RATING REPORT

Kausar Ghee Mills (Pvt.) Limited (KGML)

REPORT DATE:
September 09, 2020

RATING ANALYSTS:
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RATING DETAILS		
Rating Category	**Initial Rating**	
	Long-term	**Short-term**
Entity	A-	A-2
Rating Outlook	Stable	
Rating Date	*09 Sep'20*	

COMPANY INFORMATION	
Incorporated in 1992	External auditors: A. Aziz Chaudary & Co. Chartered Accountants
Private Limited Company	CEO: Mr. Zahid Ali Malik
Key Shareholders (with stake 5% or more):	
Sajid Ali Malik – 20.7%	
Zahid Ali Malik – 19.9%	
Malik Attique Ahmad – 18.8%	
Hamid Ali Malik – 16.5%	

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

Kausar Ghee Mills (Pvt.) Limited

OVERVIEW OF THE INSTITUTION

Kausar Ghee Mills (Pvt.) Limited (KGML) was established in 1992. The company is involved in the manufacturing of Vegetable Ghee, Cooking Oil, and allied products.

Profile of the Chairman/CEO

Mr. Zahid Ali Malik serves as the Chairman and CEO, he is an engineer by profession and has been involved with the company for over 5 decades.

Financial Snapshot

Total Equity: FY20: Rs. 3.0b; end-FY19: Rs. 2.0b; end-FY18: Rs. 1.5b

Assets: end-FY20: Rs. 4.9b; end-FY19: Rs. 4.5b; end-FY18: Rs. 3.0.b

Profit After Tax: FY20: Rs. 142m; FY19: Rs. 157m; FY18: Rs. 187m

RATING RATIONALE

The ratings assigned to Kausar Ghee Mills (pvt.) Limited (KGML) take into account its association with Kausar Group of Companies, having business stake in various sectors involving edible oils, poultry, poultry feed and rice processing. The assigned ratings reflect stable business model, sizeable equity base and sound liquidity profile. The ratings incorporate growth in revenues in the last two years, ongoing capex to enhance value addition in manufacturing operations, projected improvement in financial profile post capex completion and positive demand prospects for edible oil in the domestic market. Furthermore, ratings draw comfort from integrated production facility, well established distribution network, brand recognition in the local market and vertical integration with group owned feed mill. KGML's conservative capital structure as an outcome of minimal reliance on credit financing coupled with sound coverages is a key rating driver. However, the ratings remain sensitive to highly price sensitive import market of raw material and relatively low margins compared to peers.

The ongoing geopolitical scenario and slowdown in domestic economic activity amidst the COVID-19 pandemic has not posed any considerable threat to the financial risk profile of the company given its presence in relatively inelastic consumer goods sector catering to day to day food based requirements of the population. Nevertheless, ratings will remain dependent on the company's ability to maintain scale of operations, improvement in margins and containing of leverage indicators around current levels.

Business and industry risk factors: KGML, 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 industry is exposed to high credit risk arising from widespread debtor base, but KGML 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. The company 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. Going forward, with bumper crops of oil seeds in the countries of origin, the input costs are likely to remain in check in the medium term. Further, with improved market penetration and geographical diversification, KGML's market share has improved from 3.0% in FY19 to 3.85% at end-FY20.

Integrated manufacturing facility: The company was established by late Malik Mubarak Ali with its first production unit of vegetable ghee and edible oils processing in Gujranwala in 1992. Later in line with growth objectives, the company added a solvent plant in Karachi at Port Bin Qasim. The commercial production of edible oils including canola, soya, sunflower and blended cooking oil was started in 2014. Initially the production capacity of the solvent unit was crushing of 250 M/Ton of oil seed/day. Later in 2018, the production capacity of the solvent unit was enhanced to 400 MT/day. In addition, in Karachi another vegetable ghee unit with a capacity of 250 MT/day was installed in 2018. The company is marketing its products nationwide. KGML is a family owned business concern, the Board of Directors comprise eight directors all being members of the sponsoring family. Mr. Zahid Ali Malik serves as the CEO, he is an engineer by profession and has been involved with the company for over 5 decades. The sales and marketing team is headed by Mr. Junaid

Zahid Malik, he completed his engineering from NUST and has over 16 years of experience in the line of business. Other group companies include Kausar Feed Mills (pvt.) Limited (KFML), Kausar Rice and General Mills (KRGML) and Kausar Farms.

Steady Growth in Topline: In line with increase in the average prices of the final retail products the topline of the company improved to Rs. 12.8b (FY19: Rs. 11.5b) during FY20. On the hand, quantum sales were recorded lower; the same is an indicator of intense competition faced by the company with entry of new market players making market capitalization difficult. The trend of increasing prices prevailed in FY19 as well given the quantity sold of cooking oil declined sizably to 17.6m liters as compared to 20.3m liters in FY18; however the contribution of the same in the revenue mix improved as per liter price for FY19 was recorded higher at Rs.164.8 (FY18: Rs. 139.6). Banspati Ghee *(under the flagship brand of Kausar Banaspati Ghee)* has remained the major revenue driver over the years, representing almost half of the total sales, followed by cooking oil. The average price of ghee increased to Rs. 130.9/kg in FY19 from Rs. 127.0/kg in the preceding year. However, there was a slight shift in the revenue mix during FY19 as contribution of soya bean meal increased to 26% in comparison to 19% in FY18. KGML sells around one quarter of meal produce to its associate concern while the remaining is sold in the open market. Further, the contribution of soy bean hull, canola meal, soap and other products to the total sales mix changed marginally.

Gross margins of the company largely remained range bound in the last three years, with slight increase to 8.3% (FY18: 7.9%) during FY19 as an outcome of higher average sales price per unit of all products. Further, no notable increase in the cost of primary raw material, edible oil, also contributed positively to the gross margins of the company. The margins took a slight dip of 20 basis points to 8.1% during FY20 in line with higher fuel expense incurred during the period. The raw material mix of the company primarily comprises imported seed constituting 99% of total purchases. The capacity utilization of ghee plant and oil refinery improved to 57% (FY18: 55%) and 65% (FY18: 63%) respectively. As per the management, the production units are operational throughout the year while the ghee and solvent plants are shut down for one week and four weeks respectively for annual maintenance. Overall the underutilization is attributable to strong competition within the packaged oil market. Given the ghee plant at Karachi just began operations during FY19, the capacity utilization was recorded below 10%.

The selling and distribution cost has increased in line with increase in company's scale of operations; meanwhile, the administration expenses were largely rationalized in terms of sales growth with increase manifested in compensation benefits. Other income was recorded higher during FY20 at Rs. 23.9m (FY19: Rs. 1.4m; FY18: Rs. 1.2m) on account of sale of scrap, the company has a policy to sell scrap after every three years. The company is fully equipped and self-sufficient in manufacturing of tin containers given the entire demand of tin-based oil packaging is met indigenously. Hence, the sale of scrap primarily comprises unused tin scrapings. KGML has embarked upon long-term debt free structure since inception, therefore with recent conversion of short-term debt by sponsor loan for working-capital bridge financing, the interest expense declined to Rs.41.8m during FY20 as compared to Rs. 67.6m in the preceding year. Despite decline in finance cost, the bottom line was recorded lower on account of drop in margins coupled with increased operating expenses. Going forward, with no expected increase in input prices along with efficiency enhancements and cost cutting as a result of automated production process reducing human capital, the margins are expected to gain positive momentum.

Business model and power mix: Given the presence of the company in the edible oil industry, the business model is highly import dependent. The raw material for vegetable ghee including crude palm oil, palm olein and RBD palm oil is imported from Malaysia and Indonesia. On the other hand, for processing of edible oil, soy, canola and sunflower seeds are imported from USA, Brazil, Canada, Eastern Europe and Australia. The raw material is imported under sight letter of credit; the same operates as a mitigant against exchange rate risk.

KGML's total power requirement is around 2MW comprising 1.2MW for Karachi unit and 0.75Mw for Gujranwala unit. For Gujranwala unit Water and Power Development Authority (WAPDA) supply is available; meanwhile the solvent unit is totally dependent on alternate sources including 2.5MW gas generator as primarily source along with other secondary sources based on diesel. The power supply from WAPDA is currently relatively cheap; therefore alternate sources of 1.1MW for Gujranwala unit are hardly utilized. Going forward, to improve the power mix as the working of gas generators is affected during winters in line with load-shedding, the management plans to install an 1MW diesel generator during FY21. The capex on the same is expected to be around Rs. 50.0m and is to be funded from company's own sources.

Adequate liquidity supported by healthy cash flows in relation to outstanding obligations: Funds from Operations (FFO) improved to Rs. 294.1m (FY19: Rs.237.3m; FY18: Rs.208.2m) during FY20 primarily as a result of increase in scale of business operations. Moreover, liquidity profile of the company is sound in line with already zero reliance on long-term borrowing; the same was further cemented by reduced utilization of short-term credit given the sponsors have injected equity in the form of interest-free loan to meet working capital requirements. Subsequently, FFO to total debt increased sizably to 13.25x (FY19: 0.21x; FY18: 0.31x) at end-FY20. Further, debt service coverage ratio has also depicted an improving trend on a timeline basis.

Stock in trade was recorded lower at end-FY20 as compared to previous year and comprised imported raw material; the company is strategizing to meet its inventory demand through continuous production, in order to lower the cost associated with holding higher inventory levels and perishable nature of certain products. Similarly, stocks and spares also stood lower at end-FY20 in respect to sale revenues. Advances, prepayments and other receivables stood lower mainly on account of elimination of loan to directors coupled with recovery of sales and income tax receivables from the government. Trade debts were recorded higher relative to quantum of sales during the period under review; however the profile of receivables was satisfactory with nearly 100% of the receivables falling due within 1 to 3 months. Around 10% of the trade debts comprised receivables due from an associated concern, KFML against supply of goods. As per the management, the average working capital requirement of the company is around Rs. 1.5b which is expected to be met by sponsors' funds going forward.

During FY19, capex amounting to Rs. 97.1m was made, which majorly encompasses buying plant and machinery as a part of regular BMR requirement. As per management, the company has purchased 10 acre land near the solvent unit in Karachi to install three silos entailing a capacity of 5000MT each to be used for storage of all kinds of imported seeds. The processes involving human handling like loading and unloading of seeds in the production cycle will be eliminated; hence with automation, efficiency enhancement and cost saving will be achieved. The project is expected to be completed by end-21, the financing for the same amounting to Rs. 80.0m was arranged from own sources. Given increase in profitability, liquidity position is projected to improve further, going forward.

Conservative capital structure; debt free balance sheet: The equity position of the company has strengthened in line with internal capital generation. Debt profile of the company in the past majorly comprised short-term borrowings with zero reliance on long term financing. Further during FY20, the short-term commercial borrowings were also retired; meanwhile the bridge financing was done by sponsor's interest free loan. The loan is payable on demand depending on availability of funds with the company. As per management strategy, the company is not expected to obtain any commercial funding either for capital expenditure or for short-term requirements. At end-FY19, to meet higher working capital requirements emanating from high raw material inventory piled, short-term borrowings increased to Rs. 1.3b (FY18: Rs. 672.0m). These facilities were secured against charge on current assets, fixed assets and lien on import documents. With minimum dependence on credit financing along with strengthening of equity base, gearing and leverage indicators improved to 0.01x and 0.58x (FY19: 0.67x and 1.31x); respectively, by end-FY20. Gearing and leverage indicators are projected to improve further on account of higher equity. Going forward, to avail the benefit of price fluctuations in plastic resin, KGML plans to install pet bottle making machines by end-FY22. The expected capital expenditure on the same is projected around Rs. 38.0m and is to be arranged from company's own sources. With the investment diversification in revenue streams is expected to be achieved.

Kausar Ghee Mills (Pvt.) Limited — Appendix I

FINANCIAL SUMMARY *(amounts in PKR millions)*

BALANCE SHEET	June 30, 2018	June 30, 2019	Jun 30, 2020
Non-Current Assets	880	910	870
Stock-in-Trade	709	1,665	1,241
Stores & Spares	13	4	5
Trade Debts	363	681	843
Advances, Prepayments and other Receivables	1,008	1,203	919
Cash & Bank Balances	41	56	977
Total Assets	3,014	4,522	4,856
Trade and Other Payables	620	949	1,319
Short Term Borrowings	672	1,304	22
Long-Term Borrowings *(Inc. current maturity)*	0	0	0
Paid Up Capital	500	500	500
Tier-1 Equity	1,495	1,958	2,984
Total Equity	1,495	1,958	2,984

INCOME STATEMENT	June 30, 2018	June 30, 2019	Dec 31, 2020
Net Sales	10,117	11,426	12,793
Gross Profit	803	951	1,041
Operating Profit	453	536	510
Profit Before Tax	415	469	492
Profit After Tax	187	157	142
FFO	208	267	294

RATIO ANALYSIS	June 30, 2018	June 30, 2019	Dec 31, 2020
Gross Margin (%)	7.9	8.3	8.1
Net Working Capital	614	1,084	2,293
Current Ratio (x)	1.40	1.43	2.36
FFO to Long-Term Debt	N/A	N/A	N/A
FFO to Total Debt (%)	0.31	0.21	13.25
Debt Servicing Coverage Ratio (x)	7.45	5.29	8.04
ROAA (%)	6.5	6.9	3.0
ROAE (%)	13.5	8.0	5.7
Gearing (x)	0.45	0.67	0.01
Debt Leverage (x)	1.02	1.31	0.58
(Stock in Trade+ Trade Debts) to Short-term Borrowings (x)	1.59	1.80	93.80

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	Kausar Ghee Mills (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			
	Sep 09, 2020	A-	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.					
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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Due Diligence Meetings Conducted		**Name**	**Designation**	**Date**		
	1	Mr. Shujaat Butt	Senior Manager	26-Aug-2020		