RATING REPORT

Habib Oil Mills Limited (HOM)

REPORT DATE:
May 29, 2018

RATING ANALYSTS:
Talha Iqbal
talha.iqbal@jcrvis.com.pk

Ibad Desmukh
ibad.deshmukh@jcrvis.com.pk

RATING DETAILS		
	Initial Rating	
Rating Category	**Long-term**	**Short-term**
Entity	BBB	A-3
Rating Outlook	Stable	
Rating Date	*May 29, 2018*	

COMPANY INFORMATION

Incorporated in 1954	**External auditors:** Kodvavi & Co. Chartered Accountants
Private Limited Company	**Managing Director:** Mr. Moidul Hassan
Key Shareholders (with stake 5% or more):	
Hassan Family	

APPLICABLE METHODOLOGY(IES)

Applicable Rating Criteria: Industrial Corporates (May, 2016) ***http://www.jcrvis.com.pk/kc-meth.aspx***

Habib Oil Mills Limited (HOM)

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

OVERVIEW OF THE INSTITUTION

Habib Oil Mills Limited (HOM) was incorporated in 1954, initially established as oil expelling unit. The present management has been running the business since 1978. External auditors of the company are Kodvavi & Co. Chartered Accountants.

Profile of Managing Director

Mr. Moidul Hassan has been associated with HOM for over 27 years. He holds a degree in Electronics Engineering from University of California USA

RATING RATIONALE

Habib Oil Mills Limited (HOM) has been engaged in manufacture and sale of vegetable banaspati, cooking oil and related products for over six decades. The company is owned and managed by the Hassan Family, which has substantial experience in this business. Apart from edible oil manufacturing & sale, the sponsors have investments in restaurants, fast moving consumer goods and IT sectors.

Product Portfolio

Major brands include Habib, Super Habib, Handi, Nayab and Fry'O. In 2016, the company launched the Mayar brand for low-tier consumers. Within aforementioned brands, there are variants for banaspati, cooking oil, canola oil, soybean oil and refined olein. Alongside, HOM manufactures different types of shortening products for commercial uses. Going forward, management envisages launch of new canola-based oil blends and margarine. The company also plans to increase presence in the industrial segment where it is ranked among top three players in terms of market share.

Marketing, Sales & Distribution

The company either supplies its products from 8 self-owned warehouses directly to retailers, or through a network of third-party whole sellers and over 130 distributors covering the country at 70,000-75,000 retail outlets. The sales team comprises 4 regional managers, 12 zonal managers, 82 territory sales officers and a sizeable team of contractual order bookers. Coordination between sales and distribution teams is supported by a management information system which provides timely sales and stock movement data for decision making.

Operations & Quality Assurance

HOM is headquartered in Karachi while its operations run through regional offices in Lahore, Islamabad, Multan, Faisalabad, Quetta, Sukkur and Hyderabad. Manufacturing facility is in SITE, Karachi. It comprises a refinery with cumulative production capacity of 500 metric tonnes per day (MTPD), fractionation plant with capacity of 300 MTPD, 24 storage tanks and a filling area. On a timeline basis, capacity utilization has increased to 79.3% (FY16: 65.3%; FY15: 38.0%). Alongside, the facility houses two gas-based generators, one standby diesel power generator and waste heat recovery boiler catering to almost entire energy requirement. HOM holds ISO 9001:2008 certification and its products are Pakistan Standards and Quality Control Authority (PSQCA) certified.

Port Qasim Expansion Project

The company plans to set up an oil seed crushing facility and extraction plant with capacity of 500 MTPD at Port Qasim, Karachi. As per the feasibility plan, existing manufacturing arm will entirely be shifted to the new site. Expected date of completion is June'2019. The project is envisaged to improve profitability through backward integration, lower freight costs due to closer proximity to Port Qasim and tax benefits under Section 65E of Income Tax Ordinance. Total cost of the project is Rs. 1.5b. Phase I will be financed through loan whereas Phase II would be financed with 70% equity and 30% debt to avail tax benefit. The company will obtain long-term debt amounting to Rs. 900.0m which will be repayable from FY20 onwards for a period of 5 years with 1-year grace period. Remaining cost will be funded by sponsors' equity injection of Rs. 600.0m.

Rating Drivers

Established track record of sponsors in the edible oil business

HOM holds market share of ~3.7% and ranks among top three players in the organized edible oil industry. The company's products enjoy significant brand recognition and stand among leaders in terms of relative market share.

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.

Earnings burdened by sizeable taxation which is expected to reduce post expansion
During FY14-15, net sales of the company hovered around Rs. 7b on account of subdued growth in volumes. However, with 97.2% growth in volumes subsequently, revenues depicted sizeable growth to Rs. 12.3b in FY16 and further to Rs. 13.9b in the outgoing fiscal year. Product sales mix illustrates that 30% of sales emanate from Mega segment (higher margin) while Popular category (lower margin) contributes 42% to turnover. Remaining sales emanate from other products including those targeted towards mid-tier customers. Gross margins have declined from ~13-14% during FY14-16 to ~10% in FY17 on account of shift in product mix towards Popular category. Since then, proportion of Mega in sales mix has increased as reflected by recovery in margins during 9MFY18. Going forward, growth in topline is expected to be driven by Mega segment till completion of expansion, subsequent to which management plans to resume focus on Popular category given higher production efficiency post expansion.

Raw oil constitutes ~90% of HOM's cost of sales. The company has three sources of oil: local importers, self-import and local purchase. On average, two-thirds of oil is locally procured while remaining is imported. 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.

Marketing, selling and distribution expenses decreased by 11.2% in FY17 largely on account of lower advertisement costs. Finance cost has depicted a rising trend on account of higher running finance utilization. Over 9MFY18, HOM reported profit before tax of Rs. 142.5m (FY17: Rs. 113.7m; FY16: Rs. 279.5m). 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 from expansion project will enable to it to lower its tax burden and improve its bottom line.

High leverage indicators due to limited profitability and sizeable working capital requirement
Barring 32.6% growth in FY15, equity base of HOM has remained largely stagnant on account of declining trend in profitability. However, given positive bottom-line booked over 9MFY18, total equity (adjusted for director's loan of Rs. 200.0m) of the company increased to Rs. 1,371.1m (FY17: Rs. 1,228.6m; FY16: Rs. 1,303.7m). Over past five years, the company has not paid out any dividend. Debt profile primarily comprises short-term debt acquired for working capital financing. Stock in trade and receivables represented 1.31x (FY17: 1.31x; FY16: 1.16x) of outstanding short-term borrowings at end-9MFY18. Borrowing levels have depicted growth on a timeline basis due to higher stock levels and increase in trade debts. This along with a largely stagnant equity base resulted in increase in gearing to 2.99x (FY16: 2.42x), though some improvement was witnessed at end-9MFY18 to 2.10x.

Weak liquidity profile on account of negative cash flows and extended credit cycle
Liquidity profile was under stress during FY17 on account of negative cash flows. However, some

improvement has been noted in 9MFY18 with Fund Flow from Operations (FFO) amounting to Rs. 38.0m (FY17: Rs. Minus 23.1m; FY16: Rs. 153.3m). Cash conversion cycle has increased on a timeline basis on account of higher credit period against sales. Cognizant of the same, management has intensified focus on recoveries as reflected by lower trade debts in relation to sales of 19.9% (FY17: 22.3%; FY16: 22.3%) as at end-9MFY18. Ageing profile of trade debts is considered manageable with a limited proportion of receivables being overdue for over three months. Given projected increase in margins and lower tax burden post expansion, cash flows and debt servicing ability are expected to improve over the ratings horizon.

Adequate IT infrastructure with management focusing on improving the internal control framework

Board of Directors comprises four members including the Managing Director. Meetings are conducted on ad hoc basis. In line with best practices, board composition (through increasing board size and inclusion of independent directors) and oversight has room for improvement. The company uses Oracle based ERP with integrated modules for its IT related needs. HOM's financial statements are audited by Kodvavi & Co. Chartered Accountants. The external auditors are neither QCR rated from Institute of Chartered Accountants of Pakistan nor are they present on the panel of auditors maintained by State Bank of Pakistan. The management has appointed Deloitte Yousuf Adil Saleem & Co. Chartered Accountants to conduct an internal control evaluation and present recommendations which the management plans to implement for improving overall control environment.

Habib Oil Mills Limited (HOM) — Appendix I

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**FY15**	**FY16**	**FY17**	**9MFY18**
Fixed Assets	921.0	1,092.4	1,090.6	1,073.8
Long term Investments	194.1	194.1	194.1	194.1
Stock-in-Trade	601.1	1,215.3	1,139.4	1,743.9
Trade Debts	1,445.6	2,735.3	3,105.7	1,978.8
Cash & Bank Balances	102.2	38.2	21.3	59.3
Total Assets	3,566.6	5,534.2	5,894.8	5,556.5
Trade and Other Payables	250.9	529.5	447.6	765.3
Long Term Debt	23.8	29.7	21.9	24.7
Short Term Debt	1,580.6	3,126.2	3,651.5	2,850.3
Total Debt	1,604.4	3,155.9	3,673.4	2,875.0
Total Equity (adjusted for Director's Loan)	1,258.2	1,303.7	1,228.6	1,371.1
Surplus on Revaluation of Assets - Net	453.1	545.1	545.1	545.1
INCOME STATEMENT	**FY15**	**FY16**	**FY17**	**9MFY18**
Net Sales	7,301.6	12,267.5	13,927.2	7,489.8
Gross Profit	1,045.9	1,574.4	1,354.7	1,032.18
Operating Expense	698.6	1,167.7	1,078.6	719.4
Finance Cost	109.6	123.0	173.1	170.19
Profit (Loss) Before Tax	238.1	279.5	113.7	142.51
Profit (Loss) After Tax	309.4	45.6	(75.1)	142.51
RATIO ANALYSIS	**FY15**	**FY16**	**FY17**	**9MFY18***
Gross Margin (%)	14.3%	12.8%	9.7%	13.8%
Net Margin (%)	4.2%	0.4%	-0.5%	1.9%
Net Working Capital	606.5	580.0	497.2	667.1
Trade debts/Sales (%)	19.8%	22.3%	22.3%	19.8%
FFO	172.7	153.3	(23.1)	50.7
FFO to Total Debt (%)	10.8%	4.9%	-0.6%	1.8%
Current Ratio (x)	1.33	1.16	1.12	1.18
Debt Servicing Coverage Ratio (x)	2.54	2.14	0.82	1.22
Gearing (x)	1.28	2.42	2.99	2.10
Debt Leverage (x)	1.47	2.83	3.35	2.65
Long Term Debt to Total Debt (%)	1.5%	0.9%	0.6%	0.9%
Short Term Debt to Total Debt (%)	98.5%	99.1%	99.4%	99.1%
ROAA (%)	9.3%	1.0%	-1.3%	3.3%
ROAE (%)	28.0%	3.6%	-5.9%	14.6%

** Annualized numbers*

RATING SCALE & DEFINITION

Appendix II

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: JCR-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.jcrvis.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.jcrvis.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.

'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.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-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	Habib Oil Mills Limited				
Sector	Edible Oil Manufacturing				
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				
	29/05/2018	BBB	A-3	Stable	Initial
Instrument Structure	n/a				
Statement by the Rating Team	JCR-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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