RATING REPORT

Unity Foods Limited

REPORT DATE:
November 1, 2023

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		Negative	
Rating Date	*November 1, 2023*		*August 30, 2022*	
Rating Action	*Reaffirmed*		*Maintained*	

COMPANY INFORMATION

Incorporated in 1991	**External auditors:** Naveed Zafar Ashfaq Jaffery & Co. Chartered Accountants
Listed Public Limited Company	**Chief Executive Officer:** Muhammad Farrukh Amin
Key Shareholders:	**Chairman:** Lt Gen Omar Mahmood Hayat (Retd)
Wilmar Pakistan Holdings Pte Ltd – 22% Unity Wilmar Agro (Private) Limited – 14% Directors, CEO and family members – 12%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria Methodology – Industrial Corporates (May 2023)
https://docs.vis.com.pk/docs/CorporateMethodology.pdf

APPLICABLE RATING SCALE(S)

VIS Issue/Issuer Rating Scale:
https://docs.vis.com.pk/docs/VISRatingScales.pdf

Unity Foods Limited

OVERVIEW OF THE INSTITUTION

Unity Foods Limited ('UFL' or 'the Company') was established in Pakistan in 1991 as a private limited company and was subsequently converted into a public limited company on June 16, 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

Lt. Gen. (Retd) Omar Mahmood Hayat, Chairman of Unity Foods, brings four decades of military and corporate leadership. Notably, as head of Pakistan Ordnance Factories, he doubled sales and exports. Currently, he chairs the Pakistan Humanitarian Forum, inspiring Unity Foods and beyond.

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

Company Profile

Unity Foods Limited ('UFL' or 'the Company') was established in Pakistan in 1991 as a private limited company and was subsequently converted into a public limited company on June 16, 1991. The shares of the Holding Company have been listed on the Pakistan Stock Exchange since February 01, 1994. The primary business activity of the Holding Company has transitioned from yarn manufacturing to encompass edible oil extraction, refining, and related operations. The Company has four major brands namely Dastak, Lagan, Ehtimam and Zauqeen. Dastak, its flagship brand, is targeted at the mid-tier segment, 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. UFL has a wholly owned subsidiary, Sunridge Foods (Private) Limited ('SFPL' or 'the Subsidiary'). The Subsidiary was established in Pakistan as a privately held company on March 16, 2015. The primary operational focus of SFPL centers on the processing of various food products.

Geographic Locations and Addresses of Business Units:

- Registered office – Unity Tower, Plot No. 8-C, Block-6, P.E.C.H.S, Karachi.
- Regional Office – Plot No. 27 – C-3, M.M. Alam Road, Gulberg-III, Lahore.
- Oil Refinery – Plot No. A-48, Industrial Zone, Port Qasim., Karachi.
- Edible Oil Extraction Plant, Refinery and Pelletizing Mills - Plot No. N-25 & N-27/B, N37/A, SITE Area, Karachi.
- Feed Mill – Plot No. A-55 & 56, Industrial Zone, Port Qasim, Karachi.
- Soap Plant – Plot No. C-375, C-376, C-377, C-382, C-383 and C-384, Hub Industrial Estate, Lasbella, Hub.

Key Rating Drivers

Business Risk Profile: Elevated Exposure to External Factors.

The industry in which UFL primarily operates features high level of business risk, mainly stemming from the sensitivity of its profit margins to fluctuations in foreign exchange rates and international commodity prices. Furthermore, the sector exhibits a high level of competition, characterized by fragmentation and low barriers to entry. This has resulted in limited pricing power and narrow profitability margins for participants within the industry. However, ratings draw comfort from the Company's decision to convert its supply credit facilities into PKR-denominated lines, effectively reducing the impact of this risk factor.

Sponsor Profile: Strong with substantial experience.

Wilmar International Limited (WIL) is the Company's largest shareholder, with an equity stake exceeding 36%. This investment is facilitated through WIL's wholly owned Singapore-based entity, Wilmar Pakistan Holdings Pte Ltd. (WPH), which directly holds more than 22% of Unity Foods' shares. Additionally, WIL maintains an ownership interest of over 14% through Unity Wilmar Agro (Pvt.) Limited, a Pakistan-incorporated subsidiary of WPH. Founded in 1991, WIL is a Singapore-based conglomerate and a prominent integrated agribusiness group in Asia, publicly listed on the Singapore Stock Exchange.

The Company benefits from both financial and technical support extended by WIL. In the event of future requirements, VIS anticipates that sponsor support will be forthcoming.

Sound Business Growth Prospect with Diversification.

Ratings consider the Company's consistent growth performance, reflected in a Compound Annual Growth Rate (CAGR) of 45% in topline revenue between FY20 and FY23. Management expects this growth trajectory to continue, due to enhanced diversification across its business segments and recent investments in improving its manufacturing facilities. Latest upgrades to its edible oil processing facility enable the production of higher-quality oil, while establishment of a fractionation plant will facilitate production of Stearin, expanding UFL's product portfolio. Stearin, a vital ingredient in soft margarines and infant fat formulas, positions UFL as a significant local supplier, potentially providing imports substitution to major multinational corporations.

Profitability: Constrained by High Finance Burden and Exchange Losses.

In FY23, UFL reported a significant decline in its operational and net margins. Despite a decline in capacity utilization across several key segments, the Company managed to increase its gross margin from 9.5% in FY22 to 13.5% in FY23. This growth was attributed to strategic cost pass-through to customers and a successful push in higher-margin, branded product sales. Additionally, international palm oil price decrease in 4QFY23 further supported gross margin expansion. However, overall profitability was weighed down by substantial exchange losses and elevated finance costs. Exchange losses resulted from delayed payments to the supplier due to SBP restrictions and PKR depreciation. Rise in finance burden was on the back of a spike in short-term borrowings as working capital requirements continue to grow amid increasing benchmark interest rates.

Going forward, UFL's profitability is expected to remain constrained by the high-interest rate environment, coupled with increasing working capital requirements. UFL's outlook remains dependent on its ability to effectively manage these challenges, maintain stable margins, and improve its overall financial risk profile.

Capitalization: High Short-term Debt Utilization Keeping Metrics Under Stress.

In recent years, the Company has undertaken significant expansion efforts, diversifying into new business segments. These strategic moves have consequently driven up the working capital requirements, leading to a heightened reliance on short-term debt for funding. As a result of a recent upgrade to its edible oil processing facility and integration of a fractionation plant, working capital requirements are expected to further escalate. This expansion-driven surge in working capital needs is anticipated to exert sustained pressure on the Company's capitalization factors.

Nonetheless, the management foresees this pressure gradually alleviating as the newly expanded segments begin contributing to the Company's cash generation. It is notable that the Company has maintained minimal long-term debt, which acts as a financial cushion to address potential future financing requirements. However, it is worth mentioning that while no further CAPEX is planned for FY24, a degree of balance sheet support is expected to be extended to the subsidiary, keeping the capitalization factors under pressure.

Increasing gearing levels in a high interest rate environment is a drag on profitability which is expected to continue in the medium term. Going forward, the Company's ability to achieve its business plans, and improving its capitalization metrics will remain a key consideration for the direction of ratings.

Liquidity and Coverage: Maintenance to Remain a Key Consideration.

Strong CAPEX activity in recent years and working capital support to SFPL has constrained the Company's liquidity profile. Working capital requirements have increased due to capacity expansions, push out on receivables and subsidiary financing. Consequently, short-term debt has increased. Despite Funds from Operations (FFO) increasing, higher working capital debt financing has impacted Debt Servicing Coverage Ratio (DSCR), although still remaining within comfortable levels. Going forward, with the new fractionation plant coming online, augmentation of working capital lines is expected to remain a challenge. However, management anticipates gradual improvements in cash generation over the rating horizon, driven by contributions from new business segments. Ratings draw comfort from DSCR remaining within comfortable levels despite sensitizing projections to various pressures.

The Company's ability to maintain liquidity and coverage ratios in line with assigned ratings will remain important for ratings.

Unity Foods Limited Appendix I

FINANCIAL SUMMARY				(PKR Millions)
BALANCE SHEET	**FY20**	**FY21**	**FY22**	**FY23**
Property Plant Equipment	3,330.9	7,759.1	8,478.0	10,858.6
Stock in trade	5,048.5	10,752.5	11,222.6	10,203.7
Trade debtors	7,765.7	12,290.8	21,946.8	23,648.1
Cash & bank balances	163.4	318.0	718.3	1,006.1
Total Assets	18,943.4	42,538.4	58,621.0	71,532.0
Trade and Other Payables	8,838.1	13,631.5	20,687.0	23,751.6
Long-term Debt (incl. current portion and lease liability)	278.5	552.9	452.4	633.6
Short Term Borrowings	3,892.3	14,693.6	15,902.2	24,603.3
Total Debt	4,170.7	15,246.5	16,354.6	25,236.9
Total Liabilities	13,093.7	29,159.1	37,464.4	49,807.3
Issued, subscribed & paid-up capital	5,440.5	9,940.5	15,340.5	15,340.5
Equity	5,849.7	13,379.3	21,156.5	21,724.0
INCOME STATEMENT	**FY20**	**FY21**	**FY22**	**FY23**
Net Sales	29,872.0	66,401.0	82,184.6	90,158.2
Gross Profit	2,029.3	5,191.7	7,845.6	12,139.5
Operating Profit	731.0	4,269.3	4,152.2	3,570.0
Finance Costs	545.0	880.1	1,663.6	3,406.7
Profit Before Tax	194.6	3,389.1	2,488.6	163.4
Profit After Tax	179.5	3,111.7	2,436.4	567.5
RATIO ANALYSIS	**FY20**	**FY21**	**FY22**	**FY23**
Gross Margin (%)	6.8%	7.8%	9.5%	13.5%
Net Margin (%)	0.6%	4.7%	3.0%	0.6%
Funds from Operation (FFO)	-703.5	2,490.8	2,120.3	3,175.6
FFO to Total Debt (%)	-16.9%	16.3%	13.0%	12.6%
FFO to Long Term Debt (%)	-252.6%	450.5%	468.6%	501.2%
Gearing (x)	0.7	1.1	0.8	1.2
Leverage (x)	2.2	2.2	1.8	2.3
Debt Servicing Coverage Ratio (x)	-0.3	2.9	2.1	1.9
Current Ratio	1.2	1.2	1.3	1.1
(Stock in trade + trade debts) / STD (x)	3.3	1.6	2.1	1.4
Return on Average Assets (%)	0.0%	10.1%	4.8%	0.9%
Return on Average Equity (%)	0.0%	32.4%	14.1%	2.6%

Unity Foods Limited

REGULATORY DISCLOSURES	Appendix II
Name of Rated Entity	Unity Foods Limited
Sector	Food & Personal Care
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see table below
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	see table below

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
01-11-2023	A	A-2	Negative	Reaffirmed
30-08-2022	A	A-2	Negative	Maintained
29-04-2021	A	A-2	Stable	Upgraded
13-11-2020	A-	A-2	Stable	Reaffirmed
01-10-2019	A-	A-2	Stable	Initial

Due Diligence Meetings Conducted

S.No	Name	Designation	Date
1	Mr. Ahmed Abdullah	Manager – Business Strategy	October 5, 2023