RATING REPORT

Karachi Grains (Pvt.) Limited

REPORT DATE:
June 11, 2024

RATING ANALYST:
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RATING DETAILS				
	Latest Ratings		Previous Ratings	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	BBB+	A-2	BBB+	A-2
Rating Date	June 11, 2024		March 28, 2023	
Rating Action	Reaffirmed		Initial	
Rating Outlook	Stable		Stable	

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

VIS Entity Rating Criteria: Corporates
https://docs.vis.com.pk/docs/CorporateMethodology.pdf

VIS Rating Scale
https://docs.vis.com.pk/docs/ratingscale.pdf

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

Karachi Grains (Pvt) Ltd (KGPL or 'the Company') 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. It also produces industrial fats, and various feed ingredients for the poultry and livestock sector.

The Dada Family holds a significant portion of the company's shares and has a major expertise in the commodities industry. The core sponsors have a number of affiliated holdings in Pakistan's food industry. DD Ship Breakers, Hyderabad Roller Flour Mills (Pvt.) Limited, Korangi Roller Flour Mills (Pvt.) Limited, and Goodluck Flour Mills Limited are associated firms of KGPL that have a common directorship.

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
- 100 MTPD Desmet Fractionation Line
- Automated Oil Bottling, Doypack & Tin Filling Lines

Rice Division (Inactive)

- 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

The Palm Oil Physical Refinery is not operational due to volatile international prices of Palm oil, which may affect margins, according to the management. The margarine plant that was expected to come online by FY23-FY24 with a total cost of around Rs. 75m, has not yet been initiated.

Operations

The production plant of KGPL is situated near Karachi's Port Qasim. The company has an annual available capacity of 99,000 MT for oil seed extraction and refinery. The capacity utilization has been decreasing on a timeline basis. As per management, the capacity utilization was relatively higher in FY20 and FY21 (FY21: 84%; FY20: 80%) due to absence of a major competitor due to Covid-19, which resulted in higher market share at that time. With partial restriction on import of soybean seed, production reduced in FY23. In 1HFY24, the capacity utilization was reported lower at 11.6%, as previously imported raw material stock got expended. The available capacity, actual production and capacity utilization is tabulated below:

Oil Seed Production Capacity (MT)	FY21	FY22	FY23	HY24
Available Capacity (MT)	99,000	99,000	99,000	49,500
Actual Production (MT)	83,000	56,000	43,699	5,716
Capacity Utilization	83.84%	56.57%	44.14%	11.55%

KGPL's palm oil plant has an annual installed capacity of 140,000 MT. The plant has been setup but not yet operational. Similarly, the rice division remains inactive as per management's discretion. The Company intends to commence production of the palm oil plant and diversify into the margarine plant over time.

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. 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 off-site refineries through pipelines rather than lorries.

Key Rating Drivers

Overview of the Edible Oil Industry: 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. Since edible oil is a staple commodity, industry demand is consistent. However, variations in raw material costs, which result in inventory losses, and fluctuations in foreign currency rates are major risk factors that cause margin instability. The capacity to manage the same, which is connected to the degree of competition and operational effectiveness, determines ratings. Pakistan's edible oil industry majorly relies on imported palm oil and oilseeds in order to cater to the local demand. Roughly the total consumption of edible oil is around 4.50m MT with the local production of around 0.5m MT.

It is projected that global canola/rapeseed production would reach 87.4MT in 2023–2024, a modest decline from 2022–2023, though the second-highest output in terms of volume till date. Leading producing countries of canola and rapeseed include Canada, China, India, Australia, and the European Union. Canada's share in exports, in value terms, in 2023 was ~42%, followed by Australia at ~31%. The leading soybean producing countries are United States & Brazil, supplying around 90% of global exports. Global canola & soybean prices have been witnessing a declining trend, following major production & supply of oilseed as well as ease in export bans & global tensions that led to supply issues particularly in FY22. The edible oil market is expected to grow annually by 7.66% (CAGR 2024-2028) in Pakistan according to the Statista market insights. In Pakistan's edible oil business, with intense competition where no company has a market share in double-digit, KGPL has managed to hold a market share of 4%.

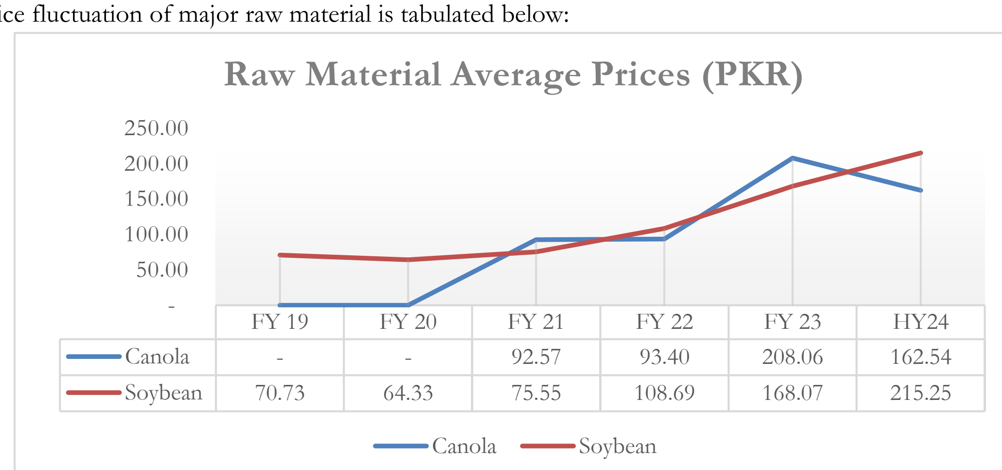
Global soybean oilseed export prices fell from ~570 USD/ton at Apr-FY23, to ~440 USD/ton by Apr-FY24, as per USDA's average prices from Brazil & USA, the two exporting countries from where KGPL have major imports. The global canola crude oil prices, which climbed as high as $2.27k in FY22, fell to $1.03k by Apr-FY23, and remained consistent around $1.06k by Apr-FY24. These prices are expected to reflect into higher margins for 4QFY24 and FY25. Palm oil prices, already being the cheapest in the global market, have decreased further by about 30% in FY23 vis-à-vis FY22. However, due to other factors including inflation and currency devaluation, local prices have not recorded a decline. Despite temporary relief in margins, the segment witnesses major price fluctuations internationally, as well as locally in the form of currency devaluation. Local prices majorly follow international trends and these fluctuations often lead to adverse impacts on margins in the form of inventory losses. Hence, KGPL has stalled the plan to venture in to the palm oil division for the time being.

Healthy topline growth and higher gross margins in FY23 mainly on account of appreciation in product prices, primarily an outcome of local currency devaluation. Sales declined in 1HFY24.

Net sales in FY23 witnessed a 43% increase to Rs. 10.4b (FY22: Rs. 7.3b) led by a 65% increase in average product prices. The higher international prices of raw material, along with the devaluation of the rupee against the dollar, triggered the local producers to increase product prices. The sales recorded a volumetric decline of 14%, a function of import ban by the government on the major raw material - soybeans. The sales of soybean oil and meal continued in FY23 and HY24 on the back of previously held stock, though its proportion in total sales declined considerably as shown in the table below:

Product Mix	FY21	FY22	FY23	HY24
Canola Oil	2%	10%	14%	54%
Soybean Oil	28%	38%	18%	14%
Palm Olein	0%	0%	0%	0%
Canola Meal	1%	4%	15%	26%
Soybean Meal	68%	49%	50%	7%
Soybean Hull	0%	0%	0%	0%
Oil Dirt	1%	0%	0%	0%
Exports - Soyabean Meal			3%	0%
	100%	**100%**	**100%**	**100%**

Price fluctuation of major raw material is tabulated below:



Client concentration is considered high as top ten clients accounting for around 76% (FY23: 46%; FY22: 52%) of the revenue base during 1HFY24. KGPL has been able to build strong relationships with its customers by delivering client requirements that ensures sustained business.

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

Gross margins of the company have been fluctuating over the years due international price sensitivity. Subsequent to a decrease in FY22 to 7.0% (FY21: 11.4%), gross margin recouped to 11.4% in FY23 with lower inventory losses, despite the devaluation of the rupee reflecting in increased costs of raw material.

Higher salary expense and elevated repairs & maintenance charge contributed to higher cost of sales during FY23. The company incurred significant other charges of Rs. 397m (FY22: Rs. 11m) mainly due to additional transportation costs offered to customers to enhance sales. These charges were mainly apportioned to cost of sales (FY23: Rs. 302m) while some were charged to operating expenses (FY23: Rs. 95m). The operating expenses also increased significantly mainly due to one-off marketing expense of Rs. 72.5m (FY22: nil). The higher donations also contributed to increase in overall expenditure of the company. The company reported higher profitability of Rs. 422.5m (FY22: Rs. 333.3m) despite higher incidence of taxation for FY23. The net margins stood lower at 4% (FY22: 4.6%; FY21: 6.2%) during FY23.

The company reported negative gross margins in 1HFY24. The company had to sell soybean and canola meal to the feed mills on losses due to ban by the government and significant inventory losses. The product-wise margins are tabulated below:

	FY23			HY24		
(per unit)	**Sales Price**	**Cost**	**Margin**	**Sales Price**	**Cost**	**Margin**
Canola Oil	382.3	418.7	-10%	300.1	160.0	47%
Soyabean Oil	366.4	322.9	12%	293.6	181.4	38%
Canola Meal	176.3	327.8	-86%	163.4	341.8	-109%
Soybean Meal	186.9	105.9	43%	227.9	522.0	-129%
Oil Dirt	17.0	16.0	6%	22.1	16.0	28%

In the absence of marketing expenses and other one-off other expenses, the company managed to control operating expense at Rs. 31.6m in HY24. Other income increased to Rs. 33m (FY23: Rs. 10.8m) in HY24 mainly due to dividend income received from investment in mutual funds and exchange gain. The company reported net loss of Rs. 156.5m in HY24. The management is projecting further loss in FY24. However, improvement in profitability is projected in FY25 with stabilization in exchange rate. The improvement in margins are important from the ratings perspective.

Adequate liquidity profile supported by short-term liquid investments on books.

Funds from Operations (FFO) were reported higher at Rs. 681.7m (FY22: Rs. 470.6m; FY21: Rs. 632.2m) in FY23 in line higher profitability. However, FFO turned negative in HY24. Meanwhile, liquidity profile is considered sufficient on account of considerable bank placements and short-term mutual fund investments. A dividend stream emanates from investment in mutual funds and equity investments. The cash conversion cycle also improved in the outgoing year. Lower inventory levels in comparison to preceding years is on account of import bans on soybean and the lag due to product mix shift towards canola. Aging of trade debts has deteriorated due to eased credit terms for distributors as well as the lag faced due to increasing the business of canola products. However, it is still considered manageable as more than 95% of the outstanding trade debts are within 90 days bracket at end-1HFY24.

	Balance Due	0 - 30 days	31 - 60 days	61 - 90 days	91 - 120 days	121 days & above
HY24	85.67m	26.36%	17.72%	52.19%	3.75%	-
FY23	685.81m	79.47%	20.53%	0.0%	0.01%	-

An increasing trend in the current ratio was reported at 1.66x (FY23: 1.35x; FY22: 1.26x) on a timeline basis.

Low leveraged capital structure; working capital needs are met through internal cash generation and interest-free related party loans.

The equity base enhanced on the back of profit retention and was reported at Rs. 2.4b (FY22: Rs. 2.0b; FY21: Rs. 1.7b) at end-FY23. With loss incurred in 1HFY24, some erosion in equity was witnessed by end-Dec'23. The company mobilizes interest-free short-term borrowing, repayable on demand, from a related party. With partial repayments, the short-term funding from related party decreased to Rs. 742.5m (FY23: Rs. 3.4b; FY22: Rs. 3.2b) by end-1HFY24. Debt leverage, including related party loan, was recorded at 0.8x (FY23: 1.6x) at end-1HFY24. Meanwhile, adjusted for liquid investments, gearing turned negative at end-1HFY24. The maintenance of virtually debt free capital structure and effective management of working capital amid challenging macroeconomic environment will be critical for the assigned ratings.

FINANCIAL SUMMARY *(amounts in PKR millions)*				
BALANCE SHEET	**FY21**	**FY22**	**FY23**	**HY24**
Fixed Assets	1,018.4	1,075.0	1,015.8	1,005.0
Stock-in-Trade	1,683.1	2,541.2	2,396.6	1,146.4
Trade Debts	1,292.7	519.8	688.7	548.3
Cash & Bank Balances	355.1	850.1	1,707.9	805.9
Other Assets	259.1	586.2	601.1	715.4
Total Assets	4,608.3	5,572.3	6,410.1	4,221.0
Trade and Other Payables	157.4	318.3	543.9	1,138.7
Other Liabilities	47.1	42.1	23.4	23.4
Long Term Debt	-	-	-	-
Short Term Debt (related party)	2,704.8	3,184.9	3,403.0	742.5
Total Debt	2,704.8	3,184.9	3,403.0	742.5
Total Equity	1,699.0	2,027.0	2,439.8	2,316.5
Total Liabilities	2,909.4	3,545.3	3,970.2	1,904.5
Paid Up Capital	1,000.0	1,000.0	1,000.0	1,000.0
INCOME STATEMENT	**FY21**	**FY22**	**FY23**	**HY24**
Net Sales	7,632.8	7,313.9	10,443.1	2,362.7
Gross Profit	870.8	510.5	1,185.5	(145.1)
Operating Expenses	211.6	122.3	397.5	31.6
Finance Costs	0.4	3.1	3.7	12.2
Profit Before Tax	663.9	487.8	794.7	(156.5)
Profit After Tax	472.4	333.3	422.5	(156.5)
RATIO ANALYSIS	**FY21**	**FY22**	**FY23**	**HY24**
Gross Margin (%)	11.4%	7.0%	11.4%	-6.1%
Net Margin (%)	6.2%	4.6%	4.0%	-6.6%
Net Working Capital	648	924	1391	1246
Trade debts/Sales	16.9%	7.1%	6.6%	11.6%
FFO	632	471	682	-94
FFO to Total Debt (x)	0.23	0.15	0.20	-
FFO to Long Term Debt (x)	NA	NA	NA	NA
Leverage (x)	1.71	1.75	1.63	0.82
Leverage - Net Debt (x)	1.50	1.33	0.93	0.47
Gearing (x)	1.59	1.57	1.39	0.32
Gearing - Net Debt (x)	1.38	1.15	0.69	-
Debt Servicing Coverage Ratio (x)	1799	151	183	-
Current Ratio (x)	1.23	1.26	1.35	1.66
Stock+Trade Debts/STD	1.10	0.96	0.91	2.28
Cash Conversion Cycle	128	152	116	176

**Annualized*

REGULATORY DISCLOSURES — Appendix II

Name of Rated Entity	Karachi Grains (Pvt.) Limited
Sector	Edible Oil
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				
11-Jun-2024	BBB+	A-2	Stable	Reaffirmed
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	April 16, 2024
	Mr. Shahzad Bagha	Senior Manager Finance	