RATING REPORT

Faisalabad Oil Refinery (Pvt.) Limited (FORL)

REPORT DATE:
April 12, 2021

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	*April 12, 2021*		*April 08, 2020*	
Rating Outlook	Positive		Stable	

COMPANY INFORMATION	
Incorporated in 1984-1985	External auditors: Zaheer Babar & Co. Chartered Accountants
Private Limited Company	Chairman of the Board/CEO: Muhammad Usman Saleem
Key Shareholders (with stake 5% or more):	
Mr. Muhammad Usman Saleem – 99.96%	

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

Faisalabad Oil Refinery (Pvt.) Limited

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. Muhammad Usman Saleem has more than 10 years of experience in edible oils, sugar, steel, and education sectors.

Financial Snapshot

Tier -1 Equity: end-HY21: Rs. 5.9b; end-FY20: Rs. 5.4b; end-FY19: Rs. 4.9b

Assets: end-HY21: Rs. 14.3; end-FY20: Rs. 14.3b; end-FY19: Rs. 15.7b

Profit After Tax: HY21: Rs. 540.5m; FY20: Rs.515.6 m; FY19: Rs. 330.9m

RATING RATIONALE

Corporate Profile: Incorporated in 1984-1985, the principal business of Faisalabad Oil Refinery (Pvt.) Limited is the manufacturing and sale of banaspati ghee, cooking oil, spices, water, and by-products. The company has numerous brands under its umbrella, with 'Kisan' being the flagship brand. Sales are primarily concentrated in Punjab with 62% followed by Sindh at 24% in FY20. The company also houses a steel division which contributes 11% to net sales.

FORL is associated with the Madinah Group having business stake in various sectors including sugar, ethanol, power generation, steel, and mass media. It remains a family owned business with several years of rich experience of the industry. Recently, the group undertook changes in shareholding, with Mr. Muhammad Usman Saleem now owning 99.96% of the shareholding, and appointed as the new Chief Operating Officer (C.E.O.). The other brothers have majority stakes in other businesses. Mian Muhammad Hanif continues to provide strategic guidance to the overall group.

Rating Drivers

Industry Risk Factors continue to impact ratings

Edible oil industry is a highly fragmented industry with the major market share largely with the unorganized sector. Leading brands like Dalda and Habib oils in the organized sector have a market share of less than 10%.The industry is characterized as highly competitive due to low product differentiation and entry barriers, which results in limited pricing power and relatively lower margins. The demand dynamics however remain favorable on account of growing population and increased health and hygiene awareness. The edible oil industry is growing at a Compound Annual Growth Rate (CAGR) of 8% at constant 2020 prices (Source: Euromonitor International). Current industry sales are recorded at Rs. 248b, registering a 13% growth on a YOY basis. The industry is heavily reliant on imports. Hence, the exposure to exchange rates and international oil price fluctuation is high. Currently, international prices for palm oil have peaked led by COVID driven supply disruptions and reduced labor availability in Malaysia. They are expected to remain high going forward on account of labor shortage and increased demand for biofuel production. Ability to manage margins depends on efficient inventory planning and transfer of increase in raw material prices to consumers, which in turn, is linked to degree of competition and operational efficiency.

Capital expenditure to contribute towards improved operational efficiencies

Faisalabad Oil Refinery is currently undertaking capital expenditure involving the replacement of the seed crushing solvent plant to increase the capacity by 500 M.T. /day from 300 M.T. /day, replacement of diesel based power generation to coal and bagasse, and construction of a neutralization plant for refining canola oil. Total estimated cost of the projects is Rs. 400mn financed through concessionary loans offered by the State Bank of Pakistan (SBP). The projects will come online by FY22 and expected to improve efficiencies and in turn costs for the company. Also, the construction of a corrugated box unit for in-house packaging requirements has been completed, and is currently operational.

Going forward, the company plans to further integrate by setting up a small paper mill at an estimated cost of Rs. 20-25mn for in house consumption.

Improvement in sales and profitability indicators on a timeline basis

During FY20, despite the decline in volume sales (4%) mainly in the bulk sale segment amid lockdown, increase in selling prices of 21% resulted in top line growth of 6.2% (FY19: 1.5%) to Rs. 17.4bn. Vegetable Ghee under their flagship brand "Kisan" continues to be the major contributor accounting for 57% of total sales, followed by cooking oil at 25%. Cooking oil sales have been picking pace with increased health awareness among the population. Volumes have stabilized in the first half 2021 and together with higher prices reflect a positive trend in turnover. For 2021, company is projecting topline to grow by 12%.

Gross Margins continued to increase during FY20 which stood at 9.8% (FY19: 8.8%) on account of higher prices. Operating expenses were contained during the year namely by reducing advertising spend and switching to group media company for lower costs. As a result, net margins registered an increase to 3% from 2% in FY2019 despite an increase in the financial charges on account of higher long term debt utilization. For 2021, while commodity prices remain high, company is expecting to maintain margins due to strategic inventory buying by the management at attractive levels.

Investment in associated companies continues to support bottom-line

Owning 31.05% shareholding of Madina Sugar Mills Limited during FY20 (FY19: 36.34%), the company continued to receive share of profit from associate which increased by 35.6% (FY20: Rs. 291.6m; FY19: Rs. 215.1m). Company expects to receive steady share of sugar mill profits going forward.

FORL has leased the steel division to associated company Madina Enterprises and extended a loan of Rs. 163mn for revamping of the steel division, budgeted at a cost of Rs. 500M. The loan will be funded internally over the next 2 years and will eventually convert to an investment for FORL once the project is complete.

Expected financial obligations to put pressure on cash flow coverage indicators; albeit remain manageable levels

Funds from Operations (FFO) increased to Rs. 185.2m in FY20 (FY19: Rs. 137.6m), depicting growth of 34.6% on the back of increased profitability despite 82.1% rise in finance cost. FFO to long term debt fell to 0.83x in FY20 on account of issuance of long term debt. The same also resulted in the Debt Service Coverage Ratio (DSCR) to fall at 1.05x (FY19: 1.30x), however remaining at manageable levels. On the flip side, FFO to total debt remained at similar levels as the company reduced its short-term borrowings over time. Going forward, while company plans to reduce short term borrowings, cash flow coverage indicators are expected to remain under pressure as long-term debt levels increase over the rating horizon to fund projects. Liquidity profile depicts improvement during the period under review with current ratio at 1.39x during FY20 (FY19: 1.28x).

Capitalization indicators show improvement; however are expected to remain under pressure going forward

Total Equity of the company, excluding surplus on revaluation of fixed assets, increased by 10.2% during FY20 to Rs. 5.4b (FY19: Rs. 4.9b) on account of higher profitability and retention of profits. At a strategic level, the company plans to reduce dependence on short-term borrowing and fund working capital requirements through own sources. Hence, the same has reduced to Rs. 5.9b in FY20 (FY19: Rs. 7.9b). On the other hand, long term debt rose to Rs. 222m during FY20 to fund planned projects and is expected to increase further over the rating horizon. Gearing and leverage indicators reflect improvement on the back of higher equity vis-à-vis debt, however are expected to remain under pressure going forward but within adequate levels.

Internal Audit & I.T Infrastructure:

The internal audit team comprises of eight members who oversee audit related matters on a group level. During FY20, the company used integrated software developed in VB6 incorporating SQL Server 2005 and Crystal9. However, it is currently replacing the legacy system and deploying COSMOSOFT (SARP Enterprise Suite).

Corporate Governance:

The senior management of the company has rich and diverse industry experience. However, there is room for progress in terms of minuting of Board meetings, segregation of duties of the Chairman and CEO positions, formulation of Board level committees and corporate governance framework.

Faisalabad Oil Refinery (Pvt.) Limited — Appendix I

FINANCIAL SUMMARY

(amounts in PKR millions)

BALANCE SHEET	FY18	FY19	FY20	H1'FY20	H1'FY21
Non-Current Assets	3,483	5,085	5,536	5,050	5,491
Stock-in-Trade	1,327	2,666	1,124	1,575	1,783
Trade Debts	4,016	4,913	4,832	4,553	4,558
Advances, Prepayments and other Receivables	1,840	2,349	2,015	1,817	1,789
Cash & Bank Balances	12	395	430	541	415
Other Assets	131	299	321	321	262
Total Assets	10,809	15,707	14,259	13,856	14,298
Trade and Other Payables	201	134	240	89	162
Short Term Borrowings	5,246	7,937	5,899	5,658	5,577
Long-Term Borrowings *(Inc. current maturity)*	2	43	222	38	217
Paid Up Capital	700	1,500	1,500	1,500	1,500
Tier-1 Equity	4,114	4,943	5,446	5,575	5,921
Total Equity	5,028	6,791	7,180	7,422	7,655

INCOME STATEMENT	FY18	FY19	FY20	H1'FY20	H1'FY21
Net Sales	16,194	16,442	17,461	8,512	8,807
Gross Profit	1,170	1,440	1,703	1,127	1,029
Operating Profit	929	1,172	1,448	973	901
Profit Before Tax	702	790	953	582	673
Profit After Tax	338	331	516	385	541
FFO	178	138	185	198	1266

RATIO ANALYSIS	FY18	FY19	FY20	H1'FY20	H1'FY21
Gross Margin (%)	7.2	8.8	9.8	13.2	11.7
Net Working Capital	1,805	2,355	2,453	2,947	2,974
Current Ratio (x)	1.33	1.28	1.39	1.50	1.51
FFO to Long-Term Debt	85.94	3.18	0.83	10.40*	11.69*
FFO to Total Debt (%)	0.03	0.02	0.03	0.07*	0.45*
Debt Servicing Coverage Ratio (x)	1.59	1.30	1.05	1.38	5.26
ROAA (%)	3.4	2.5	3.4	5.2*	7.6*
ROAE (%)	8.5	7.3	9.9	14.6*	19.0*
Gearing (x)	1.28	1.61	1.12	1.02	0.95
Debt Leverage (x)	1.41	1.80	1.30	1.06	1.12
(Stock in Trade+Trade Debts) to Net Short-term Borrowings (x)	1.02	1.00	1.09	1.20	1.23

**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	

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
		RATING TYPE: ENTITY		
April 12, 2021	BBB+	A-2	Positive	Maintained
April 08, 2020	BBB+	A-2	Stable	Reaffirmed
June 28, 2019	BBB+	A-2	Stable	Reaffirmed
June 29, 2018	BBB+	A-2	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.
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Due Diligence Meetings Conducted

	Name	Designation	Date
1	Mr. M. Naeem Malik	Finance Manager	01-April-2021