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
10-Feb-2020	BBB	A2	Stable	Maintain	-
29-Aug-2019	BBB	A2	Negative	Maintain	-
27-Mar-2019	BBB	A2	Negative	Maintain	-
25-Sep-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. 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 over ~4MMT, is tilted towards vegetable ghee (~80%). Production is met through a combination of imported oils and imported oil seed for extraction by solvent extraction units. Pakistan’s edible oil industry produced ~1.7 MMT of ghee and edible oil in FY19 following a stable growth pattern of ~3%. High dependence on imports and devaluation of Pakistani rupee and recent imposition of sales tax have impacted industry players. However, majority of the cost increase has been passed on to consumers.

The ratings reflect the Company’s association with Hi-Tech Group, one of the major integrated players in Pakistan’s poultry and allied industry. Expansion in domestic market, inter alia, enhanced production capacity and stable utilization levels led the topline to grow. However, high dependence on imported raw materials and rupee depreciation made the Company susceptible to price fluctuations. Timely passing on the increased cost led to better margins. However, high finance cost eroded the Company's profitability. The Company has a highly leveraged structure, though leveraging decreased slightly on YOY basis, with stressed coverages. Moreover, high inventory levels and its associated financing requirements further stretched the Company’s financial profile.

The ratings are dependent on the Company's ability to prudently manage liquidity and debt structure. Improvement in margins and ensuing coverages while, ensuring working capital discipline, remains critical for the ratings. Any further deterioration in Company's profits, subsequently coverages will adversely impact the Company's 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-19),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria | Rating Modifier(Jun-19)
Related Research	Sector Study | Edible Oil(Feb-20)
Rating Analysts	Bakhtawar Abid | bakhtawar.abid@pacra.com | +92-42-35869504

Profile

Legal Structure Hi-Tech Edible Oils (Private) Limited ('Hi-Tech Oil' or 'The Company) was incorporated as a Private Limited Company in 2002.

Background The Company is an backward integrated venture of Hi-Tech Group, which has presence across the poultry supply chain. In 1980, the Group started from a small scale poultry breeder business and later diversified vertically. Hi-Tech Oils became formally operational in 2006. However, its edible oil extraction mill was set up in Sahiwal in 2007.

Operations The Company is primarily engaged in the of seed filtering, seed crushing, oil extraction and refining by chemical processes. The Company is ranked among the largest importer of premium quality soybean oilseed, from Brazil and USA. Currently, the Company has three solvent extraction units with a combined capacity of 1000 TPD. The Group's registered office is located in Shadman Chowk, Jail Road, Lahore. While, the oil extraction facility is located at Main GT Road, Sahiwal

Ownership

Ownership Structure Ownership of the Company is divided 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 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 operates a total of four entities in the poultry segment. Moreover, the Group has business interests in edible oil and rice. 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 Executive Directors. Absence of Non-executive Director and lack of independent oversight indicates a room for improvement in the Company’s governance framework.

Members’ Profile Board members are qualified individuals possessing significant industry knowledge relating to poultry and allied industries. Dr. Anwar Mehmood Randhawa, Chairman of all Group Companies, is a Doctor of Veterinary Medicine and holds 44 years of experience. Dr. Anwar was a member of Standing Committee (North) in Pakistan Poultry Association. Currently he is the Chairman of Pakistan's Solvent Extractions Association.

Board Effectiveness Keeping in view the size of the Company’s Board, absence of sub-committees may not impact Board's effectiveness. During FY19, various informal Board meetings were though, minutes of these meetings were not formally maintained.

Financial Transparency Hameed Zahid & Co. Chartered Accountants, who are not rated by the SBP but hold a satisfactory QCR rating, are appointed as the external auditor of the Company. The firm has expressed an unqualified opinion on the financial statements for the year ending June' 19.

Management

Organizational Structure The Company's organogram is structured as per organizational needs. All functions related to production are consolidated under the General Manager for production. Similarly, functions of audit, accounting and marketing are headed by the Chief Financial Officer. Lastly, the IT function is led by a separate head. Subsequently, highest level of authority lies with the Chief Executive Officer.

Management Team Founder of the Group, Dr. Muhammad Arshad, is the Chief Executive Officer. He is a Doctor of Veterinary Medicine and actively participates in international and local seminars relating to poultry, feed milling and pharmaceutical industries. He is supported by a professional management staff.

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

MIS Hi-Tech Group has built a customized software in-house to monitor and generate reports relating to the Company’s inventory management, sales, receivables and payables. To ease other functions, many other modules are in development stage. 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 that 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. 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 over ~4MMT, is tilted towards vegetable ghee (~80%). Production is met through a combination of imported oils and imported oil seed for extraction by solvent extraction units. Pakistan’s edible oil industry produced ~1.7 MMT of ghee and edible oil in FY19 following a stable growth pattern of ~3%. High dependence on imports and devaluation of Pakistani rupee and recent imposition of sales tax have impacted industry players. However, majority of the cost increase has been passed on to consumers.

Relative Position The Company holds an adequate position in the semi-refined oil market. 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 (61%), semi-refined oil (38%) and soap stock (1%), a by-product of the refining process. During FY19, topline posted an increase of 20% (FY19: 14bln, FY18: 11.8bln) backed by higher prices. Also, increased production on the back of capacity enhancement during FY19 had a positive impact on the Company’s topline. Substantial revenue growth (33%) can be traced to higher proceeds from soybean meal sales (FY19: PKR 8.4bln, FY18: PKR 6.4bln). Likewise, revenue from semi refined edible oil also grew by of 3.6% (FY19: PKR 5.9bln, FY18: PKR 5.3bln). Around 44% of revenue is generated from central region of the country. The Company is trying to reduce its reliance on selling through dealers, however, tilt remains significant.

Margins Significant increase in the prices resulted in improved margins at gross level (FY19: 6.9%, FY18: 5.6%). Similarly, operating margin posted an increase to 6% in FY19 (FY18: 4.6%). Bottom line of the company grew to PKR 101mln (FY18: PKR 96mln) while maintaining the net margin (FY19: 0.7%, FY18: 0.8%) despite higher financial cost.

Sustainability Edible oil is a staple food item, thus, its demand is anticipated to grow. Keeping this in view, the management is confident to capture a significant share of the industry. Going forward, the Company plans on enhancing its product portfolio by venturing into the branded oils and ghee segment.

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. However, during FY19, net working capital improved mainly owing to reduced inventory held days. Substantial portion of receivables emanate from associated companies, however, receivable days remain inflated. Relatively lower short-term borrowings improved the room to borrow for the Company.

Coverages Coverages continue to remain under pressure owing to high finance costs and low profitability. During FY19, interest cover fell to 1.5x (FY18: 1.7) while, core and total interest cover fell to 0.7x (FY18: 1.7x), reflecting pressure on the Company’s ability to meet financial obligations.

Capitalization The Company has a highly leveraged capital structure characterized by a debt-to-equity ratio of 74% during FY19, signifying risk. However, fixed asset revaluation and equity injection has helped contain leveraging from escalating further. During FY19, total borrowings decreased and stood at PKR 7bln (FY18: PKR 7.4bln). Debt mix mainly comprises short-term borrowings mainly. However, long-term debt of PKR 590mln includes interest free loan obtained from associated ventures.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Hi-Tech Edible Oils (Pvt.) Limited Edible Oil	Jun-19 12M	Jun-18 12M	Jun-17 12M
A BALANCE SHEET			
1 Non-Current Assets	1,607	477	423
2 Investments	-	-	-
3 Related Party Exposure	158	145	126
4 Current Assets	8,296	8,442	6,077
a Inventories	*4,754*	*5,245*	*4,307*
b Trade Receivables	*2,636*	*1,341*	*934*
5 Total Assets	10,061	9,064	6,626
6 Current Liabilities	617	365	283
a Trade Payables	*83*	*60*	*57*
7 Borrowings	6,952	6,899	5,242
8 Related Party Exposure	-	590	434
9 Non-Current Liabilities	29	30	15
10 Net Assets	2,463	1,180	653
11 Shareholders' Equity	2,463	1,180	653
B INCOME STATEMENT			
1 Sales	14,142	11,795	7,427
a Cost of Good Sold	*(13,173)*	*(11,139)*	*(7,108)*
2 Gross Profit	969	656	319
a Operating Expenses	(127)	(119)	(86)
3 Operating Profit	842	537	233
a Non Operating Income or (Expense)	*(15)*	*(22)*	*(3)*
4 Profit or (Loss) before Interest and Tax	827	515	230
a Total Finance Cost	*(544)*	*(280)*	*(153)*
b Taxation	*(182)*	*(139)*	*(54)*
6 Net Income Or (Loss)	101	96	23
C CASH FLOW STATEMENT			
a Free Cash Flows from Operations (FCFO)	*826*	*479*	*78*
b Net Cash from Operating Activities before Working Capital Changes	*359*	*240*	*(83)*
c Changes in Working Capital	*(2,368)*	*(899)*	*(631)*
1 Net Cash provided by Operating Activities	(2,009)	(659)	(714)
2 Net Cash (Used in) or Available From Investing Activities	(3)	(76)	(201)
3 Net Cash (Used in) or Available From Financing Activities	1,234	1,785	977
4 Net Cash generated or (Used) during the period	(778)	1,050	62
D RATIO ANALYSIS			
1 Performance			
a Sales Growth (for the period)	19.9%	58.8%	85.3%
b Gross Profit Margin	6.9%	5.6%	4.3%
c Net Profit Margin	0.7%	0.8%	0.3%
d Cash Conversion Efficiency (EBITDA/Sales)	6.2%	4.9%	3.7%
e Return on Equity (ROE)	5.6%	10.4%	3.5%
2 Working Capital Management			
a Gross Working Capital (Average Days)	180	183	213
b Net Working Capital (Average Days)	179	181	211
c Current Ratio (Total Current Assets/Total Current Liabilities)	13.4	23.2	21.4
3 Coverages			
a EBITDA / Finance Cost	1.6	2.1	1.8
b FCFO / Finance Cost+CMLTB+Excess STB	0.7	1.7	0.5
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	2.1	2.9	-5.9
4 Capital Structure (Total Debt/Total Debt+Equity)			
a Total Borrowings / Total Borrowings+Equity	73.8%	86.4%	89.7%
b Interest or Markup Payable (Days)	98.3	92.6	75.4
c Average Borrowing Rate	7.5%	4.2%	3.3%

Rating Scale | Corporate

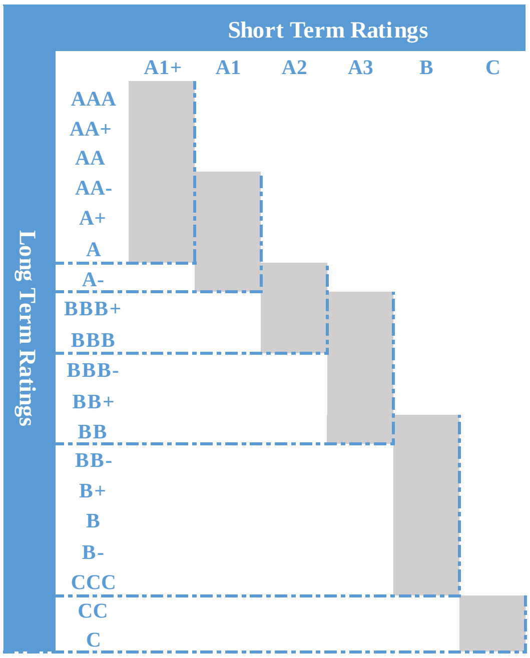
2019

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**
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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)

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)
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(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)
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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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