RATING REPORT

Unity Foods Limited

REPORT DATE:
November 13, 2020

RATING ANALYST:
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RATING DETAILS				
Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A-	A-2	A-	A-2
Rating Outlook	Stable		Stable	
Rating Date	*Nov 14, 2020*		*Oct 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 – 16.4% Wilmar Pakistan Holdings PTE Limited – 7.1% Directors, CEO and family members – 28.4% General Public – 24.3%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria - Industrial Corporates (May 2019) ***https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Corporate-Methodology-201904.pdf***

Unity Foods Limited

OVERVIEW OF THE INSTITUTION

Unity Foods Limited (UFL) 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. Registered office of the company is located in Karachi, Pakistan.

Profile of Chairman

Abdul Majeed Ghaziani holds more than 17 years of experience which encompasses work in the fields of both Accounting and Information Technology. He also has vast experience in imports and exports.

Profile of CEO

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

RATING RATIONALE

Unity Foods Limited (UFL) is primarily engaged in the extraction, refining and marketing of edible oil products. The company also produces industrial fats, and various feed ingredients for the poultry and livestock sector. During FY20, UFL completed acquisition of 69% equity stake in Sunridge Foods (Pvt.) Limited (SFPL). To date, SFPL is the only PESA Mill in Pakistan producing PSQCA certified 100% whole wheat flour. SFPL is marketing whole wheat flour under the Sunridge brand. The plant is located at Port Qasim and has a capacity of 43,800 tonnes per annum. Going forward, SFPL plans to diversify its product portfolio by introducing several different types of flours used in various food products.

Shareholding of UFL is vested with individual shareholders and general public. Latest shareholding pattern indicates that the total equity stake of Wilmar International (held through United Wilmar Agro Private Limited (UWA) and Wilmar Pakistan Holdings PTE Ltd. (WPH)) in UFL accumulates to 23.5%. WPH is a directly wholly-owned subsidiary of Wilmar international. UWA is jointly owned by 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 integrated agribusiness groups with revenue and net profit of US$ 36.0b and US$ 1.1b in 9M'2020.

UFL caters to both retail and industrial segments in the banaspati and cooking oil segments. The company has four major brands namely Dastak, Lagan, Ehtimam and Zauqeen. Dastak is targeted to the premium category, while the other three brands cater to the Discounted category.

<u>Business Strategy</u>

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 is targeting both organic and inorganic growth in order to achieve its long term vision.

<u>Expansion plans</u>

In line with its vision of shifting its product suit from bulk to branded, expanding SKUs and undertaking product line extensions, catering to all business segments including General Trade, Industrial and Bulk and integrating the business value chain, UFL is currently undertaking an extensive expansion plan which includes addition of hydrogenation, fractionating, margarine & shortening plants. UFL also plans to set up an oil storage terminal at Port Qasim and a soap finishing line, which will allow the company effectively utilize by product of Oil refining in soap manufacturing. It is expected that full scale commercial operations of soap and related products will commence in Q2'FY21. This expansion will be funded through acquisition of Temporary Export Refinance Facility (TERF) amounting to Rs. 1.06b and issuance of Sukuk amounting to Rs. 2.0b (with greenshoe option of Rs. 1b). During FY20, the company has already established ghee plant, which is now fully operational. Timely completion of ongoing projects is a key rating driver as the expansion will enable UFL to achieve its projected growth targets.

<u>Investment in REEM Rice Mills (Pvt.) Limited</u>

UFL is considering an acquisition of 29.9m ordinary shares (face value Rs. 10 per share) of REEM Rice Mills (Pvt.) Limited (REEM), comprising 100% of REEM's share capital. The acquisition will be funded by internally generated capital. Presently, REEM operates as a Joint Venture between the EAST Al-Ghurair Group of UAE and Al Muhaidib Group of Saudi Arabia. Reem is considered to be one the premium basmati brands of Pakistan, which has access to both local and international markets.

Production Capacity and Capacity Utilization

Production Capacity (Metric Tonnes)	**FY19**	**FY20**
Edible Oil Refinery	234,000	234,000
Solvent Extraction Plant	162,000	162,000
Feed Mill	-	302,400
Actual Production (Metric Tonnes)		
Edible Oil Refinery	48,935	176,553
Solvent Extraction Plant	76,410	9,795
Feed Mill	-	170,728
Capacity Utilization		
Edible Oil Refinery	21%	75%
Solvent Extraction Plant	47%	6%
Feed Mill	-	56%

Key Rating Drivers:

Sound profile and substantial experience of sponsors

Shareholders of UFL have substantial experience in agro-commodity trading business. WIL is one of the leading agribusiness groups in Asia. UFL benefits from both financial and technical assistance provided by WIL. VIS expects sponsor support to emanate in future, in case a need arises.

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 results in limited pricing power and thin profitability margins. In 2019, a total of 122 companies in Pakistan were engaged in the business of manufacturing edible oil and other allied products. Several large players which have been operating for a long period enjoy strong brand equity established through sound product quality and consistent marketing campaigns. However, fragmentation in the industry is evident as no single entity commands double digit market share in the industry.

Demand outlook of edible oil is favourable as Pakistan is ranked amongst the leading importers and consumers of edible oil. Current per capita consumption in Pakistan stands at 24kg per annum, which is lower than the global average of 28kg/year. Moreover, around two third of the local demand is met through imports, thereby providing significant opportunity for local players to capture this demand by expanding their capacities. Going forward, overall demand is likely to expand on account of increasing demand for frying and processed food, increasing number of restaurants, urbanization and growing disposable incomes along with ongoing shift from unpackaged to packaged products. 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.

Decrease in edible oil prices and inventory losses resulted in lower profitability despite

significant growth in topline during FY20. With recovery in margins, profitability improved in Q1'FY21. Going forward, bottom line is projected to be driven by higher revenues and improvement in margins

Net sales of UFL were reported higher at Rs. 29.9b (FY19: Rs. 14.1b) in FY20. Volumetric increase in product sales contributed to improvement in topline of the company. Branded oil segment witnessed the largest increase in sales vis-à-vis previous year. Increasing regulatory requirements with regards to the discounted segment products entailed additional capex requirements on the part of small unorganized segment industry players; this development provided an opportunity to UFL to capture market share through its brands catered to the discounted segment.

Gross margins of UFL were reported lower at 6.8% (FY19: 9.1%) on account of inventory losses due to rupee devaluation. Moreover, decrease in business activity translated to a significant decline in crude oil prices. Resultantly, edible oil prices which closely track crude oil also trended downwards, thereby contributing to further erosion in gross margins. Decrease in gross margins coupled with increasing selling and distribution expenses and higher finance costs due to higher utilization of debt translated to lower net profits (FY20: Rs. 209.6m; FY19: Rs. 255.1m) and net margins (FY20: 0.7%; FY19: 1.8%).

The company reported net sales of Rs. 12.2b (Q1'FY20: Rs. 4.6b) primarily on the back of volumetric increases. With recovery in margins, net profit was also reported higher at Rs. 590.8m (Q1'FY20: Rs. 92.7m) in Q1'FY21. Going forward, sales are projected to depict double digit year on year growth over the rating horizon. Increase in sales is expected to be achieved on the back of both volumetric growth and recovery in prices. Increasing market penetration of existing products and introduction of new products will facilitate growth in volumetric sales. Gross margins are also expected to increase on account of the following factors:

- Further improvement in sales mix with movement 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.

Furthermore, 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 growth in equity base, leverage indicators have increased on a timeline basis due to greater utilization of short term borrowing for working capital requirements. With significant increase in the equity base due to rights issue in June 2020, leverage indicators witnessed improvement in Q1'FY21

At end-FY20, total equity base of the company increased to Rs. 5.8b (FY19: Rs. 5.7b) on account of internal capital generation. In June 2020, the company announced 82.71% rights issue at par to raise Rs. 4.5b to satisfy the increasing working capital requirements. The proceeds were realized in September 2020. Resultantly, the paid up capital has increased from Rs. 5.4b to Rs. 9.9b at end-Q1'FY21.

Total debt primarily comprises short term borrowings acquired for working capital requirements. Borrowing levels have depicted growth due to higher stock levels and increase in trade debts. Both gearing and leverage ratios were reported higher at 0.71x (FY19: 0.45x) and 2.24x (FY19: 0.84x) at end-FY20. Although quantum of total debt further increased in Q1'FY21, sizeable increase in equity base resulted in decrease in gearing and leverage ratios to 0.63x and 1.39x at end-Q1'FY21. Borrowings are projected to increase over the rating horizon in order to fund expansion Capex and fund increasing working capital requirements with growth in business volumes. The same will result in increase in leverage indicators over the medium term. Ratings remain dependent upon effective working capital management and maintenance of leverage indicators in line with the ratings benchmarks. Sponsor support in the form supplier credit arrangement as has been communicated is considered important in this regard.

Weak liquidity profile on account of sizeable taxation expense. The edible oil industry is subjected to import stage taxation on raw materials. With increase in profitability, improvement has been witnessed in internal cash flow generation and liquidity profile in Q1'FY21

Liquidity profile of the company depicts room for improvement as Funds flow from Operations (FFO) were negative in FY20 (FY20: Rs.-702.4m; FY19: Rs.-232.9m). Low profitability and high taxation expense resulted in negative cash flows. The edible oil industry is subjected to import stage taxation under which advance income tax is charged by the tax authorities on imported raw material. As this adjustment of advance tax generally happens over a lengthy period, the liquidity profile of the companies in the edible oil sector is constrained. Hence, reliance on short term borrowings increases. With increase in profitability, cash flows and liquidity profile has depicted improvement in Q1'FY21.

Ageing profile of trade debts is considered manageable as approximately 99% of outstanding trade receivables are due within three months. Stock in trade and trade debts amounted to 329.2% (FY19: 244.0%) of total short term borrowings, thereby indicating adequate coverage. Current ratio was reported at 1.17x (FY19: 1.54x) at end-FY20. Given projected increase in margins, lower incidence of advance tax on imported raw material (from 5.5% to 2.0%) and lower tax burden post expansion, cash flows are expected to improve over the ratings horizon.

Sound governance framework, comprehensive sales and distribution network and solid IT infrastructure will support growth plans

Composition of Board of Directors (BoD) at UFL is line with best practices. BoD comprises seven members including four one executive director (CEO), non-executive directors and two independent directors. BoD consists of three female directors. Chairman of the BoD is an independent director. Two committees, namely Board Audit Committee (BAC) and Board Human Resource and Remuneration Committee (BHRRC), are present in order to ensure effective governance. Both committees are also chaired by an independent director.

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.

The company either supplies its products from self-owned warehouses directly to retailers and points of consumption, or through a network of distributors across the country. Comprehensive distribution and sales team network provides support to the ratings. Going forward, the management intends to undertake further expansion in the distribution facilities to facilitate growth in operations.

Unity Foods Limited Appendix I

FINANCIAL SUMMARY				(amounts in PKR millions)
BALANCE SHEET	FY18	FY19	FY20	Q1'FY21
Fixed Assets	1,551	3,094	3,816	3,886
Stock-in-Trade	1,479	3,201	5,049	5,017
Trade Debts	1,148	3,064	7,766	10,112
Cash & Bank Balances	10	40	163	1,621
Total Assets	4,567	10,466	18,943	25,968
Trade and other payables	1,745	1,984	8,838	8,175
Long Term Debt	-	-	278	413
Short Term Borrowings	616	2,567	3,892	6,387
Total Debt	616	2,567	4,171	6,799
Issued, subscribed and paid up capital	1,691	5,441	5,441	9,941
Total Equity	1,774	5,694	5,850	10,868
INCOME STATEMENT	FY18	FY19	FY20	Q1'FY21
Net Sales	2,782	14,097	29,872	12,169
Gross Profit	248	1,277	2,029	1,002
Administrative Expenses	(55)	(181)	(220)	(70.3)
Marketing, Sales and Distribution Expense	(55)	(357)	(691)	(173)
Other operating expenses	(22)	(178)	(388)	12
Other income	34	1	9	17
Finance Cost	(52)	(288)	(545)	(147)
Profit (Loss) Before Tax	98	275	195	642
Taxation	24	(20)	15	(51)
Profit (Loss) After Tax	121	255	210	591
RATIO ANALYSIS	FY18	FY19	FY20	Q1'FY21
Gross Margin (%)	8.9%	9.1%	6.8%	8.2%
Net Margin (%)	4.4%	1.8%	0.7%	4.9%
Current Ratio (x)	1.1	1.5	1.2	1.5
(Stock in Trade + Trade debt)/ST Borrowings (%)	426.4%	244.0%	329.2%	236.9%
FFO	33.8	(232.9)	(702.4)	590.7
FFO to Long Term Debt (%)	-	-	-252.2%	572.7%
FFO to Total Debt (%)	5.5%	-9.1%	-16.8%	34.8%
Debt Servicing Coverage Ratio (x)	1.8	0.1	(0.4)	5.4
Gearing (x)	0.3	0.5	0.7	0.6
Leverage (x)	1.6	0.8	2.2	1.4
ROAA (%)	5.3%	3.4%	1.4%	10.5%
ROAE (%)	13.7%	6.8%	3.6%	28.3%

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	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				
13-11-2020	A-	A-2	Stable	Reaffirmed
01-10-2019	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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Due Diligence Meetings Conducted	

S.No	Name	Designation	Date
1	Mr. Amir Shehzad	Executive Director	October 7, 2020