	13.6%
** Annualized numbers*			

REGULATORY DISCLOSURES					Appendix III
Name of Rated Entity	Unity Foods Limited				
Sector	Edible Oil				
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				
	1-10-2019	A-	A-2	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.				
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