The Pakistan Credit Rating Agency Limited

Rating Report

Shujabad Agro Industries (Pvt.) Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
09-Aug-2019	BBB+	A2	Stable	Maintain	-
08-Feb-2019	BBB+	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Pakistan is a leading consumer of edible oils and the industry is heavily reliant on imports. Additionally, low domestic oil seed production caused by a distortion in support price mechanism for wheat and sugar cane has attracted farmers away from oil seed, further increasing dependence on imports. Annual demand, which stands at ~4MMT, is primarily met through imports, wherein, ~80% (of total imports) is in the form of finished product. Remaining production is met through import oil seed for extraction by solvent extraction units. Pakistan’s edible oil refinery industry, currently produces ~1.6 MMT of oil and is on a stable growth path. However, owing to devaluation of Pakistani rupee, industry players have been impacted.

The ratings reflect Shujabad Agro Industries (Pvt.) Limited's developing brand equity for its premium (Eva) and middle tier (Maan) brands. The Company maintained a stable topline despite a significant demand growth the meal segments. However, the Company managed to improve its margins. Refined and branded edible oil segment of the industry remains competitive where volumes and margins are function of timeliness and cost of raw materials procurement and supply.

Procuring edible oilseed in bulk due to seasonal constraints, highlights the inherent price risk of raw material along with storage issues and high holding. To manage this, the Company has loaded more debt on its balance sheet. Thus, stressing the financial risk profile of the Company. The rising interest rates are expected to impact the profitability, going forward. Competing in the branded edible oil segment and being an exporter of meal, enables Shujabad Agro to fairly pass on the increased cost due to rupee devaluation.

The ratings are dependent on the management's ability to grow its business volumes, while sustaining the business margins and prudently managing the working capital. Sustaining the business and financial profile along with effective changes in governance framework would be beneficial for the ratings.

Disclosure

Name of Rated Entity	Shujabad Agro Industries (Pvt.) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	PACRA_Methodology_Corporate_FY19(Jun-19),PACRA_Crtieria_LT ST Relationship_FY19(Jun-19),PACRA_Criteria_Rating Modifiers_FY19(Jun-19)
Related Research	Sector Study | Edible Oil(Mar-19)
Rating Analysts	Silwat Malik | silwat.malik@pacra.com | +92-42-35869504

Profile

Legal Structure Shujabad Ago Industries (Pvt.) Limited is incorporated as a private limited company in Pakistan, since Feb-2000.

Background Sponsors had been supplying variants of semi-refined edible oils to local refiners since 1990. In 2000, Mian Ashfaq and his friend Mian Abdul Wahid cofounded Shujabad Agro Industries (Pvt.) Limited. Initially the Company was extracting and supplying edible oil to B2B consumers only. Later, it tapped into branded edible oil segment. The Company is competing in premium edible oil segment with 'Eva' and middle tier edible oil segment with 'Maan'.

Operations Shujabad Agro is primarily engaged in edible oilseed crushing/solvent extraction, refining, ghee manufacturing, and its packaging. The Company manufactures two different products (refined edible oil and meal) in four variants (cottonseed, sunflower, soybean and canola). The combined seed crushing capacity of the Company's three solvent extraction units is 225,000 MT per annum, with utilization upto 66%. The Company's edible oil refinery has an installed capacity of 69,000 MT per annum, with utilization upto 97%. Shujabad Agro's ghee manufacturing plant has an installed capacity of 10,800 MT per annum, utilized upto 13%. Pouch making and filling plants have an installed capacity of making 43,200 pouches per day and filling 138,000 pouches per day, respectively. Around 7,000 PET bottles of 3-5 litre edible oil are filled per day. The Company's registered office is located in P.E.C.H.S, Karachi. While, the manufacturing facility is situated at Port Qasim, Karachi.

Ownership

Ownership Structure Shujabad Agro is majorly (60%) owned by the family members of Mr. Shakil Ashfaq, of which Mrs. Ambreen Shakil holds 45% of the shares. The remaining 40% of the shareholding resides with Mr. Abdul Wahid.

Stability Major ownership resides with Mr. Shakil Ashfaq and family. The Company has agreed to execute a shareholding agreement for further clarification in the ownership.

Business Acumen Ashfaq family has been associated with the edible oil industry since 1990's. The sponsors through their vast experience have become reliable partner for the consumer, hotel and retail industry, by making the Company to consistently comply with the standards of high quality. The Company has successfully established its brand's position.

Financial Strength Shujabad Agro is a stable business entity. The Sponsors have substantial financial strength to support the Company in financial distress.

Governance

Board Structure Shujabad Agro 's Board comprises two Non-Executive Directors and one Executive Director. Lack of independent oversight indicates a room for improvement in the Company's governance structure.

Members' Profile The Board's Chairman, Mr. Shakil Ashfaq has been associated with the Company since inception. He is currently the President of All Pakistan Solvent Extractors' Association (APSEA). He has served as the President of Bin Qasim Association of Trade and Industry (BAQTI). He was a member of Executive Committee of Pakistan Vanaspati Manufacturers' Association (PVMA).

Board Effectiveness During 9MFY19, the Board met informally to discuss pertinent matters and make strategic decisions, with majority attendance. Minutes of these meetings are not formally documented.

Financial Transparency Shujabad Agro external auditors, M/s Haroon Zakaria & Co. Chartered Accountants, have expressed an unqualified opinion on the financial statements of the Company for the year ended June 30, 2018. The firm has been QCR rated by ICAP and are in auditors panel 'B' of SBP.

Management

Organizational Structure Shujabad Agro has structured and organized its organogram as per its operational needs. The Company operates through four divisions: Production, Finance, Marketing and Sales. All Divisional Heads report to the Company's CEO, who then makes pertinent decisions.

Management Team Shujabad Agro has experienced and professional management, with long association with the Company. The Company's CEO, Mr. Shakil Ashfaq laid the foundation of the Company. He is currently the President of All Pakistan Solvent Extractors' Association (APSEA).

Effectiveness An Executive Committees is formally in place and meets as per requirement to discuss pertinent matters of the Company. Minutes of these meetings are documented as per requirement.

MIS To observe and evaluate the business activity, a customized software is installed to generates production sheets. These sheets are reviewed by the respective departmental heads before presenting to the CEO. However, monthly reports are also generated as per requirement.

Control Environment To ensure operational efficiency, the Company has setup an internal audit function, which implements and monitors the policies and procedures of the Company. Head of Internal Audit reports to the Company's CEO.

Business Risk

Industry Dynamics Pakistan is a leading consumer of edible oils - a function of its population and eating habits. With ~ 4MMT annual demand, Pakistan is the 4th largest market for edible oil. This is met primarily through imports (~ 86% of total consumption), wherein ~ 80% (of total imports) is in the form of finished product and for the rest oilseed is imported to be crushed and refined locally. Pakistan's edible oil refinery industry, currently producing ~1.2 MMT of oil and ~3MMT of meal for manufacturing cattle/poultry feed, has seen steady demand. However, growth in the demand is at a sluggish pace.

Relative Position Shujabad Agro has secured prominent position in the branded edible oil market due to its sustained quality, culminating in an increased demand for their product. The Company holds a sizable share in the branded edible oil industry.

Revenues Shujabad Agro generates 40% revenue by manufacturing and selling refined and branded edible oil (29%) and banaspati ghee (11%) - Eva and Maan. Remaining 60% of the revenue is generated by selling meal in local (27%) and export (6%) markets, and crude oil in bulk (27%). Tilt in revenue is witnessed towards the southern region (49%); with top ten local customers generating 35% revenue for the Company. During 9MFY19, Shujabad's top line posted a minimal increase ~ 4% (FY18: 43%) and clocked in at PKR 10.3bln (FY18: PKR 13.2bln). This increase was backed by volumes. Major increase was witnessed in the sale of branded Soybean oil - Eva and Soybean meal in the local market. Export of meal posted a sluggish trend during the period under review.

Margins Gross margins of the Company improved despite a significant increase in the input cost after rupee devaluation. High input costs mainly relates to raw material (i.e. soybean oilseed) imported from Brazil and USA. Being in the branded edible oil segment, the Company increased its selling and marketing expenses. Visible increase in the Company's borrowing cost and dip in the exchange gain led to a decline in the Company's net margins (9MFY19: 1.9%, FY18: 2..5%). Going forward, margins may remain under pressure in the rising input costs. Thus, net margin reflects inherent business risk.

Sustainability Going forward, growth in demand is anticipated in edible oil industry. The management is eyeing on expanding its refinery operations upto 200 – 250 MT/day. The required CAPEX for this expansion would be around PKR 650mln. The rising interest rates are expected to impact the profitability, going forward. Competing in the branded edible oil segment and being an exporter of meal, enables Shujabad Agro to fairly pass on the increased cost due to rupee devaluation.

Financial Risk

Working Capital At Shujabad Agro working capital is dominated by high inventory days (9MFY19: 74days, FY18: 68 days). Operating with meal customers on credit with a period of 50 - 60 days, led to average debtor days of 54 days in 9MFY19. Most of the raw materials i.e. oilseed are purchased on Sight LC, payable within one to two weeks This led the Company's net cash cycle to 123 days in 9MFY19 (FY18: 110 days).

Coverages Interest cover (9MFY19: 1.9x, FY18: 2.4x) is a function of increase in the Company's gross interest due to increased short term borrowings. The Company's free cash flows also posted a dip (9MFY19: 485mln, FY18: PKR 661mln) deteriorated the core and total coverage ratios (Core and Total Coverage: 9MFY19: 1.9x, FY18: 2.5x). However, the coverage ratios remained above 1, indicating the Company's ability to timely pay off its liabilities.

Capitalization Shujabad Agro has a highly leveraged capital structure with debt to equity ratio of 71% in 9MFY19 (FY18: 68%). The Company's total debt increased to PKR 4bln in 9MFY19 (FY18: PKR 3.2bln), to procure/import raw materials (oilseed) in bulk after rupee depreciation.

The Pakistan Credit Rating Agency Limited

Financial Summary

PKR mln

Shujabad Agro Industries (Pvt.) Limited Edible Oil	Mar-19 9M	Jun-18 12M	Jun-17 12M	Jun-16 12M
A BALANCE SHEET				
1 Non-Current Assets	567	546	523	481
2 Investments	-	-	-	-
3 Related Party Exposure	-	-	-	-
4 Current Assets	5,654	4,800	4,439	3,069
a Inventories	*2,897*	*2,655*	*2,259*	*1,682*
b Trade Receivables	*2,294*	*1,778*	*1,778*	*1,035*
5 Total Assets	6,221	5,345	4,962	3,550
6 Current Liabilities	506	656	444	408
a Trade Payables	*134*	*247*	*287*	*329*
7 Borrowings	3,977	3,159	3,142	2,003
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	73	59	77	57
10 Net Assets	1,666	1,471	1,298	1,081
11 Shareholders' Equity	1,666	1,471	1,298	1,081
B INCOME STATEMENT				
1 Sales	10,286	13,205	9,239	7,740
a Cost of Good Sold	*(9,066)*	*(11,757)*	*(8,245)*	*(6,935)*
2 Gross Profit	1,220	1,449	994	805
a Operating Expenses	(625)	(754)	(491)	(450)
3 Operating Profit	595	694	503	355
a Non Operating Income or (Expense)	*20*	*47*	*(11)*	*(10)*
4 Profit or (Loss) before Interest and Tax	616	742	492	345
a Total Finance Cost	*(274)*	*(277)*	*(163)*	*(135)*
b Taxation	*(147)*	*(135)*	*(111)*	*(69)*
6 Net Income Or (Loss)	195	329	218	142
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*485*	*661*	*492*	*314*
b Net Cash from Operating Activities before Working Capital Changes	*260*	*386*	*356*	*157*
c Changes in Working Capital	*(858)*	*(303)*	*(1,366)*	*(96)*
1 Net Cash provided by Operating Activities	(598)	83	(1,010)	61
2 Net Cash (Used in) or Available From Investing Activities	(68)	(79)	(97)	(162)
3 Net Cash (Used in) or Available From Financing Activities	667	17	1,139	101
4 Net Cash generated or (Used) during the period	2	20	32	0
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	3.9%	42.9%	19.4%	6.2%
b Gross Profit Margin	11.9%	11.0%	10.8%	10.4%
c Net Profit Margin	1.9%	2.5%	2.4%	1.8%
d Cash Conversion Efficiency (EBITDA/Sales)	6.6%	6.1%	6.0%	5.7%
e Return on Equity (ROE)	16.6%	23.8%	18.4%	14.1%
2 Working Capital Management				
a Gross Working Capital (Average Days)	128	117	133	130
b Net Working Capital (Average Days)	123	110	121	119
c Current Ratio (Total Current Assets/Total Current Liabilities)	11.2	7.3	10.0	7.5
3 Coverages				
a EBITDA / Finance Cost	2.6	3.1	3.5	3.6
b FCFO / Finance Cost+CMLTB+Excess STB	1.9	2.4	2.9	2.5
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.0	0.0	0.1	0.0
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	70.5%	68.2%	70.8%	64.9%
b Interest or Markup Payable (Days)	96.1	57.6	88.0	45.2
c Average Borrowing Rate	9.6%	8.2%	6.1%	6.3%

Rating Scale | Corporate

2019

Credit Rating Scale & Definitions

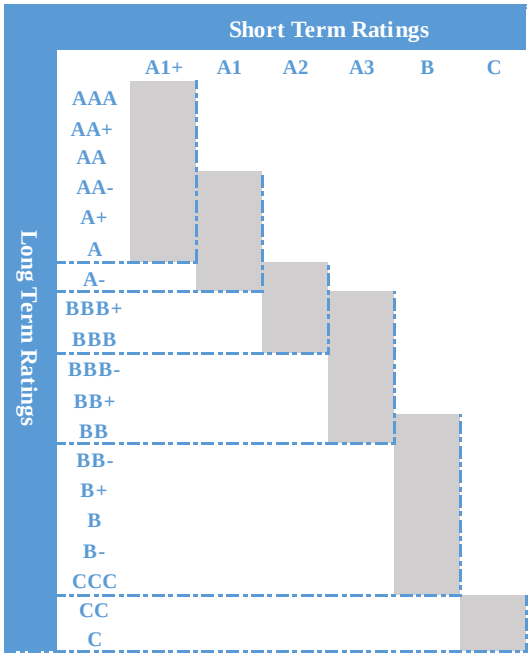
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings

AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short Term Ratings

A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
C	An inadequate capacity to ensure timely repayment.



Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Rating Team Statements
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest
(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)
Probability of Default
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)
Proprietary Information