The Pakistan Credit Rating Agency Limited

Rating Report

STS Oil Mills (Pvt.) Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
03-Mar-2022	BB	A3	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Pakistan's edible oil industry is heavily reliant on imports since oilseeds account for ~80% of the cost of production. Edible oil is the country's 2nd largest import after petroleum. Pakistan's total oil and fats consumption is ~ 5 million metric tons per annum and its per capita consumption is ~22 kg. Consumption is met by 70% (~3.3 MMT) of edible oil import. The remaining 30% (~1.7 MMT) of edible oil is produced from oilseeds (local ~ 3.5MMT, imported ~ 3.1 MMT). Additionally, low domestic oilseed production in Pakistan caused by a distortion in support price mechanism and lower yields have pushed farmers away from oilseed, further increasing dependence on imports. On the supply side, the key raw materials – oilseed and RBD palm oil – are imported primarily from USA, Brazil, and Malaysia. Moreover, raw material prices have continued to inflate amid supply uncertainties and historically low global inventory levels, along with rupee devaluation impacting importers. Subsequently, prices of cooking oil and vegetable ghee have remained on the higher side. Going forward, sales are expected to remain stable. Margins and profitability are expected to improve for players and costs will be offset by the increased demand and in turn prices. The rating reflects STS Oil Mills (Pvt.) Limited's ('STS Oils' or 'the Company') developing position in edible oil segment. STS Oils is primarily engaged in the process of hydrogenation of crude palm oil; producing and selling vegetable ghee. Over the years, capacity utilization remains low, however, is expected to increase being a staple food item. Moreover, the Company has tapped in the export market. However, the share of exports remain small. With a relatively small market share, the Company has experienced dwindling top-line owing to reduced demand for banaspati ghee, in local and export market, post covid-19 outbreak. Margins also showcased a variation over the years. Inventory management system and related efficiencies would require the Company's attention to keep its working capital costs low. Being an importer of palm oil, the Company remains exposed to the inherent risk related to currency fluctuations and prices of raw material. Being an exporter, though in small quantum, the Company's debt book majorly comprises Export Refinancing Facility availed to fund its working capital needs. The debt cover remains strong. However, the Company's financial risk profile remains considerably high.

The ratings are dependent on the management's ability to prudently improve margins, profitability and financial profile of the Company. Meanwhile, strengthening of governance practices will have a positive impact on the ratings. Any deterioration in debt coverages leading to higher financial risk or substantial losses will have a negative impact on ratings.

Disclosure

Name of Rated Entity	STS Oil Mills (Pvt.) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating(Jun-21),Criteria | Correlation Between Long-term & Short-term Rating Scales(Jun-21),Criteria | Rating Modifiers(Jun-21)
Related Research	Sector Study | Edible Oil(Feb-21)
Rating Analysts	Ahmad Ziaf | ahmad.ziaf@pacra.com | +92-42-35869504

Profile

Legal Structure STS Oil Mills (Pvt.) Limited ('STS Oil' or 'the Company') was incorporated in Sept-15 as a private limited company.

Background In 1990, the Group started its first venture Shamshad Floor Mills (Pvt.) Limited in Peshawar. In 2003, the Group incorporated its first edible oil company Sohail Vegetable Ghee (Pvt.) Limited, Peshawar. STS Oil Mills (Pvt.) Limited was setup in 2015 in Hattar, while the company started its operations in Mar-17.

Operations The Company is primarily engaged in the process of hydrogenation of crude palm oil; producing and selling vegetable ghee and cooking oil. Capacity utilization is dependent on the local demand and availability of crude palm oil which is primarily imported from Malaysia and Indonesia.

Ownership

Ownership Structure The Company's ownership resides with the sponsors. Mr. Sohail Shamshad and his wife Ms. Afia Sohail holds an equal share of ~ (32.5%) in the Company. The remaining share (35%) resides with Mr. Sohail's son, Mr. Asfandyar Sohail.

Stability The ownership structure of the Company seems stable as the Company is completely owned by the sponsoring family. Next generation is also inducted in the business. However, Mr. Asfandyar is currently getting familiar with the operations.

Business Acumen Mr. Sohail has been associated with the edible oil industry from almost 30 years. He started his career working alongside his father's first edible oil venture, Sohail Vegetable Ghee in 2003 after setting up Shamshad Floor Mills (Pvt.) Limited. Mr. Sohail has industry specific knowledge and day-to-day interaction with the procurement side of the business.

Financial Strength The Group mainly comprises of one other entity in the edible oil sector. Apart from the Group's financial strength, the sponsors have adequate net worth to support the Company in times of duress.

Governance

Board Structure The Company's BoD constitutes one Executive Director and two Non-Executive Directors. All three directors are from the sponsoring family. Lack of independent oversight and diversity indicates a room for improvement in the Company's governance structure.

Members' Profile The BoD is a key source of oversight and guidance for the management of the Company. The Board's Chairman, Mr. Sohail Shamshad has been associated with the edible oil industry from almost 30 years. Ms. Afia Sohail serves as the non-Executive Director on the Board and has been associated with the Board from ~6 years. Mr. Asfandyar also serves as the non-Executive director and has been associated with the Board from ~6 years as well.

Board Effectiveness The Board lacks presence of sub-committees. However, the BoD meets informally to discuss pertinent matters.

Financial Transparency The external auditors of the Company, Iftikhar Ali & Co Chartered Accountants, have expressed an unqualified opinion on the financial statements of the Company for the year ended Jun-20. The Company has appointed Baker Tilly Mehmood Idrees Qamar Chartered Accountants for FY21. The firm is QCR rated by ICAP and is placed on SBP's 'Category A' panel of auditors.

Management

Organizational Structure The organizational structure has been optimized as per the operational needs. The Company operates through four functions: Production, Finance, HR and Sales. All functional managers' report to the Company's CEO. The CEO makes all pertinent decisions of the Group. As the Company's CEO is responsible for the whole unit, thus highlighting the key man risk of management.

Management Team The overall control of the Company vests with Board's Chairman, who is also the Chief Executive Officer. Hence, there is no segregation of responsibilities. Mr. Sheraz serves as CFO/Finance Manager for the Company and has been with the group from past ~20 years. Mr. Aslam Baloch heads the production as the Production Manager and has been with the group from ~12 years.

Effectiveness There are no management committees in place. Management meets on need basis to ensure efficiency of the Company's operations.

MIS There is no information management system in place and Microsoft Excel is used. Reports are prepared on need-basis for the management and Directors.

Control Environment The Company lacks formal internal audit department.

Business Risk

Industry Dynamics Pakistan's edible oil industry is heavily reliant on imports since oilseeds account for ~80% of the cost of production. Edible oil is the country's 2nd largest import after petroleum. Pakistan's total oil and fats consumption is ~ 5 million metric tons per annum and its per capita consumption is ~22 kg. Consumption is met by 70% (~3.3 MMT) of edible oil import. The remaining 30% (~1.7 MMT) of edible oil is produced from oilseeds (local ~ 3.5MMT, imported ~ 3.1 MMT). Since Dec-20, raw material prices have continued to inflate amid supply uncertainties and historically low global inventory levels, along with rupee devaluation impacting importers. Subsequently, prices of cooking oil and vegetable ghee have remained on the higher side.

Relative Position The Company being a small player in the edible oil industry of the country has a market share of less than 1%.

Revenues The Company mainly generates revenue by manufacturing and selling of vegetable ghee/cooking oil product under the brand name Shamshad Banaspati. The local market is segmented towards villages near Hattar so the vegetable ghee constitutes majority of the revenue mix. The Company's revenues increased to PKR 822mln (FY20: PKR 260mln) owing to continuation of local sales which were hampered in FY20 due to lower prices prevailing in the market.

Margins The Company is exposed to foreign currency risk as RBD Palm Oil is primarily imported from Malaysia and Indonesia. The import price has volatility depending on the demand and supply mechanics. Despite the increase in import price from $1050/MT (FY20) to $1375/MT (FY21), the margins have improved to 11.5% (FY21) from 9.1% (FY20) due to an offsetting increase in price of vegetable ghee in FY21. On net level the Company's bottom-line closed at PKR 84mln (FY20: 9mln, FY19: 71mln). Subsequently net margin stood at 10.2% (FY20: 3.5%, FY19: 8.6%) due to minimal finance cost and tax exempt status for FATA/BATA.

Sustainability The Company plans to increase its customer base to utilize capacity. There are no set wholesalers and sales are made to small-scale dealers so the customer base stability poses a significant risk. However, capacity expansion is not in pipeline in near future.

Financial Risk

Working Capital The Company's working capital management is supported through short-term running finance facility obtained from commercial bank. The Company's inventory days were kept at 73 days during FY21 which showcased variation and it was 180 days in FY20 and 64 days in FY19 indicating that the Company takes time to sell out its inventory. The Company's receivable days have been kept low as well by the Company indicating less reliance on credit sales. The Company's receivable days stood at 26 days in FY21 (FY20: 98 days, FY19: 31 days). On the payable days side, the Company has been able to meet its obligations timely and payable days stood at 1 day in FY21 (FY20: 9 days, FY19: 4 days). Subsequently, the Company's net working capital days stood at 98 days in FY21 (FY20: 270 days, FY19: 91 days).

Coverages Free cash flows stood at PKR 84mln in FY21 (FY20: PKR 20mln). The Company's finance cost stood at PKR 4mln in FY21 (FY20: PKR 5mln). Subsequently, due to lower finance cost and higher free cash flows, the Company's coverage ratios have improved in FY21. Interest cover stood at 24x in FY21 (FY20: 4x). Core and Total interest cover stood at 24x each in FY21 (FY20: 4x each). Moreover, debt payback period stands at minimum.

Capitalization The Company has moderately leveraged capital structure as at FY21 with leverage ratio at 39%. During FY20 and FY19, the Company's leveraging ratio stood at 45% and 44%, respectively. Moreover, short-term borrowings comprise 100% of the total debt. Total debt of the Company stood at PKR 119mln in FY20 (FY20: PKR 91mln, FY19: PKR 77mln).

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Financial Summary
PKR mln

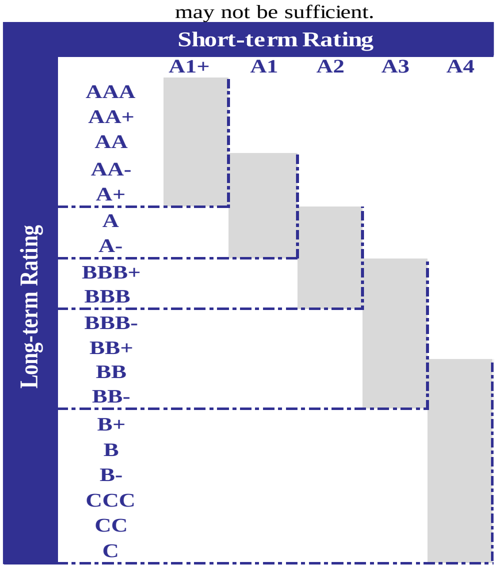
STS Oil Mills (Pvt.) Limited Edible Oil	Dec-21 6M	Jun-21 12M	Jun-20 12M	Jun-19 12M	Jun-18 12M
A BALANCE SHEET					
1 Non-Current Assets	61	63	67	73	76
2 Investments	-	-	-	-	-
3 Related Party Exposure	-	-	-	-	-
4 Current Assets	415	233	251	218	258
a Inventories	*295*	*136*	*202*	*54*	*238*
b Trade Receivables	*36*	*35*	*9*	*130*	*14*
5 Total Assets	476	296	318	291	333
6 Current Liabilities	159	38	75	70	261
a Trade Payables	*21*	*7*	*2*	*10*	*10*
7 Borrowings	75	75	91	77	0
8 Related Party Exposure	29	29	29	29	29
9 Non-Current Liabilities	-	-	-	-	-
10 Net Assets	213	153	123	114	43
11 Shareholders' Equity	213	153	123	114	43
B INCOME STATEMENT					
1 Sales	721	768	260	833	55
a Cost of Good Sold	*(655)*	*(722)*	*(236)*	*(743)*	*(59)*
2 Gross Profit	67	46	24	91	(5)
a Operating Expenses	(7)	(13)	(10)	(10)	(2)
3 Operating Profit	60	32	14	80	(7)
a Non Operating Income or (Expense)	-	-	-	-	-
4 Profit or (Loss) before Interest and Tax	60	32	14	80	(7)
a Total Finance Cost	*(1)*	*(3)*	*(5)*	*(9)*	*(0)*
b Taxation	-	-	-	-	-
6 Net Income Or (Loss)	59	30	9	71	(7)
C CASH FLOW STATEMENT					
a Free Cash Flows from Operations (FCFO)	*59*	*37*	*20*	*77*	*(6)*
b Net Cash from Operating Activities before Working Capital (	*59*	*35*	*15*	*77*	*(6)*
c Changes in Working Capital	-	*(19)*	*(33)*	*(148)*	*(5)*
1 Net Cash provided by Operating Activities	59	16	(18)	(71)	(11)
2 Net Cash (Used in) or Available From Investing Activities	-	-	-	(3)	(12)
3 Net Cash (Used in) or Available From Financing Activities	-	(16)	14	77	24
4 Net Cash generated or (Used) during the period	59	0	(4)	3	1
D RATIO ANALYSIS					
1 Performance					
a Sales Growth (for the period)	88.0%	195.8%	-68.9%	1428.4%	545142.5%
b Gross Profit Margin	9.2%	6.0%	9.1%	10.9%	-8.5%
c Net Profit Margin	8.2%	3.9%	3.5%	8.6%	-12.7%
d Cash Conversion Efficiency (FCFO adjusted for Working Ca	8.2%	2.3%	-5.1%	-8.5%	-20.1%
*e Return on Equity [Net Profit Margin * Asset Turnover * (To*	64.4%	21.6%	7.6%	90.6%	-16.1%
2 Working Capital Management					
a Gross Working Capital (Average Days)	63	92	278	95	1582
b Net Working Capital (Average Days)	60	89	270	91	1514
c Current Ratio (Current Assets / Current Liabilities)	2.6	6.1	3.4	3.1	1.0
3 Coverages					
a EBITDA / Finance Cost	54.5	15.7	4.1	9.0	5677.3
b FCFO / Finance Cost+CMLTB+Excess STB	54.5	15.7	4.1	9.0	-1.6
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Fin	0.0	0.0	0.0	0.0	-0.6
4 Capital Structure					
a Total Borrowings / (Total Borrowings+Shareholders' Equity	26.1%	32.9%	42.3%	40.3%	0.0%
b Interest or Markup Payable (Days)	95.8	86.3	14.9	105.8	-749166.2
c Entity Average Borrowing Rate	2.9%	2.9%	5.8%	22.0%	-100.0%

Credit Rating

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 Rating	
Scale	**Definition**
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 Rating	
Scale	**Definition**
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
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



The correlation shown is indicative and, in certain cases, may not hold.

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 some material identifiable event with indeterminable rating implications. 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 rating 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) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) 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.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

Entities

a) Broker Entity Rating
b) Corporate Rating
c) Financial Institution Rating
d) Holding Company Rating
e) Independent Power Producer Rating
f) Microfinance Institution Rating
g) Non-Banking Finance Companies (NBFCs) Rating

Instruments

a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk Rating

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