The Pakistan Credit Rating Agency Limited

Rating Report

Sadiq Oil Extraction (Pvt.) Ltd

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
10-Aug-2019	BBB	A2	Stable	Maintain	-
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 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, which 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 units. 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 impacted.

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 supports its vertical integration strategy. After tapping in the branded oil segment, the expected increase in utilization levels of extraction plants resulted in higher production volumes, inturn, sales. Margins improved, however, remain volatile due to international oilseed prices. The Company imports oilseeds (Soybean, Canola and Sunflower), thus is exposed to the inherent risk of currency fluctuations and prices of raw material. Financial risk profile of the Company is characterized by high leveraging – both to fund the increasing working capital needs and expansion activities. Coverages have improved, however, remain on the lower side. Working capital cycle remains stretched but drives comfort from Groups integrated presence in poultry sector.

The ratings are dependent on the management's ability to prudently mange 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	PACRA_Methodology_Corporate_FY19(Jun-19),PACRA_Crtieria_LT ST Relationship_FY19(Jun-19),PACRA_Criteria_Rating Modifiers_FY19(Jun-19)
Related Research	Sector Study | Edible Oil(Mar-19)
Rating Analysts	Silwat Malik | silwat.malik@pacra.com | +92-42-35869504

Profile

Legal Structure 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: Semi-refined Soybean oil and Soya Meal, Semi refined Canola Oil and Canola Meal and Semi-refined Sunflower Oil and Sunflower Meal. The Company has two solvent extraction facilities having a crushing capacity of 600 MT/ day. While, the chemical refinery can semi-refine the edible oil up to 300 MT/ day. The Company has also set up a physical refinery with a refining capacity of 200 MT/ day. With this, the Company has tapped into branded edible oil segment under the brand name of 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' 18. 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. Absence of independent directors on the Company’s Board indicates a room for improvement in the 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 been associated to the business world from over a decade.

Board Effectiveness There are no sub-committees of the Board. During 9MFY19, the Board met with full/majority attendance 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, IT and Human Resource, work as shared services for the Group. All departments eventually report to the Group's 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. Technical committee comprises 4 members and meet are per requirement. Operational committee comprises representative form each department and meet in weekly basis. Minutes of these meetings are documented informally.

MIS Two financial software, set up 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 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, which 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 units. 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 impacted.

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 generates revenue by selling edible oil in semi- refined and refined form, meal and soap sludge. Major chunk of revenue ~ 55% is generated by selling meal to poultry/cattle feed industry; followed by Soybean edible oil sale ~ 43%. The Company mostly sell its products through dealers. During 9MFY19, Sadiq Oils topline witnessed a massive increase of 62% and clocked in at PKR 7.8bln (FY18: PKR 6.4bln). This increase emanates from enhanced utilization of capacity. The Company entered into branded oil segment during FY19, translating into the Company's topline.

Margins GP margins improved despite an increase in the input cost after rupee devaluation in 9MFY19 ~ 7.8% (FY18: 6.9%). However, remained on the lower side. Higher input costs majorly relate to the import of soybean oilseed from Brazil and USA. The Company's selling and marketing expenses increased after the launch of SB Gold. Slight increase in borrowing cost on account of timely borrowing and gain on sale of fixed assets improved the net margins (9MFY19: 1.8%, FY18: 0.7%). Going forward, margins may remain under pressure in the rising input costs. Thus, net margin reflects inherent business risk.

Sustainability Going forward, the Company aims to fully utilize its production capacity along with keeping the costs 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 increased (9MFY19: 137 days, FY18: 122 days) on account of holding high finished goods inventory. Procuring raw materials on advance kept creditor days moderate, at the same time stable (2 days). Net cash cycle clocked in ~138 days at end of 9MFY18 (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 borrowings, 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 1.8x during 9MFY19 (FY18: 0.9x) despite increase in short-term borrowing. Short-term borrowing increased at the end of 9MFY19 to finance the import of raw materials in bulk. Core and Total Coverage was 1.6x, during 9MFY19 (FY18: 1.2x - Core and Total Interest Cover). Despite showing an improvement, coverages remain low on account of higher quantum of borrowings, signalling 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 ~ 81% at the end of 9MFY19. In view of increase in working capital requirements for new projects and high leveraging, the Sponsors injected equity of PKR 150mln during 9MFY19.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Sadiq Oil Extraction (Pvt.) Limited Edible Oil	Mar-19 9M	Jun-18 12M	Jun-17 12M	Jun-16 12M
A BALANCE SHEET				
1 Non-Current Assets	1,222	999	715	478
2 Investments	-	-	-	-
3 Related Party Exposure	-	-	-	-
4 Current Assets	5,396	3,969	1,414	1,034
a Inventories	*4,407*	*3,404*	*897*	*835*
b Trade Receivables	*108*	*45*	*141*	*22*
5 Total Assets	6,618	4,968	2,130	1,511
6 Current Liabilities	445	527	304	367
a Trade Payables	*79*	*40*	*20*	*8*
7 Borrowings	5,007	2,940	972	615
8 Related Party Exposure	-	834	240	44
9 Non-Current Liabilities	-	-	-	2
10 Net Assets	1,166	668	613	483
11 Shareholders' Equity	1,166	668	623	483
B INCOME STATEMENT				
1 Sales	7,800	6,407	4,416	2,262
a Cost of Good Sold	*(7,191)*	*(5,964)*	*(4,117)*	*(2,173)*
2 Gross Profit	609	443	298	89
a Operating Expenses	*(36)*	*(31)*	*(22)*	*(17)*
3 Operating Profit	574	412	276	72
a Non Operating Income or (Expense)	*(3)*	*(7)*	*(10)*	*0*
4 Profit or (Loss) before Interest and Tax	570	405	267	72
a Total Finance Cost	*(369)*	*(302)*	*(100)*	*(52)*
b Taxation	*(61)*	*(58)*	*(25)*	*-*
6 Net Income Or (Loss)	141	45	141	19
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*624*	*263*	*93*	*55*
b Net Cash from Operating Activities before Working Capital Changes	*327*	*7*	*(1)*	*18*
c Changes in Working Capital	*(2,461)*	*(1,626)*	*(78)*	*(535)*
1 Net Cash provided by Operating Activities	(2,133)	(1,620)	(80)	(518)
2 Net Cash (Used in) or Available From Investing Activities	(109)	(335)	(303)	(47)
3 Net Cash (Used in) or Available From Financing Activities	2,256	1,964	357	602
4 Net Cash generated or (Used) during the period	14	10	(26)	37
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	62.3%	45.1%	95.2%	--
b Gross Profit Margin	7.8%	6.9%	6.8%	3.9%
c Net Profit Margin	1.8%	0.7%	3.2%	0.9%
d Cash Conversion Efficiency (EBITDA/Sales)	8.3%	7.3%	7.8%	6.2%
e Return on Equity (ROE)	20.4%	7.0%	25.5%	4.1%
2 Working Capital Management				
a Gross Working Capital (Average Days)	140	128	78	124
b Net Working Capital (Average Days)	138	126	77	123
c Current Ratio (Total Current Assets/Total Current Liabilities)	12.1	7.5	4.7	2.8
3 Coverages				
a EBITDA / Finance Cost	1.8	1.6	3.4	2.7
b FCFO / Finance Cost+CMLTB+Excess STB	1.6	0.8	0.9	1.0
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.4	-25.1	-37.1	16.2
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	81.1%	85.0%	66.1%	57.8%
b Interest or Markup Payable (Days)	107.0	81.4	76.3	105.2
c Average Borrowing Rate	10.8%	12.0%	10.7%	15.0%

Credit Rating Scale & Definitions

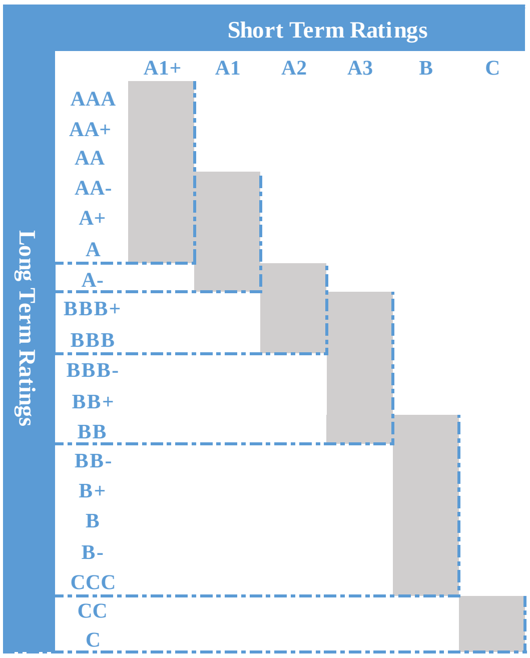
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings

AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short Term Ratings

A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
C	An inadequate capacity to ensure timely repayment.



Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

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

Regulatory and Supplementary Disclosure

(Credit Rating Companies Regulations,2016)

Rating Team Statements

(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**

i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

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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.
(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)

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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)
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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)

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