The Pakistan Credit Rating Agency Limited

Rating Report

LOTTE Kolson (Pvt.) Limited

Report Contents

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Rating History					
Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
08-Jun-2023	A-	A2	Stable	Maintain	-
09-Jun-2022	A-	A2	Stable	Maintain	-
09-Jun-2021	A-	A2	Stable	Maintain	-
26-Jun-2020	A-	A2	Stable	Maintain	Yes
27-Dec-2019	A-	A2	Stable	Maintain	-
27-Jun-2019	A-	A2	Stable	Maintain	-
31-Dec-2018	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect LOTTE Kolson (Pvt.) Limited's ('LOTTE Kolson' or 'the Company') association with LOTTE Corporation, one of the biggest conglomerates in South Korea. The food industry has posted steady growth, owing to growing middle class and stable demand for snacks and confectionery. The Company's revenue growth remained meager, supported mainly by 'Slanty'. Substantial increase in marketing expenses, for brand visibility and awareness, led the operating income and, in turn margins to close in red. Being an FMCG, the Company needs to remain competitive. Furthermore, the ultimate goal is to occupy a notable market share in all its product categories. This further impacts the profitability. However, cost control mechanisms must be devised so as to ensure operational efficiency and achieve sustainable profits. For this, the Company is focusing on changing its sales mix to higher margin products, such as pasta, and increasing capacity utilization of new plant through product innovation (change in flavor - grammage). The financial risk profile of the Company is characterized by strong working capital management due to cash based sales and a modestly leveraged capital structure with long term loan at fixed rate. However, coverages are still weak as the Company's cashflows are under pressure. The ratings draw comfort from the Sponsor's financial strength, guidance on managing interest rate fluctuation, and demonstrated ability to provide support, if needed.

The ratings are dependent on the Company's ability to improve sales, margins, and profitability. Increasing capacity utilization of the new plant and gaining traction with newly introduced products will be important. However, any further deterioration in margins and/or coverages will adversely impact the ratings. Continued support from Lotte WELLFOOD Co. Ltd., technical and financial, remains imperative to sustain the ratings.

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

Profile

Legal Structure LOTTE Kolson (Private) Limited ('LOTTE Kolson' or 'the Company') was incorporated in 1975 as a private limited company.

Background The Company was formerly known as KS Sulemanji Esmailiji & Sons (Private) Limited. It was renamed to LOTTE Kolson (Private) Limited after it was fully acquired by LOTTE Corporation, a multinational conglomerate headquartered in South Korea, in 2014. In Apr-23, LOTTE Confectionary has been renamed as LOTTE WELLFOOD Co. Ltd.

Operations The Company manufactures and sells five product categories, namely, i) Snacks, ii) Biscuits, iii) Pasta, iv) Cakes, and v) Gum. LOTTE Kolson's overall capacity utilization was ~53%. Snack segment had the highest utilization level at ~66% and the Cake segment had the lowest utilization. Production facilities are located in Karachi, Islamabad and Lahore, whereas, the head office is in Karachi.

Ownership

Ownership Structure Major shareholding of the Company lies with LOTTE Confectionery (96.5%). Remaining stake is held by Mr. Dong Bin Shin (3.5%), son of the founder, Mr. Shin Kyuk-Ho, whereas, Mr. Choi Myeong Rim (Chairman), Mr. Abdul Latif (non-executive director) and Mr. Yongsung Shin (executive director) hold one share each.

Stability The Company went through an ownership change as the Group realigned its businesses under a holding company structure. Ownership share of LOTTE Corporation (96.5%) was transferred to LOTTE WELLFOOD, its subsidiary.

Business Acumen LOTTE Corporation, is a Korean multinational conglomerate, which has business ventures spread across the globe, in addition to having a strong footprint in South Korea and Japan. The Corporation has business interests in food, retail, chemicals, infrastructure and finance, among other areas. Moreover, the Group has established a strong presence in Pakistan and operates in the confectionery, chemical, beverages and construction industries.

Financial Strength The Company is considered to have strong financial strength owing to support from LOTTE WELLFOOD and LOTTE Corporation. Additionally, LOTTE Corporation is the fifth largest conglomerate in South Korea.

Governance

Board Structure Board of Directors comprises four members that include the Chairman, two executive directors and a non-executive director. The Company lacks representation of independent members on its Board.

Members' Profile The Board represents qualified individuals who specialize in retail and production, in addition to confectionery. Mr. Choi Myeong Rim, Chairman of the Board, has over 29 years of experience in the industry and has been associated with the Company's Board for ~2 year.

Board Effectiveness The Company has no Board committees in place. The Board meets twice a year to discuss matters pertaining to current performance and future strategy, with minutes of meetings being captured in a formal manner.

Financial Transparency EY Ford Rhodes & Co., Chartered Accountants are the external auditors of the Company. The auditor has expressed an unqualified opinion on the financial statements for the year ending 31st December, 2022.

Management

Organizational Structure The organizational structure of the Company is split between twelve departments. Some of the major departments are sales, supply chain, production, quality and finance. Each department head reports to the CEO, who in turn, reports to the Chairman. The CFO has additional reporting line to the Chairman in Korea.

Management Team The management team comprises experienced individuals in the retail industry with diversified skills. Mr. Khayyam Rajput, the Chief Executive Officer, holds an MBA and specializes in sales, marketing and general management. He joined the Company in 2018 and has previously worked for multi-nationals. The Company also receives support from LOTTE's regional platform in terms of strategy and best practices.

Effectiveness In order to ensure efficient operations, the Company has in place a management committee, which meets twice a month. Meetings are chaired by the CEO and are attended by all functional heads. Purpose of the Committee is to improve coordination in operations while ensuring compliance.

MIS The Company has deployed Oracle 12-C as its Enterprise Resource Planning (ERP) system and operates five modules.

Control Environment The Company has a strong control environment represented by strict quality control measures, with an increased emphasis on hygiene, and an efficient internal audit department. Findings are reported to the CEO, in addition to headquarters in Korea.

Business Risk

Industry Dynamics The market operates with unbranded segment as a sizeable player. However, an opportunity for expansion exists in the branded segment. Overall performance of the players has improved during CY22. Going forward, cashflow and liquidity is expected to remain stable

Relative Position The Company has robust brand recognition in the snacks industry with its flagship product 'Slanty'. However, 'Lays' remains clear market leader in the segment. The Company holds a strong position in the pasta segment, it is yet to establish a notable presence in other product categories.

Revenues The Company's revenue emanates from four product segments which include snacks, biscuits, pasta and gum, with Slanty contributing over ~66% of the total revenue. During CY22, the Company's revenue rose by ~8.7% and clocked in at PKR 13,225mln (CY21: PKR 12,161mln). This increase was supplemented by increase in retail prices for all products due to the inflation and the economic situation. Going forward, revenues are expected to grow at a slow pace.

Margins During CY22, the Company's gross margin increased to ~21% (CY21: ~16%) due to increase in retail prices of all products. The Company is also working on increasing efficiency in various areas such as production and sales. However, the Company has heavy reliance on advertisements and sales promotion to create product awareness among the consumers to remain competitive in the market. Resultantly, the Company incurred higher admin and selling expenses (CY22: PKR 3,070mln, CY21: PKR 2,139mln), posting an operating loss of ~PKR 266mln during CY22 (CY21: Loss ~PKR 252mln), which translated into an operating margin of ~ (2%) (CY21: -2.1%). Finance cost of the Company increased to ~PKR 387mln (CY21: ~PKR 351mln) due to higher interest rates despite lowering total borrowings. The Company observed significant deterioration at net level, and posted a loss (CY22: PKR -678mln, CY21: PKR -362mln). Net margins stood at -5% (CY21: -3%). Going forward, margins are expected to remain stretched.

Sustainability Going forward, given the economic situation the Company plans to make prudent decision to introduce new products in the market. The Company is looking to reduce its borrowings and improve its margins to be able to survive the current economic downturn.

Financial Risk

Working Capital In CY22, the receivables days improved to 5 days (CY21: 7 days) due to a better recovery. Moreover, the Company observed a slight improvement in inventory days, as they stood at 36 days (CY21: 33 days). Resultantly, gross working capital days stood at 41 days in CY22 (CY21: 40 days). The Company delayed payments to creditors, and hence, the payable days rose significantly to 28 days (CY21: 21 days). The net working capital days amounted to 13 days as at CY22 (CY21: 18 days). The Company holds sufficient room to borrow against trade and total current assets. This is expected to support the Company's working capital cycle, going forward.

Coverages The Company's free cash flows decreased to PKR 599mln in CY22 (CY21: PKR 691mln) due to higher taxes. The finance cost (CY22: PKR 361mln, CY21: PKR 362mln) of the Company remained stagnant despite lowering borrowings as interest rates has risen. As a result, the interest coverage ratio of the Company decreased to 1.5x (CY21: 2.0). Core and Total coverage remained weak (CY22: 0.4x, CY21: 0.5x), due to high number of current maturity of long-term debt (CY22: PKR 1,129mln, CY21: PKR 1,194mln). Going forward,, coverages are expected to remain weak.

Capitalization The Company has a moderately leveraged capital structure, with a leveraging ratio of ~30.6% as at CY22 (CY21: 30.2%). Majority of the debt comprises long terms borrowings to finance the ChocoPie plant and expansion projects. Total borrowings of the Company stood at PKR 3,648mln as at CY22 (CY21: PKR 3,858mln). Going forward, leveraging is expected to remain stable.

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Financial Summary
PKR mln

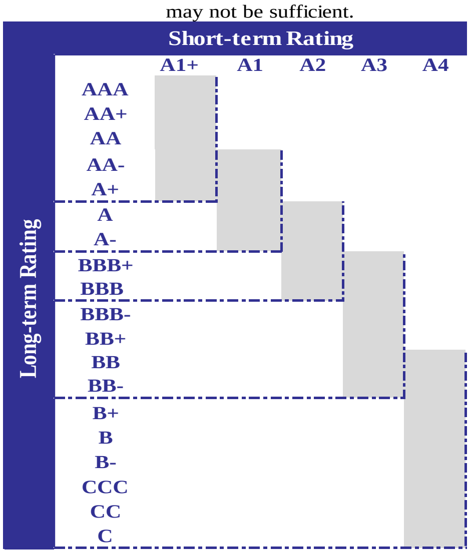
LOTTE Kolson (Pvt.) Limited	Dec-22	Sep-22	Jun-22	Dec-21	Sep-21	Jun-21	Dec-20
Food Products	12M	9M	6M	12M	9M	6M	12M
A BALANCE SHEET							
1 Non-Current Assets	10,841	10,845	10,986	11,464	11,664	11,894	12,391
2 Investments	159	223	223	135	141	141	140
3 Related Party Exposure	-	-	-	-	-	-	-
4 Current Assets	3,024	3,562	3,610	2,945	3,104	3,250	2,746
a Inventories	*1,446*	*1,630*	*1,457*	*1,168*	*1,251*	*1,209*	*1,021*
b Trade Receivables	*146*	*246*	*249*	*239*	*260*	*328*	*224*
5 Total Assets	14,024	14,630	14,819	14,544	14,909	15,285	15,277
6 Current Liabilities	2,007	2,743	2,436	1,554	1,937	1,848	1,030
a Trade Payables	*1,150*	*1,838*	*1,432*	*895*	*1,269*	*1,245*	*525*
7 Borrowings	3,648	3,236	3,582	3,858	3,846	4,054	4,298
8 Related Party Exposure	-	-	-	-	-	-	250
9 Non-Current Liabilities	110	109	106	206	310	378	527
10 Net Assets	8,258	8,542	8,695	8,926	8,817	9,005	9,172
11 Shareholders' Equity	8,258	8,542	8,695	8,926	8,817	9,005	9,172
B INCOME STATEMENT							
1 Sales	13,225	9,902	6,287	12,161	9,039	5,987	11,891
a Cost of Good Sold	*(10,421)*	*(7,850)*	*(4,984)*	*(10,274)*	*(7,614)*	*(5,015)*	*(9,749)*
2 Gross Profit	2,804	2,052	1,303	1,887	1,425	972	2,142
a Operating Expenses	(3,070)	(2,286)	(1,423)	(2,139)	(1,589)	(1,048)	(2,023)
3 Operating Profit	(266)	(234)	(120)	(252)	(164)	(76)	119
a Non Operating Income or (Expense)	*(84)*	*(89)*	*(71)*	*81*	*(32)*	*13*	*(11)*
4 Profit or (Loss) before Interest and Tax	(350)	(323)	(191)	(170)	(196)	(63)	108
a Total Finance Cost	*(400)*	*(266)*	*(175)*	*(364)*	*(253)*	*(169)*	*(408)*
b Taxation	*73*	*188*	*120*	*184*	*114*	*82*	*(122)*
6 Net Income Or (Loss)	(678)	(401)	(247)	(350)	(335)	(150)	(421)
C CASH FLOW STATEMENT							
a Free Cash Flows from Operations (FCFO)	*599*	*546*	*407*	*704*	*586*	*454*	*1,062*
b Net Cash from Operating Activities before Working Capital Cha	*239*	*123*	*150*	*356*	*264*	*262*	*653*
c Changes in Working Capital	*164*	*396*	*264*	*50*	*34*	*(42)*	*(25)*
1 Net Cash provided by Operating Activities	402	519	414	406	298	220	629
2 Net Cash (Used in) or Available From Investing Activities	351	150	(94)	(96)	(104)	(55)	(154)
3 Net Cash (Used in) or Available From Financing Activities	(679)	(608)	(271)	(556)	(453)	(245)	(285)
4 Net Cash generated or (Used) during the period	75	61	49	(247)	(258)	(80)	190
D RATIO ANALYSIS							
1 Performance							
a Sales Growth (for the period)	8.7%	8.6%	3.4%	2.3%	1.4%	0.7%	0.6%
b Gross Profit Margin	21.2%	20.7%	20.7%	15.5%	15.8%	16.2%	18.0%
c Net Profit Margin	-5.1%	-4.0%	-3.9%	-2.9%	-3.7%	-2.5%	-3.5%
d Cash Conversion Efficiency (FCFO adjusted for Working Capita	5.8%	9.5%	10.7%	6.2%	6.9%	6.9%	8.7%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total A*	-7.9%	-6.1%	-5.6%	-3.9%	-5.0%	-3.3%	-4.4%
2 Working Capital Management							
a Gross Working Capital (Average Days)	41	45	45	40	42	42	43
b Net Working Capital (Average Days)	13	8	11	18	15	15	28
c Current Ratio (Current Assets / Current Liabilities)	1.5	1.3	1.5	1.9	1.6	1.8	2.7
3 Coverages							
a EBITDA / Finance Cost	2.2	2.8	3.0	2.5	2.9	3.2	3.1
b FCFO / Finance Cost+CMLTB+Excess STB	0.4	0.5	0.6	0.5	0.5	0.6	0.7
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance	12.9	5.9	5.5	9.0	7.6	6.5	6.4
4 Capital Structure							
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	30.6%	27.5%	29.2%	30.2%	30.4%	31.0%	31.9%
b Interest or Markup Payable (Days)	42.3	3.0	4.2	5.6	11.8	5.4	3.0
c Entity Average Borrowing Rate	10.7%	9.3%	8.8%	8.7%	8.0%	7.8%	9.1%

Credit Rating

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

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

Short-term Rating	
Scale	**Definition**
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

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

Rating Watch Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

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

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

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

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

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

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

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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(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)

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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)
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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)
(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)
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(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)
Probability of Default
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)
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