RATING REPORT

Habib Oil Mills Limited (HOM)

REPORT DATE:
December 22, 2020

RATING ANALYSTS:
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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	*Dec 22, 2020*		*Aug 26, 2019*	

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)
Industrial Corporates (April 2019) https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Corporate-Methodology-201904.pdf

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. 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.

<u>Updates on Port Qasim Expansion Project</u>

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 raw material (soft oil) requirement of the company. Total cost of the project was initially estimated at around Rs. 1.5b and at present has been increased to Rs. 2.2b on account of significant rupee devaluation during the outgoing year FY20 and management decision to buy latest equipment instead of transferring old equipment to minimize operational cost. Project cost is being funded through a mix of debt and equity. Majority (around 95%) of the work for expansion is completed while Chinese contractors are awaited for commissioning of the new plant. Management expects the plant to be fully operational by 1QCY2021.

As per management, existing oil refinery of the plant may 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, significantly higher turnover and tax benefits (under Section 65E of Income Tax Ordinance) resulting in improved margins.

<u>Product Portfolio and Marketing, Sales & Distribution</u>

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.

The company either supplies its products from 8 self-owned warehouses to retailers, or through a network of third-party whole sellers and over 200 distributors covering the country at 70,000-75,000 retail outlets. 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.

Profitability profile is constrained by sizeable finance cost and high effective tax rate. Profitability profile is expected to improve post expansion.
Gross sales increased by 17% (FY19: -5%) in FY20 on account of higher prices. Volume levels remained around prior year level given the company's focus on existing premium segment and strict credit policy being pursued by the management. However, sales revenue of the company slightly decreased from Rs. 9.4b in FY19 to Rs. 9.2b in FY20. The decline was on the back of change in sales tax regime. At present, revenue mix comprises of 60% of cooking oil and remaining 40% comprises Ghee segment.

Gross profit margins remained stable at 16.0% (FY19: 15.8%) as increase in input cost were passed on to customers in the form of higher average selling prices. Key risks to gross margins are rupee devaluation and significant volatility in prices of palm oil. However, the impact of these uncertainties on the company is manageable due to its ability to pass on price increases to customers being an end-product player in the industry. As per management, efficient inventory management has also contributed in sustaining gross margins. Marketing, selling and distribution expenses decreased to Rs. 741m FY19: Rs. 830m) in FY20 due to a sizeable reduction in advertisement activities. Finance cost increased from Rs. 258m in FY19 to Rs. 294m in FY20 due to higher average interest rates during the period. Going forward, financial charges for 1HFY21 will be lower given decline in interest rates and lower borrowings in the ongoing year given further reduction in trade debts. However, financial charges are expected to increase subsequently with higher working capital requirements post expansion.

Historically, the company has been subject to high taxation regime with 5.5% tax applicable on import of oil and 2.0% tax on locally procured oil consumed. Nonetheless, change in tax regime in the ongoing year is expected to result in lower effective tax rates. This along with higher revenues post completion of expansion and improvement in margins is expected to support profitability profile over the rating horizon.

Overall liquidity profile remains constrained due to limited funds generated from operations and extended working capital cycle which requires utilization of short-term borrowing. Comfort is drawn from sizeable tax refunds in the ongoing year which will support in meeting short-term liquidity requirements.

Funds from operations (FFO) have remained on the lower side and declined on a timeline basis. The decline in FFO is on the back of higher tax paid in FY20. Resultantly, debt servicing coverage ratio and cash flow coverage of total debt remains weak. Nevertheless, given expected growth in revenues and profitability post expansion, cash flow coverages are expected to improve. Liquidity profile will also be supported by tax refunds (FY20: Rs. 114m) and benefit of Section 65E post expansion which will result in a decline in tax liability.

Trade debts have depicted a decrease to Rs. 1.2b (FY20: Rs. 1.41b; FY19: Rs. 1.44b; FY18: Rs. 1.67b) at end-October 2020 on a timeline basis on account of implementation of a stringent credit policy. Working capital requirement is projected to increase post expansion. Stock in trade and trade debts to short-term borrowing was reported at 1.19x (FY19: 1.35x; FY18: 1.26x) while current ratio is also considered satisfactory at 1.1x (FY19: 1.2x; FY18: 1.0x) at end-FY20.

Although equity base has increased on the back of capital injections, leverage indicators are expected to escalate on account of higher working capital requirements post expansion

Equity base of the company has increased to Rs. 2.0b (FY19: Rs. 1.8b; FY18: Rs. 0.8b) at year-end 2020 on account of increased profitability and capital injections. Around 70% of HOM's debt profile is short term in nature acquired to finance working capital requirements. Short-term borrowings were reported at around Rs. 2.7b (FY19: Rs. 2.3b; FY18: Rs. 2.9b) at year-end 2020. Debt repayment for long-term debt is scheduled to begin last quarter of the ongoing year. At present, total debt amount to Rs 3.92b (FY19: Rs. 2.96b; FY18: Rs. 2.97b) at year-end FY20. Leverage and gearing ratio were reported at 2.37x (FY19: 2.20x, FY18: 5.65x) and 1.95x (FY19: 1.68x; FY18: 3.89x) at year-end FY20. Borrowing levels have declined to around Rs. 3.5b at end-October 2020. Leverage ratios are expected to remain elevated on account of higher working capital requirement post expansion.

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

BALANCE SHEET	FY18	FY19	FY20
Fixed Assets	1,921.3	1,983.0	1,949.1
Long term Investments	194.1	194.1	194.1
Stock-in-Trade	2,028.0	1,712.2	1,846.7
Trade Debts	1,667.5	1,440.1	1,409.3
Cash & Bank Balances	25.0	157.7	28.2
Total Assets	6,327.3	6,850.6	7,981.9
Trade and Other Payables	694.3	723.7	648.3
Long Term Debt	27.9	627.7	1,182.8
Short Term Debt	2,942.6	2,336.6	2,738.7
Total Debt	2,970.5	2,964.3	3,921.5
Total Equity (adjusted for Director's Loan)	763.4	1763.5	2,013.0
Paid up Capital	20.0	480.5	580.5
Surplus on Revaluation of Assets - Net	1,399.1	1,399.1	1,399.1
INCOME STATEMENT	**FY18**	**FY19**	**FY20**
Net Sales	10,043.0	9381.6	9,210.0
Gross Profit	1,419.6	1,497.8	1,452.0
Operating Expense	1,059.8	1,039.6	966.1
Finance Cost	228.7	258.2	294.2
Profit (Loss) Before Tax	181.3	208.7	186.7
Profit (Loss) After Tax	34.8	79.2	49.6
RATIO ANALYSIS	**FY18**	**FY19**	**FY20**
Gross Margin (%)	14.1%	16.0%	15.8%
Net Margin (%)	0.3%	1.0%	0.5%
Net Working Capital	56.0	629.7	387.5
Trade debts/Sales (%)	16.6%	15.0%	15.3%
FFO	(16.9)	104.5	(8.6)
FFO to Total Debt (%)	(1.0)%	4.0%	(0.2)%
Current Ratio (x)	1.0	1.2	1.1
Debt Servicing Coverage Ratio (x)	1.0	1.4	0.8
Gearing (x)	3.9	1.7	1.9
Debt Leverage (x)	5.7	2.2	2.4
Long Term Debt to Total Debt (%)	1.0%	21.0%	30.0%
Short Term Debt to Total Debt (%)	99.0%	79.0%	70.0%
ROAA (%)	1.0%	1.0%	1.0%
ROAE (%)	4.0%	6.0%	3.0%

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	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.
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 Meeting	see table below

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
22/12/2020	BBB	A-3	Stable	Reaffirmed
26/08/2019	BBB	A-3	Stable	Reaffirmed
29/05/2018	BBB	A-3	Stable	Initial

Due Diligence Meeting

Name	Designation	Date
Mr. Yousuf	Director Finance	12/11/2020