

RATING REPORT

The Organic Meat Company Limited (TOMCL)

REPORT DATE:

July 02, 2024

RATING ANALYSTS:

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Rating Category	RATING DETAILS		RATING DETAILS	
	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A	A-1	A-	A-2
Rating Date	July 02, 2024		December 15, 2022	
Outlook/Rating Watch	Stable		Positive	
Rating Action	Upgrade		Maintained	

COMPANY INFORMATION

Incorporated in 2010	External Auditors: BDO Ebrahim & Co. Chartered Accountants
Public Limited Company (Listed on PSX)	Chairman: Mr. Nihal Cassim
Key Shareholders (with stake 5% or more):	Chief Executive Officer: Mr. Faisal Hussain
Mr. Faisal Hussain – 45.54%	
Mr. Ali Hussain – 9.50%	

APPLICABLE METHODOLOGY

VIS Entity Rating Criteria: Corporates

<https://docs.vis.com.pk/docs/CorporateMethodology.pdf>

VIS Rating Scale

<https://docs.vis.com.pk/docs/ratingscale.pdf>

The Organic Meat Company Limited

OVERVIEW OF THE INSTITUTION

The Organic Meat Company Limited (TOMCL) began as a private limited company in 2010. The registered office of the company is situated at Plot No. 257, Sector 24, Korangi Industrial Area, Karachi. The major integrated facility of TOMCL is located at Gadap Town, Karachi and an additional pet food facility been established in Korangi Industrial Area, Karachi. The Company was made public & listed on Pakistan Stock Exchange (PSX) in August 2020

Profile of Chairman

Mr. Nihal is an MBA from McGill University. He is currently a director on the Boards of International Steels Limited, The Organic Meat Company Limited, Uniquity Trading Limited, National Institutional Facilitation Technologies (Pvt) Limited (NIFT) and its subsidiary ISM (Pvt) Limited. He has served on the Board of Pakistan Oilfields Limited, Ferozsons Laboratories Limited and Mutual Funds Association of Pakistan (MUFAP).

Profile of CEO

Mr. Faisal Hussain is an MBA from IBA and also holds a Master of Finance Degree from Cardiff Business School, UK. He has over 21 years working experience in sheep casings (meat offal processing) industry and 11 years of experience in the meat processing industry.

RATING RATIONALE

The Organic Meat Company Limited ('TOMCL' or 'the Company') is positioned amongst the largest processors and leading exporters of red meat, and the only offal processor (meat byproducts) in the formal meat sector. The company deals in processed beef, mutton & camel meat in various forms including fresh-chilled, vacuum-packed, M.A.P vacuum-packed & heat-treated meat and meat byproducts. TOMCL has also ventured into pet chews and cooked meat products, with plans to make these the market leading products.

In Pakistan, TOMCL has the largest capacity from slaughtering to packaging, largest fattening farm integrated operations, highest halal meat exports receipts, and access to 16 export jurisdictions. The business risk profile of the company incorporates the price variations prevalent in the food and allied segment due to seasonal impacts in the local market coupled with high geographical concentration in UAE. The ratings incorporate the Company's expansion plans regarding chilling and freezing units, and efforts to further reduce leverage indicators on a timeline basis. TOMCL has a lean business model that minimizes wastage by exporting byproducts from the internal organs and entrails of the butchered animals.

Economic Overview

Global:

World meat production increased by 7.2% in 5 years, from 2018 to 2023, to an estimated 351m MT. Beef, veal and sheep production remained 26% on average of the total meat production, with increase mainly in sheep production. As per OECD-FAO, the global beef & veal demand is expected to remain stable while growth is likely to be seen in poultry & pork production and demand. The global average per capita demand is expected to increase by 2% only, in 10 years, by 2032. This is explained further by a projected decline in red meat products due to concerns about environment, human health and animal welfare, in high-income countries. In middle & low-income countries, however, higher meat consumption is expected.

The top 5 importers of meat in fresh, chilled and frozen forms are China, USA, South Korea, Japan & Egypt. Collectively, the above five countries have a share of approximately 60% in global imports. TOMCL has export contracts in 3 out of 5 of these countries.

Pakistan's Industry

Pakistan's annual meat production reached an estimate of 5.5m MT (2022: 5.2m MT) in 2023, a mere 1.6% of the global production. Moreover, Edible offals and casings & guts production stood at 0.5m MT and 85.6m MT, respectively. With a 2.6% population growth, the country is producing ample meat in excess for exports, currently mainly to the GCC states and some Far East countries. In 2022, Pakistan's exports of meat and edible meat offals were recorded at \$376.3m at an 11% YoY increase from 2021, with a consistent upward trend in meat exports. Going forward, the meat exports of Pakistan are expected to increase further.

Capacity Utilization

TOMCL employs a 90-day fattening process for its livestock. If the animals do not gain weight within the first two weeks, they are culled immediately; otherwise, the 90-day process is completed before slaughtering. The fattening farm currently has a capacity of approximately 4,200 animals. By end-Jun'24, the company plans to maintain 2,500 animals at the farm, operating at 60% of its capacity.

Overall, TOMCL has an annual slaughtering capacity of 149,760 cattle heads. The majority of the cattle are procured directly from the market (Mandi) for slaughtering. The capacity utilization decreased to 45% (FY22: 49%) in FY23, due to variations in customer demand. By end-Jun'24, in-house animals will account for only 3% of the company's average slaughtering demand.

	FY21	FY22	FY23
Installed Slaughtering Capacity (heads/year)	149,760	149,760	149,760
Actual Slaughtering Capacity (heads/year)	84,449	74,059	67,650
Capacity Utilization	56%	49%	45%

Key Rating Drivers

Asset base enhanced on a timeline basis mainly on the back of expansion of chilling and freezing capacities

The company's asset base augmented to Rs. 2.9b (FY23: Rs. 2.5b; FY22: 1.9b) by end-9MFY24, reflecting considerable enhancement of the company's operational infrastructure. The growth is underpinned by an initial capex of Rs. 600m for the expansion of meat chilling and freezing capacities, which has since been revised upwards by an additional Rs. 150m, with the total capex expected to reach Rs. 1b upon the project's completion by end-Dec'24. The expansions, funded mainly by internal sources of funds, are designed to enhance the company's footprint in the international markets, aligned with its growth prospects and expectations.

International Investments and M&As Update

International equity investment:

Saudi Agricultural & Livestock Investment Company (established by Royal Decree in 2009 as a Saudi joint-stock company owned by the Public Investment Fund) expressed interest in acquiring up to 30% of TOMCL's shareholding. Pricewaterhouse Coopers had been engaged to conduct a due diligence, which is currently still outstanding. Furthermore, Mohsin Tayebaly & Co. (MTC) has been hired as legal consultant. Discussions are ongoing, and there have been delays with no binding agreements reached as yet. The proposed investment is expected to support capacity enhancement of the fattening farm. Additionally, the capital raised will be utilized to further reduce gearing levels. These developments will be closely monitored for their potential impact from a ratings perspective.

Acquisition of Muhammad Saeed Muhammad Hussain Ltd. (MSMHL)

The IPO funds that were initially allocated for construction of an offal processing facility in the Export Processing Zone were utilized for the acquisition of 100% stake in MSMHL, located in the Karachi Export Processing Zone (KEPZ), due to regulatory changes and unavailability of vacant land in the KEPZ. This marks as a strategic enhancement for the company as MSMHL is licensed to process and export sheep casing to the EU and animal offal, aligning with the company's goal to diversify and strengthen its value-added product portfolio in both emerging and developed markets.

The acquisition, completed on August 15, 2023, was executed through a cash cum deferred price arrangement with MSMHL's former shareholders. *An amount of Rs. 138m has been paid while the remaining amount of Rs. 36m of the total Rs. 174m is deferred till or before August 15, 2025.* The acquisition is expected to be completed, including management control, by July 15, 2024, pending regulatory approvals. The acquisition is expected to contribute positively to the margins, as offal is considered a high margin business.

Revenue enhanced on a timeline basis mainly due to inflationary pressure on product prices. Net margins declined lately as exchange gains subsided subsequent to stabilization of USD-PKR parity.

The company exhibited significant growth in revenue amounting Rs. 6.4b (FY21: 3.9b; FY22: 4.7b) in FY23. The growth in export revenue was driven mainly by higher product prices despite a 2% decrease in volumetric sales. In 9MFY24, however, the net sales augmented to Rs. 8.6b, 106% higher compared SPLY, mainly on the back of 69% growth in volumetric sales, while average prices per MT also increased by 5.2%. The growth is underpinned by the company's expansion into existing markets in the CIS, and the GCC and entrance into new international markets of North & South America. Exports to the CIS countries increased, utilizing the export route through Afghanistan border towards Uzbekistan and Azerbaijan. TOMCL achieved a unique competitive advantage as one of the only two companies from South Asia to have obtained the license for export of cooked beef to China, and the first to export the same. The exports to China amounted to 2.1% of the total revenue in the form of cooked meat. Additionally, the company has obtained several key approvals and licenses for new products and markets, such as pet chews in Canada (becoming the first Pakistani company to export pet food to Canada), beef casings to Europe, and red & white offals to the UAE. These initiatives are expected to drive revenue growth further.

The sales in 9MFY24 increased mainly owing to higher frozen meat sales. The company's chilled meat sales declined significantly, when the UAE placed a chilled meat import ban on Pakistan during 1QFY24. However, TOMCL switched to frozen meat exports. *TOMCL signed two \$4m contracts with First Quality Food Stuff LLC of UAE for the export of frozen boneless beef.* In a competitive global market, TOMCL is capitalizing on its proximity to UAE for the export of meat and byproducts, especially products with a shorter shelf life. It has also secured authorization to export red & white offals to the UAE (frozen or fresh vacuum packed). TOMCL is also engaged in exports of privately labeled frozen meat products to the Saudi Arabian market, and plans to initiate the same in UAE. The product-wise details of TOMCL's volumetric sales are given below:

Volume (Metric Tons)	FY21	FY22	FY23	9MFY24
Chilled Meat	3,176	4,897	4,591	2,848
Chilled Vacuum Packed Meat	20	67	74	150
Frozen Meat	2,134	480	798	3,735
Frozen Offals	1,310	822	674	926
Cooked Meat			-	168
Pet Chews			25	4
Total	6,640	6,266	6,163	7,830

The top-10 client concentration accounts for 84.3% of total sales in 9MFY24 (FY23: 80.7%). As Pakistan is a small exporter in terms of meat at the global level, the management focuses on specific clients in countries with competitive advantage, to retain its share in the global exports, thereby having high concentration risk. However, the management plans to reduce the said concentration to 60-65% in the medium term.

The cost of sales increased to an average of Rs. 894/kg (FY22: Rs. 646/kg), a 38% increase in line with higher procurement costs. Higher prices of animals were linked to illegal cross-border selling, which put pressure on local prices. A reduction in offals sales, a high gross margins product, was also observed. However, gross margin of the company improved slightly to 13.4% (FY22: 13.1%) during FY23, mainly on account of higher average sales prices and lower feed costs.

The administrative expenses stood higher at Rs. 123m (FY22: Rs. 88m) in FY23, mainly as a result of general inflation, increments in salaries, and higher fee, subscription, legal and professional charges on account of acquisition related costs. Moreover, the selling expenses also increased to Rs. 412m (FY22: Rs. 293m) majorly due to higher clearing and forwarding charges. The other income increased significantly to Rs. 675m (FY22: 374.5m) in line with sizable foreign exchange gain amounting to Rs. 617m (FY22: 348m). With higher average borrowings along with higher interest rates, the financial charges increased to Rs. 181m (FY22: Rs. 88m). TOMCL reported higher profit of Rs. 722m (FY22: Rs. 411m; FY21: Rs. 303m) in FY23, mainly on account of significant exchange gain. Consequently, the net margin was reported higher at 11.3% (FY22: 8.8%).

In 9MFY24, the gross margin decreased slightly to 13.2%. The admin & selling expenses were Rs. 106m & Rs. 429m, respectively. However, other income witnessed a significant decline to Rs. 13m (FY23: 657m) as the rupee stabilized against the dollar resulting in lower net profit of Rs. 341m. The net margin fell to 4% during 9MFY24.

Improvement in the liquidity profile

Improvement in the liquidity profile has been witnessed on a timeline basis with funds from operations (FFO) amounting Rs. 811m (FY22: Rs. 490m; FY21: Rs. 437m) in FY23. Resultantly, FFO-to-total debt ratio improved to 0.78x (FY22: 0.55x; FY21: 0.59x) in FY23, before settling at 0.63x in 9MFY24. The FFO to long-term debt ratio was reported at 7.4x (FY23: 8.3x; FY22: 4.3x). Given higher finance cost paid and scheduled principal repayments, with a lower FFO of Rs. 436m, debt service stood lower at 3.1x (FY23: 4.7x; FY22: 6.0x) during 9MFY24. The metrics remain robust, indicating the company's sound capacity to repay its financial obligations.

Inventory levels increased on a timeline basis, though remained manageable, to Rs. 266m (FY22: Rs. 245m; FY21: Rs. 117m) mainly on account of shift in product mix towards frozen meat and the tension in the Red Sea trade route leading to a backlog on frozen meat inventory. Loans & advances, comprised mainly of advance payments to suppliers adjustable against future purchases of meat, offal and animals declined to Rs. 152m (FY23: Rs. 353m; FY22: Rs. 385m).

Trade debts increased in line with business expansion, amounting to Rs. 2.3b (FY22: Rs. 1.6b) by end-9MFY24. However, cash conversion cycle (CCC) increased to 113 days (FY22: 101 days; FY21: 90 days) by the end of FY23, before improving to 76 days in 9MFY24. Most of sales are on advance payments or on short-term credit while sales

to UAE are conducted through the letter of credit. The aging profile is considered adequate as ~88% of receivables are within 60-120 days while remaining amount of Rs. 171.3m above one year has been fully provided for.

The current ratio has been increasing on a timeline basis to 2.9x (FY23: 2.7x; FY22: 2.3x) while inventory plus receivables to short-term borrowings coverage has also been increasing to 2.9x (FY23: 2.7x; FY22: 2.2x; FY21: 1.6x) by end-9MFY24. Maintenance of sound liquidity profile and operational efficiency remains crucial from ratings perspective.

Conservative capital structure maintained

The paid-up capital was recorded higher at Rs. 1.49b (FY23: Rs. 1.35b; FY22: Rs. 1.23b) at end-1QFY24 in line with the issuance of bonus shares of 0.975 for every 10 shares. The equity base (excluding revaluation surplus) augmented to Rs. 3.9b (FY23: Rs. 3.5b; FY22: Rs. 2.7b) on the back of profit retention. The short-term borrowing from related parties was fully repaid in FY23. Long-term borrowings decreased over the review period. The commercial short-term funding increased to Rs. 945m (FY22: Rs. 645m; FY21: Rs. 568m) by end-FY23, however, the same decreased to Rs. 845m at end-9MFY24. Gearing and leverage indicators remained low at 0.24x & 0.29x (FY23: 0.30x & 0.36x), respectively. The management does not intend to mobilize further borrowings in the short to medium term.

Corporate Governance Framework is reflective of the Company's operational status as a listed entity

The company has an experienced and qualified management team with the function wise organizational hierarchy in place. Board members consist of two executive and five independent directors including a female representation. The roles of chairman and chief executive are different with each being clearly defined. In addition, the audit, IT and HR committees are chaired by independent directors. The IT committee has been reconstituted in 1QFY24 as Ms. Sehrish Hafeez Mastoor replaced Mr. Nihal Cassim as a member. All directors have obtained certification under directors' certification training program.

Financial Statement (Amount in Million)				
BALANCE SHEET	FY21	FY22	FY23	9MFY24
Property, Plant & Equipment	1,827	1,864	2,516	2,890
Stock in Trade	188	117	245	266
Trade Debts	912	1,598	2,266	2,168
Loans & Advances	336	385	353	152
Other Assets	255	163	217	461
Cash & Bank Balances	125	142	219	97
Total Assets	3,643	4,268	5,815	6,034
Trade and Other Payables	89	150	130	99
Short Term Borrowings	568	645	945	845
Short Term Borrowings from Related Parties	134	134	0	0
Long-Term Borrowings (<i>Inc. current matur</i>)	38	115	98	78
Total Borrowings	740	893	1,043	923
Other Liabilities	71	69	103	131
Total Liabilities	900	1,113	1,276	1,153
Issued, Subs, and Paid-Up Capital	1,118	1,230	1,350	1,485
Total Equity	2,744	3,155	4,540	4,881
Equity (Exc. Reval. Surplus on PPE)	2,270	2,745	3,528	3,923
INCOME STATEMENT	FY21	FY22	FY23	9MFY24
Net Sales	3,928	4,658	6,365	8,575
Gross Profit	650	610	853	1,133
Operating Expenses	257	411	558	546
Other Income	37	345	675	13
Finance Costs	89	88	181	176
Profit Before Tax	340	455	789	423
Profit After Tax	303	411	722	341
RATIO ANALYSIS	FY21	FY22	FY23	9MFY24
Gross Margin (%)	16.5	13.1	13.4	13.2
Net Margin (%)	7.7	8.8	11.3	4.0
FFO	437	490	811	436
FFO to Long-Term Debt	11.5	4.3	8.3	7.4
FFO to Total Debt	0.59	0.55	0.78	0.63
Debt Servicing Coverage Ratio (x)	5.2	6.0	4.7	3.1
ROAA (%)	9.5	10.4	14.3	7.5
ROAE (%)	16.8	16.4	23.0	11.6
Gearing (x)	0.33	0.33	0.30	0.24
Debt Leverage (x)	0.40	0.41	0.36	0.29
Current Ratio	2.1	2.3	2.7	2.9
Inventory + Receivables/Short-term Borrowings	1.6	2.2	2.7	2.9
CCC	90	101	113	76

The Organic Meat Company Limited

REGULATORY DISCLOSURES		Appendix II			
Name of Rated Entity	The Organic Meat Company Limited				
Sector	Food				
Type of Relationship	Solicited				
Purpose of Rating	Entity Ratings				
Rating History	Rating Date	Medium to Long Term	Short Term	Outlook/ Rating Watch	Rating Action
	RATING TYPE: ENTITY				
	02-July-2024	A	A-1	Stable	Upgrade
	15-Dec-2022	A-	A-2	Positive	Maintained
07-Dec-2021	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.				
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Due Diligence Meetings Conducted	Name	Designation	Date		
	Mr. Faisal Idrees	CFO	May 15, 2024		