RATING REPORT

Faisalabad Oil Refinery (Pvt.) Limited (FORL)

REPORT DATE:
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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-2	BBB+	A-2
Rating Date	*June 28, 2019*		*June 29, 2018*	
Rating Outlook	Stable		Stable	

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)

VIS Entity Rating Criteria: Corporates (May 2019)
https://www.vis.com.pk/kc-meth.aspx

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-1HY19: Rs. 4.46b; end-FY18: Rs. 4.19b; end-FY17: Rs. 3.83b; end-FY16: Rs. 3.43b

Assets: end-1HY19: Rs. 12.35; end-FY18: Rs. 10.81b; end-FY17: Rs. 8.82b; end-FY16: Rs. 10.24b

Profit After Tax: 1HY19: Rs. 236.1; FY18: Rs. 316.2m; FY17: Rs. 335.6m; FY16: Rs. 269.4m

RATING RATIONALE

The ratings assigned to Faisalabad Oil Refinery (Pvt.) Limited (FORL) take into account its association with Madinah Group, having business stake in various sectors encompassing edible oils, sugar, ethanol, power generation, mass media and steel. The assigned ratings reflect stable business model, positive trajectory of sales and sound liquidity profile. Furthermore, ratings draw comfort from integrated production facility, profound distribution network along with well-established brand. Minimal reliance of the company on long term financing, adequate coverages and positive demand prospects of edible oil have also provided strength to the business. However, the ratings are constrained due to suppressed margins and highly price sensitive import market of raw material.

Business and industry risk factors: FORL, like all branded edible oil firms, faces pricing pressure from the unorganized segment which has a significantly higher market share in Pakistan's edible oil industry. The company also faces challenges in marketing since there is little product differentiation and minimal switching cost. The industry is exposed to high credit risk arising from widespread debtor base, but FORL avoids it by taking advance payments from most of its distributors. The industry provides a natural hedge to some extent as input and output prices are fairly correlated, and yet, the management maintains an optimal level of raw material inventory to avoid inventory losses in case of adverse movements in prices. While FORL does not take positions in agro-commodity futures, the senior management 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.

Topline reinforced by multiple product lines: During FY18, net sales of the company posted a growth of 57.3% and stood at Rs. 16.3b (FY17: Rs. 10.3b; FY16: Rs. 11.9b). Vegetable ghee *(under the flagship brand of Kisan Vegetable Ghee)* has remained the major revenue driver, followed by cooking oil; the same contributed around 59% and 22% (FY17: 64% and 23%; FY16: 71% and 21%) respectively, to the total gross revenue. Moreover, the revenue generated from steel business stood higher at Rs. 1.8b (FY17: Rs. 713m; FY16: Nil) by end-FY18, the same has also increased on relative basis to 11% (FY17: 7%; FY16: Nil) of the gross sales. Nearly two-third of the sales originated from Punjab region, meanwhile overall region wise concentration has exhibited improvement. The steel business initiated by FORL in FY17, has opened new avenue for the company in export business, as a result of which it has recorded export of steel bars amounting to Rs. 42.3m (FY17 & FY18: Nil). The contribution of oil meal, soap and other products to the total sales mix has changed marginally.

Albeit average sales price per unit of all products have increased from that of previous year; however gross margins declined on account of noticeable increase in the cost of seeds. Further, the company has increased the proportion of seeds in raw material mix to capitalize on oil meal market, the sale of which has increased on timeline basis. Capacity utilization of oil refinery has improved to 79% (FY17: 61%), as the number of days, the plant has remained operational increased to 243 days (FY17: 224 days) during outgoing year. Given the steel unit has started its operations during FY17, capacity utilization for the same has remained low. Keeping in view the market dynamics, capacity utilization is expected to improve further, going forward. Following the addition of steel unit, power and fuel expenses have surged over the last two business cycles and stood higher at Rs. 727.9m (FY17: Rs. 499.7m) by the end-FY18. The distribution cost has increased in line with increase in company's operations, meanwhile, the administration expenses were largely rationalized in terms of sales growth with a slight increase manifested in compensation benefits. Moreover, bottom line was recorded lower on account of increased finance cost, resulting from higher quantum of average borrowings during the year along with higher taxation.

During HY19, net sales amounted to Rs. 8.3b, in consistent with the projections put forward by management. Gross margins exhibited an increase during ongoing year in line with increase in prices of end-products. As per management, the impact of Pak rupee depreciation has not been fully passed on yet; after incorporating the revised tax rates, management expects the prices to increase, thereby supporting the margins, going forward.

Investment in associated company provided impetus to profitability: FORL has increased its stake to 36.3% (FY17: 31.2%) in its associated concern, Madina Sugar Mills Limited, in respect of which it has made an additional investment of Rs. 292.0m during FY18. Further, the share of profit from associated concern increased to Rs. 159.4m (FY17: Rs. 88.7m). Accordingly, the value of long term investment in associate stood higher at Rs. 1.6b (FY17: Rs. 1.2b) by end-FY18. The management expects that the investment will continue to provide support to bottom-line, going forward.

Adequate liquidity supported by healthy cash flows in relation to outstanding obligations: Funds from Operations (FFO) declined during FY18 as a result of reduced margins and higher finance cost incurred. However, liquidity profile of the company has largely remained intact given FFO to long term debt was sizeable as a result of minimal reliance on long term financing. On the other hand, in line with higher utilization of short term borrowings, FFO to total debt stood lower at end-FY18. Stock in trade was recorded lower by end-FY18, as the company was meeting its inventory demand through continuous production, in order to lower the cost associated with holding higher inventory levels and perishable nature of certain products. Advances, prepayments and other receivables stood higher mainly on account of higher sales tax receivables. Consistent with higher quantum of sales, trade debts stood higher by the end-FY18, with nearly 100% of the receivables falling due within 1 to 3 months. Stock in trade stood higher at Rs. 2.8b by the end-HY19, accordingly in order to meet higher working capital needs, short-term borrowings increased to Rs. 6.6b during the same period. FORL has access to Rs. 3.5b of working capital lines available through various banks. During FY18, freehold land and vehicles costing Rs. 131.5m and Rs. 70.5m were purchased. An additional capex amounting to Rs. 181m was made during HY19, which majorly encompasses buying a plant and machinery as a part of regular BMR requirement. As per management, the company has planned to make an additional investment of Rs. 500m during FY20, which entails buying a seed crushing plant and a generator. The aforementioned capex will be financed through long-term loan facility. Debt service coverage ratio, albeit declined, has remained adequate at 1.59x (FY18: 2.16x) at the end-HY19. Given increase in profitability, liquidity position is projected to improve further, going forward.

Augmentation in equity on back of profit retention: Given increase in unappropriated profits, equity has strengthened on timeline basis. Debt profile of the company majorly comprises short-term borrowings with minimal reliance on long term financing. Furthermore, to meet higher working capital requirements emanating from higher scale of operations, short-term borrowings peaked to Rs. 5.2b (FY17: Rs. 3.7b; FY16: Rs. 5.5b) by the end-FY18; the same has further increased to Rs. 6.7b during HY19. These facilities are secured against charge on current assets, fixed assets and lien on import documents Moreover, these facilities are subject to markup of 3 month KIBOR+ 0.25% per annum. Albeit equity base has strengthened on timeline basis, given higher utilization of short-term borrowings gearing and leverage indicators have increased to 1.25x and 1.32x (FY17: 0.97x and 1.01x; respectively, by end-FY18. During HY19, the company procured long-term finance of Rs. 38m from MCB Bank Limited, in respect of finance lease of vehicles. Gearing and leverage indicators are likely to improve on account of higher equity and lower utilization of short-term borrowings by meeting working capital needs through internally generated capital.

Internal Audit & IT: An internal audit team of 8 employees oversees the audit related matters on group level. Currently the company is in process of deployment of MS Dynamics AX as a replacement of legacy system (SQL Server 2005 and reporting tool Crystal 19).

Corporate Governance: Senior management team of the company comprises experienced resources having relevant experience in the industry. However, in terms of minuting of Board meetings, formulation of Board level committees and segregation of Chairman and CEO positions the corporate governance framework exhibits room for improvement.

FINANCIAL SUMMARY *(amounts in PKR millions)*				
BALANCE SHEET	**June 30, 2016**	**June 30, 2017**	**June 30, 2018**	**Dec 31, 2018**
Non-Current Assets	2,923	2,934	3,483	3,601
Stock-in-Trade	2,575	1,939	1,327	2,828
Trade Debts	3,446	2,113	4,016	3,335
Advances, Prepayments and other Receivables	1,110	1,566	1,840	2,393
Other Assets	190	266	143	188
Total Assets	10,244	8,818	10,809	12,345
Trade and Other Payables	118	99	201	95
Short Term Borrowings	5,452	3,722	5,246	6,652
Long-Term Borrowings *(Inc. current maturity)*	-	-	2	38
Other Liabilities	71	56	107	72
Tier-1 Equity	3,430	3,827	4,196	4,456
Total Equity	4,603	4,940	5,253	5,489
INCOME STATEMENT	**June 30, 2016**	**June 30, 2017**	**June 30, 2018**	**Dec 31, 2018**
Net Sales	11,867	10,341	16,263	8,310
Gross Profit	1,249	986	1,238	792
Operating Profit	954	756	929	627
Profit After Tax	269	336	316	236
FFO	(33)	229	178	35
RATIO ANALYSIS	**June 30, 2016**	**June 30, 2017**	**June 30, 2018**	**Dec 31, 2018**
Gross Margin (%)	10.5	9.5	7.6	9.5
Net Working Capital	1,704	2,031	1,805	1,951
Current Ratio (x)	1.3	0.97	1.33	1.29
FFO to Long-Term Debt	-	-	104.1	1.88*
FFO to Total Debt (%)	-	0.06	0.03	0.01
Debt Servicing Coverage Ratio (x)	0.87	2.16	1.59	1.15
ROAA (%)	3.2	3.5	3.2	4.1*
ROAE (%)	7.2	7.0	7.9	10.9*
Gearing (x)	1.30	0.97	1.25	1.50
Debt Leverage (x)	1.64	1.01	1.32	1.54
(Stock in Trade+Trade Debts) to Short-term Borrowings (x)	1.10	1.09	1.02	0.93

**Annualized*

ISSUE/ISSUER RATING SCALE & DEFINITIONS 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	Faisalabad Oil Refinery (Pvt.) Ltd
Sector	Consumer Goods
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				
June 28, 2019	BBB+	A-2	Stable	Reaffirmed
June 29, 2018	BBB+	A-2	Stable	Initial