RATING REPORT

Madina Oil Refinery Limited

REPORT DATE:
February 20, 2023

RATING ANALYSTS:

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RATING DETAILS		
Rating Category	**Initial Rating**	
	Long-term	**Short-term**
Entity	BBB-	A-2
Rating Outlook	*Stable*	
Rating Action	Initial	
Rating Date	*Feb 20, 2023*	

COMPANY INFORMATION	
Incorporated in 2021	**External auditors:** Zaheer Babar & Co. Chartered Accountants
Public (Unlisted) Limited Company	**CEO/Chairman:** Mr. Muhammad Rasheed
Key Shareholders (with stake 5% or more):	
Mian Muhammad Rasheed – 74.6%	
Mian Muhammad Hassan – 10.40%	
Miss Arooj Fatima – 10.0%	
Mr. Muhammad Awais – 5.0%	

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

Madina Oil Refinery Limited

OVERVIEW OF THE INSTITUTION

Madina Oil Refinery Limited was incorporated as Private Limited Company and later converted into public unlisted company as at January 29, 2021. It is principally engaged in manufacturing and sale of vanaspati ghee, cooking oil and by products. Registered office of the company is located at F-8/1 Tipu Sultan Road, Karachi Gulberg Town, Sindh.

Financial Snapshot

Tier-1 Equity: end-1Q'23: Rs. 959m; end-FY22: Rs. 896m; end-FY21: Rs. 480m

Assets: 1Q'23: Rs. 1.5b; FY22: Rs. 3.7b; end-FY21: Rs. 1.4b

Profit After Tax: 1Q'23: Rs. 62m; FY22: Rs. 298m; FY21: Rs. 205m

RATING RATIONALE

Madina Oil Refinery Limited (MORL) is associated with 'Madinah Group' having diversified business interests including sugar, ethanol, edible oil & vanaspati ghee, power generation, steel and mass media. MORL is relatively a new venture of the group, with shareholding entirely vested within the family. The ratings incorporate extensive experience of the sponsors in the related industry, that leads to long-standing relationship with the distributors and an established procurement network. The company started commercial operations of its refinery with per day capacity of 200 MT in 2021 and has recently installed a solvent extraction plant with a capacity of 300 MT per day for backward integration, which is expected to come online by end-February'23.

The topline almost doubled in the outgoing year and largely constituted vanaspati ghee. The company sells its products under the brands of 'Zaavi' and 'Khushroz' through dealers across Punjab and KPK. The growth in revenue was driven by higher average selling prices and quantity sold during FY22. However, gross margins decreased amidst the impact of sharp currency devaluation on raw material prices and overall increase in cost of production due to inflationary pressure. Net margins also declined owing to surge in operating expenses and finance cost. Liquidity profile is underpinned by manageable working capital cycle. Leverage indicators increased on account of higher short-term borrowings amidst elevated working capital requirements at end-FY22. Meanwhile, the same have receded in line with offtake of inventory by end-1Q'23. The debt profile of the company comprised only short-term borrowings while the recent capex has entirely been executed through own sources. Nonetheless, high gearing and relatively smaller equity size vis-à-vis peers lead to enhanced financial risk profile.

Given synergies at the group level, MORL has been able to address the current issue related to import of raw material as LC payments are being settled against export proceeds. The demand outlook for consumer goods industry including edible oil, though quite inelastic, may get impacted amidst all time high inflation suppressing purchasing power of the masses in the country. In addition, higher markup rates, unstable forex parity and depleting foreign exchange reserves will remain major challenges. Further, VIS classifies edible oil industry as 'High' business risk given its heavy reliance on imported raw material, fragmented market, low value addition and switching cost along with thin sector margins. The ratings will remain sensitive to achieving projected growth in sales and profitability, maintaining margins and improving capitalization and liquidity indicators, going forward.

Key Rating Drivers

VIS classifies Edible Oil Industry as 'High' business risk, given its heavy reliance on imported raw material, fragmented market, low value addition & switching cost and thin sector margins: Pakistan's edible oil industry majorly relies on imported palm oil and seeds in order to cater the local demand. Roughly, around three-quarters of the local demand is catered through imported palm oil. According to latest update from United States Department of Agriculture (USDA), The forecast for 2022/23 palm oil imports is reduced to 3.2 million tons owing to overall food inflation eroding consumer purchasing power. Although international palm oil prices have decreased in recent months, the lower prices are taking some time to be fully transferred to consumers. In addition, Pakistan's fluctuating currency further contributed to decrease in palm oil imports. On the other hand, due to uncertainty regarding policy on imports of genetically engineered (GE) commodities for food, feed and processing (FFP), 2022-23 import forecast for soybeans has also been reduced. Beginning in Oct'22, Pakistan regulatory authorities stopped allowing soybean imports, unless the importers obtain a license from Ministry of Climate Change (MOCC) while MOCC has not issued any license for GE soybean imports for FFP. Resultantly, as of end-Nov'22, about 130,000 tons of soybeans were detained at Port Qasim, Karachi, and another 70,000 tons vessel was holding outside the port, awaiting resolution on import approval. In addition, another 300,000 tons of U.S. soybean have been sold but not shipped yet, and additional vessels of GE soybean from other origins are in transit. As of date, the issue remains unsolved and uncertain. The stoppage has caused extremely low soybean stocks, leading to shortage of soybean meal (SBM). Meanwhile, feed compounders report a pike in SBM prices and rapidly declining poultry feed stocks.

In Pakistan, the edible oil sector comprises more than 200 registered cooking oil and ghee manufacturing companies in Pakistan, including around 50 ghee manufacturing units, which collectively produce ~10,000 tons of oil and ghee on daily basis. Pakistan Vanaspati Manufacturers Association (PVMA) is representative body of around 125 ghee and oil manufacturers in the organized sector, which has installed capacity of over 4m MT. VIS characterizes the business risk profile of the sector by high competitive intensity, fragmentation with low barriers to entry, resulting in limited pricing power and thin profit margins. While leading players are playing important part in catering to demand for packaged edible oils, fragmentation in the industry is evident from no single entity holding a double-digit market share. In Jun'22, the Sindh High Court has imposed a ban on sale of loose edible oil in the province, with the objective to curtail adulteration of cooking oil i.e., a health hazard. The development bodes well for the organized sector.

Group's Introduction: MORL is a part of 'Madina Group of Industries' involved in diversified business interests primarily encompassing sugar, ethanol, edible oil & ghee, power generation, steel and mass media. The group was established by late Haji Muhammad Amin in 1946. After demise of Haji Muhammad Amin, his four sons jointly expanded and diversified the business. At present, the group comprises Faisalabad Oil Refinery (Pvt.) Ltd. (FORL), Madinah Sugar Mills (Pvt.) Ltd. (MSM), Madina (Pvt.) Ltd. (MPL) and Madinah Enterprises Ltd. (MEL-Steel Division). The shareholding of the group is entirely vested within the family, with FORL virtually wholly owned by eldest brother Mr. Muhammad Usman Saleem while MSML along with its steel division is owned jointly by the family. MPL became operational in Feb'21 with an installed refining and extraction capacities of 350 MT each per day. The manufacturing facility of MPL is located at Gharo, Sindh. MORL is relatively another new venture of the group, with equity stake held by Mr. Muhammad Rasheed and his family.

FORL is an integrated unit of edible oil comprising solvent extraction plant, physical refinery, neutralization, fractionation and interestrification plant, margarine manufacturing division and ghee manufacturing plant. The company has installed capacity of 1,2500 MT per annum. MSML has sugarcane crushing capacity of 16,000 MT per day and distillery with ethanol production capacity of 300 MT per day. The captive bagasse fueled generators have power generation capacity of 45 MW. In order to capitalize on in-house bagasse and steam production, the group has recently established a steel unit comprising two induction furnaces, each having melting capacity of 15 tons per hour and a rolling mill having capacity of 30 tons per hour.

In pursuit of following Environment, Social and Governance (ESG) framework, the group has been committed to reduce energy consumption, develop and implement technologies enabling to increase dependence on renewables, and alternative sources of energy while reducing emissions and preserving biodiversity. Two of the group companies have been able to achieve ISO 9001:2000 and ISO 14000 certifications which pertain to quality management system and effective environmental management system. The sponsors are effectively fulfilling their social and corporate responsibilities through various initiatives including establishment of a not-for-profit organization (Madinah Foundation), providing educational (the University of Faisalabad) and health services (Madinah Medical complex). In addition, the sponsors have been providing various other philanthropic services, including, religious services, jail welfare program, graveyard and burial services, mass marriage program and relief for natural calamities.

Company's operations: MORL's refining plant capacity stands at 200 MT per day which started commercial operations in FY21. Capacity utilization was reported at 57.1% (FY21: 46.5%) during the outgoing year. The company has recently expanded its operations by installation of a solvent extraction plant with capacity of 300 MT per day and is expected to come online in February' 2023. Property, plant and equipment (PP&E) was reported higher at Rs. 631.5m (FY22: Rs. 595.3m; FY21: Rs. 167.0m) at end-1Q'23. The increase in PP&E is primarily on account of establishment of solvent extraction plant and related installation cost and civil work. The company has incurred around Rs. 500m on this project, out of which Rs. 250m pertained to imported machinery component. The entire financing has been arranged through own sources.

The current power requirement is around 2 MW which has been met through captive bagasse fueled engines of its associated company. The company also has sanctioned load of required capacity from national grid while it has recently installed solar setup of around 150 KW capacity. The laboratory is equipped with controlled temperature stirrer, tento meter, moisture analyzer and other equipment for quality assurance.

The organizational structure of the company entails three directors, Director Finance/CFO, Technical Director and Supply Chain Management Director, who, along with the company secretary report to the CEO. The finance, human resource and administrative teams come under the ambit of director finance/CFO. There is a team of general managers, managers, supervisors and foreman under the direct administration of production/technical department manager, who reports to the technical director. The director supply chain management, oversees both, general managers sales and general managers procurement. Under the supervision of general manager sales, there are sales, marketing & distribution managers, executives and officers. The sales and marketing team has staff strength of 80 persons. General managers procurement has a team of managers, executive and officers for purchase/import/warehouse. The internal audit division of the company has seven members. The company has customized ERP system, comprising production, inventory and human resource modules.

Revenue growth driven by higher average product prices and quantity sold while gross margins decreased owing to relatively higher cost of production: The company sells its products under the brands of 'Zaavi' and 'Khushroz' through dealers. During FY22, net sales more than doubled to Rs. 7.6b (FY21: 3.2b) and largely constituted vanaspati ghee. The revenue growth was driven by ~55% increase in average selling prices and ~52% increase in volumetric sales. Sales concentration risk, in terms of sales to top ten clients remained quite manageable as they accounted for only 4% in total sales. Breakdown of sales is tabulated below:

	FY 2021			FY 2022		
	Quantity (M.T)	Value million Rs.	Average Price	Quantity (M.T)	Value million Rs.	Average Price
Vanaspati Ghee	18,989	3,241.6	170,708	28,843	7,609.9	263,842
Edible Oil	16.51	2.8	171,407	19.57	5.3	272,677
Total		**3,244.4**			**7,615.2**	

During the outgoing year, the company generated higher gross profits amounting Rs. 576.9m (FY21: Rs. 293.4m). However, despite significant increase in product prices, gross margins decreased to 7.6% (FY21: 9.0%) primarily on account of impact of sharp currency devaluation on raw material prices. The company imports 99.7% (FY21: 99.6%) of raw material which largely included RBD palm oil while canola oil is purchased locally. Average cost of raw material procured surged by 55% whereas almost all other cost components also underwent increase in line with inflationary pressure and scale of operations. Similarly, administrative expenses increased to Rs. 43.2m (FY21: Rs. 9.7m) during FY22. Selling and distribution expenses amounted to Rs.15.8m (FY21: Rs. 3.0m). Finance cost increased to Rs. 198.8m (FY21: Rs. 48.5m) on account of higher average borrowings and markup rates during FY22. Other expenses amounting Rs. 22.2m (FY21: Rs. 16.0m) mainly included employee related fund contributions. The income of the company is eligible for 100% tax credit of tax payable including on amount of minimum tax and final taxes payable under section 65D of the income tax ordinance, 2001. The facility is available to the newly established undertaking for the period of five years beginning from the date of setting up or commencement of commercial production, whichever is later. The company reported Rs. 298.3m (FY21: Rs. 204.8m) in net profits while net margins declined to 3.9% (FY21: 6.3%) owing to increase in operating expenses and finance cost.

During 1Q'23, the company reported Rs. 1.9b in net revenues with gross margins of 7.1%. The management projects a YOY average growth of around 12% in topline. Gross margins are expected to improve on account of backward integration and economies of scale, going forward.

Adequate liquidity in terms of working capital management: The company generated Rs. 169.2m (FY21: Rs. 161.9m) in funds from operations (FFO). Despite some improvement in profitability, FFO remained at prior year's level owing to higher tax payments. FFO to total debt remained under pressure due to higher short-term borrowings. Whereas, debt service coverage, albeit decreased, remained sizeable due to absence of long-term repayments.

Stock in trade was reported notably higher at Rs. 1.9b (FY21: Rs. 182m) at end-FY22. This included raw material inventory worth Rs. 1.3b (FY21: Rs. 93.2m) and finished goods stock amounting Rs. 639.2m (FY21: Rs. 89.0m). In view of depreciating local currency, the management stocked raw materials to minimize losses. The inventory levels subsequently decreased to Rs. 292m at end-1Q'23 in line with product offtake. Trade debts stood at Rs. 108.2m (FY21: Rs. 666.3m) at end-FY22. Aging profile is satisfactory as entire receivables were due for less than 3 months. Majority of the sales are executed on advance payment basis while for credit sales, the distributors are provided with credit period of around 2 months. Advances, prepayments and other receivables amounted to Rs. 776.2m (FY21: 109.1m), which mainly included sales tax refundable of Rs. 492.2m (FY21: 36.5m) and advance income tax paid amounting Rs. 283.1 (FY21: Rs. 71.4m). Sales tax refundable decreased to Rs. 237.5m and advance income tax to Rs. 139m by end-1Q'23. Cash and bank balances amounted to Rs. 111.5m (FY21: 242.2m; FY21: Rs. 291.8m) at end-FY22. Trade and other payables amounted to Rs. 115.6m (FY21: 57.8m) which included trade creditors amounting Rs. 50.7m (FY21: Rs. 28.8m). The raw materials are purchased through LC at sight. Current ratio remained adequate at 1.11x (FY21: 1.35x). Coverage of short-term borrowing via stock in trade and trade debts stood less than one (FY22: 0.78x; FY21: 0.99x). Cash conversion cycle remained manageable and comparable to industry peers (FY22: 68 days; FY21: 45 days). Overall liquidity position of the company is projected to improve steadily on the back of higher profitability and some improvement in working capital management.

High gearing due to elevated short-term borrowings for working capital requirements: Core equity of the company augmented to Rs. 896.3m (FY21: 479.7m; FY20: Rs. 147.7m) on the back of internal capital generation. In addition, the sponsors also provided interest-free loan to the tune of Rs. 119m (FY21 & FY20: Nil) to support expansion; the loan is payable at the discretion of the company. Paid-up capital amounted to Rs. 250m (FY21: Rs. 250m; FY20: Rs. 100m). Debt profile of the company included only short-term borrowings for its working capital requirements. Short-term borrowings increased substantially to Rs. 2.6b (FY21: Rs. 855.9m) at end-FY22. These comprised Musawamah finance arrangements (MSFA) with sanctioned limit of Rs. 1.5b, running finance facility with sanctioned limit of Rs. 350m and finance against trade receipts (FATR) with sanctioned limit of Rs. 2.5b. The debt leverage and gearing increased notably to 3.09x (FY21: 1.96x) and 2.88x (FY21: 1.78x), respectively by end-FY22. The debt leverage and gearing reduced to 0.60x and 0.45x, respectively in line with significantly lower short-term borrowings outstanding at end-1Q'23. The management intends to execute BMR and expand capacity of its extraction and refinery operations in tandem with market demand, going forward, where the financing is contemplated to be met entirely through own sources.

Madina Oil Refinery Limited Annexure I

BALANCE SHEET (in million Rs)	Jun 30, 2020	Jun 30, 2021	Jun 30, 2022	Sep 30, 2022
Property, Plant and Equipment	-	167	595	632
Stores, Spares and Loose Tools	-	2	29	30
Stock in Trade	-	182	1,917	292
Trade Debts	-	666	108	96
Advances, Deposits and Prepayments	140	109	776	377
Cash and Bank Balance	8	292	242	111
Total Assets	148	1,418	3,668	1,538
Trade and Other Payables	-	58	116	118
Short Term Borrowings	-	856	2,582	433
Long-Term Borrowings (incl. current maturity)	-	-	-	-
Total Interest-Bearing Debt	-	856	2,582	433
Other Liabilities	-	26	74	28
Total Liabilities	-	939	2,772	579
Paid Up Capital	250	250	250	746
Tier-1/ Total Equity	148	480	896	959

INCOME STATEMENT	Jun 30, 2020	Jun 30, 2021	Jun 30, 2022	Sep 30, 2022
Net Sales	-	3,247	7,621	1,930
Gross Profit	-	293	577	138
Operating Profit	(2)	281	518	123
Finance Cost	-	49	199	55
Profit Before Tax	(2)	216	297	62
Profit After Tax	(2)	205	298	62

RATIO ANALYSIS	Jun 30, 2020	Jun 30, 2021	Jun 30, 2022	Sep 30, 2022
Gross Margin (%)	-	9.0%	7.6%	7.1%
Net Margins (%)	-	6.3%	3.9%	3.2%
Current Ratio	493.2	1.35	1.11	1.59
Net Working Capital	148	325	316	336
Cash Conversion Cycle (days)	-	45	68	55*
Funds from Operations (FFO)	(2)	162	169	112
FFO to Total Debt (x)	-	0.19	0.10	1.03*
FFO to Long Term Debt (x)	-	-	-	-
Debt Leverage (x)	-	1.96	3.09	0.60
Gearing (x)	-	1.78	2.88	0.45
Debt Servicing Coverage Ratio (x)	n.m.	5.53	2.11	61.6
ROAA (%)	n.m.	26.2	11.7	9.6*
ROAE (%)	n.m.	65.3	43.4	26.9*
(Stock in Trade+ Trade Debt) to Short-Term Borrowing (x)	-	0.99	0.78	0.90

**Annualized*

ISSUE/ISSUER RATING SCALE & DEFINITION Annexure 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	Annexure III
Name of Rated Entity	Madina Oil Refinery Limited
Sector	Consumer Goods
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings
Rating History	

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
20-Feb-23	BBB-	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
Mr. Dawood Shah	CFO	January 11, 2023