RATING REPORT

Servo Motor Oil (Private) Limited

REPORT DATE:
September 09, 2022

RATING ANALYSTS:
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Rating Category	Initial Rating	
	Long-term	**Short-term**
Entity	BBB	A-2
Rating Outlook	Stable	
Rating Action	*Initial*	
Rating Date	*September 09, 2022*	

COMPANY INFORMATION

Incorporated in 2008	**External Auditors:** Mudassar Ehtisham & Co. Chartered Accountants
Private Limited Company	**Chairman/ CEO:** Mr. Arif Iqbal
Key Shareholders (with stake 5% or more):	
- Mr. Arif Iqbal – 51% - Mr. Waseem Akhtar – 25% - Mr. Rashid Iqbal – 24%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Industrial Corporates (August 2021)
https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

Servo Motor Oil (Private) Limited

OVERVIEW OF THE INSTITUTION

Servo Motor Oil (Private) Limited was incorporated in Pakistan on June 05, 2008. The Company is principally engaged in the business of manufacturing and sale of Blended Lubrication Oil and Greases. The Company's registered office and manufacturing plant is located in Industrial Estate Phase 1 Multan, Pakistan.

Profile of Chairman/ CEO

Mr. Arif Iqbal is Chief Executive Officer of Servo Motor Oil (Private) limited. He has CPA degree from USA. He has been running Group as a CEO/Director since 1997 and Servo Motor Oil (Private) Limited since 2008. He has an experience of more than 25 years.

RATING RATIONALE

Servo Motor Oil (Private) Limited ('SMOPL' or 'the Company') was incorporated in Pakistan on June 05, 2008 as a private limited company. SMOPL is principally involved in manufacturing and sales of Blended Lubrication Oil and Greases. The Company is part of Chicago Group (CG) of Companies which is based in Multan. The Company operates 48 warehouses within Pakistan. The Company's registered office and manufacturing plant is located in Industrial Estate Phase 1 Multan, Pakistan.

Rating Drivers

Ratings take into account SMOPL's sponsor profile

SMOPL is part of Chicago Group (CG) of Companies. CG is based in Multan, Pakistan and has a diversified group portfolio across various sectors including Tracking Solution (TRAXX VTMS (Pvt) Limited), Food (Riverside Raw Material (Pvt) Limited & Sidra Foods (Pvt) Limited) and Spare parts (Chicago Metal Works (Pvt) Limited and Oil & Filter Company).

Ratings incorporate SMOPL's sales mix and long term association with clients

SMOPL's revenue base is diversified across lubricant and grease products, with the most dominant segment being Motorcycle oil, comprising 58.9% of the sales mix as of 9M'FY22. The business mix does feature client concentration with top 4 clients accounting for 98% (FY21: 94.8%, FY20: 96.7%) of the topline during 9M'FY22. However, the risk is addressed as 3 of these 4 clients (Lube World, Oil & Filter and Top Class Lube) are directly or indirectly associated with SMOPL. As per management, these clients are distributors for SMOPL products.

Ratings incorporate competitive environment of lubricant sector and high finance cost

The recent decline in gross margin is due to an increase in base oil prices, and limited ability of the SMOPL to be a price maker. Recently with the sizable price increase in finished product pricing, the price sensitive consumer base of the Motorcycle lubricant has depicted change in buying patterns substituting to recycled oil which is much more price competitive.

SMOPL's net margin does depict sensitivity to changes in cost of doing business and benchmark rates, given that the Company relies on running finance lines to fund its working capital requirements.

Going forward, the net margins may come under pressure, given significant hike in petroleum prices observed in Q4'FY22 (up 42.5% QoQ), which will increase SMOPL's cost of doing business, and high competition. However, the inflationary pressure will also translate in uptick in product pricing and hence the revenue on each product. Accordingly, there might be short term pressure on profitability margins, which will likely to normalize over medium term.

There is also the added risk of higher inflationary pressure resulting in short to medium term demand contraction, which may affect revenue growth of SMOPL. However, the same has been incorporated into the business risk profile for lubricant business.

Ratings incorporate stressed cash flow coverage due to growing working capital requirement

The Company's annualized cash flow as of 9M'FY22, provided 31% (FY21: 27.1%, FY20: 56.6%, FY19: 110.3%) coverage of total debt, which means that the Company can pay off the entire debt with a little over 3 years cash flows. During the rating horizon, the Company's FFO to Debt is expected to remain in the range of 30-32%. DSCR is projected to remain at comfortable level as financing is limited to running finance lines, while there are no plans of raising additional long term debt.

As of Mar'22, debt on the Company's balance sheet is largely short-term (Mar'22: 65.5%; Jun'21: 43.6%). Comfort is derived from adequate coverage of short term debt with inventory and trade debts, which stood at 1.98x.

Equity base of the Company has grown at a CAGR of 27.4% (Jun'18 – Mar'22). The shareholders of the Company injected Rs. 31m as capital to fund working capital requirement. The Company maintained 100% profit retention for the past 4 years. Given the internal capital generation capacity, full profit retention and equity infusion, gearing has remained below 1x.

As per management, the long-term loan as of Mar'22 pertains to borrowings taken for fleet expansion. The Company doesn't plan to take further loan in coming period with no capital expenditure planned in the short to medium term horizon.

Servo Motor Oil (Private) Limited — Appendix I

Financial Summary *(Amount in Million)*					
BALANCE SHEET	**Jun'18**	**Jun'19**	**Jun'20**	**Jun'21**	**Mar'22**
Property, Plant & Equipment	235	253	326	344	346
Stock in Trade	180	205	332	453	443
Trade Debts	19	44	34	188	151
Cash & Bank Balances	12	33	17	18	16
Other Assets	73	110	134	202	187
Total Assets	**519**	**645**	**841**	**1,204**	**1,143**
Trade and Other Payables	153	209	116	94	74
Short Term Borrowings	14	18	93	318	299
Long-Term Borrowings *(Inc. current matur)*	-	52	120	168	142
Deferred Liabilities	2	2	4	4	-
Other Liabilities	76	25	100	135	61
Total Liabilities	**245**	**306**	**432**	**718**	**576**
Issued, Subs, and Paid Up Capital	189	209	209	209	240
Equity	**274**	**339**	**409**	**486**	**567**
INCOME STATEMENT	**FY18**	**FY19**	**FY20**	**FY21**	**9M22**
Net Sales	945	1,207	1,602	2,342	2,088
Gross Profit	120	128	177	215	182
Operating Profit	48	72	120	153	124
Profit Before Tax	38	62	96	112	70
Profit After Tax	24	45	70	77	50
RATIO ANALYSIS	**FY18**	**FY19**	**FY20**	**FY21**	**9M22**
Gross Margin (%)	12.7%	10.6%	11.0%	9.2%	8.7%
Net Margin (%)	2.5%	3.7%	4.4%	3.3%	2.4%
FFO	50	77	121	132	103
FFO to Long-Term Debt	-	1.50	1.00	0.78	0.96*
FFO to Total Debt	3.65	1.10	0.57	0.27	0.31*
Debt Servicing Coverage Ratio (x)	-	8.62	2.27	2.26	1.49*
ROAA (%)	0.0%	7.7%	9.4%	7.5%	5.7%*
ROAE (%)	0.0%	14.6%	18.7%	17.2%	12.7%*
Gearing (x)	0.05	0.21	0.52	1.00	0.78
Debt Leverage (x)	0.89	0.90	1.06	1.48	1.02
Current Ratio	1.17	1.34	1.50	1.40	1.54
Inventory + Receivables/Short-term Borrowings	14.63	13.50	3.94	2.02	1.98

**Annualized*

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

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	Servo Motor Oil (Private) Limited
Sector	Oil & Gas
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.
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Due Diligence Meetings Conducted	see table below

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
09-Sept-22	BBB	A-2	Stable	Initial

Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Ahsen Karim	Accounts Manager	**25 July 2022**