RATING REPORT

Agro Processors & Atmospheric Gases (Private) Limited

REPORT DATE:
August 29, 2019

RATING ANALYSTS:
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RATING DETAILS		
	Initial Ratings	
Rating Category	**Long-term**	**Short-term**
Entity	BBB-	A-2
Rating Outlook	Stable	
Rating Date	*August 22, 2019*	

COMPANY INFORMATION	
Incorporated in 1980	**External auditors:** BDO Ebrahim & Co. Chartered Accountants
Private Limited Company	**Chief Executive Officer:** Ahmad Aziz Ghulam Hussain
Key Shareholders (with stake 5% or more):	**Chairman:** Abdul Aziz Rafiq
Amina Nadir Ghulam Hussain – 30.51% **Ahmed Aziz Ghulam Hussain – 24.17%** **Amyn Abdul Aziz Rafiq – 14.97%** **Abdul Ali Rafiq – 8.65%**	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria - Industrial Corporates (May 2016) **http://www.vis.com.pk/docs/Corporate-Methodology-201605.pdf**

Agro Processors & Atmospheric Gases (Private) Limited

OVERVIEW OF THE INSTITUTION

Agro Processors & Atmospheric Gases (Private) Limited was incorporated in 1980 as a private limited company. The company is mainly engaged in business of manufacturing and selling of vegetable ghee, cooking oil and allied items and substances.

Profile of CEO

Ahmad Aziz Ghulam Hussain completed his bachelors in Economics and MPA from University of Southern California (USA). He joined the family business in 1990. His prior work experience includes working under the Mayor of Los Angeles in the City Economic Development Office. Mr. Aziz was actively involved in the launch of Soya supreme brand in 1991.

Profile of Chairman

Abdul Aziz Rafiq started his career by joining the family business in 1975. He has served twice as the Executive Member of Pakistan Vanaspati Manufacturers Association and is currently a member of the same association. He completed his MBA from Institute of Business Administration Karachi.

RATING RATIONALE

Established in 1980, Agro Processors & Atmospheric Gases (Private) Limited (APAG) is engaged in manufacture and sale of edible oil, banaspati & related products for both B2B (business-to-business) and B2C (business-to-consumer) markets. The company is owned and managed by the Ghulam Hussain family, which has substantial experience in this business. Soya Supreme, the flagship product of APAG, is one of the oldest cholesterol-free ultra-high temperature (UHT) treated edible oil brands in the country.

APAG's manufacturing facility is in SITE, Karachi. During ongoing fiscal year, annual production capacity was increased to 90,000 MT (FY18: 60,000 MT) as at end-9MFY19. Although capacity utilization depicted a rising trend from 75% in FY16 to 94% in FY18 on the back of increasing demand. APAG holds ISO 9001:2008 certification and its products are Pakistan Standards and Quality Control Authority certified.

Strategic investment in APAG Oil (Private) Limited

In January 2018, APAG completed investment amounting to Rs. 249.9m in APAG Oil (Pvt.) Limited (AOL) in order to acquire 99.99% shares in the company as at end-FY18. Furthermore, in 9MFY19, APAG invested an additional Rs. 325.0m in AOL as part of equity injection to fund construction of AOL's production facility. Consequently, APAG's cumulative long-term investment in AOL amounted to Rs. 575.0m as at end-9MFY19.

AOL was set up as a wholly-owned subsidiary of APAG to undertake oil-seed crushing and solvent extraction, to produce crude oil. Main customer of the output i.e. crude edible oil will be the parent company, which will purchase crude oil from AOL for its brands. As per management, this will allow it to reduce its tax burden by directly procuring local crude oil from AOL rather than importing the same, and improve its inventory management (better management of imported vs. local crude oil mix). AOL is operated by the management team of APAG. AOL's manufacturing facility was established at a cost of ~Rs. 575m. It is located on 4 acres of land in Port Qasim Karachi and has been operational since April 2019. AOL's seed crushing facility is capable of processing both canola and soybean oil seeds.

Product Portfolio

Major brands comprise Soya Supreme and Malta. Among all APAG products, Soya Supreme is most popular in retail segment with prominence in south region. B2B brands comprise Champion (margarine), Malta (cooking oil & banaspati), Taqat (margarine) and Supremo (cooking oil). Across the product portfolio, there are variants for banaspati, cooking oil, canola oil and soybean oil. Recently, the company launched consumer food products under the brand name of Smart. This business covers mayonnaise and ketchup products targeted towards retail and hotel/restaurant/café (HORECA) segments. Going forward, the company plans to launch Canola Oil variant of Malta and shortening agents, along with continued focus on Soya Supreme.

Marketing, Sales & Distribution

The company either supplies its products from 6 self-owned warehouses (Karachi, Hyderabad, Sukkur, Lahore, Multan, and Islamabad) to distributors (primary channel); distributors then provide products to retailers (secondary channel). Moreover, through the modern trade channel, retailers procure inventory directly. The sales team comprises 3 regional managers, 4 zonal managers, 9 Area managers and 71 territory sales officers. Coordination between sales and distribution teams is supported by a management information system which provides timely sales and stock movement data for decision making. The company has a stronghold in South particularly in Karachi.

Key Rating Drivers:

Established track record of sponsors in the edible oil business.
Senior management of the company has a rich experience spanning over five decades in edible oil processing industry. This has aided in building healthy relationships with customers and suppliers along with significant brand recognition in the market.

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. 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.

Earnings burdened by sizeable taxation which is expected to reduce post recent expansion and tax savings from procurement of local oil from AOL.
Net sales have increased at 5-year compound annual growth rate (CAGR) of 14% during FY15-19 amounting to Rs. 8.2b (FY18: Rs. 8.2b; FY17: Rs. 7.5b) in 9MFY19 (annualized). Product sales mix illustrates that 41% sales emanate from Soya Supreme while Malta brand contributes 23% to turnover. Remaining sales emanate from B2B products (35%) and other products targeted towards mid-tier customers. More than one-half of sales are directed towards retail consumers and the remaining portion is dedicated to B2B market.

Gross margins declined to 11.6% in FY18 from 14.8% in FY15, although gross margins have subsequently recovered to 14.6% in 9MFY19. Gross margins compare favorably to peers. Crude oil constitutes ~90% of APAG's cost of sales. The company has three sources of oil: local importers, self-import and local purchase. On average, ~40% of oil is locally procured while remaining is imported. To manage inventory loss and rupee depreciation risk, management passes on increase/decrease in input prices to consumers while efficient procurement is also considered important.

In FY18, profit before tax (PBT) declined to Rs. 135.3m (FY17: Rs. 225.3m; FY16: Rs. 127.6m) on account of lower gross margins, increase in marketing expenses and higher financial charges. Rise in financial charges is attributed to higher utilization of running finance and draw down of long term loan. Despite recovery in gross margins in 9MFY19, the company reported decline in PBT to Rs. 90.0m (annualized) on account of continued increase in finance cost in view of higher short term borrowing and rising interest rates while marketing expenses remained around prior year levels.

APAG is subject to high taxation regime with 5.5% tax applicable on import of oil and 2.0% tax on locally procured oil consumed. As a result, high effective tax rate is a drag on net profitability of the company. APAG reported loss of Rs. 2.1m (FY18: Loss of Rs. 49.7m) in 9MFY19 (annualized).
Going forward, effective tax rate is projected to reduce from 136.7% in FY18 to 81.9% in FY19 and further to 13.6% by end-FY22. This is attributed to 1) tax credit on account of Income Tax Ordinance Section 65E with respect to APAG's capacity expansion in FY19 and 2) lower tax payable on account of

locally procured crude oil consumed from subsidiary, AOL. This, along with growth in sales will result in improving trend in profitability.

High leverage indicators due to limited equity base and higher debt levels.
Equity base has remained largely stagnant on account of low profitability. In FY18, the company paid cash dividend of Rs. 210m; the dividend was re-injected into the company by way of rights issue and paid up capital increased to Rs. 352.7m (FY17: Rs. 175.0m). However, negative bottom-line resulted in decline in total equity at end-June 2018 (FY18: Rs. 515.0m; FY17: Rs. 596.5m). Around two-thirds of APAG's debt is short-term in nature. Total debt of the company has increased due to long-term loan of Rs. 763.3m acquired to fund AOL acquisition while short borrowings are utilized for working capital requirements. This along with a largely stagnant equity base resulted in significantly higher leverage indicators. The company's long term debt facility has been obtained from three banks and is repayable after 2 years from date of disbursement i.e. from FY20. Rate on the facilities was reported at KIBOR+1%.

Leverage and gearing were reported at 6.97x (FY18: 5.41x; FY17: 3.50x) and 5.31x (FY18: 4.21x; FY17: 2.38x) at end-9MFY19, respectively. Stock in trade and receivables represented 1.19x (FY18: 1.15x) of outstanding short-term borrowings at end-9MFY19. Going forward, leverage indicators are projected to trend downwards on account of reduction in short term borrowings and increase in equity base by way of multiple capital injections.

Existing debt coverage metrics remain under stress on account of limited cash flows. Cash flows are projected to improve as tax burden reduces over the ratings horizon.
Liquidity profile was under stress during FY18 on account of limited cash flows. On a timeline basis, Funds from operations (FFO) has remained on the lower side whereas during 2018 FFO declined significantly to Rs. 9m (FY17: 170.3m; FY16: 90m). Increase in debt levels translated in to weakening of FFO to total debt ratio while debt servicing coverage ratio was reported at 0.94x (FY17: 2.69x) in FY18. Cash conversion cycle has increased over FY15-18 to 60 days on account increase in inventory and sales outstanding days. Trade debts in relation to sales remained below 15% during FY15-18 though increasing to 17% in 9MFY19. Given projected reduction in tax burden and higher sales, cash flows and debt servicing ability are expected to improve over the ratings horizon.

Adequate IT infrastructure with management focusing on improving corporate governance.
Board of Directors comprises six members including the CEO. Other directors are members of the Ghulam Hussain family. Given the company's status as a private limited company, overall board composition and oversight has room for improvement through induction of additional directors on board (including independent directors). APAG's financial statements are audited by BDO Ebrahim & Co. Chartered Accountants, which belong to category 'A' of SBP's panel of auditors. APAG has an independent internal audit department. Going forward, management plans to improve corporate governance framework of the organization.

Agro Processors & Atmospheric Gases (Private) Limited — Appendix I

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**FY16**	**FY17**	**FY18**	**9MFY19**
Fixed Assets	817.0	864.7	855.5	1,293.3
Long term Investments	-	-	250.0	575.0
Stock-in-Trade	526.7	917.0	924.3	1,213.6
Trade Debts	492.5	850.1	1,037.2	1,073.0
Cash & Bank Balances	36.7	85.2	37.7	38.5
Total Assets	**2,067.4**	**2,942.1**	**3,566.5**	**4,626.3**
Trade and Other Payables	339.4	598.6	507.4	704.8
Long Term Debt	-	-	763.3	763.3
Short Term Borrowings	822.2	1,354.8	1,356.1	1,921.9
Total Debt	891.5	1,421.4	2,169.3	2,725.2
Total Equity (excluding surplus)	**506.6**	**596.5**	**515.0**	**513.4**
Surplus on Revaluation of Assets - Net	256.6	255.8	265.2	535.2
INCOME STATEMENT	**FY16**	**FY17**	**FY18**	**9MFY19**
Net Sales	6,186.2	7,489.9	8,222.4	6,157.4
Gross Profit	850.9	994.9	952.2	896.2
Administrative Expense	112.4	138.5	172.2	128.9
Marketing, Sales and Distribution Expense	421.3	488.0	547.7	525.1
Finance Cost	70.0	70.7	128.7	178.9
Profit (Loss) Before Tax	127.6	225.3	135.3	67.5
Taxation	184.5	159.6	185.0	69.1
Profit (Loss) After Tax	(56.9)	65.7	(49.7)	(1.6)
RATIO ANALYSIS	**FY16**	**FY17**	**FY18**	**9MFY19**
Gross Margin (%)	13.8%	13.3%	11.6%	14.6%
Net Margin (%)	-0.9%	0.9%	-0.6%	-0.03%
Current Ratio (x)	1.03	1.04	1.19	1.02
(Stock in Trade + Trade debt)/ST Borrowings (%)	124.0%	130.4%	144.6%	119.0%
FFO	90.0	170.3	9.0	n/a
FFO to Long Term Debt (%)	162.5%	338.6%	1.1%	n/a
FFO to Total Debt (%)	10.1%	12.0%	0.4%	n/a
Debt Servicing Coverage Ratio (x)	1.82	2.69	0.94	n/a
Gearing (x)	1.76	2.38	4.21	5.31
Leverage (x)	2.57	3.50	5.41	6.97
ROAA (%)	-2.9%	2.6%	-1.5%	-0.1%
ROAE (%)	-10.6%	11.9%	-8.9%	-0.4%
** Annualized numbers*				

RATING SCALE & DEFINITION 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	Agro Processors & Atmospheric Gases (Private) Limited
Sector	Edible Oil
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see table below
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		
08/22/2019	BBB-	A-2	Stable	Initial