# RATING REPORT

# Al-Makkah Oil Refinery Limited

**REPORT DATE:**
March 28, 2019

**RATING ANALYSTS:**
Muhammad Ibad Desmukh
*ibad.deshmukh@jcrvis.com.pk*

## RATING DETAILS

| Rating Category | Latest Rating | | Previous Rating | |
|---|---|---|---|---|
| | **Long-term** | **Short-term** | **Long-term** | **Short-term** |
| **Entity** | BBB | A-2 | BBB- | A-2 |
| **Rating Outlook** | Stable | | Stable | |
| ***Rating Date*** | *March 28, 2019* | | *July 12, 2018* | |

## COMPANY INFORMATION

| | |
|---|---|
| **Incorporated in 2014** | **External auditors:** Horwath Hussain Chaudhary & Co. Chartered Accountants |
| **Public Limited Company** | **Chairman of the Board:** Mr. Salman Khan |
| **Key Shareholders (with stake 5% or more):** | **Chief Executive Officer:** Mr. Salman Khan |
| Family Group of Industries | |
| | |
| | |

## APPLICABLE METHODOLOGY(IES)

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

# Al-Makkah Oil Refinery Limited

## OVERVIEW OF THE INSTITUTION

In 2014, Al-Makkah Oil Refinery Limited (AOL) was incorporated as a private limited company. In 2015, AOL was converted to a public limited company. Primary business of the company entails manufacturing and selling of vegetable ghee.

**Profile of CEO and Chairman**
Mr. Salman Khan is the Chief Executive Officer (CEO) of the company and Chairman of the Board. He has significant experience pertaining to the edible oil sector.

## RATING RATIONALE

Set up in 2014, Al-Makkah Oil Refinery Limited is engaged in manufacturing and selling of vegetable banaspati. The company is owned and managed by Family Group of Industries, which has substantial experience in this business. Apart from edible oil, the sponsors have investments in packaged juice and disposal syringe manufacturing businesses.

AOL is engaged in sale of vegetable banaspati for retail customers. Alongside, the company manufactures laundry soap. Management may consider launch of new products in order to diversify sales mix. Products are sold under various brands including Karwan and Kamran. These are targeted towards buyers from middle to lower income segment of the market. Some of the main competitors of the company include Dalda Foods (Private) Limited, Habib Oil Mills (Private) Limited and Hafeez Iqbal Oil & Ghee Industries (Private) Limited. Products are supplied to retailers through a network of distributors covering Northern region of the country.

AOL's production facility is located at Port Qasim, Karachi while its registered office is situated in Industrial Estate Hattar, Khyber Pakhtunkhwa. Recently, the company completed capacity expansion of the plant; as a result, cumulative production capacity stands at 200 metric tonnes per day (MTPD) (FY17: 150 MTPD). Given close proximity to point of import, the company benefits from lower raw material transportation costs. With increased production levels, capacity utilization of the company has increased from 73.3% in FY16 to 100.0% in FY17. The company holds Pakistan Standards & Quality Control Authority (PSQCA) accreditation for all of its products.

**Rating Drivers**

**Established track record of sponsors in the edible oil business**
As per management, AOL primarily sells products in KPK, Punjab and Azad Jammu Kashmir; in the KPK, the company holds market share of ~70% in the organized edible oil sector. Alongside, AOL benefits from extensive managerial experience of its sponsors in the edible oil business.

**Highly fragmented industry characterized by intense competition though supported by favorable demand prospects**
Pakistani edible oil industry is characterized by high competitive intensity due to fragmentation and low barriers of entry which result in limited pricing power and inherently thin profitability. However, several large players have been operating for a long period of time and thus enjoy stronger brand equity in relation to other firms. Pakistan is amongst the leading importers and consumers of edible oil. Current per capita consumption level of Pakistan stands at ~23 kg/year for 2016 compared to global average of ~28.0 kg/year (2015-16). Over the medium to long-term, demand is expected to increase in line with GDP growth which is further supported by positive demographic fundamentals. Nevertheless, changes in raw material prices (resulting in inventory losses) and foreign exchange rate fluctuations are key risk factors resulting in volatility in margins. Ability to manage the same depends on pass through to consumers, which in turn, is linked to degree of competition and operational efficiency.

**Tax credit provides significant support to earnings; profitability remains vulnerable to decline in margins**
Sales revenue of the company has increased to Rs. 4,462.9m (FY16: Rs. 2,710.9m). Growth in sales was largely a function of volumes while prices varied in line with market dynamics. On a timeline basis, gross margins have depicted an increasing trend. Imported raw palm oil constitutes at-least 90% of AOL's cost of sales. Accordingly, margins may be adversely impacted by inventory loss resulting from variation in import rates and rupee depreciation. To manage the same, management passes on increase/decrease in input prices to consumers while efficient procurement is also considered important.

Administrative expenses amounted to Rs. 10.9m during FY17 and Rs. 6.2m over 1HFY18. Some of the largest expenses include salaries, loading charges, leakage and discount and freight outward. Given low utilization of on-balance sheet financing, financial charges have represented less than 1% of net sales over the years. AOL benefits from 100% tax credit in line with Section 65D of Income Tax Ordinance for newly established industrial undertakings. This is applicable from 2016 to 2021. Profit after tax has increased to Rs. 160.4m (FY17: Rs. 137.6m) in 1HFY18.

**Liquidity profile to remain a function of volatility in gross margins**

Liquidity profile has depicted similar trend to profitability during the past three years. Growth in profitability has translated into higher cash flows (FFO: FY17: Rs. 146.7m; FY16: Rs. 0.2m) due to margin enhancement (Gross Margin: 1HFY18: 6.7%; FY17: 5.2%) while FFO to Total Debt increased to 1.70x (FY16: 0.01x) at end of the outgoing fiscal year. Cash flows continue to remain a function of volatility in gross margins. Overall liquidity profile is considered adequate as indicated by satisfactory cash flows in relation to debt obligations and adequate current ratio. Ageing profile of trade debts is considered manageable with a limited proportion of receivables being overdue for over three months while cash conversion cycle is favorable in relation to peers.

**Low gearing levels on the back of conservative debt profile and growth in equity base**

Total equity has increased over the years on the back of profit retention and stood at Rs. 372.4m at end-1HFY18. Since inception, the company has not paid out any dividend. Debt profile of the company is conservative in nature, comprising low quantum of short term borrowings only. For working capital, AOL primarily utilizes LC facilities while short term borrowings are acquired as per seasonal procurement requirements and resultantly vary throughout the year. As a result, gearing of the company stands on the lower side at 0.20x (FY17: 0.41x; FY16: 0.45x) at end-1HFY18. However, debt leverage increased to 1.90x (FY16: 0.92x) at end-FY17 on account of increase in LC bills payable; the same decreased to 0.49x by end-1HFY18. To date, the company has no plans for mobilizing fresh long term borrowings in near future.

**Governance framework depicts significant room for improvement in view of informal board oversight and absence of internal audit function**

In line with best practices, board composition (through increasing board size and inclusion of independent directors) and oversight has room for improvement. The company uses an off-the shelf software for its IT related needs. External auditors for FY17 financial statements are neither Quality Control Review rated from Institute of Chartered Accountants of Pakistan nor are they present on panel of auditors maintained by State Bank of Pakistan. However, appointment of Horwath Hussain Chaudhary & Co. Chartered Accountants as external auditors (placed in Category A of SBP's panel of auditors) for FY18 is considered to be a positive development. While management has implemented control procedures, a formalized internal audit function does not exist at present.

| FINANCIAL SUMMARY | | | | *(amounts in PKR millions)* |
|---|---|---|---|---|
| **BALANCE SHEET** | **FY15** | **FY16** | **FY17** | **6MFY18** |
| **Fixed Assets** | 11.3 | 70.7 | 81.6 | 78.6 |
| **Long term deposits** | 2.0 | 3.4 | 5.2 | 5.0 |
| **Stock-in-Trade** | - | 17.2 | 283.3 | 71.1 |
| **Trade Debts** | 28.0 | 30.2 | 22.3 | 25.0 |
| **Cash & Bank Balances** | 1.9 | 1.0 | 0.8 | 9.3 |
| **Total Assets** | 43.2 | 143.0 | 614.5 | 555.7 |
| **Trade and Other Payables** | 6.4 | 34.8 | 315.1 | 109.3 |
| **Short Term Debt** | - | 33.7 | 86.4 | 73.3 |
| **Total Debt** | - | 33.7 | 86.4 | 73.3 |
| **Total Equity** | 36.8 | 74.5 | 212.0 | 372.4 |
| **Surplus on Revaluation of Assets - Net** | - | - | - | - |
| **INCOME STATEMENT** | **FY15** | **FY16** | **FY17** | **6MFY18** |
| **Net Sales** | - | 85.4 | 3,129.1 | 2,498.6 |
| **Gross Profit** | - | 0.2 | 162.2 | 168.0 |
| **Operating Expense** | - | 1.2 | 21.1 | 6.2 |
| **Finance Cost** | - | 0.1 | 3.6 | 1.4 |
| **Profit (Loss) Before Tax** | - | (1.1) | 137.6 | 160.4 |
| **Profit (Loss) After Tax** | - | (1.1) | 137.6 | 160.4 |
| **RATIO ANALYSIS** | **FY15** | **FY16** | **FY17** | **6MFY18** |
| **Gross Margin (%)** | | 0.2% | 5.2% | 6.7% |
| **Net Margin (%)** | | -1.3% | 4.4% | 6.4% |
| **Net Working Capital** | 23.4 | 0.2 | 125.1 | 288.8 |
| **Trade debts/Sales (%)** | | 35.3% | 0.7% | 0.5% |
| **FFO** | - | 0.2 | 146.7 | n/a |
| **FFO to Total Debt (%)** | | 0.01 | 1.70 | - |
| **Current Ratio (x)** | 4.64 | 1.00 | 1.31 | 2.58 |
| **Debt Servicing Coverage Ratio (x)** | | 3.50 | 41.68 | - |
| **Gearing (x)** | - | 0.45 | 0.41 | 0.20 |
| **Debt Leverage (x)** | 0.17 | 0.92 | 1.90 | 0.49 |
| **ROAA (%)** | | -1.2% | 36.3% | 54.8% |
| **ROAE (%)** | | -2.0% | 96.0% | 109.8% |

## 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** | Al-Makkah Oil Refinery Limited |
| **Sector** | Edible Oil Manufacturing |
| **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. |
| **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. VIS is not an NRSRO and its ratings are not NRSRO credit ratings. Copyright 2018 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS. |

Rating History:

| Rating Date | Medium to Long Term | Short Term | Rating Outlook | Rating Action |
|---|---|---|---|---|
| | | RATING TYPE: ENTITY | | |
| **Mar-28-19** | BBB | A-2 | Stable | Upgrade |
| Jul-12-18 | BBB- | A-2 | Stable | Initial |