



The Pakistan Credit Rating Agency Limited

Rating Report

Sadiq Oil Extraction (Pvt.) Ltd

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
20-Mar-2019	BBB	A2	Stable	Maintain	-
18-Sep-2018	BBB	A2	Stable	Maintain	-
22-Mar-2018	BBB	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

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

The ratings reflects Sadiq Oil's association with an established poultry group, named Sadiq Group. The Group has significant presence along poultry supply chain and Sadiq Oil is supporting its vertical integration strategy. At present, Sadiq Oil is experiencing growth in sales, driven by volume. The margins are remain volatile, in line with international seed prices. The expected increase in extraction capacities will result in higher production volumes. However, being an importer of oilseeds (Soybean, Canola and Sunflower), there is an inherent risk of currency fluctuations and prices of raw material. Financial risk profile of the Company is characterized by high leveraging – both to fund increasing working capital needs and expansion activities and weak coverages signifying high risk. The working capital cycle remains stretched but comfort can be drawn by Groups presence and integration in the Poultry sector.

The ratings are dependent on the management's ability to prudently manage the liquidity and debt profile of the company, particularly working capital, while improving margins. Any prolonged deterioration in margins and/or coverages will impact the ratings. Envisaged improvement in business and financial profile along with effective changes in governance framework would be beneficial.

Disclosure

Name of Rated Entity	Sadiq Oil Extraction (Pvt.) Ltd
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Corporate Ratings(Jun-18),Methodology Criteria Rating Modifier(Jun-18),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
Related Research	Sector Study Edible Oil(Mar-19)
Rating Analysts	Adnan Dilawar adnan@pacra.com +92-42-35869504

Profile

Legal Structure Sadiq Oil Extraction (Pvt.) Ltd. was incorporated in 2013 as a Private Limited Company.

Background Sadiq Group came into existence as a small scale family business and became formally operational in Apr, 1975. Today, the Group is known as one of the leaders in poultry operating under the brand name of Sadiq.

Operations Sadiq Oil primarily extracts and produces two different products in three variants. These include: i) Semi-refined Soybean oil and Soya Meal, ii) Semi refined Canola Oil and Canola Meal and iii) Semi-refined Sunflower Oil and Sunflower Meal. The Company has two solvent extraction facilities having a crushing capacity of 600 tons per day. While the chemical refinery can semi-refine the edible oil up to 300 tons per day. Recently, the Company set upped a physical refinery with a refining capacity of 200 MT per day. This was completed with necessary approvals at the end of 1HFY19 and will sell branded oil, SB Gold.

Ownership

Ownership Structure Sadiq Oil's major shareholding vests with Dr. Muhammad Sadiq (70%), followed by his two sons, Mr. Asif Zubair (15%) and Mr. Salman Sadiq (15%).

Stability Ownership of the business is seen as stable as the major ownership vests with Dr. M. Sadiq. While ownership is not expected to change, the Company is in the process of re-structuring assets in it's Group among associated entities.

Business Acumen Sadiq Group has experienced multiple business cycles and have maintained their position since 1975. The Group's broiler farms are among the highest chick producers in Pakistan. Currently, there are six companies and one trust working under Sadiq Group. All are operating in various segments of poultry chain.

Financial Strength Sadiq Group has consolidated asset base of ~PKR 35bln supported by an equity of the ~PKR 10.5bln as at end Jun' 2018. Through its diverse set of businesses, it has generating a turnover of ~PKR 43bln and a pre-tax bottom line of ~PKR 948mln in FY18.

Governance

Board Structure Sadiq Oil's Board, comprising three members, is dominated by the sponsoring family. The Company's Board lack independence, indicating room for improvement in governance framework.

Members' Profile All BoD members have relevant expertise. Dr. Muhammad Sadiq, Board's Chairman, holds a DVM degree and has four decades of experience in poultry and integrated businesses. The Company's Directors, Mr. Asif Zubair and Mr. Salman Sadiq, are US graduates and have an experience of more than 10 years.

Board Effectiveness There are no sub-committees of the Board. During FY18, four Board meetings, with full/majority attendance, were held to discuss pertinent matters and make strategic decisions.

Financial Transparency Sadiq Oil's external auditors, Muniff Ziauddin and Co Chartered Accountants, have expressed an unqualified opinion on the financial reports for FY18. The firm has been QCR rated by ICAP and are in Category 'A' of SBP panel.

Management

Organizational Structure The Company's sales and production are monitored by GM Production, whereas, support departments work as shared services for the Group. These include IT and Human Resource. All departments eventually report to the CEO.

Management Team Sadiq Oil's management comprises experienced professionals. Dr. Muhammad Sadiq, Group's CEO, has headed several national and international forums and is also recognized as a leading authority on poultry sciences and avian welfare.

Effectiveness Management ensure effectiveness through Technical and Operational committee, established at the Group level. Each comprises 4 members.

MIS Two financial software, set upped by Sidat Hyder, are used at the Group level. However, for internal dissemination, information is documented when required.

Control Environment At Sadiq Oil, internal audit department has been established at group level to ensure controls. The Company's entire extraction and refining facilities is fully automated.

Business Risk

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

Relative Position As per the All Pakistan Solvent Extractions' Association, there are 95 solvent extraction units out of which only 30 are operational. Among these 30 companies, Sadiq Oil Extraction (Pvt.) Limited holds a share of 2%.

Revenues Sadiq Oil's sales mix comprises semi-refined oil, meal and soap with meal comprising major chunk of revenue (~60%). Majority sales are made through dealers whereas direct sales constitute a smaller portion of sales revenue. Revenue witnessed a massive increase clocking in at PKR 5.8bln during 1HFY19 (FY18:~PKR6.4bln). The increase emanates from enhanced utilization of capacity. Successful completion of it's physical refinery has marked the entrance into branded oil segment, which is expected to translate into it's topline.

Margins GP margins remained stable despite rising input cost and rupee devaluation in 1HFY19 (7%) but are on the lower side. Higher costs are majorly related to raw material procurement of soyabean seeds imported from Brazil and USA and locally procured maize. Selling and Marketing expenses have drastically increased on account of ramping up the Company's sales and marketing teams for the launch of it's branded oil. Owing to lower borrowing cost on account of timely borrowing and gain on sale of fixed assets net margins improved by 1% closing in at 2% at the end of 1HFY19. Going forward, the Company's GP Margins may remain under pressure amid the rising cost of raw materials if the client is unable to pass on the price in a timely manner. Thus net margins reflects inherent business risk.

Sustainability Going forward, the Company aims to fully utilize its production capacity to keep cost in control. The management is eyeing on an early commencement of Ghee plant and Soap plant's commercial operations.

Financial Risk

Working Capital Sadiq Oil's high inventory days refers to buffer stock of at least 2 to 3 months. Inventory days clocked in at 116 days at end 1HFY19 lower in comparison to end FY18 (122 days). Procuring raw materials on advance kept creditor days moderate (4 days). Net cash cycle clocked in ~118 days at end of 1HFY18 (FY18:126 days). Going forward, as the Company aims to establish a market for it's branded edible oil, receivables are expected to increase. Despite the surge in borrowing, the Company was able to improve it's debt mix with slightly higher long term loans. The Company has to manage its working capital vigilantly as it is mainly financed through debt.

Coverages Interest coverage improved to 1.6x during 1HFY19 (FY18:.9) despite increase in short-term borrowing. Short-term borrowing increased at the end of 1HFY19 to finance import of raw materials. Core Coverage was .7x during 1HFY19. Despite the improvement, coverages remain low on account of higher quantum of borrowing, signifying financial risk.

Capitalization The Company is highly leveraged owing it's expansion and need for credit facilities for working capital requirements. Leveraging closed in at ~82% at the end of 1HFY19. In view of increase in working capital requirements for new projects and high leveraging, the Sponsors plan on injecting equity of PKR 500mln before the end of FY19.



Sadiq Oil Extraction (Pvt.) Limited

Private Limited

BALANCE SHEET

	Dec-18 6M	Jun-18 12M	Jun-17 12M	Jun-16 12M
Non-Current Assets	1,211	999	715	478
Investments (Incl. Associates)	-	-	-	-
Equity	-	-	-	-
Fixed Income	-	-	-	-
Current Assets	4,832	3,969	1,425	1,034
Inventory	4,015	3,404	897	835
Trade Receivables	188	45	141	22
Others	629	520	387	177
Total Assets	6,043	4,968	2,140	1,511
Debt/Borrowings	4,270	2,940	972	615
Short-Term	4,138	2,860	966	604
Long-Term (Incl. Current Maturity of Long-Term Debt)	131	80	7	11
Other Short-Term Liabilities	840	1,360	545	413
Other Long-Term Liabilities	-	-	-	-
Shareholder's Equity	933	668	623	483
Total Liabilities & Equity	6,043	4,968	2,140	1,511

INCOME STATEMENT

Turnover	5,854	6,407	4,416	2,262
Gross Profit	412	443	298	89
Net Other Income	(7)	(7)	(10)	0
Financial Charges	(214)	(302)	(100)	(52)
Net Income	143	45	141	19

CASH FLOW STATEMENT

Free Cash Flow from Operations (FCFO)	351	260	93	55
Total Cashflows (TCF)	351	260	93	55
Net Cash changes in Working Capital	(1,341)	(1,626)	(78)	(535)
Net Cash from Operating Activities	(1,188)	(1,623)	(80)	(518)
Net Cash from Investing Activities	(279)	(335)	(303)	(47)
Net Cash from Financing Activities	1,461	1,964	357	602
Net Cash generated during the period	(7)	7	(26)	37

RATIO ANALYSIS

Performance

Turnover Growth (vs SPLY)	78%	45%	95%	N/A
Gross Margin	7%	7%	7%	4%
Net Margin	2%	1%	3%	1%
ROE	36%	7%	26%	4%

Coverages

Debt Service Coverage (X) (FCFO/Gross Interest+CMLTD+Uncovered STB)	0.7	0.1	0.1	0.1
Interest Coverage (X) (FCFO/Gross Interest)	1.6	0.9	0.9	1.1

Capital Structure (Total Debt/Total Debt+Equity)

Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	118	126	77	137
Capital Structure (Total Debt/Total Debt+Equity)	82%	81%	60%	56%

Sadiq Oil Extraction (Pvt.) Limited

Feb-19

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		Short Term Ratings	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
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.	A1	A strong capacity for timely repayment.
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.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial 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.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
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.	C	An inadequate capacity to ensure timely repayment.
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.		



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 surveil the opinion due to lack of requisite information.

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

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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

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- (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.
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- (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)

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- (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)

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- (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)

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