RATING REPORT

Habib Oil Mills (Pvt.) Limited (HOM)

REPORT DATE:
June 06, 2023

RATING ANALYSTS:
Asfia Aziz
asfia.aziz@vis.com.pk

Sundus Qureshi
sundus.qureshi@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	Negative		Negative	
Rating Date	*Jun 06, 2023*		*Mar 14, 2022*	

COMPANY INFORMATION	
Incorporated in 1954	**External auditors:** Crowe Hussain Chaudhury & Co.
Private Limited Company	**Managing Director & CEO:** Mr. Moidul Hassan
Key Shareholders (with stake 5% or more):	
- Hassan Family	

APPLICABLE METHODOLOGY(IES)
Applicable Rating Criteria: 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

Habib Oil Mills (Pvt.) Limited (HOM)

OVERVIEW OF THE INSTITUTION

Habib Oil Mills Limited (HOM) was incorporated in 1954, initially established as an 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 Northrop University in 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 sponsors have exposure in food chains, fast moving consumer goods and IT sector. Companies owned by sponsors include MCR (Private) Limited, Millenium Software (Private) Limited, HOM Quality Foods (Private) Limited, First Habib Water (Private) Limited, and Satcom (Private) Limited.

HOM has two facilities situated in Port Qasim and SITE, Karachi with the latter one being non-operational. The current cumulative refining capacity of edible oil and ghee stood at 270,000 MT (FY21: 135,000 MT) at end-June'22. Power requirement of the unit is met through gas and diesel based generators and waste heat recovery boiler.

The company now runs its day to day operations through 5 (FY21: 7) regional offices located in Lahore, Islamabad, Multan, Sukkur and Hyderabad. During 9MFY23, branches in Faisalabad and Quetta were closed and rationalized through Karachi & Lahore offices. HOM holds ISO 9001:2008 certification and its products are Pakistan Standards and Quality Control Authority certified.

Product Portfolio and Marketing, Sales & Distribution

HOM's major brands include Habib, Super Habib, Handi, Nayab, Mayar and Fry'O. Habib and Super Habib pertain 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. Moreover, HOM also manufactures different types of shortening products for commercial uses. 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.

Update on Port Qasim Expansion Project

- In the outgoing year, HOM completed its oil seed crushing and solvent extraction at Port Qasim to produce crude oil. 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; however, the same has increased to Rs. 2.7b on account of significant rupee devaluation along with management's decision to buy latest equipment instead of transferring old equipment to minimize operational cost.
- After a delay in visit from Chinese contractors amid COVID-19 related travel restrictions, the plant became fully operational in FY22. Around Rs. 1.1b was financed with internal cash generation, whereas remaining was funded through debt (long term and short term). As per management, the Company has repaid most of the debt drawn for expansion, with around Rs. 600m remaining at end-Dec'22.

- The project is envisaged to improve liquidity and financial profile of HOML through backward integration, lower transportation cost, significantly higher turnover and tax benefits (under Finance Act 2021 where income tax on edible oils has been slashed from 1.5% to 1.25% and 65E allowing tax credit for 5 years for any industrial undertaking to be set-up by end-FY22) resulting in improved margins.
- With installation of a new plant, annual capacity of the Company doubled. However, capacity utilization has decreased in FY22 due to raw material constraints.

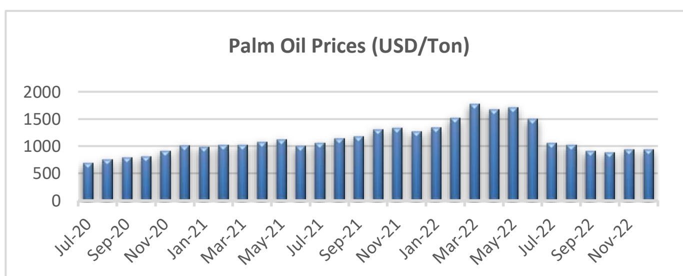
	FY21	FY22
Annual Capacity (tons)	135,000	270,000
Actual Production (tons)	52,761	48,973
Capacity Utilization (%)	39%	18%

Key Rating Drivers

VIS classifies Edible Oil Industry as 'High' business risk, given its heavy reliance on imported raw material, fragmented market, low value addition & switching cost and thin sector margins.

- 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 990/ton, as of Jan'21, to USD 1,777/ton as of Mar'22, up 79% during the 3-months period. With the cost in its entirety, being passed on to the consumers, local edible oil pricing also increased. During the first half of FY23, the prices of palm oil in global market displayed bearish trend which tend to result in inventory losses to the local players.

Figure 1: Palm Oil Prices (USD/Ton) (Jul 2020 – Dec 2022)



- Demand side of palm oil remained strong and is expected to grow, as palm oil is a staple product, with wide variety of uses including its consumption as food and as a commercial raw material for the FMCG industry.

- In Pakistan, the edible oil sector comprises more than 200 registered cooking oil and ghee manufacturing companies in Pakistan, including around 50 ghee manufacturing units, which collective product ~10,000 tons of oil and ghee on daily basis. Pakistan Vanaspati Manufacturers Association (PVMA) is representative body of around 125 ghee and oil manufacturers in the organized sector, which has installed capacity of over 4.5m MT.

- 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. While leading players are playing important part in catering to demand for packaged edible oils, fragmentation in the industry is evident from no single entity holding a double-digit market share.
- Comfort is drawn from HOM managing to hold a market share of 10% under the premium segment in the edible oil industry of Pakistan.

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 sizable experience spanning over six decades in edible oil processing industry. This has aided in building healthy relationships with customers and suppliers. In addition, implicit support from sponsors was witnessed in terms of equity injection/directors' loan as and when required.

Topline growth contributed by higher average selling prices; high sensitivity of exchange rate volatility on margins due to dependence on imports

- The company's topline registered an increase of around 53% and was reported at Rs. 17.7b (FY21: Rs. 11.6b; FY20: Rs. 9.2b) during FY22; the same being an outcome of increase in retail prices of final products.
- Major brands of the Company include Mega, Handi and Nayab. As per management, the fully operational new plant contributed in cost-efficiencies during FY22 and HYFY23.
- Currently, revenue mix comprises of three-fifths of ghee and remaining two-fifths comprises cooking oil segment.
- Gross profit of the Company in absolute terms increased to Rs. 2.4b (FY21: Rs. 1.4b; FY20: Rs. 1.5b) in FY22 due to higher revenues. Subsequently, gross margins also inclined to 13.7% (FY21: 12.0%; FY20: 15.8%) in the same period on account of significant increase in topline along with inventory gains during FY22.
- The key risks to gross margins remain rupee devaluation and significant volatility in prices of palm oil.
- Administrative expenses in FY22 increased primarily due to higher salaries expensed and provisions for expected credit losses booked during the year. Finance charges were also reported higher at Rs. 494.8m (FY21: Rs. 204.6m; FY20: Rs. 293.8m) mainly due to higher benchmark rates and elevated short-term borrowing levels in FY22.
- Despite elevated expenses, net margins of the Company remained stable during the outgoing year due to strong growth in revenue base. Net margins were reported at 1.8% (FY21: 1.8%; FY20: 0.5%) in FY22.
- During 1HYFY23, the Company's gross margins reduced to 7.0% (FY22: 13.7%) largely due to inventory losses arising from stuck inventory at port causing disruption in production levels. Further with elevated financial costs, HOM reported negative net margin of 6.9% in the same period.

- Amidst challenging macroeconomic environment, improving margins will be important from a ratings perspective.

Liquidity profile warrants improvement

- Although liquidity indicators were reported sufficient for FY22, the same depicted significant weakening in the ongoing year.
- FFO to Total Debt and FFO to Long-Term Debt increased to 10% (FY21: 6%; FY20: -7%) and 53% (FY21: 21%; FY20: -24%) respectively during FY22. However, the same was insufficient in HYFY23 due to losses incurred.
- Ratings remain dependent on improvement of the liquidity indicators as per the benchmarks for the assigned ratings.
- Current ratio as of 1HFY23 end stood at 0.94x, which is around the minimum threshold level. Short-term borrowing coverage is also low at 108% at end-Dec'22.
- Ratings draw some comfort from manageable aging profile of trade debts with 98% of outstanding trade receivables due within three months. During FY22, the company has written off trade debts to the tune of Rs. 90.0m, which was around 3% of the total trade debts.
- Exposure in TDRs to the tune of Rs. 72.6m at end-FY22 provides a meager support to the liquidity profile.

Rising leverage levels in the review period.

- Equity base of the company declined to Rs. 3.9b (FY22: 4.4b; FY21: Rs. 4.1b) by end-Dec'22 due to losses incurred.
- Capital structure of the company comprises interest free loan from director to the tune of Rs. 200.0m which is payable at the discretion of the company.
- The debt profile comprises a mix of long-term (22%) and short-term borrowings (78%). The outstanding balance of long-term borrowings, inclusive of current maturity, reduced to Rs. 821m (FY22: Rs. 957.4m, FY21: Rs. 1,285.6m) at end-Dec'22 on account of repayment of debt employed. Quantum of short-term borrowings increased to Rs. 4.4b (FY21: Rs. 3.3b) at end-FY22 to meet higher working capital requirements in lieu of growth in scale of operations.
- In 1HFY23, total quantum of debt was reported lower at Rs. 4.4b (FY22: Rs. 5.3; FY21: Rs. 4.6b).
- Gearing and leverage ratios were reported at 2.3x (FY22: 2.2x; FY21: 2.0x) and 2.8x (FY22: 2.9x; FY21: 2.5x) respectively, at end-1HFY23.
- In addition, going forward no major capital investment is forecasted for the rating horizon, only normal BMR expenditure is expected to be carried out.
- However, given the challenging market dynamics and pressure on margins, improving financial risk profile over the rating horizon will remain critical for ratings.

REGULATORY DISCLOSURES — Appendix II

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				
06/06/2023	**BBB**	**A-3**	**Negative**	**Reaffirmed**
14/03/2022	BBB	A-3	Negative	Maintained
22/12/2020	BBB	A-3	Stable	Reaffirmed
26/08/2019	BBB	A-3	Stable	Reaffirmed
29/05/2018	BBB	A-3	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.
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. Copyright 2023 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.
Due Diligence Meeting	

Name	Designation	Date
Mr. Iftikhar Iqbal	CFO	10/04/2023