RATING REPORT

Faisalabad Oil Refinery (Pvt.) Limited (FORL)

REPORT DATE:
July 5, 2018

RATING ANALYSTS:
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RATING DETAILS

	Latest Rating		Previous Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	BBB+	A-2		
Rating Outlook	*Stable*		*NA*	
Rating Outlook	Initial			
Rating Date	*June 29th, '18*			

COMPANY INFORMATION

Incorporated in 1984-1985	External auditors: Zaheer Babar & Co. Chartered Accountants
Private Limited Company	Chairman of the Board/CEO: Mr. Mian Muhammad Hanif
Key Shareholders (with stake 5% or more):	
Muhammad Usman Saleem – 34.0%	
Muhammad Haider Amin – 10.45%	
Muhammad Hamza Amin – 10.45%	
Fatima Amin – 10.44%	
Muhammad Hassan Rasheed – 8.95%	

APPLICABLE METHODOLOGY(IES)

JCR-VIS Entity Rating Criteria: Industrial Corporates (May 2016)
http://jcrvis.com.pk/docs/Corporate-Methodology-201605.pdf

OVERVIEW OF THE INSTITUTION

Faisalabad Refinery Oil (Pvt.) Limited (FORL) was established in 1984-1985. The company is involved in the manufacturing of Vegetable Ghee, Cooking Oil, and allied products.

Profile of the Chairman/CEO

Mr. Mian Muhammad Hanif has more than 25 years of experience in edible oils, sugar, steel, and education sectors. He is also acting chairman of Pakistan Edible Oils Refiners Association.

Financial Snapshot

Total Equity: end-1HY18: Rs. 4.04b; end-FY17: Rs. 3.83b; end-FY16: Rs. 3.43b; end-FY15: Rs. 2.84b

Assets: end-1HY18: Rs. 10.98b; end-FY17: Rs. 8.82b; end-FY16: Rs. 10.24b; end-FY15: Rs. 6.56b

Profit After Tax: end-1HY18: Rs. 180.7m; end-FY17: Rs. 335.6m; end-FY16: Rs. 269.4m; end-FY15: Rs. 116.3m

RATING RATIONALE

FORL is an edible oil refinery unit which manufactures vegetable ghee and cooking oil. The sponsors of the company have over three decades of experience in the industry, resulting in long-standing relationships with the distributors and an established procurement network. The assigned ratings take into account moderate business risk profile of the company owing to its presence in edible oil market; demand dynamics of the sector remain favorable on account of growing population. Ratings drive strength from a well-recognized brand name and adequate debt service coverage ratio since there is no long-term debt on the company's balance sheet. However, ratings remained constrained on account of declining sales, high competition in branded edible oil retail market, significant accumulation of advance income tax and sales tax refundable due from the government and weak corporate governance framework.

Key Rating Drivers:

Keeping business risk at moderate levels

FORL, like all branded edible oil firms, faces stiff competition and pricing pressure from the unorganized sector which has a significantly higher penetration in Pakistan's edible oil industry. The company also faces challenges in marketing since there are little product differentiation and almost non-existent switching cost. The industry is exposed to high credit risk, but FORL manages this risk by taking advance payments from most of its distributors. Although the industry provides a natural hedge to a certain extent since input and output prices are fairly correlated, the company holds minimum safety stock of raw material to avoid inventory losses in case of a sustained downtrend in prices. The company does not take positions in agro-commodity futures, but the procurement team closely monitors the trends and volatility levels to manage the pricing risk. The commodity statistics show that the price volatility of palm oil and rapeseed oil has remained range-bound over the past twelve months.

Profitability and liquidity burdened by declining sales

Net sales registered a decline of 12.9% during FY17 on the back of 31.1% reduction in volume sales of vegetable ghee and 4.8% in cooking oil. The weakness in gross and operating margins was also noticeable despite 14.4% decrease in raw material cost. The company witnessed a sizeable increase in power & fuel and salaries & wages expenses with the addition of steel manufacturing division. The bottom-line, however, went up by 24.6% on account of lower financial and tax charges. The concentration among top ten customers remained on the lower side. Funds from Operations (FFO) increased at a modest growth rate of 4.5% to Rs. 228.4m (FY16: Rs. 218.7m; FY15: Rs. 481.8m) primarily due to a reduction in finance cost and taxes paid during FY17, resulting in very low FFO to total debt ratio of 0.06x. The debt service coverage ratio improved to 2.16x during FY17 (FY16: 1.84x; FY15: 2.06x) in the absence of long-term debt. Going forward, the company is planning to increase the production output of steel unit.

Increased gearing due to elevated working capital requirements

The company has experienced a healthy growth in core equity owing to increase in paid-up capital and accumulation of unappropriated profits. The management remains reliant on short-term borrowings for working capital financing but has no intention of raising long-term debt in the foreseeable future. The short-term borrowings stood higher at Rs. 5.73b due to elevated working capital requirements during 1HFY18. The gearing indicators have deteriorated to 1.42x during 1HFY18 (FY16: 0.97x; FY15: 1.59x) on account for a sizeable increase in short-term borrowings. The leverage indicators are likely to fluctuate in a similar range in the absence of fresh equity issuance from the sponsors. However, the expected continuation of positive momentum in bottom-line should positively impact the gearing levels.

Room for improvements in corporate governance framework

The Board of Directors of FORL comprises five members, including the Managing Director. The board meetings are held on ad hoc basis. The senior management team is well-equipped with the industry knowledge and experience. However, the overall corporate governance can improve with the formulation of Board level committees, the appointment of an independent director, and segregation of the Chairman and CEO roles.

Adequate IT infrastructure in place but internal control system requires more attention
The company uses ERP platform with integrated modules and other applications to manage its business processes. A group level internal audit team of eight employees overseas the audit-related matter of FORL. The external auditors review the effeteness of internal controls once a year. Mr. Haider Amin overseas the group level IT team of ten employees.

Faisalabad Oil Refinery (Pvt.) Limited — Appendix I

FINANCIAL SUMMARY *(amounts in PKR millions)*				
BALANCE SHEET	**June 30, 2015**	**June 30, 2016**	**June 30, 2017**	**Dec 31, 2017**
Non-Current Assets	2,702.3	2,923.3	2,934.0	2,940.0
Stock-in-Trade	727.3	2,575.1	1,939.1	4,161.2
Trade Debts	2,069.3	3,446.1	2,112.9	1,800.3
Advances, Prepayments & other Receivables	870.3	1,109.9	1,565.6	1,731.9
Cash & Bank Balances	25.6	9.2	52.7	165.8
Total Assets	6,559.7	10,244.5	8,817.5	10,977.8
Trade and Other Payables	127.3	118.1	98.9	66.7
Short Term Borrowings	2,028.3	5,452.4	3,722.4	5,734.1
Long-Term Borrowings *(Inc. current matur)*	-	-	-	-
Tier-1 Equity	2,840.6	3,430.0	3,827.4	4,035.6
Total Equity	4,058.8	4,603.4	4,939.7	5,120.5
INCOME STATEMENT	**June 30, 2015**	**June 30, 2016**	**June 30, 2017**	**Dec 31, 2017**
Net Sales	16,454.7	11,867.4	10,341.3	5,591.3
Gross Profit	1,686.0	1,248.6	986.1	550.8
Operating Profit	1,330.1	907.6	717.5	399.3
Profit After Tax	116.3	269.4	335.6	180.7
FFO	481.8	218.7	228.4	46.3
RATIO ANALYSIS	**June 30, 2015**	**June 30, 2016**	**June 30, 2017**	**Dec 31, 2017**
Gross Margin (%)	10.2%	10.5%	9.5%	9.9%
Net Working Capital	1,653.0	1,703.6	2,031.1	2,206.0
FFO to Long-Term Debt	-	-	-	-
FFO to Total Debt (%)	23.8%	4.0%	6.1%	1.6%
Debt Servicing Coverage Ratio (x)	2.06	1.84	2.16	1.47
ROAA (%)	1.8%	3.2%	3.5%	3.5%
ROAE (%)	4.2%	8.6%	9.2%	9.1%
Gearing (x)	0.71	1.59	0.97	1.42
Debt Leverage (x)	0.88	1.64	1.01	1.45

ISSUE/ISSUER RATING SCALE & DEFINITIONS — 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	Faisalabad Oil Refinery (Pvt.) Limited
Sector	Consumer Goods
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see below
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.
Probability of Default	JCR-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		
29/06/2018	BBB+	A-2	Stable	Initial