The Pakistan Credit Rating Agency Limited

Rating Report

Kangore Traders

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
29-Oct-2020	BBB	A2	Stable	Upgrade	-
30-Nov-2019	BB+	A3	Stable	Maintain	-
31-May-2019	BB+	A3	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Rice is among the five major crops of Pakistan and is the second main staple food, after wheat. Both basmati (long, thin and aromatic rice) and non-basmati (long grain white rice - IRRI 6 and IRRI 9) rice are cultivated in Punjab and Sindh, respectively. In Pakistan, ~85% of basmati rice is consumed locally and only 15% is exported. While, ~90% of non-basmati or IRRI rice is exported and only 10% is consumed locally. During FY20, rice production grew by ~3%, standing at ~7.4MT (FY19: ~7.2MT). Out of this, ~3 to 4MT of rice is exported to generate ~PKR 300bln of export revenue. During 2MFY21, rice exports deteriorated to ~PKR 41bln(USD 248mln) (2MFY20: ~PKR 53bln) (USD 333mln) owing to higher prices at the mill-gate and shortage of exportable non-basmati rice in Jul-20 to Aug-20.

The ratings reflect Kangore Trader’s ('Kangore')relative position in the country's rice export market. Over the couple of years, Kangore has augmented its position. The sponsor is associated with the related business for long. Attributed to agricultural nature of its product - non-basmati rice, business risk is low, yet bears a cyclicality. Over the years, Kangore has emerged as one of the prominent rice exporters of the country, therefore, strength is derived from its strong and growing topline. During FY20, the country’s rice industry observed a subtle growth, whereas rupee devaluation favored the rice exporters to enhance their revenue base, including Kangore. Profitability margins remained stable supported by higher selling expenses, while operating costs remained high during Covid-19. Kangore bears the status of a sole proprietorship with a single owner being the man of the last mile therefore, the corporate structure is limited and lacks on basic grounds. Financial risk profile is reflected by a topline centric approach with a moderately leveraged capital structure; debt book majorly constitutes export related short term funding needs. The sizable equity base of the firm provides it comfortable position among the peer group having same entity ratings. With major focus of business towards African markets, working capital cycles have enlarged gradually, creating need for short term borrowing over a relatively longer horizon.

The ratings are dependent upon sustained business growth and profitability margins. Meanwhile, improved governance practices, including financial veracity, remain imperative to the ratings.

Disclosure	
Name of Rated Entity	Kangore Traders
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-20),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria | Rating Modifier(Jun-20)
Related Research	Sector Study | Rice(Nov-19)
Rating Analysts	Faiqa Qamar | faiqa.qamar@pacra.com | +92-42-35869504

Profile

Legal Structure Kangore Traders, is a sole proprietorship established in 1996.

Background Mr. Nawal's family has been in the rice business since 1983, with three rice mills in the regions of Sindh; Golarchi and Badin. In 1996, Kangore Traders was established with a view of growing business prospects. Additionally, from 1996 Kangore was among the top 'pulses' exporters till a ban was imposed by GOP on the exports of pulses in 2006. At present, the business has vastly expanded its avenues in the African side, mainly exporting to; Benin, Niger, Madagascar and Nairobi.

Operations Kangore's core business involves processing and trading of non-basmati rice locally and internationally, with main concentration in Afro based regions. The business has five (5) processing units, each with 37.5 M.Tons per hour capacity, located in Landhi, Karachi.

Ownership

Ownership Structure Kangore, being a sole proprietorship, is 100% owned by an individual, Mr Nawal.

Stability Ownership structure of the business is seen as stable.

Business Acumen Mr. Nawal is the man at the last mile, alongside his brother Mr. Gangoomal and other family members, spearheads the business.

Financial Strength Sponsor's support is the backbone of business since its establishment.

Governance

Board Structure There exist no formal board structure since Kangore is a sole proprietorship.

Members' Profile Mr. Nawal, has more than two decades of experience and has been associated with the business since its inception. He belongs to an entrepreneurial background.

Board Effectiveness Absence of proper governance structure and lack of independent oversight instigate need for improvement.

Financial Transparency Amir Hussain Associates and Chartered Accountants are the auditors for the Kangore Traders. The firm is neither QCR rated nor does it is classified in any of the categories defined by the State Bank of Pakistan. The audit for FY20 is in progress. However, the audit issued an unqualified opinion on the business's financial statements for the year ended June 30, 2019.

Management

Organizational Structure Kangore has a lean organization structure with defined departments and a thorough line of management.

Management Team The overall chores of operations are in the hands of family members who are well experienced in the field. Mr. Nawal's elder son, Mr. Avinash and Mr. Sunil are directly involved in the business operations while Mr. Prem, Finance Manager, is his nephew.

Effectiveness At present, there is no culture of conducing formal management committees since the sponsor is directly involved in the business activities.

MIS An in-house system based processes is in place at Kangore that is capable of systematic reporting, covering the following areas i) Purchase ii) Sale/Export iii) loan outstanding position and iv) pledge report.

Control Environment On the side of corporate governance framework, improvement is required, though the internal controls are directly overseen by the directors.

Business Risk

Industry Dynamics Pakistan's Rice industry is an instrumentalist segment in the overall economy as it is one of the five major crops of the country and a contributor to the national exports revenue. After wheat, it is Pakistan's second main staple food crop. Major factors affecting rice production include water availability, area of cultivation, crop yield and the governing policies and initiatives. It contributes about 3.1% in agriculture and 0.6% in GDP. During FY20, rice cropped area increased to ~3.03MH (FY19: ~2.8MH), reflecting an increase of ~8% or ~0.2MH. Consequently, the production of rice witnessed an increase of ~3% and stood at ~7.4MT (FY19: ~7.2MT). The maximum contribution from the rice sector in country's foreign exchequer is from non-basmati rice exports, as basmati rice is locally consumed and minimal quantity is exported. During 2MFY21, rice exports deteriorated to ~USD 248mln (2MMFY20: ~USD 333mln) owing to higher prices at the mill-gate level in Pakistan compared to India and shortage of exportable non-basmati rice in July/August this year.

Relative Position The business mainly involves exporting non-basmati rice with a small market share of ~2%. Kangore has a major customer base in Afro-Asian countries, with the top consumers being from Africa, Kenya, U.A.E, China and Indonesia.

Revenues Kangore mainly generates revenue from exports, followed by local sales. The export business in FY20 was well diversified and routed through different banks. Kangore's topline tend to witness an increasing trend since FY16. In line with the industry, the topline remained stable (FY20: PKR 6.9bln, FY19: PKR 6.9bln). While, it increased by 19% in FY19. This mainly attributed to the fact that demand for rice from West Africa remained stable during Covid-19 posing favorable impact on exporters including Kangore. It was among the list of top 100 exporters with earnings of ~ USD 49mln. Pakistan is expected to benefit from the rice demand potential in the international market, as it is one of those countries which are operative due to better COVID-19 situation.

Margins The margins in FY20 are expected to add to its retained profits. Gross Margins of the business dropped to 19% in FY19 after a period of consistency for three consecutive years; (FY18: 32%, FY17: 32%) mainly due to some one off export challenge, whereas net margins dropped to 1.1% in FY19 from 11% in FY18 (FY17: 10%).

Sustainability Sponsor support is a major catalyst for the Kangore's sustainability. With an aim to diversify its exporting regions, the business will be focusing on strengthening relationships with buyers in the Middle Eastern, African and as well as European countries, through their own brands.

Financial Risk

Working Capital In anticipation to the future demand and sale prospects, Kangore's stock level have raised to 98days in FY19, hence leading the working capital cycle to a higher end; 157days (FY18: 149days, FY17: 170days). The entire working capital management is heavily supported by short term borrowings FY19: 1,762mln (FY18: PKR 1,505mln, FY17: 538mln), which also comprises export refinance facility.

Coverages Kangore's FCFO base has shrunk to 86mln during FY19, after a strong trend over the years; FY18: PKR 481mln, FY17: PKR 400mln, on account of dwindled profitability, which kept its coverages conservative at 0.9x in FY19 (FY18: 11x).

Capitalization Kangore has not entered into any long term debt arrangement over the years. The financial profile is supported through mix of internally generated cashflows and short term borrowings. The business has maintained its capital structure at adequate level, though pacing towards higher end: FY19: 43% (FY18: 39%, FY17: 21%)

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Financial Summary
PKR mln

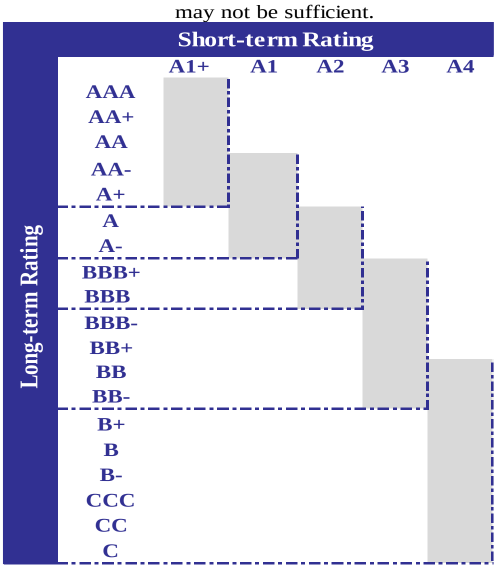
Kangore Traders Rice	Jun-19 12M	Jun-18 12M	Jun-17 12M
A BALANCE SHEET			
1 Non-Current Assets	35	35	36
2 Investments	-	-	-
3 Related Party Exposure	-	-	-
4 Current Assets	4,180	3,918	2,583
a Inventories	*2,054*	*1,652*	*1,046*
b Trade Receivables	*1,138*	*1,273*	*910*
5 Total Assets	4,215	3,953	2,619
6 Current Liabilities	84	66	56
a Trade Payables	*84*	*65*	*53*
7 Borrowings	1,762	1,505	538
8 Related Party Exposure	-	-	-
9 Non-Current Liabilities	-	-	-
10 Net Assets	2,369	2,382	2,025
11 Shareholders' Equity	2,369	2,382	2,025
B INCOME STATEMENT			
1 Sales	6,936	5,844	4,084
a Cost of Good Sold	*(5,625)*	*(3,996)*	*(2,771)*
2 Gross Profit	1,311	1,848	1,313
a Operating Expenses	(1,125)	(1,126)	(820)
3 Operating Profit	186	722	493
a Non Operating Income or (Expense)	-	-	-
4 Profit or (Loss) before Interest and Tax	186	722	493
a Total Finance Cost	*(99)*	*(45)*	*(36)*
b Taxation	*(9)*	*(56)*	*(34)*
6 Net Income Or (Loss)	78	621	423
C CASH FLOW STATEMENT			
a Free Cash Flows from Operations (FCFO)	*86*	*481*	*400*
b Net Cash from Operating Activities before Working Capital Changes	*(13)*	*436*	*365*
c Changes in Working Capital	*(236)*	*(1,111)*	*(1)*
1 Net Cash provided by Operating Activities	(249)	(675)	363
2 Net Cash (Used in) or Available From Investing Activities	-	-	-
3 Net Cash (Used in) or Available From Financing Activities	258	682	(359)
4 Net Cash generated or (Used) during the period	8	7	4
D RATIO ANALYSIS			
1 Performance			
a Sales Growth (for the period)	18.7%	43.1%	1.3%
b Gross Profit Margin	18.9%	31.6%	32.1%
c Net Profit Margin	1.1%	10.6%	10.3%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	-2.2%	-10.8%	9.8%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Shareholders' Equity)]*	3.4%	31.3%	21.0%
2 Working Capital Management			
a Gross Working Capital (Average Days)	161	152	174
b Net Working Capital (Average Days)	157	149	170
c Current Ratio (Current Assets / Current Liabilities)	50.0	59.4	45.8
3 Coverages			
a EBITDA / Finance Cost	1.9	16.0	13.8
b FCFO / Finance Cost+CMLTB+Excess STB	0.9	10.7	11.2
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.0	0.0	0.0
4 Capital Structure			
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	42.7%	38.7%	21.0%
b Interest or Markup Payable (Days)	0.0	0.0	0.0
c Entity Average Borrowing Rate	6.2%	4.4%	5.0%

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):

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

Instruments
a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk Rating

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

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