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
29-Feb-2020	BBB+	A2	Stable	Maintain	-
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 impacted the eroded profitability of industry players. Moreover, challenging industry dynamics represented by stiff competition, low domestic supply for oil seed and increased taxes levied on imports are likely to keep the industry under pressure.

The ratings reflect Punjab Oil Mills Limited's ('Punjab Oil' or 'the Company') established presence in the cooking oil industry through its flagship brands Canolive and Zaiqa. The Company's premium brand (Canolive) enjoys solid margins as the Company was able to pass on the higher cost to consumers. Curtailed selling and distribution costs resulted in maintained operating margin. Moreover, higher prices coupled with better volumes, specially in cooking oil segment, led to increase in profitability. Nonetheless, going forward, profitability may come under stress amid challenges arising from stern market competition, inflationary pressure and high interest rates. The Company is expected to engage in high marketing and promotional activities for the development of new products. The ratings draw strength from the Company's strong financial profile, comprising minimal short-term borrowings only. Punjab Oil Mills enjoys a low leveraged capital structure, strong coverages and efficient working capital management.

The ratings are dependent on the management's ability to improve profitability and gain market share, while maintaining prudent working capital management. Substantial increase in leveraging may impact ratings.

Disclosure	
Name of Rated Entity	Punjab Oil Mills Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-19),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria | Rating Modifier(Jun-19)
Related Research	Sector Study | Edible Oil(Feb-20)
Rating Analysts	Bakhtawar Abid | bakhtawar.abid@pacra.com | +92-42-35869504

Profile

Legal Structure Punjab Oil Mills Limited ('Punjab Oil' or 'the Company') is a public listed 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 combined production capacity of 33,000 M.T per annum. It employs 206 individuals at end FY19.

Ownership

Ownership Structure Three families, namely, Jahangir Family, Mailk Family and Batla Family combined have majority 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 The Company's Board of Directors consists of seven members including the Chairman, four non-executive directors and two executive directors. One non-executive director is a nominee of NIT. The Company has appointed a new non-executive director Ms. Munizae Jahangir in place of Mr. Syed Tahir Hussain who was an independent Board member. The Company will induct an independent director in the upcoming board meeting is comply with Code of Corporate Governance.

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.

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

Financial Transparency The Company has appointed M/s Maqbool Haroon Shahid Safdar & Co., Chartered Accountants, as external auditors. The firm is QCR rated but is not on SBP Panel of auditors. The firm had expressed an unqualified opinion on the financial statements of the Company ending in June 2019.

Management

Organizational Structure The Company's organizational structure is based on four main departments, namely, Operations & Technical, Planning & 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. 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 that 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 plants. 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 negatively impacted. Going forward, challenging industry dynamics, represented by reliance on imports, stiff competition and rising taxes are likely to keep the industry under pressure.

Relative Position Pakistan's edible oil industry has 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 branded cooking oil industry of Pakistan.

Revenues The Company generates its revenue from seven different segments – cooking oil, banaspati ghee, specialty fats, soap, mushrooms and coffee. However, dominant portion of revenue (98% in FY19) emanates from cooking oil and banaspati ghee. Moreover, 94% of revenue is attributable to the Company's top three products, (Canolive, Zaiqa Ghee and Zaiqa Oil), reflecting concentration in revenue stream. During FY19, net revenue clocked in at PKR 5,504mln (FY18: PKR 4,951mln), depicting growth of 11%, YoY. Growth in revenues was mainly due to upward revision of prices. However, the Company's revenue decreased during the first quarter of FY20, standing at PKR 969mln, depicting a decline of 12% over the corresponding period.

Margins Gross margin for the year remained stable (FY19: 15%, FY18: 15%). This was due to the Company's ability to pass on the increase in raw material costs. In 3MFY20, further improvement can been seen in the gross margins (3MFY20: 17%, 3MFY19: 13%). The Company reaps higher revenue from its products in the oil segment (66%) due to better brand positioning and relatively lower segmental competition. Whereas, operating margin significantly improved (3MFY20: 6%, FY19: 4.5%, FY18: 3.8%). This was due to major decrease in selling and distribution cost, as management took a conscious decision to reduce advertising budget to cater rising cost due to inflationary pressure.

Sustainability The Company's future strategy involves focusing on development of new product lines while maintaining existing share in the cooking oil segment. Moreover, 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 is maintained. Prudent management of debtors is reflected in stable average debtor days, which have ranged between 45-50 days over the past three years (FY17 – FY19). Moreover, substantial room to borrow additional funds further supplement the Company's working capital position.

Coverages The Company significantly improved its cashflows, as a result of better profitability. FCFO during FY19 stood at PKR 174mln and grew by 45% as compared to preceding year (FY18: PKR 120mln). However, short-term borrowings, and related finance costs, have reduced the Company's coverages. During FY19, interest coverage stood at 13x, coming down form 20x in the preceding year owing to higher interest costs. Coverage ratio was further impacted during 3MFY19, coming down to 12.8x, due to higher utilization of short-term borrowings and reduced cashflows.

Capitalization The Company has a low leveraged capital structure, represented by a debt-to-equity ratio of 9% in FY19. Debt taken up by the Company only comprises short-term borrowings, which are utilized for working capital requirements and retirement of letters of credit. In FY19 short term borrowing increased by 44% (FY19: PKR 124mln, FY18: PKR 86mln). Similarly, in 3MFY20, short term borrowings increased by 3% (3MFY20: PKR 117mln, 3MFY19: PKR 114mln).

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Punjab Oil Mills Limited Edible Oil	Sep-19 3M	Jun-19 12M	Jun-18 12M	Jun-17 12M
A BALANCE SHEET				
1 Non-Current Assets	718	717	671	675
2 Investments	-	-	-	-
3 Related Party Exposure	-	1	0	0
4 Current Assets	1,542	1,480	1,375	1,376
a Inventories	*355*	*329*	*332*	*301*
b Trade Receivables	*685*	*702*	*640*	*674*
5 Total Assets	2,260	2,199	2,046	2,051
6 Current Liabilities	772	732	707	728
a Trade Payables	*171*	*166*	*117*	*64*
7 Borrowings	117	124	86	94
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	103	100	93	87
10 Net Assets	1,267	1,242	1,160	1,142
11 Shareholders' Equity	1,267	1,242	1,160	1,142
B INCOME STATEMENT				
1 Sales	969	5,504	4,951	4,441
a Cost of Good Sold	*(809)*	*(4,697)*	*(4,211)*	*(3,746)*
2 Gross Profit	159	808	740	695
a Operating Expenses	(101)	(558)	(550)	(474)
3 Operating Profit	58	249	190	221
a Non Operating Income or (Expense)	*(1)*	*(5)*	*(7)*	*(10)*
4 Profit or (Loss) before Interest and Tax	57	244	182	211
a Total Finance Cost	*(5)*	*(16)*	*(8)*	*(3)*
b Taxation	*(27)*	*(121)*	*(105)*	*(64)*
6 Net Income Or (Loss)	26	107	69	144
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*44*	*174*	*120*	*154*
b Net Cash from Operating Activities before Working Capital Changes	*40*	*159*	*112*	*152*
c Changes in Working Capital	*(17)*	*(97)*	*(34)*	*(184)*
1 Net Cash provided by Operating Activities	23	61	78	(32)
2 Net Cash (Used in) or Available From Investing Activities	(11)	(89)	(37)	(87)
3 Net Cash (Used in) or Available From Financing Activities	(8)	14	(58)	2
4 Net Cash generated or (Used) during the period	4	(13)	(16)	(117)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	-29.6%	11.2%	11.5%	5.5%
b Gross Profit Margin	16.5%	14.7%	14.9%	15.7%
c Net Profit Margin	2.7%	1.9%	1.4%	3.2%
d Cash Conversion Efficiency (EBITDA/Sales)	7.8%	5.7%	4.9%	6.0%
e Return on Equity (ROE)	8.2%	8.9%	6.0%	14.1%
2 Working Capital Management				
a Gross Working Capital (Average Days)	98	66	72	82
b Net Working Capital (Average Days)	82	57	65	78
c Current Ratio (Total Current Assets/Total Current Liabilities)	2.0	2.0	1.9	1.9
3 Coverages				
a EBITDA / Finance Cost	18.4	23.5	41.2	300.0
b FCFO / Finance Cost+CMLTB+Excess STB	10.8	13.0	20.4	173.1
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	8.5%	9.1%	6.9%	7.6%
b Interest or Markup Payable (Days)	36.3	35.2	20.2	74.8
c Average Borrowing Rate	13.5%	12.7%	6.5%	1.5%

Rating Scale | Corporate

2019

Credit Rating Scale & Definitions

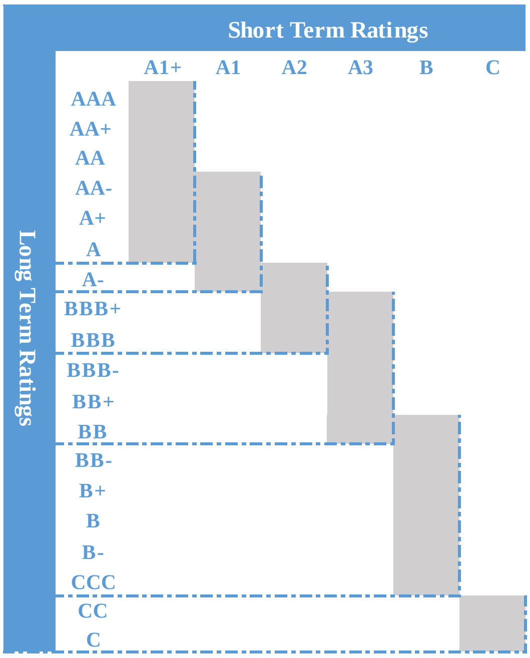
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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.

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