The Pakistan Credit Rating Agency Limited

Rating Report

Hi-Tech Edible Oils (Pvt.) Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
27-Mar-2019	BBB	A2	Negative	Maintain	-
25-Sep-2018	BBB	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The edible oil industry of Pakistan, largely dependent on imports, has been impacted by the devaluation of Pakistani Rupee. This has increased the cost of production and impacted margins for industry players. Moreover, challenging industry dynamics represented by stiff competition, low domestic supply for oil seed and rising interest rates are likely to keep the industry under pressure. The ratings reflect the Company's association with Hi-Tech Group, one of the major players in Pakistan's poultry and allied industry. An expanding domestic market in conjunction with enhancement in production capacity has led to increased revenues over the past few years. However, high dependence on imported raw materials makes the Company susceptible to external dynamics. Recent devaluation of Pakistani Rupee has had a lagged impact on the Company, impacting margins and eroding profitability. Resultantly, the Company's financial profile has deteriorated, represented by adequate working capital management, weak coverages and a highly leveraged capital structure.

The ratings are dependent on the Company's relative positioning and its ability to prudently manage liquidity and debt structure. Improvement in margins and ensuing coverages while, ensuring working capital discipline, is critical for future rating movement. Sustained losses and weak coverages will adversely impact the ratings.

Disclosure

Name of Rated Entity	Hi-Tech Edible Oils (Pvt.) Limited
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 Hi-Tech Edible Oils (Private) Limited is a private limited company.

Background The Company was incorporated on 8th August, 2002 and commenced operations in 2006. It is part of Hi-Tech Group's integrated value chain throughout the edible oil and poultry sectors.

Operations The Company is primarily engaged in the process of seed filtering, seed crushing, oil extraction and refining by chemical processes. Major portion of raw materials (90-95%), which includes premium quality soybean seeds, are mainly imported from Brazil and USA. Currently, the Company has three solvent extraction units with a combined capacity of 750 TPD. While the facility can extract the edible oil up to 650 TPD, the oil refinery can only process 150 TPD.

Ownership

Ownership Structure Ownership of the Company is shared equally between four founding members of the Company represented by Dr. Muhammad Arshad, Dr. Anwar Mahmood Randhawa, Dr. Muhammad Asim and Dr. Hafiz Abdul Qayyum. Sponsors of the business are close acquaintances with no biological relationship.

Stability Ownership structure of the business is seen as stable as no changes in ownership are expected. The second generation is gradually being inducted in the business.

Business Acumen The Company is a venture of Hi-Tech Group which has an established presence in Pakistan's poultry and allied industry. The Group's flagship entity, Hi-Tech Feeds, has grown to become one of the Country's leading feed mills catering to its clients in the poultry industry.

Financial Strength The Group has a strong presence in Pakistan's poultry industry and operates a total of four entities in the segment. Moreover, the Group has business interests in edible oil and rice segments. Sponsors willingness to support the business and a considerable equity base of the Group bodes well for the Company.

Governance

Board Structure Board of Directors comprises four members including the Chairman, an executive member and two non-executive members.

Members' Profile Board members are qualified individuals possessing significant industry knowledge relating to poultry and allied industries. Dr. Anwar Mehmood Randhawa is the Chairman of all group companies. He is a Doctor of veterinary medicine by profession and holds 44 years of experience.

Board Effectiveness During the year, no formal meetings were conducted. However, board members held various informal meetings, though, meeting minutes are not formally maintained. The Board lacks independent oversight.

Financial Transparency Hameed Zahid & Co. Chartered Accountants, who are not rated by the SBP but hold a satisfactory QCR rating are the external auditors of the Company. They have expressed an unqualified opinion on the financial statements of the Company.

Management

Organizational Structure The Company has a straight forward organizational structure split between three individuals. All functions related to production are consolidated under the General Manager for production. Similarly, functions of administration, accounting and marketing are headed by the Chief Financial Officer. Lastly, the audit function is led by a separate designation. Subsequently, highest level of authority lies with the Chief Executive Officer.

Management Team Dr. Muhammad Arshad, the Chief Executive Officer, is a Doctor of Veterinary Medicine. He completed his education from the University of Agriculture, Faisalabad in 1976. Dr. Arshad actively participates in international and local seminars relating to poultry, feed milling and pharmaceutical industries. Additionally, he is supported by a professional management staff.

Effectiveness The Company lacks presence of formal management committees. However, issues are discussed among management with minutes being captured informally.

MIS The Company relies on customized software for the following modules; i) Revenue Cycle ii) Payroll Cycle iii) Expenditure Cycle iv) Treasury Cycle and v) Conversion Cycle. Moreover, Microsoft Excel is used for the compilation of a few reports which are reviewed by the Board frequently.

Control Environment To observe and evaluate business activity, various production data is generated which highlights and enables management to monitor performance at different steps of the production process.

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 The Company holds an adequate position in the semi-refined oil market, though, further brand development is needed. It is yet to penetrate the branded oil segment but the management is working in this dimension.

Revenues Major portion of revenue emanates from the sale of soybean meal (54%) and semi-refined oil (45%). Additionally, soapstock, a by-product of the refining process, is sold to soap manufactures but comprises a very small portion (1%) of overall sales. During FY18, net revenue clocked in at ~PKR 11,795mln, an increase of ~59% over the preceding year. Substantial revenue growth can be traced to higher proceeds from semi-refined oil sales, which almost doubled during the year and stood at ~PKR 5,293mln (FY17: ~PKR 2,666mln). Similarly, revenue from soybean meal grew by ~36% and stood at ~PKR 6,383mln. Higher revenues can be seen as an effect of increased production on the back of capacity enhancement (145,000 MT to 250,500 MT). The Company posted revenues worth ~PKR 7,216mln in 1HFY19.

Margins After a dip in profitability during FY17 owing to an increase in global soybean prices, the Company enjoyed relatively better margins during FY18, though they remained modest. Gross margin stood at ~6% (FY17: ~4%), with operating margins standing at ~5% (FY17: ~3%). Moreover, depreciation of the Pakistani Rupee, which lost ~10% of its value during the second half of FY18, did not fully impact the Company as import of raw material is made well in advance. However, margins deteriorated during 1HFY19 as lagged impact of rupee devaluation was realized in terms of high raw material costs. During 1HFY19, gross margin receded to ~3%. Similarly, operating margin declined to ~2% (1HFY18: ~4%). Unfavorable industry dynamics and burden of high finance cost resulted in a loss of ~PKR 159mln during 1HFY19. Going forward, business performance will remain dependent on prices of soybean and how effectively the Company can pass on increase in costs.

Sustainability Going forward the Company plans on enhancing its product portfolio by venturing into the branded oils and ghee segment. This will require concentrated efforts and significant resource for brand building.

Financial Risk

Working Capital The Company's working capital requirements are a function of its inventories and trade receivables. Working capital requirements have been increasing over the years in-line with expanding operations and are funded predominantly through short-term borrowings. During 1HFY19, net working capital remained on the higher side mainly owing to high balance of trade receivables. Although, a substantial portion of receivables emanate from associated companies, it has caused receivable days to be inflated. Additionally, short-term borrowings have remained elevated. However, room to borrow still exists to an extent.

Coverages Coverages continue to remain under pressure owing to high finance costs and poor profitability. During 1HFY19, interest coverage fell to 0.5x (FY18: 1.7x), reflecting the Company's weak ability to meet financial obligations.

Capitalization The Company has a highly leveraged capital structure characterized by a debt-to-equity ratio of 88% during 1HFY19, signifying risk. Equity injection worth ¬PKR 432mln during FY18 has helped contain leveraging from escalating further. During 1HFY19, total borrowings decreased slightly and stood at ¬PKR 7,465mln (FY18: ¬PKR 7,489mln). Debt mix is inclined towards short-term borrowings, representing ¬92% of total debt. Moreover, long-term debt includes interest free loan obtained from an associated company.

Hi-Tech Edible Oils (Private) Limited

Private Limited

BALANCE SHEET	Dec-18	Jun-18	Jun-17	Jun-16
	6M	12M	12M	12M
a Non-Current Assets	**471**	**477**	**423**	**263**
b Investments (Incl. Associates)	**-**	**-**	**36**	**36**
Equity Instruments	-	-	36	36
Debt Instruments	-	-	-	-
c Current Assets	**8,466**	**8,587**	**6,167**	**3,994**
Inventory	4,578	5,245	4,307	2,380
Trade Receivables	3,044	1,341	934	1,051
Others	844	2,001	926	563
d Total Assets	**8,937**	**9,064**	**6,626**	**4,293**
e Debt/Borrowings	**6,954**	**6,899**	**5,242**	**3,195**
Short-Term	6,954	6,899	5,242	3,195
Long-Term (Incl. Current Maturity of Long-Term Debt)	-	-	-	-
Other Short-Term Liabilities	353	365	284	267
Other Long-Term Liabilities	20	30	15	8
f Shareholder's Equity	**1,611**	**1,770**	**1,086**	**823**
g Total Liabilities & Equity	**8,937**	**9,064**	**6,626**	**4,293**
INCOME STATEMENT				
a Turnover	**7,216**	**11,795**	**7,427**	**4,009**
b Gross Profit	211	656	319	219
c Net Other Income	-	(25)	(8)	(46)
d Financial Charges	(228)	(280)	(153)	(98)
e Net Income	**(159)**	**96**	**23**	**13**
CASH FLOW STATEMENT				
a Free Cash Flow from Operations (FCFO)	113	479	78	100
b Total Cashflows (TCF)	113	479	78	100
c Net Cash changes in Working Capital	(2,728)	(899)	346	(19)
d Net Cash from Operating Activities	(2,792)	(659)	263	6
e Net Cash from InvestingActivities	(6)	(76)	(201)	(27)
f Net Cash from Financing Activities	1,747	1,785	-	-
g Net Cash generated during the period	(1,050)	1,050	62	(22)
RATIO ANALYSIS				
a Performance				
Turnover Growth	22%	59%	85%	22%
Gross Margin	3%	6%	4%	5%
Net Margin	-2%	1%	0%	0%
ROE	-29%	10%	4%	2%
b Coverages				
Debt Service Coverage (X) (FCFO/Gross Interest+CMLTD+Uncovered STB)	0.5	1.7	0.5	1.0
Interest Coverage (X) (FCFO/Gross Interest)	0.5	1.7	0.5	1.0
Debt Payback (Years) (Total Debt (excluding Covered Short Term Borrowings) / FCFO)	-2.6	2.9	-5.9	72.0
c Capital Structure (Total Debt/Total Debt+Equity)				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	178	181	211	323
d Capital Structure (Total Debt/Total Debt+Equity)	88%	86%	90%	84%

Hi-Tech Edible Oils (Private) Limited

Mar-19

Rating Scale

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.

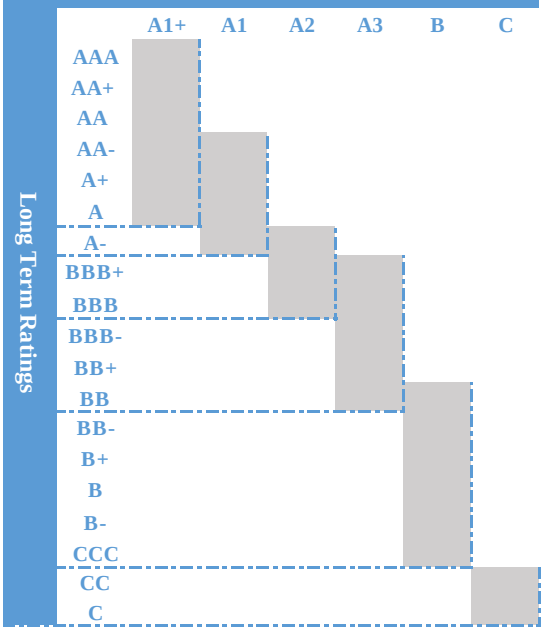
Long Term Ratings

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.

Short Term Ratings



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.

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