RATING REPORT

Habib Oil Mills Limited (HOM)

REPORT DATE:
August 30, 2019

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

Muhammad Tabish
muhammad.tabish@vis.com.pk

RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	BBB	A-3	BBB	A-3
Rating Outlook	Stable		Stable	
Rating Date	*Aug 26, 2019*		*May 29, 2018*	

COMPANY INFORMATION

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

APPLICABLE METHODOLOGY(IES)

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

Habib Oil Mills Limited (HOM)

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 & CEO

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

Established in 1954, Habib Oil Mills Limited (HOM) has been engaged in the manufacture and sale of cooking oil, vegetable banaspati & related products to both retail (B2C) and industrial (B2B) consumers nationwide 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, the group has also invested in food chains, fast moving consumer goods and IT sector.

HOM's manufacturing facility is located in SITE, Karachi. The current cumulative refining capacity of the plant stands at 500 metric tons per day (MTPD) while fractionation plant has a capacity of 300 MTPD. 24 storage tanks and a filling area cater to the needs of warehousing management. During outgoing year FY19, annual capacity utilization declined from 79.3% to 54.3% on account of lower production. Utilization levels dropped further to ~48% during HFY19 on annualized basis. Alongside, the facility houses two gas-based generators, one standby diesel power generator and waste heat recovery boiler catering to almost entire energy requirements of the Company.

The company runs its day to day operations through 7 regional offices located in Lahore, Islamabad, Multan, Faisalabad, Quetta, Sukkur and Hyderabad. HOM holds ISO 9001:2008 certification and its products are Pakistan Standards and Quality Control Authority certified.

Updates on Port Qasim Expansion Project

HOM is currently in process of setting up an oil seed crushing and solvent extraction plant to produce crude oil at Port Qasim Karachi. The plant with a crushing capacity of 500 MTPD is sufficient to cater to total raw material (crude oil) requirement of the company. Revised expected date of project completion is March'2020. Total cost of the project was initially estimated at around Rs. 1.5b; nevertheless, on account of significant rupee devaluation during outgoing year 2018 the same increased by Rs. 500m. Project cost is being funded through a mix of debt and equity.

As per management, existing oil refinery of the plant will be entirely shifted to the new site (Port Qasim) in medium to long term while the plant's close proximity to oilseed crushing facility would benefit the company in terms of cost efficiencies. The project is envisaged to improve liquidity and financial profile of HOM through backward integration, lower transportation cost and tax benefits (under Section 65E of Income Tax Ordinance) resulting in improved margins.

Product Portfolio

Major brands include Habib, Super Habib, Handi, Nayab, Mayar and Fry'O. Habib and Super Habib belong to 'Mega' product category. Mega and Handi both are targeted to premium segment which remains the key focus area of the company. 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, senior management has planned to regain its market share in industrial segment post expansion.

Marketing, Sales & Distribution

The company either supplies its products from 8 self-owned warehouses to retailers, or through a network of third-party whole sellers and over 180-190 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.

__Key Rating Drivers__

Strong brand recognition and sizeable market share.

HOM ranks among top five players in the organized sector of edible oil industry and has a strong brand franchise in the premium segment. Habib cooking oil, flagship product of HOM, is one of the oldest edible oil brands in the country.

Established track record of sponsors.

The sponsors have a rich experience spanning over six decades in edible oil processing industry. This has aided in building healthy relationships with customers and suppliers. Also, the sponsors have demonstrated support in terms of equity injection/directors' loan as and when required.

Highly fragmented industry characterized by intense competition and low margins. Business risk relates to managing of foreign exchange and price volatility risks in imported raw material procurement.

Pakistan's edible oil industry is characterized by high competitive intensity due to fragmentation and low barriers to entry, resulting in limited pricing power and thin profitability margins. Fragmentation in the industry is evident from no single entity registering a double-digit market share. The industry is divided in to two segments; a few large national level players in the organized sector who target the middle and high income groups and enjoy strong brand equity by quality and advertisement campaign. The other but larger segment is highly fragmented and caters to middle and lower income groups with players often dominating in selected regional areas. Based on pricing, the industry is further categorized into Premium segment (15% market), Middle Tier (30%-40% market) and Low Tier segment (50%-55% market).

Pakistan is amongst the leading importers and consumers of edible oil. Over the medium to long-term, demand is expected to increase in line with GDP growth which is further supported by positive demographic fundamentals. Given the relative inelasticity of demand in edible oil, the risks relate to managing of foreign exchange and price volatility in imported raw material procurement. Ability to manage margins depends on efficient inventory planning and pass through to consumers, which in turn, is linked to degree of competition and operational efficiency.

Significant decline in turnover post FY17 due to focus on high margin products. Resultantly, product mix has shifted towards high margin segment. Achieving growth in Mega and Handi segment remain the core focus area of the company.

Sales revenue of the company has declined from Rs. 13.9b in FY17 to Rs. 10.0b in FY18. This significant reduction in topline was largely on account of lower sales volumes mainly in low margin products (Nayab, Mayar and other industrial products) and decline in sales to utility stores given the stringent credit policy being pursued by the management. Net sales during HFY19 were reported at Rs. 4.7b.

HOM, over the years, had been facing stiff competition in middle and low tier product segments due to the presence of a large number of unorganized players. Mostly these players are operating at the regional level and have a price advantage due to limited value addition and lower transportation costs. Given the high level of substitution available to consumers in these segments, the demand is highly price elastic. In view of the same, senior management of the company during FY18 decided to shift their focus on serving premium segment. Post FY17, product mix has been shifted towards high margin segment (Mega and Handi) which now contributes around four-fifth to total sales revenue. Remaining sales emanate from other products including those targeted towards mid-tier customers and industrial consumers.

Profitability margins (Gross) have improved during FY18 and the ongoing fiscal year on account of shift in product mix.

Despite significant decline in topline, gross profit margins have recovered considerably during FY18 and in the ongoing year due to shift in sales mix towards high margin products. Gross margins were reported at 15.9% (2018: 14.1%; 2017: 9.7%) during HFY19. Crude oil constitutes ~90% of HOM's cost of sales. The company uses three sources for oil procurement: 1) Self-import 2) Local importers 3) Local purchase. On average, two-third of oil is locally procured while remaining is imported.

During HFY19, HOM reported profit before tax of Rs. 127.7m (FY18: Rs. 181.2m; FY17: Rs. 113.7m). The increase in operating profitability can be attributed to improved gross margins and higher other income earned. Administration and marketing expenses largely remained similar around prior year level. Despite decline in overall borrowings, financial charges were reported higher during FY18 and in the ongoing year on the back of increasing interest rate regime.

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. As a result, high effective tax rate is a drag on net profitability. Going forward, management expects further growth in net profitability on the back of cost efficiencies and tax rebate (with respect to expansion project).

Growth witnessed in equity base on account of fresh equity injection. Leverage indicators have depicted improvement on a timeline basis due to reduction in short-term borrowing (on account of improved working capital management) and higher equity base.

Equity base of the company has increased considerably to Rs. 1.6b (FY18: Rs. 0.8b; FY17: Rs. 1.2b) at end- June 2019, primarily on account of sizable fresh capital injections and increased bottom-line profitability. In FY18, the company declared an interim dividend of Rs. 500m. Around three-fourth of HOM's debt profile is short-term in nature acquired to finance working capital requirements. Total short-term borrowings were reported at around Rs. 2.3b (FY18: Rs. 2.9b; FY17: Rs. 3.65b) at end-June 2019. Short-term borrowing is expected to reduce further due to implementation of strict credit terms and efficient inventory management. Total debt of the company has increased due to long-term loan of Rs. 900m acquired (in two tranches) to fund expansion project. The long-term debt is repayable from FY20 and onwards for a period of 5 years.

Leverage indicators have depicted improvement on a timeline basis. Leverage and gearing were reported at 2.06x (FY18: 5.46x; FY17: 3.35x) and 1.68x (FY18: 3.89x; FY17: 2.99x) at end-HFY19, respectively. Stock in trade and receivables represented 1.36x (FY18: 1.26x; FY17: 1.16x) of outstanding short-term borrowings at end-HFY19.

Improved working capital management has supported liquidity profile. Nevertheless, overall liquidity profile remains constrained due to limited funds generated from operations. Cash flows are projected to improve with completion of ongoing expansion and realization of tax benefits.

Funds flow from operations (FFO) has remained on the lower side on a timeline basis. Resultantly, cash flow coverage of total debt and debt servicing coverage ratio have remained on the lower side.

Trade debts have depicted a noticeable reduction over the last 2 years on account of implementation of a stringent credit policy. Trade debts in relation to sales was reported lower at 17.3% (FY18: 16.6%; FY17: 22.3%) at end-HFY19. Ageing profile of trade debts is considered manageable with a very limited proportion of receivables being overdue for over three months. Given projected reduction in tax burden post expansion and increase in margins, cash flows and debt servicing ability are expected to improve liquidity profile over the ratings horizon. Ratings remain dependent on timely completion of ongoing project and realization of tax benefits post expansion to ensure sound debt servicing ability.

Adequate IT infrastructure with management focusing on improving corporate governance and internal controls

Board of Directors comprises four members including the CEO & Managing Director. Other directors are members of Hassan family. Given the company's status as a private limited company, overall board composition and oversight has room for improvement through induction of additional directors on board (including independent directors).

Meetings are conducted on ad hoc basis. The company uses Oracle based ERP with integrated modules for its IT related needs. Moreover, in order to enhance inventory management system, the company has initiated the project of integrating store wise dispatches to keep track of overall inventory. 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. Deloitte Yousuf Adil Saleem & Co. Chartered Accountants, in order to improve overall control environment, conducted evaluation of internal controls and provide recommendations which are being implemented.

Habib Oil Mills Limited (HOM) Appendix I

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**FY16**	**FY17**	**FY18**	**HFY19**
Fixed Assets	1,092.4	1,090.6	1,921.3	1,878.3
Long term Investments	194.1	194.1	194.1	194.1
Stock-in-Trade	1,215.3	1,139.4	2,028.0	1,514.9
Trade Debts	2,735.3	3,105.7	1,667.5	1,621.6
Cash & Bank Balances	38.2	21.3	25.0	82.3
Total Assets	5,534.2	5,894.8	6,327.3	6,459.8
Trade and Other Payables	529.5	447.6	694.3	582.3
Long Term Debt	29.7	21.9	27.9	471.6
Short Term Debt	3,126.2	3,651.5	2,942.6	2,300.0
Total Debt	3,155.9	3,673.4	2,970.5	2,771.6
Total Equity (adjusted for Director's Loan)	1,303.7	1,228.6	763.4	1,652.3
Surplus on Revaluation of Assets - Net	545.1	545.1	1,399.1	1,399.1
INCOME STATEMENT	**FY16**	**FY17**	**FY18**	**HFY19**
Net Sales	12,267.5	13,927.2	10,043.0	4,685.2
Gross Profit	1,574.4	1,354.7	1,419.6	743.6
Operating Expense	1,167.7	1,078.6	1,059.8	519.5
Finance Cost	123.0	173.1	228.7	111.4
Profit (Loss) Before Tax	279.5	113.7	181.2	127.7
Profit (Loss) After Tax	45.6	(75.1)	34.7	114.5
RATIO ANALYSIS	**FY16**	**FY17**	**FY18**	**HFY19**
Gross Margin (%)	12.8%	9.7%	14.1%	15.9%
Net Margin (%)	0.4%	-0.5%	0.3%	2.4%
Net Working Capital	580.0	497.2	56.0	1,310.5
Trade debts/Sales (%)	22.3%	22.3%	16.6%	17.3%*
FFO	153.3	(23.1)	3.6	-
FFO to Total Debt (%)	4.9%	-0.6%	0.1%	-
Current Ratio (x)	1.16	1.12	1.01	1.45
Debt Servicing Coverage Ratio (x)	2.14	0.82	1.02	-
Gearing (x)	2.42	2.99	3.89	1.68
Debt Leverage (x)	2.83	3.35	5.46	2.06
Long Term Debt to Total Debt (%)	0.9%	0.6%	0.9%	17.0%
Short Term Debt to Total Debt (%)	99.1%	99.4%	99.1%	83.0%
ROAA (%)	1.0%	-1.3%	0.6%	3.6%*
ROAE (%)	3.6%	-5.9%	3.5%	19.0%*

** Annualized numbers*

RATING SCALE & DEFINITION 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	Habib Oil Mills Limited
Sector	Edible Oil Manufacturing
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	
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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Rating History:

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
26/08/2019	BBB	A-3	Stable	Reaffirmed
29/05/2018	BBB	A-3	Stable	Initial