The Pakistan Credit Rating Agency Limited

Rating Report

Punjab Oil Mills Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-Aug-2019	BBB+	A2	Stable	Maintain	-
01-Mar-2019	BBB+	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The edible oil industry of Pakistan, largely dependent on imports, has been impacted by the devaluation of Pakistani Rupee. This has inflated the cost of production and has eroded profitability for industry players. Moreover, challenging industry dynamics represented by stiff competition, low domestic supply for oil seed and increased taxes levied on imports by incumbent government are likely to keep the industry under pressure.

The ratings reflect Punjab Oil Mills Limited's established presence in the cooking oil industry through its flagship brands Canolive and Zaiqa. The Company's premium brand (Canolive) has helped in posting solid gross margins. However, recent macro-economic challenges have suppressed profitability, leading to a slight decline in gross margins. A cutback in selling and distribution costs resulted in maintained operating margin. Nonetheless, higher taxes and finance costs led to a decline in net profit margin. Going forward, profitability is expected to remain under stress amid challenges arising from stern market competition. Moreover, the Company is expected to engage in high marketing and promotional activities for the development of new products while maintaining existing share during 4QFY19. The ratings draw strength from the Company's strong financial profile, only consisting of minimal short-term borrowings. Punjab Oil Mills enjoys a minimally leveraged capital structure, strong coverages and efficient working capital management.

The ratings are dependent on the management’s ability to improve profitability and gaining market share, while maintaining prudent working capital management. Substantial increase in debt profile may impact ratings.

Disclosure	
Name of Rated Entity	Punjab Oil Mills 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 Punjab Oil Mills is a public limited company, listed on the Pakistan Stock Exchange.

Background The Company was incorporated on 5th February, 1981, and commenced operations three years later in 1984. Over the years, the Company's product portfolio, which initially comprised only banaspati ghee and cooking oil, has diversified with the addition of several new products.

Operations The Company is principally engaged in the manufacturing and sale of banaspati ghee, cooking oil, specialty fats, laundry soaps, mushrooms and coffee. The Company's facility is located in the Industrial Triangle, Islamabad, with a production capacity of 30,000 M.T per annum and employed ~269 individuals at end of FY18.

Ownership

Ownership Structure Three families, namely, Jahangir Family, Mailk Family and Batla Family have shareholding in the Company. Other shareholders include NIT, Mutual Funds, Financial Institutions and the general public.

Stability Ownership structure of the business is seen as stable, although no formal shareholding agreement exists among sponsoring families.

Business Acumen Sponsors of the Company have strong profiles relating to textile, finance and economics, in addition to the edible oil industry.

Financial Strength Punjab Oil Mills Limited is seen as the flagship entity for the Malik Family, whereas, Jahangir Family and Batla Family also have other business interests.

Governance

Board Structure Board of Directors comprises seven members including the Chairman, two non-executive directors, two executive directors, an independent director and a NIT nominee. The Board is dominated by the sponsoring families with two members from Jhangir Family, two from Ilahi Family, and one from Batla Family.

Members' Profile Board members poses strong profiles and specialize in textiles, finance and economics, in addition to edible oils. Additionally, Board Chairman, Mr. Tahir Jahangir, previously presided over Towel Manufacturers Association of Pakistan. Meanwhile, Mr. Izaz

Board Effectiveness Board of Directors maintain effective oversight through the formation of Audit Committee and Human Resources and Remuneration Committee. High frequency and participation among board members bodes well for the Company.

Financial Transparency M/s Maqbool Haroon Shahid Safdar & Co. Chartered Accountants, have expressed an unqualified opinion on the financial reports for FY18. The firm possess a satisfactory QCR rating but is not listed on the State Bank of Pakistan's panel of auditors suggesting room for improvement.

Management

Organizational Structure The Company's organizational structure is based on four main departments, namely, Operations & Technical, Planning and Development, Internal Audit and Finance. All aspects related to production, supply chain, information technology and administration come under Director Operations. Similarly, functions pertaining to sales and marketing, human resources and technical services come under the purview of Director Planning and Development. Subsequently, the highest level of authority lies with the Managing Director.

Management Team Management comprises of experienced individuals, representing a good skill mix. Mr. Izaz Ilahi Malik, the Managing Director, holds a BSc in engineering and previously acted as the president for Pakistan Vanaspati Manufacturers Association. Director Planning and Development, Mr. Usman Ilahi Malik, holds a degree in Finance and Marketing from the Wharton School of Business and is a qualified Chartered Financial Analyst.

Effectiveness Management lacks presence of formal committees. However, meetings among senior management are conducted daily to ensure operational efficiency.

MIS Implemented in 2013, the Company deploys Microsoft Dynamics as its Enterprise Resource and Planning system with eleven, fully integrated, modules.

Control Environment In order to ensure operational efficiency, the Company has setup an Internal Audit function. Regular reviews are undertaken by the department to monitor operational control.

Business Risk

Industry Dynamics Pakistan is a leading consumer of edible oils and the industry is heavily reliant on imports. The edible oil industry of Pakistan is largely dependent on global raw material prices, making it susceptible to external dynamics. Challenging economic conditions intensified by a weakening domestic currency, rising inflation, elevated interest rate and tighter import controls by incumbent government are likely to keep industry growth modest. Annual demand of edible oil, which stands at ~4MMT, is primarily met through imports, wherein, ~80% (of total imports) is in the form of finished product. Meanwhile, local refineries currently produce ~1.6MMT of oil.

Relative Position Pakistan's edible oil industry is formed of ~350 players, marketing over 500 brands. Owing to the high number of players involved, market share is fragmented. Punjab Oil Mills Limited has a market share of 1% in the cooking oil industry of Pakistan.

Revenues The Company generates its revenue from seven different segments – cooking oil, banaspati ghee, specialty fats, soap, gases, mushrooms and coffee. However, dominant portion of revenue (96% in FY18) emanates from cooking oil and banaspati ghee. Moreover, ~81% of revenue is attributable to the Company's top three products, (Canolive, Zaiqa Ghee and Zaiqa Oil), reflecting concentration in revenue stream. During 9MFY19, net revenue clocked in at PKR 3,990mln, depicting growth of ~12%, YoY. Growth in revenues can be seen as a combination of slightly higher volumes and an upward revision of prices. Going forward, the Company is expected to maintain modest growth in sales.

Margins Margins for the Company showed a declining trend over the years owing to elevated costs of raw materials, a significant portion of which are imported. The costs were further amplified due to depreciation of the Pakistan Rupee, which lost 14% of its value in 9MFY19. As a result, during 9MFY19, gross margin declined, standing at ~14% as compared to 16% in the corresponding period. The Company was able to maintain operating margin at ~6% during 9MFY19 (9MFY18: ~6%) owing to a cutback in selling and distribution costs. Additionally, the Company posted net profit worth ~PKR 126mln during 9MFY19 (9MFY18: ~PKR 125mln). Net margin was ~3% in 9MFY19 (9MFY18: ~4%) due to higher provisioning of taxes owing to increased duties on raw materials. Going forward, margins are expected to remain under pressure due to macro-economic factors, represented by Dollar appreciation and elevated interest rates. Moreover, combined with planned promotional campaigns in 4QFY19, margins are expected to remain subdued.

Sustainability The Company's future strategy involves focusing on development of new product lines while maintaining existing share in the cooking oil segment. Moreover, owing to high number of players and relatively lower margins, the Company is looking to gradually consolidate its position in the banaspati ghee segment.

Financial Risk

Working Capital The Company's working capital requirements emanate from inventories and trade receivables as sales are made on credit and sufficient stock of raw materials must be maintained. Prudent management of inventories and receivables is reflected in a downward trend and relative stability in net working capital days, standing at 70 days during 9MFY19 (FY18: 72 days; FY17: 74 days). Moreover, substantial room to borrow additional funds further supplement the Company's working capital position.

Coverages Owing to squeezed profitability, the Company witnessed a slight decline in FCFO which stood at ~PKR 169mln during 9MFY19 as compared to PKR 179mln in the corresponding period. However, absence of long-term debt and conservative short-term borrowings have helped the Company maintain very strong coverage ratios, despite elevated finance costs. During 9MFY19, interest coverage stood at 20.7x (FY18: 20.4x).

Capitalization The Company has low leveraging, represented by a debt-to-equity ratio of ~10% in 9MFY19. Debt taken up by the Company only comprises short-term borrowings, which are utilized for working capital requirements and retirement of letters of credit. During 9MFY19, total debt increased by ~ 65% standing at ~PKR 142mln, as compared to ~PKR 86mln in FY18, owing to higher utilization of short-term lines.

PKR mln

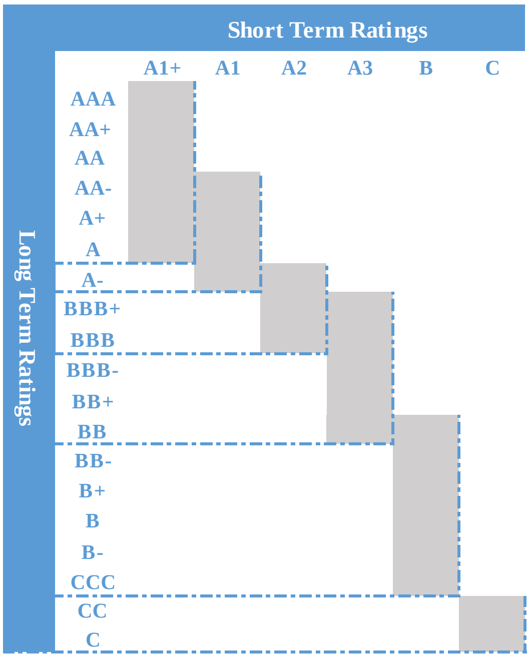
Punjab Oil Mills Limited Edible Oil	Mar-19 9M	Jun-18 12M	Jun-17 12M	Jun-16 12M
A BALANCE SHEET				
1 Non-Current Assets	685	671	675	434
2 Investments	-	-	-	-
3 Related Party Exposure	16	0	0	0
4 Current Assets	1,498	1,375	1,376	1,292
a Inventories	*408*	*332*	*301*	*275*
b Trade Receivables	*660*	*640*	*674*	*556*
5 Total Assets	2,199	2,046	2,051	1,726
6 Current Liabilities	685	707	728	741
a Trade Payables	*167*	*117*	*64*	*38*
7 Borrowings	142	86	94	23
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	93	93	87	70
10 Net Assets	1,279	1,160	1,142	891
11 Shareholders' Equity	1,279	1,160	1,142	891
B INCOME STATEMENT				
1 Sales	3,990	4,951	4,441	4,211
a Cost of Good Sold	*(3,421)*	*(4,211)*	*(3,746)*	*(3,410)*
2 Gross Profit	569	740	695	801
a Operating Expenses	(335)	(550)	(474)	(462)
3 Operating Profit	234	190	221	339
a Non Operating Income or (Expense)	*(9)*	*(7)*	*(10)*	*(15)*
4 Profit or (Loss) before Interest and Tax	225	182	211	324
a Total Finance Cost	*(11)*	*(8)*	*(3)*	*(3)*
b Taxation	*(88)*	*(105)*	*(64)*	*(116)*
6 Net Income Or (Loss)	126	69	144	206
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*169*	*120*	*154*	*277*
b Net Cash from Operating Activities before Working Capital Changes	*158*	*112*	*152*	*275*
c Changes in Working Capital	*(163)*	*(34)*	*(184)*	*(122)*
1 Net Cash provided by Operating Activities	(5)	78	(32)	153
2 Net Cash (Used in) or Available From Investing Activities	(44)	(37)	(87)	(66)
3 Net Cash (Used in) or Available From Financing Activities	49	(58)	2	(60)
4 Net Cash generated or (Used) during the period	(0)	(16)	(117)	28
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	7.4%	11.5%	5.5%	N/A
b Gross Profit Margin	14.3%	14.9%	15.7%	19.0%
c Net Profit Margin	3.2%	1.4%	3.2%	4.9%
d Cash Conversion Efficiency (EBITDA/Sales)	6.9%	4.9%	6.0%	9.6%
e Return on Equity (ROE)	13.8%	6.0%	14.1%	23.1%
2 Working Capital Management				
a Gross Working Capital (Average Days)	70	72	74	63
b Net Working Capital (Average Days)	60	65	70	60
c Current Ratio (Total Current Assets/Total Current Liabilities)	2.2	1.9	1.9	1.7
3 Coverages				
a EBITDA / Finance Cost	33.9	41.2	300.0	578.1
b FCFO / Finance Cost+CMLTB+Excess STB	20.7	20.4	173.1	398.5
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.0	0.0	0.0	0.0
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	10.0%	6.9%	7.6%	2.6%
b Interest or Markup Payable (Days)	23.8	20.2	74.8	30.0
c Average Borrowing Rate	9.5%	6.5%	1.5%	3.0%

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.

Regulatory and Supplementary Disclosure
(Credit Rating Companies Regulations,2016)

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