The Pakistan Credit Rating Agency Limited

Rating Report

Al-Khair Rice Mills (Pvt.) Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
18-Jan-2023	BBB	A2	Stable	Upgrade	-
18-Jan-2022	BBB-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Rice is among the five major crops of Pakistan and is the second main staple food, after wheat. The segment contributes about 3.5% in agriculture value addition and 0.7% to GDP. Local consumption includes ~95% of basmati rice and ~5% non-basmati. During FY22, rice crop area increased to ~3.4mln Hec (FY21: ~3.3mln Hec), reflecting an increase of ~3%. Rice production increased by ~6%, standing at ~8.9mln MT in FY22 (FY21: ~8.4mln MT). New higher-yielding hybrid rice varieties, improved agronomic practices, and increased planting area, as farmers shift out of cotton, are factors driving the increased production. Around ~4mln MT of rice is consumed locally, while, the remaining is exported. During FY22, Pakistan exports increased to ~USD 2.5bln (FY21: ~USD 2bln). Going forward, 2022 floods are anticipated to cause ~12% loss to the forecasted rice production for FY23. The rupee depreciation is anticipated to compensate for the reduction in export volumes. However, with an increase in the policy rate and lately, in ERF rate, the interest cost is likely to be impacted. Cashflows and coverages of the industry may become stretched. Due to the current economic scenario, the outlook of the industry seems to be developing, going forward.
The ratings reflect Al-Khair Rice Mills association with well-established players in the oil marketing and distribution segments, namely Gas & Oil Petroleum and Sitara Petroleum. The Group also has presence in oil logistics, organic farming, and real estate segments of the economy. Being an establishing player in terms of volume, the Company mainly generates revenue from local Basmati sales, along with sizeable contribution from exports. Moreover, the Sponsors are further pursuing export avenues in the Middle East and European regions. To cater this, they have enhanced the rice processing capacity to 30MT/hr. Governance and management are still evolving, as the Group plans to integrate Al-Khair's systems and reporting alongside the other Group entities. Streamlined operations at Group level are anticipated to be beneficial for the Company and assist in improving the relative position in the rice segment of the country. Business risk profile portrays an improving topline, with modest margins due to low quantum of exports. However, the management anticipates improved financial performance emitting from growth in revenues and profitability, in the subsequent years. Financial risk profile of the Company remains stable owing to moderately leveraged capital structure; consisting majorly of long-term debt, obtained for acquisition of machinery and building. Coverage ratios remain adequate.

The ratings are dependent on the management's ability to remain consistent in improving the revenue stream along with business margins. Prudent management of expansion and related debt in order to meet financial obligations will remain important. Any significant decline in coverages and/or erosion of margins may adversely impact the ratings.

Disclosure	
Name of Rated Entity	Al-Khair Rice Mills (Pvt.) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating(Jun-22),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jun-22),Methodology | Rating Modifiers(Jun-22)
Related Research	Sector Study | Rice(Oct-22)
Rating Analysts	Faiqa Qamar | faiqa.qamar@pacra.com | +92-42-35869504

Profile

Legal Structure Al-Khair Rice Mills (Pvt.) Limited ("Al-Khair" or "the Company") is a private limited company, incorporated in 2019.

Background Al-Khair is associated with well-established players in the oil marketing and distribution segments. The Group also has presence in oil logistics, organic farming, and real estate segments. The Group initially entered in the business arena by setting up an oil distribution. In 2009, Mr. Javed tapped in the rice trading business. In 2012, the oil distribution channel was formally incorporated as Sitara Petroleum. The Group then formed an OMC; Gas & Oil Petroleum. In 2012, rice trading channel was formally incorporated as Al-Khair Rice Mills. Initially, the Company was established as a partnership concern and was run and managed by the sponsoring family. In 2019, Al-Khair's legal status was changed to a private limited company. Today, the Company holds the membership of Rice Export Association of Pakistan (REAP).

Operations The Company's core operation includes processing and sale of Basmati rice. The processing plant is located at Okara and spans across 25 acres. Initially, the Unit had a processing capacity of 15MT/hr. Later, the installed capacity was enhanced to 25MT/hr. Lately, the Unit's capacity is enhanced to 30MT/hr. Al-Khair has latest imported machinery in place and the plant is a complete processing composite that is capable to perform all stages: Pre-cleaning, Drying, Color Sorting, De-stoning, Polishing, and Packing.

Ownership

Ownership Structure The shareholding of the Company resides between Mr. Javed Iqbal (~90%) and his son, Mr. Siddique Javed (~10%).

Stability Ownership stake with no expectation of change in the short horizon adhere to stability in the structure.

Business Acumen Before the formal establishment of Al-Khair, Mr. Javed Iqbal, was associated with the family Business of rice farming and trading.

Financial Strength Financial strength of the Group is considered strong, as they are involved in oil marketing, oil logistics, organic farming, real estate. Total consolidated revenue of the Group stood at PKR 213bln during FY22.

Governance

Board Structure The Company's BoD comprises two Executive Directors only. Mr. Javed Iqbal and Mr. Siddique Javed.

Members' Profile Mr. Javed Iqbal chairs the BoD and has an overall experience of over 26 years in rice farming and manufacturing.

Board Effectiveness The Directors are directly engaged in the management of the Company. Moreover, there are no sub-committees in place to assist the Board. Pertinent matters are discussed informally and documented as per requirement. Thus, there is room for improvement in the governance framework.

Financial Transparency Crowe Hussain Chaudhury & Co. Chartered Accountants have been appointed as the auditors for the Company. The firm satisfies QCR ratings, and are classified in 'A' category of SBP panel of auditors. In the year ended 31-Aug-22, the auditors issued an unqualified opinion.

Management

Organizational Structure The Company has an experienced team. All managerial staff at the head office and factory report directly to the Directors.

Management Team Mr. Javed, the CEO and Board's Chairman, has been in the Business for more than 25 years. Before the formal establishment of Al-Khair, Mr. Javed was associated with the family Business of rice farming and trading.

Effectiveness Keeping in view the size and operations of the Company, management lacks effectiveness as there are no management committees in place. Thus, indicating a room for improvement.

MIS The Company has deployed ERP software from Oracle for internal disseminations. It plans to shift to SAP in the near future.

Control Environment Internal audit function is placed at Group level. Going forward, the Group plans to enhance its control environment through induction of additional individuals for Al-Khair primarily.

Business Risk

Industry Dynamics Rice is among the five major crops of Pakistan and is the second main staple food, after wheat. The segment contributes about 3.5% in agriculture value addition and 0.7% to GDP. Local consumption includes ~95% of basmati rice and ~5% non-basmati. The major players in rice exports include Pakistan, India, Thailand, and Vietnam. Pakistan is in direct competition with India, while Thailand and Vietnamese rice are considered premium. During FY22, rice crop area increased to ~3.4mln Hec (FY21: ~3.3mln Hec), reflecting an increase of ~3%. Rice production increased by ~6%, standing at ~8.9mln MT in FY22 (FY21: ~8.4mln MT). New higher-yielding hybrid rice varieties, improved agronomic practices, and increased planting area, as farmers shift out of cotton, are factors driving the increased production. Around ~4mln MT of rice is consumed locally, while, the remaining is exported. During FY22, Pakistan exports increased to ~USD 2.5bln (FY21: ~USD 2bln). Going forward, 2022 floods are anticipated to cause ~12% loss to the forecasted rice production for FY23. However, the rupee depreciation is anticipated to compensate for the reduction in export volumes. However, with an increase in the policy rate and lately, in ERF rate, the interest cost is likely to be impacted. Cashflows and coverages of the overall industry may become stretched. In the current economic scenario, the overall outlook of the industry seems to be developing, going forward.

Relative Position Al-Khair's revenue is driven from sale of Basmati rice and holds a market share of less than ~1%.

Revenues The Company generates ~66% of its revenue from local sales and ~34% through export sales. Over the years, the Company's revenue stream has increased, mainly showing improvement in the export market. The Company makes local sales through a well-defined distribution channel across Punjab. During Aug-22, revenue surged and clocked at ~ PKR 3,544mln witnessing an increase of ~ 54% (Aug-21: ~ PKR 2,305mln), supported by an increase in price for Basmati rice and volumetric increase of ~27% (Aug-22: 28,229 MT, Aug-21: 22,073 MT).

Margins Al-Khair has rising profitability margins; Gross profit margin rose to ~11% during Aug-22 (Aug-21: 8%), as high input (paddy) costs were passed on to the consumers reflected in the increased price of Rice. Operating margins increased to ~10% in Aug-22, from ~7%, due to trickle-down effect. Net income recorded at ~PKR 95mln in Aug-22 (Aug-21: ~ PKR 60mln), despite higher finance costs incurred (Aug-22: ~PKR 211mln, Aug-21: ~PKR 72mln). Hence, the net profit margin remained stable (Aug-22: ~3%, Aug-21: ~3%).

Sustainability The Company has recently increased the production capacity of its existing operations to 30MT/hr. Materialization of projected revenue growth is essential considering the competitiveness of rice market. Going forward, the Company plans to expand its footings in the export market. Moreover, in increased ERF rates, working capital management remains pivotal.

Financial Risk

Working Capital Working capital needs are derived from receivables and inventory days while the cash conversion cycle is linked to rice seasonality. Net working capital days improved as of Aug-22 to 104 days (Aug-21: 136 days) due to higher receivable days (Aug-22: 49 days, Aug-21: 44 days) owing to late receipts. Higher stock offtake led to limited inventory days (Aug-22: 66 days, Aug-21: 109 days). Furthermore, the payable days remain manageable at ~11 days (Aug-21: ~17 days) as Company procures paddy on cash. The Company has a moderate borrowing cushion. Going forward, the Company plans to further expand its footing in the export market. thus, the working capital cycle is expected to inflate.

Coverages Interest cover is a function of free cash flows and finance costs. Free cash flows improved to ~PKR 432mln as of Aug-22 (Aug-21: ~PKR 169mln) supported by better profits. While finance costs increased and stood at ~PKR 221mln as of Aug-22 (Aug-21: ~PKR 72mln) due to increased interest rates. This led the interest cover to post a slight dip (Aug-22: 2.1x, Aug-21: 2.5x). Similarly, total and core coverage dipped as of Aug-22 to 1.0x (Aug-21: 2.2x). In the inclining interest rate scenario, coverages are expected to become stretched.

Capitalization The Company's business model is designed around securing short-term borrowings to fuel working capital needs. Total debt of the Company clocked in at ~PKR 1,121mln as of Aug-22 (Aug-21: ~PKR 835mln). Out of this, ~PKR 649mln (Aug-21: PKR 804mln) is short-term debt. While ~PKR 238mln (Aug-21: ~PKR 22mln) is long-term in nature and was obtained for CAPEX. The Company's equity base stood at ~PKR 962mln (Aug-21: ~PKR 867mln) as of Aug-22. This increased the Company's leverage ratio to ~54% as of Aug-22 (Aug-21: ~50%). Going forward, the leverage ratio is expected to inflate.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Al-Khair Rice Mills Pvt. Limited	Aug-22	May-22	Aug-21	Aug-20
Rice	12M	9M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	1,155	1,201	647	202
2 Investments	-	-	-	-
3 Related Party Exposure	-	-	-	-
4 Current Assets	1,104	1,914	1,211	782
a Inventories	*615*	*1,150*	*668*	*704*
b Trade Receivables	*443*	*754*	*508*	*52*
5 Total Assets	2,259	3,115	1,858	984
6 Current Liabilities	172	186	153	104
a Trade Payables	*104*	*139*	*116*	*94*
7 Borrowings	1,121	2,000	835	634
8 Related Party Exposure	-	-	-	41
9 Non-Current Liabilities	3	3	3	-
10 Net Assets	962	926	867	205
11 Shareholders' Equity	962	926	867	205
B INCOME STATEMENT				
1 Sales	3,544	2,625	2,305	416
a Cost of Good Sold	*(3,144)*	*(2,329)*	*(2,125)*	*(380)*
2 Gross Profit	400	297	181	36
a Operating Expenses	(27)	(20)	(20)	(4)
3 Operating Profit	374	277	160	32
a Non Operating Income or (Expense)	*(6)*	*(5)*	*(6)*	-
4 Profit or (Loss) before Interest and Tax	367	272	154	32
a Total Finance Cost	*(211)*	*(173)*	*(72)*	*(25)*
b Taxation	*(61)*	*(40)*	*(23)*	*(2)*
6 Net Income Or (Loss)	95	59	60	5
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*432*	*323*	*169*	*30*
b Net Cash from Operating Activities before Working Capital Changes	*432*	*150*	*97*	*6*
c Changes in Working Capital	*131*	*(697)*	*(386)*	*(655)*
1 Net Cash provided by Operating Activities	563	(547)	(289)	(649)
2 Net Cash (Used in) or Available From Investing Activities	(632)	(645)	(180)	(202)
3 Net Cash (Used in) or Available From Financing Activities	75	1,165	473	875
4 Net Cash generated or (Used) during the period	5	(27)	4	24
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	53.7%	51.8%	454.8%	-74.2%
b Gross Profit Margin	11.3%	11.3%	7.8%	8.6%
c Net Profit Margin	2.7%	2.2%	2.6%	1.2%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	15.9%	-14.2%	-9.4%	-150.3%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	10.4%	8.8%	11.2%	1.7%
2 Working Capital Management				
a Gross Working Capital (Average Days)	115	161	153	615
b Net Working Capital (Average Days)	104	147	136	570
c Current Ratio (Current Assets / Current Liabilities)	6.4	10.3	7.9	7.5
3 Coverages				
a EBITDA / Finance Cost	2.4	2.2	2.6	1.3
b FCFO / Finance Cost+CMLTB+Excess STB	1.0	0.9	2.2	0.9
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	2.1	2.2	0.3	13.3
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	53.8%	68.3%	49.1%	76.7%
b Interest or Markup Payable (Days)	55.5	0.0	91.8	92.8
c Entity Average Borrowing Rate	14.9%	14.9%	9.1%	4.2%

Credit Rating

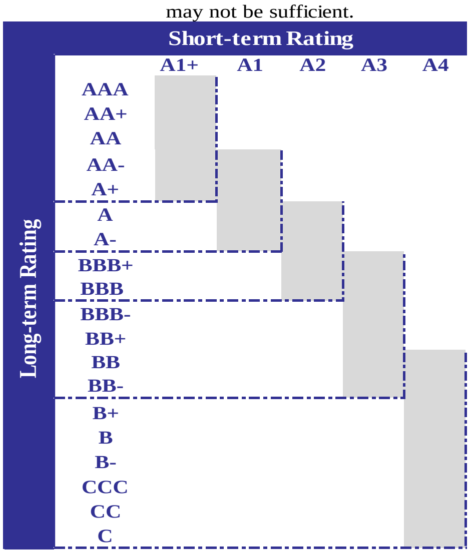
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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):

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

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)

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i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
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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

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(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 | Clause 11-(A)(p).
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(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
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(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)
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(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)
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