RATING REPORT

Karachi Grains (Pvt.) Limited

REPORT DATE:
March 28, 2023

RATING ANALYST:
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Rating Category	Initial Rating	
	Long-term	Short-term
Entity	BBB+	A-2
Rating Outlook	Stable	
Rating Date	March 28, 2023	
Rating Action	Initial	

COMPANY INFORMATION	
Incorporated in 2001	**External auditors:** SARWARS Chartered Accountants
Private Limited Company	**Chief Executive Officer:** Mr. Saad Salim Dada
Key Shareholders (with stake 5% or more):	**Chairman:** Mr. Salim Dada
Mr. Salim Dada – 35% Mr. Muhammad Hanif – 8% Mr, Farooq Moosa – 8% Mr. Saad Dada – 5% Ms. Samina Dada – 5% Mr. Ashfaq Hashim – 5% Mr. Haji Moosa – 5%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria - Industrial Corporates (August 2021) https://www.vis.com.pk/kc-meth.aspx

Karachi Grains (Pvt.) Limited

OVERVIEW OF THE INSTITUTION

Karachi Grains (Pvt.) Limited (KGPL) was incorporated as a private limited company in 2001 and commenced commercial production in 2004. Registered office of the company is located in Karachi, Pakistan. The manufacturing facility is located in Industrial Zone, Port Qasim Karachi. Major shareholding of the Company is vested with the Dada Family.

Profile of Chairman
Mr. Salim Dada has over 50 years of experience in multiple areas of the commodity business. Mr. Salim is currently also serving as the Chief Executive Officer of Hyderabad Roller Flour Mills.

Profile of CEO
Mr. Saad Salim Dada has over 25 years of experience in the commodity business. Mr. Saad did his graduation from Babson College (USA). He is also one of the Directors in Hyderabad Roller Flour Mills.

RATING RATIONALE

Established in 2001 and commenced commercial production in 2004, Karachi Grains (Private) Limited (KGPL) is primarily engaged in the extraction, refining and sale of edible oil products. KGPL caters to B2B (business-to-business) market mainly covering local institutional clients. The Company also produces industrial fats, and various feed ingredients for the poultry and livestock sector.

NAME	% OF SHARE HOLDING
Salim Dada	35.00%
Muhammad Hanif	8.00%
Saad Dada	5.00%
Other Family Members	52.00%

Major shareholding of the Company (50%) is vested with the Dada Family, which has substantial experience in commodity businesses. The core group of sponsors has various allied investments in the food sector of Pakistan. Other related companies of KGPL with common directorship include DD Ship Breakers, Hyderabad Roller Flour Mills (Pvt.) Limited, Korangi Roller Flour Mills (Pvt.) Limited and Goodluck Flour Mills Limited.

The Company operates through two divisions, namely Oilseed (Soybean and Canola) & Palm Oil Division and **inactive** Rice Division, with their respective facilities mentioned below;

Oilseed & Palm Oil Division

- 350 MTPD (Metric tons per day) Desmet Oilseed Extraction Plant
- 150 MTPD Desmet Soft Oil Chemical Refinery
- 150 MTPD Desmet Oil Winterizing Refinery
- 150 MTPD Desmet Soft Oil Physical Refinery
- 300 MTPD Desmet Palm Oil Physical Refinery (commenced operations in the ongoing year)
- 100 MTPD Desmet Fractionation Line
- 70 MTPD Margarine Production Line (planned expansion under process)
- Automated Oil Bottling, Doypack & Tin Filling Lines

Rice Division

- Line 1- 10 Tons per Hour Rice Polishing Plant with Sortex
- Line 2- 10 Tons per Hour Rice Polishing Plant with Sortex
- 20,000 MT Warehouse

Operations

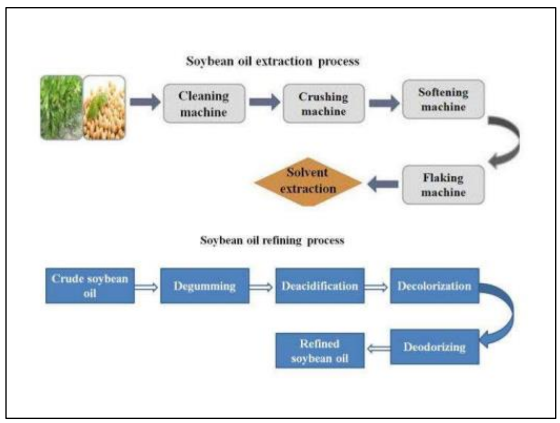
Oil Seed Production Capacity (MT)	FY20	FY21	FY22	1Q23
Annual Installed Capacity (MT)	99,000	99,000	99,000	99,000
Actual Production (MT)	79,000	83,000	56,000	8,000
Capacity Utilization	80%	84%	57%	32%

KGPL's manufacturing facility is located at Port Qasim, Karachi. The Company operates with an annual Oilseed Extraction and Refinery capacity of 99,000 MT from FY19 to 1QFY23. The capacity utilization witnessed an upward trend up until FY21 (FY21; 84%; FY20: 80%; FY19: 47%) depicting volumetric growth over the period. However, the same dipped to 57% in FY22 due to a major chunk of soybean seed halted at the port, which suppressed production output in the outgoing year.

KGPL's palm oil plant holds an annual installed capacity of 140,000 MT. The plant has been set up but not yet operational due to the management's deliberate intention to focus on the core business of soybean sales. Similarly, the rice division remains inactive as per management's discreet. However, going forward, the Company intends to enhance sales volumes and gain economies of scale through commencement of the palm oil and margarine plant over the rating horizon. The margarine plant is expected to come online by FY23-FY24 with a total cost of around Rs. 75m which will be financed through internal cash generation.

Production process

Production process in KGPL involves importing, extracting and refining of oilseeds (soybean and Canola) from Canada, USA and Brazil. The sales are made in bulk to local institutional refineries. The process is picturized below:



Competitive advantage of the company stem from the following key factors:

- Fully integrated state of the art facility with the oil recovery on the higher side around 17.5% and lowest hexane consumption.
- No contamination due to automatic handling of Oilseed from import stage till final production of finished products. Further risk of contamination eliminated by transfer of oil to on-site refineries through pipelines rather than lorries.

Rating Drivers

Ratings are constrained on account of 'High' business risk, given heavy reliance on imported raw material, and fragmented market.

Pakistan's edible oil industry majorly relies on imported oil seeds in order to cater the local demand. The total edible oilseed market is estimated at around 3m MT per annum having value of approximately $2b, out of which around four-fifth seed requirement is imported and the rest is procured from local production. Prices of palm oil in international market have stabilized after hitting record high levels of $1,646/MT in Jun'22. Pakistan's import unit cost for palm oil in Dec'22 was recorded at $1,043/MT, lowest in the last 21-month period, dropping a 3.2% from $1,077/MT as of Mar'22. The drop in international market may be attributable to improved supplies, ongoing global stagflation and recession induced squeezed demand.

However, with the cost in its entirety, being passed on to the consumers, local edible oil pricing hasn't dropped in the same pace as international prices. Around Sept'22, the top A-grade brands sold oil at Rs. 570/kg, which was previously priced at Rs. 600/kg, depicting a decrease of only 5%. Likewise, the B-grade local brands have only dropped their prices by nearly 17%. The limited decrease in edible oil prices is mainly linked to the constant deterioration in rupee-dollar exchange rates in the outgoing year. With Ramadan around the corner, local prices are expected to further escalate on account of demand-push inflation. Expected changes in Pakistan's tax regime in the ongoing year may also negatively impact prices of local edible oil.

While industry demand remain stable with edible oil being a staple product, changes in raw material prices (inventory losses) and foreign exchange rate fluctuations are key risk factors resulting in volatility in margins. Ratings are dependent on ability to manage the same which is in turn correlated to the level of competition and operational efficiency.

VIS characterizes the business risk profile of the sector by high competitive intensity, high fragmentation with low barriers to entry, resulting in limited pricing power and thin profitability margins. KGPL has managed to hold a small market share (4%) in the edible oil industry of Pakistan, where the industry remained largely fragmented with no single entity holding a double-digit market share.

Topline depicted decline in FY22 due to raw material stuck at port; however recovery in the same noted in 1HFY23.

After reporting a CAGR of 51% between FY19-FY21, topline of the Company decreased marginally by 4% to Rs. 7.3b (FY21: Rs. 7.6b; FY20: Rs. 4.9b) in FY22 led primarily by volumetric decline of 36%. Lower volumes were a function of subdued production on account of oil seeds stuck at the port. As per management, around 17,000 MT of oilseeds were stuck at the port during the last quarter of FY22. In routine practices, KGPL focuses on selling bulk oil to local refineries.

Product mix of KGPL comprises of Canola Oil, Soyabean Oil, Palm Olein, Canola Meal, Soyabean meal and Soyabean Hull. Highest proportion of sales emanate from Soyabean Meal segment (48.7%), followed by Soyabean oil (37.5%) in FY22. After commencement of palm oil plant, the sales mix is expected to change.

Product Mix	FY19	FY20	FY21	FY22	1QFY23
Canola Oil	1%	0%	2%	10%	0%
Soybean Oil	28%	29%	28%	38%	43%
Palm Olein	10%	5%	0%	0%	0%
Canola Meal	1%	0%	1%	4%	0%
Soybean Meal	60%	66%	68%	49%	57%
Soybean Hull	0%	0%	0%	0%	0%
Oil Dirt	1%	1%	1%	0%	0%
	100%	**100%**	**100%**	**100%**	**100%**

Client concentration is at the higher end with top ten clients accounting for around 59% (FY22: 52%; FY21: 50%) of the revenue base during 1QFY23. However, KGPL has been able to build strong relationships with its customers by delivering client requirements that ensures repeat business. Moreover, the diversified clientele every year represents the large number of customers in hand.

With the release of raw material inventory in the ongoing year and higher production, sales revenue was reported higher in HYFY23 to the tune of Rs. 5.0b. The Company plans to expand into branded segment over the rating horizon to gain benefit from brand loyalty. Sufficient order book supports projected revenue growth over the rating horizon. Keeping up with the same amidst challenging macroeconomic environment will be important from a ratings perspective.

High sensitivity of exchange rate volatility on margins due to dependence on imports

After a steep increase in FY21 to 11.4% (FY20: 6.3%), gross margin dipped to 7.0% in FY22 largely attributable to higher international seed prices contributed by both exchange rate fluctuation and demand supply dynamics in the global market along with lower production volumes. Higher salary expense and elevated direct insurance charge also contributed to higher cost of sales during FY22. In absolute terms, gross profit of KGPL was reported lower at Rs. 510.5m (FY21: Rs. 870.8m; FY20: Rs. 309.6m) during FY22. With seed inventory held at port, the company reported gross loss of -2.4% during 1HFY23. Given release of oil seed inventory in Jan'23, the company reported inventory gains in Jan-Feb'23 covering the loss incurred in the first half FY23. Furthermore, management also forecasts margin improvement in view of planned diversification into the palm oil and margarine segments over the rating horizon. Timely commencement of the planned projects will be critical.

In line with reducing gross margins, net margins of the company have also showcased similar trend. However, during FY22, one-off claim from supplier to the tune of Rs. 99.5m somewhat supported the bottom-line of the company. Profitability profile of the company also garners support from low finance cost with no interest bearing obligation on the book and consistent dividend income from short-term investment exposure in the listed equity market. Improving margins will be important from a ratings perspective as they continue to be exposed to exchange rate volatility.

Adequate liquidity profile supported by short-term liquid investments on books. Low leveraged capital structure as working capital needs are met through internal cash generation and interest-free short-term director and related party loans.

Funds from Operations (FFO) were reported lower at Rs. 470.6m (FY21: Rs. 632.2m; FY20: Rs. 255.9m) in FY22 in live with decline in profitability. However, given no debt on books, liquidity profile is considered sufficient. Further support in the liquidity profile is reaped from presence of short-term investments in the listed equity market. Given extended working capital cycle in the outgoing and ongoing year, quantum of short-term financing from related parties have increased on a timeline basis to Rs. 3.4b (FY22: Rs. 3.2b; FY21: Rs. 2.7b) at end-Dec'22. Higher inventory levels in comparison to preceding years is on account of elevated prices of raw material. Aging of trade debts is considered manageable as around four-fifth of the outstanding trade debts are due within 30 days. Current ratio was reported at 1.21x (FY22: 1.26x; FY21: 1.23x) at end-Dec'22. Maintaining similar strength will be important from ratings perspective.

Equity base of the company has grown at a CAGR of 25% over the past three years (FY19-FY22) due to profit retention and was reported at Rs. 2.0b (FY21: Rs. 1.7b; FY20: Rs. 1.2b) at end-FY22. With loss incurred in 1HFY23, equity base went down to Rs. 1.8b at end-Dec'22. Ratings are underpinned on un-geared balance sheet given no reliance on commercial banks to meet working capital requirements. The company attains short-term interest free financing from related party- DD Shipbreakers and from the directors to meet working capital needs. Including the same, leverage levels of the company were reported at 2.0x (FY22: 1.7x) at end-Dec'22. Ratings remain dependent upon effective working capital management and maintenance of leverage indicators in line with the ratings benchmarks.

Adequate corporate governance framework. However, room for improvement exists in effective segregation of ownership and management as owners are involved in day to day activities of the company along with establishment of a separate internal audit.

Board and management's oversight of operations is considered thorough with detailed discussion conducted on every aspect of the business during the board and management meetings. Management team comprises of seasoned professionals and a management committee has been established which meets on a quarterly basis. Two Board level committees also exist including Compensation Committee and Audit Committee. Formalized board and management committee meeting minutes ensures greater transparency. In line with best practices, management may consider inclusion of independent directors on the board. Furthermore, establishment of a separate and independent internal audit in line with management plans is also considered important from governance perspective. External auditors of the company are SARWARS Chartered Accountants who are classified in the 'Category C' of SBP Panel of Auditors.

SAP Business One Version 10.0 ERP system is employed by the Company for its IT related needs, which is fully integrated with modules including procurement, receivables, inventory, production and financials. The Company also maintains a cloud database that provides updated data on a real-time basis where data backup is conducted on a daily basis. Corporate governance framework may be further improved in terms of elaboration of Board level deliberations.

Karachi Grains (Pvt.) Limited — Appendix I

FINANCIAL SUMMARY *(amounts in PKR millions)*						
BALANCE SHEET	**FY19**	**FY20**	**FY21**	**FY22**	**HYFY23**	**8MFY23**
Fixed Assets	485.0	529.7	1,018.4	1,075.0	1,062.0	1,068.7
Stock-in-Trade	735.6	1,492.2	1,661.8	2,524.3	2,865.3	1,782.4
Trade Debts	630.1	621.7	1,292.7	519.8	236.1	875.4
Cash & Bank Balances	686.3	200.9	355.1	850.1	1,054.8	1,975.4
Total Assets	2,806.0	3,252.3	4,608.3	5,572.3	5,651.3	6,404.9
Trade and Other Payables	58.5	48.7	157.4	318.3	301.8	552.4
Long Term Debt	-	-	-	-	-	-
Short Term Debt	-	-	-	-	-	-
Total Debt	-	-	-	-	-	-
Short-term Interest free loan fro	1,709.8	1,959.8	2,704.8	3,184.9	3,443.0	3,273.0
Total Equity	1,037.7	1,217.5	1,699.0	2,027.0	1,864.4	2,537.5
Total Liabilities	1,768.3	2,034.8	2,909.4	3,545.3	3,786.9	3,867.5
Paid Up Capital	1,000.0	1,000.0	1,000.0	1,000.0	1,000.0	1,000.0
INCOME STATEMENT	**FY19**	**FY20**	**FY21**	**FY22**	**HYFY23**	**8MFY23**
Net Sales	3,368.3	4,925.5	7,632.8	7,313.9	4,957.7	7,393.9
Gross Profit	135.3	309.6	870.8	510.5	(120.1)	668.9
Profit Before Tax	93.4	252.4	663.9	487.8	(153.9)	519.2
Profit After Tax	41.6	180.6	472.4	333.3	(215.8)	519.2
RATIO ANALYSIS	**FY19**	**FY20**	**FY21**	**FY22**	**HYFY23**	**8MFY23**
Gross Margin (%)	4.0%	6.3%	11.4%	7.0%	-2.4%	9.0%
Net Margin (%)	1.2%	3.7%	6.2%	4.6%	-4.4%	7.0%
Net Working Capital	487.6	645.0	647.8	924.3	784.7	1451.0
Trade debts/Sales	18.7%	12.6%	16.9%	7.1%	2.4%	7.9%
FFO	84.3	255.9	632.2	470.6	-13.8	581.4
FFO to Total Debt (%)	NA	NA	NA	NA	NA	NA
FFO to Long Term Debt (%)	NA	NA	NA	NA	NA	NA
Debt Servicing Coverage Ratio (	NA	481.2	1798.7	151.2	-2.7	168.3
Current Ratio (x)	1.28	1.32	1.23	1.26	1.21	1.38
Stock+Trade Debts/STD	NA	NA	NA	NA	NA	NA
Gearing (x)	0.0	0.0	0.0	0.0	0.0	0.0
Leverage (x)	1.7	1.7	1.7	1.7	2.0	1.5

**annualized*

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	Karachi Grains (Pvt.) Limited
Sector	Edible Oil
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				
28-Mar-2023	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	

S.No	Name	Designation	Date
1	Mr. Zohaib Nagda	CFO	January 11, 2023
2	Mr. Shahzad Bagha	Senior Manager Finance	January 11, 2023