# RATING REPORT

# Unity Foods Limited

**REPORT DATE:**
August 30, 2022

**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** | Negative | | Stable | |
| ***Rating Date*** | *August 30, 2022* | | *April 29, 2021* | |
| ***Rating Action*** | *Maintain* | | *Upgrade* | |

| COMPANY INFORMATION | |
|---|---|
| **Incorporated in 1991** | **External auditors:** KPMG Taseer Hadi & Co. Chartered Accountants |
| **Listed Public Limited Company** | **Chief Executive Officer:** Muhammad Farrukh |
| **Key Shareholders:** | **Chairman:** Sulaiman S. Mehdi |
| Unity Wilmar Agro (Private) Limited – 14%<br>Wilmar Pakistan Holdings Pte Ltd – 21%<br>Directors, CEO and family members – 27% | |

| APPLICABLE METHODOLOGY(IES) |
|---|
| **VIS Entity Rating Criteria - Industrial Corporates (August 2021)**<br>**https://www.vis.com.pk/kc-meth.aspx** |

## OVERVIEW OF THE INSTITUTION

Unity Foods Limited (UF) 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**
Mr. Mehdi has over 21 years of experience in multiple areas of financial services including investments, operations, marketing, legal and corporate affairs. Mr. Mehdi has served as the Chairman of the Board for PSX and has held executive level positions in various financial services organizations

**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 (Company or UF) is primarily engaged in the extraction, refining and marketing of edible oil products. UF caters to both retail and industrial and commercial segments in the banaspati and cooking oil segments. The Company has four major brands namely Dastak, Lagan, Ehtimam and Zauqeen. Dastak, its flagship brand, is targeted to the premium category, while the other three brands cater to the discounted category. The Company also produces industrial fats, and various feed ingredients for the poultry and livestock sector.

Production Capacity and Capacity Utilization

UF's manufacturing facility is located at Port Qasim. During FY21, capacity utilization levels for Edible Oil refinery and Solvent Extraction Plant increased as the post lockdown demand inched higher along with increase in activity within HORECA segment.

| Production Capacity (Metric Tonnes) | FY19 | FY20 | FY21 | HY'22 |
|---|---|---|---|---|
| Edible Oil Refinery | 234,000 | 234,000 | 234,000 | 117,000 |
| Solvent Extraction Plant | 162,000 | 162,000 | 162,000 | 81,000 |
| Feed Mill | - | 302,400 | 302,400 | 151,200 |
| Actual Production (Metric Tonnes) | | | | |
| Edible Oil Refinery | 48,935 | 176,553 | 206,117 | 103,867 |
| Solvent Extraction Plant | 76,410 | 9,795 | 36,391 | 34,797 |
| Feed Mill | - | 170,728 | 273,824 | 83,501 |
| Capacity Utilization | | | | |
| Edible Oil Refinery | 21% | 75% | 88% | 89% |
| Solvent Extraction Plant | 47% | 6% | 22% | 43% |
| Feed Mill | - | 56% | 91% | 55% |

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. Going forward, the management intends to undertake further expansion in the distribution facilities to facilitate growth in operations.

**Rating Drivers**

**Sound profile and substantial experience of sponsors**

Wilmar International Limited (WIL) is the largest shareholder of the Company holding over 28% equity stake. This investment is held through WIL's 100% owned Singapore based company Wilmar Pakistan Holdings Pte Ltd. (WPH) which directly holds over 21% shares of Unity Foods while over 7% shares are held through Unity Wilmar Agro (Pvt.) Limited a Pakistan-incorporated subsidiary of WPH. Founded in 1991, WIL, a Singapore-based conglomerate and one of Asia's leading integrated agribusiness groups is listed on Singapore Stock Exchange. UFL benefits from both financial and technical assistance provided by WIL. VIS expects sponsor support to emanate in future, in case a need arises.

**Ratings are constrained on account of 'High' business risk, given heavy reliance on imported raw material, and fragmented market.**

Pakistan's edible oil industry majorly relies on imported palm oil and seeds in order to cater the local demand. Roughly, around three-quarters of the local demand is catered through imported palm oil. Prices of palm oil in international market witnessed a significant hike from USD 1200/ton, as of Jan'22, to USD 1,777/ton as of Mar'22, up 79% during the 3-month period. With the cost in its entirety, being passed on to the consumers, local edible oil pricing also increased. In Jun'22, sales price of edible oil through Utility Stores Corporation- wherein household staples are sold at controlled pricing – was increased by 30%. Prices, however, nosedived to a 9 month low in July 2022 attributable to surging exports from Indonesia dismissing apprehensions about supply shortages of palm oil. While demand metrics in the industry remain fairly sound, being a staple product, 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.

VIS characterizes the business risk profile of the sector by high competitive intensity, fragmentation with low barriers to entry, resulting in limited pricing power and thin profitability margins. Whereas, UF has managed to hold a substantial market share (~8%) in the edible oil industry of Pakistan, the industry remained largely fragmented with no single entity holding a double-digit market share.

**Investment in Sunridge Foods supports long term revenue diversification plans**

During FY21, UF acquired additional 31% equity stake in Sunridge Foods (Pvt.) Limited (SF) taking the total holding to 100%. SF commenced operation in 2017, plant located at Port Qasim, and is the only PESA Mill in Pakistan producing PSQCA certified 100% whole wheat flour. SF is marketing whole wheat flour under the Sunridge brand. During the outgoing fiscal year, SF acquired flour processing mill, a roller miller with capacity of 57,600 tons per annum of flour processing. Following this acquisition, the total milling capacity has increased to 101,400 tons per annum (previously 43,800 tons p.a.).

SF has diversified product portfolio comprising several different types of flours used in various food products. Currently, SF is in losses owing to significant expenses undertaken to enhance its national reach and build brand equity. More recently, Sunridge Foods has announced to acquire 100% stake in Uni-Foods Industries Limited (UFI), a Joint venture between Habib Sugar, Faran Sugar and Mehran Sugar. UFI owns a bakery and confectionary brand named "Good Goodies Cakes".

**Growth has been primarily funded through equity**

UF has so far added Rs. 15b to its total equity through right issue shares over the period of 3 years. 1$^{st}$ right issue (worth Rs. 1.6b) pertained to revamping the Company from textile unit to Edible Oil Manufacturer. Second right issue of Rs. 3.75b subscribed in 2019 was aimed to undertake an extensive expansion which comprised of acquisition of Palm Oil Refinery at Port Qasim (Rs. 2.85b) and establishment of Oil Terminal (Rs. 0.9b). The work is in progress with delivery of remaining machinery additions expected end of year 2022. Furthermore, the Company has identified site for establishment of Oil Terminal storage capacity and is in process of closing the land purchase deal. The 3$^{rd}$ and 4$^{th}$ right issue, worth Rs. 4.5b and Rs. 5.4b respectively, pertained to financing working capital requirements. Assigned ratings derive comfort from equity-funded growth of the Company, reflective in sound capitalization indicators.

**Topline posted strong growth on the back of higher sales volume coupled with increase in average selling prices; margins stood upbeat.**

Topline of the Company increased to Rs. 66.4b (FY20: Rs. 29.8b; FY19: Rs. 14.0b) exhibiting a sizeable growth of 122.3% during FY21, led primarily by volumetric increase (FY21: 777k tons; FY20: 440k tons). Volumetric growth was attributable to overall surge in demand and increase in HORECA activity post lock-down. In addition, the Company focused on selling bulk oil to customers in industrial segment where UF has positioned itself through customized product offering and thus leveraging a stronger bargaining power.

Product mix of UF comprises of Industrial & Commercial Oils (Bulk Oils), Branded Oils, Animal Feed and Other (soaps, etc.). Highest proportion of sales emanate from Bulk Oils segment (51.2%), followed by Branded Oils (19.2%) and Animal Feed (16.8%). The trend continued during 9MFY22 with Company reporting Net Sales of Rs. 56.6b. The branded segment witnessed growth in the flagship brand 'Dastak' with a healthy volumetric increase as a part of deliberate strategy to ensure receivables remain secure and the Company does not face any bad debts hence growth in the discounted segmented brands 'Ehtimam' and 'Zauqeen' remained subdued.

Client concentration is at the lower end with top ten clients accounting for less than 30% of the revenue base. In addition, UF has been able to build strong relationship amongst its customers that ensures repeat business as it has been able to meet specific client requirements. Moreover, comprehensive distribution and sales team network provides support to the ratings. Going forward, management foresees volumetric growth with increased focus on consumer packs and industrial segment, where UF commands higher margins.

Though margins depict improvement, they remain exposed to commodity price and exchange rate fluctuations.

Gross margins of UFL further improved to 9.5% (FY21: 7.8%; FY20: 6.8%; FY19: 9.1%) during the 9MFY22 vis-à-vis FY21. The uptick in margins is attributable to higher selling prices, prudent inventory management; focus towards higher margin items and increased economies of scale resulting from larger production volume. With commodity prices crashing in Q4 FY22, we expect some rationalization in margins due to inventory loss, however, the Company is expected to draw benefit from backward integration supported by seed crushing and solvent extraction plant and establishment of oil storage terminal in the long run. However, margins remain exposed to exchange rate volatility.

With volumetric growth and recovery in margins, net profit was reported at Rs. 1.9b (FY21: Rs. 3.1b; FY20: Rs 0.2b) during 9MFY22. The increased financed cost with rising interest rates and significant FX loss of Rs. 1.4b (9MFY21: FX gain Rs. 650m) was nominally offset by the income generated through short term investments, leading to decline in profitability compared to comparative period last year. We expect profitability likely to come under pressure on account of inflationary pressures and rising interest rates.

**Improvement in capitalization indicators**

At end-9MFY22, total equity base of the Company increased to Rs. 20.7b (FY21: Rs. 13.3b; FY20: Rs. 5.8b) on account of internal capital generation and proceeds realized from right issue. In November 2021, the Company mobilized Rs. 5.4b through right issued at premium to meet the increasing working capital requirements. The issue was primarily subscribed by WPH, increasing their stake in the Company, which provides comfort to ratings.

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 1.15x (FY20: 0.71x) and 2.18x (FY20: 2.24x) at end-FY21. Although quantum of total debt further increased in 9M'FY22, sizeable increase in equity base resulted in decrease in gearing and leverage ratios to 0.80x and 1.85x at end-9M'FY22. 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 from Wilmar is considered important in this regard.

**Adequate liquidity profile, however, the same is expected to come under pressure given reversal in edible oil prices and local currency weakening leading to inventory and FX losses.**

In line with growing profitability, funds from operations (FFO) turned positive to Rs. 2.b (negative PRs. 0.7b in FY20) during FY21. With increase in FFO, Debt Service Coverage improved to 4.08x (FY20: -0.4) in FY21. In 9MFY22, DCSR normalized and stood comfortable at 1.76x, albeit receded vis-à-vis FY21 incorporating impact of higher finance cost. Higher borrowings, despite equity raised through rights issue, are going to exert pressure on liquidity in terms of higher finance cost paid in high interest rate situation. FFO to Total Debt stood at 10.8% (FY21: 16.3%) in 9M FY22.

Given extended working capital cycle in the ongoing year, quantum of short term borrowing increased to Rs. 15.8b (FY21: Rs. 14.6b; FY20: 3.8b) in 9MFY22. Inventory increased by 75% in ongoing year due to increased prices as compared to previous year comprising mainly of imported raw material. Trade debts were recorded higher whereas ageing profile of trade debts is considered manageable as approximately 80% of outstanding trade receivables are due within three months, in line with industry norms. Stock in trade and trade debts amounted to 156.8% (FY20: 329.2%) of total short term borrowings, thereby indicating adequate coverage. Current ratio was reported at 1.33x (FY21: 1.17x; FY20: 1.17x) at end-9MFY22.

**Ratings remain sensitive to outcome of SECP investigation**

UF has been subject of SECP investigation for alleged misrepresentation in 2018 and 2019 Financial accounts with regard to inter party transactions and certain expenditures, to which UF has submitted all its responses and is yet to receive any correspondence from the regulator. VIS will continue to closely monitor the situation.

| FINANCIAL SUMMARY | | | | *(amount in PKR million)* |
|---|---|---|---|---|
| **BALANCE SHEET** | **FY19** | **FY20** | **FY21** | **9MFY22** |
| **Fixed Assets** | 3,094.2 | 3,816.3 | 8,809.9 | 8,999.2 |
| **Stock-in-Trade** | 3,201.2 | 5,048.5 | 10,752.5 | 18,802.8 |
| **Trade Debts** | 3,063.6 | 7,765.7 | 12,290.8 | 16,449.0 |
| **Short Term Investments** | - | - | 6,859.0 | 9,731.5 |
| **Cash & Bank Balances** | 40.0 | 163.4 | 318.0 | 513.6 |
| **Total Assets** | 10,465.6 | 18,943.4 | 42,538.4 | 58,902.7 |
| **Trade and other payables** | 1,983.7 | 8,838.1 | 13,631.5 | 21,345.2 |
| **Long Term Debt (including current maturity)** | - | 295.6 | 579.9 | 584.8 |
| **Short Term Borrowings** | 2,567.4 | 3,892.3 | 14,693.6 | 15,889.4 |
| **Total Debt** | 2,567.4 | 4,187.8 | 15,273.4 | 16,474.2 |
| **Issued, subscribed and paid up capital** | 5,440.5 | 5,440.5 | 9,940.5 | 11,940.5 |
| **Share Premium** | - | - | - | 3,342.8 |
| **Total Equity** | 5,694.5 | 5,849.7 | 13,379.3 | 20,701.9 |
| **INCOME STATEMENT** | **FY19** | **FY20** | **FY21** | **9MFY22** |
| **Net Sales** | 14,097.2 | 29,872.0 | 66,401.0 | 56,677.6 |
| **Gross Profit** | 1,277.2 | 2,029.3 | 5,191.7 | 5,401.2 |
| **Finance Cost** | (288.2) | (545.0) | (880.1) | (1,113.1) |
| **Profit (Loss) Before Tax** | 274.7 | 194.6 | 3,389.1 | 2,207.8 |
| **Taxation** | (19.6) | 15.1 | (277.4) | (228.0) |
| **Profit (Loss) After Tax** | 255.1 | 209.6 | 3,111.7 | 1,979.8 |
| **RATIO ANALYSIS** | **FY19** | **FY20** | **FY21** | **9MFY22** |
| **Gross Margin (%)** | 9.1% | 6.8% | 7.8% | 9.5% |
| **Net Margin (%)** | 1.8% | 0.7% | 4.7% | 3.5% |
| **Current Ratio (x)** | 1.5 | 1.2 | 1.2 | 1.3 |
| **Short Term Borrowings coverage** | 244.0% | 329.2% | 156.8% | 221.9% |
| **FFO** | (232.9) | (703.5) | 2,490.8 | 1,330.1 |
| **FFO to Long Term Debt (%)** | - | -238.0% | 429.5% | 303.3%* |
| **FFO to Total Debt (%)** | -9.1% | -16.8% | 16.3% | 10.8%* |
| **Debt Servicing Coverage Ratio (x)** | 0.1 | -0.4 | 4.1 | 1.9* |
| **Gearing (x)** | 0.5 | 0.7 | 1.1 | 0.8 |
| **Leverage (x)** | 0.8 | 2.2 | 2.2 | 1.8 |
| **ROAA (%)** | 2.4% | 1.4% | 10.1% | 5.2%* |
| **ROAE (%)** | 4.5% | 3.6% | 32.4% | 15.5%* |

**annualized*

**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** | Food & Personal Care |
| **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 | | | | |
| 30-08-2022 | A | A-2 | Negative | Maintain |
| 29-04-2021 | A | A-2 | Stable | Upgrade |
| 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. |
| **Probability of Default** | VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default. |
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| **Due Diligence Meetings Conducted** | |

| S.No | Name | Designation | Date |
|---|---|---|---|
| 1 | Mr. Ahmed Abdullah | Deputy Manager – Business Strategy | June 30, 2022 |