

Oils and fats are used mainly for food purposes. However, both oilseeds and extracted oil are also used in some part as animal feed. Oils also have industrial uses. Traditionally, these have been mainly used in production of soap and other molecules. But increasingly they are used for energy producing purposes, such as transport use by automobiles, trains, airplanes or boats, or direct production of energy. In terms of type, the market can be classified into palm oil, canola oil, olive oil, sunflower oil, specialty blended oil and corn oil.

Edible oil is further segmented into blended (mix of various oils) and pure oil. Pure oil is comparatively more expensive than blended oil. Blended oil is the preferable choice of consumers in terms of cooking. In case of banaspati, there are two major segments: Virtually Trans-fat (VTF) and Non-VTF. In buying decision of banaspati - taste, aroma and heritage play an important role. In case of cooking oils, vitamins, no cholesterol benefits, light color, less viscosity, all-purpose use and aroma are key features.

Edible oil processing comprises three operations – crushing and expelling (separating oil from the solids – generally done by small-scale expellers/oilseed crushers), solvent extraction (to crush and process hard oilseeds with low oil content such as soybean and cottonseed as well as chemically extract residual oil from the oil-cake), and oil refining (which includes some or all of the following treatments—filtering, neutralization, winterizing, bleaching, deodorization and degumming, and filtering to make oil fit for human consumption).

Global Edible Oil Industry

The global edible oil market is expected to register a Compound Annual Growth Rate (CAGR) of 5.1% to reach an estimated value of US\$ 130.3b by end of 2024. China is one of the leading markets of edible oil followed by India, United Arab Emirates and Pakistan. Global production of vegetable oil is dominated by soybean oil and palm oil. Argentina and Brazil, as major producers of soybeans and soybean oil, are now responsible for a large share of exports of this oil. Palm oil production and export are located principally in South East Asia, with Indonesia and Malaysia responsible for bulk of both. Manufacturers are adopting new techniques to increase production of edible oil such as cold pressing. This combined with growing disposable incomes and growing demand for snacks and fried food globally are major drivers in the global market. The rising retail sector is a major boon to the global edible oil market as well. Major players in the global edible oil market include The Adani Wilmar Ltd., Ruchi Soya Industries Ltd., Associated British Foods, Borges Mediterranean Group and Archer Daniels Midland Company.

Pakistani Edible Oil Industry

Demand

At present, Pakistan plays a significant role in the global edible oil market. Research and development activity in Pakistan is on the lower side vis-à-vis other countries like India; therefore, the country will continue to rely on imports. In 2017, Pakistani edible oil industry registered volumetric sales of ~4m tons (translating into a market size of over Rs. 500b) growing at a CAGR of ~5-7%. Given the demographic profile of the country, ghee accounts for ~70% of the market while cooking oil contributes ~30% of sales. This proportion is expected to remain the same over the coming years. Moreover, given that palm oil is cheaper vis-à-vis soft oil it is utilized more with ~65% of the market captured by palm oil compared to ~35% for soft oil. Around 2.5m tons of edible oil is consumed by retail customers while industrial sales account for the remaining 1.5m tons.

Pakistan is amongst the leading importer and consumers of edible oil. Current per capita consumption level of Pakistan stands at ~23 kg/year compared to global average of ~28 kg/year (2015-16). Over the medium to long-term, demand is expected to increase in line with GDP growth which is further supported by positive demographic fundamentals.

Supply

Local production of edible oil (cotton seed/rape seed/sunflower seed/canola oil) was reported at ~0.4m tons. Domestic production of oil extracted from imported seeds amounted to ~0.7m tons. Remaining 2.9m tons of edible oil is directly imported. Palm oil is the major raw material, followed by soybean, sunflower and canola. Edible oil imports cost more

than US\$ 3.1 billion annually making it the second largest import after petroleum products. Pakistan imports crude and refined cooking oil (palm and palm olein) mainly from Malaysia and Indonesia and brings in soybean oil from North America and Brazil.

Industry Structure

The Pakistani edible oil industry is characterized by high competitive intensity due to fragmentation and low barriers of entry which results in limited pricing power and inherently thin profitability. However, a number of large players have been operating for a long period of time and thus enjoy stronger brand equity in relation to other firms. Key regulating entities include the following:

- Pakistani Vanspati Manufacturing Association (PVMA)
- All Pakistan Solvent Manufacturing Association (APSEA)
- Pakistan Edible Oil Refiners Association (PEORA)
- Pakistan Soap Manufacturers Association (PSMA)

Currently, a total of 122 companies operate in the country engaged in manufacture of edible oil and other allied products. There are 95 solvent extraction entities, of which 30 are in working condition. Moreover, there are over 150 ghee manufacturing units. The industry is bifurcated into organized and unorganized segments. The organized segment produces ~1m ton of edible oil per annum. Major players in the organized segment (in order of descending market share) comprise Dalda Foods Limited (market share of ~8.1%), Habib Oil Mills Limited (market share of ~3.7%), Sufi Banaspati & Cooking Oil, Seasons Edible Oil, Mezan Cooking Oil & Banaspati, Punjab Oil Mills Limited and Kashmir Cooking Oil & Banaspati.

Business Risk

Market risk

Favorable demand prospects for the edible oil industry in general and soybean products in particular due to the high nutritional value. Sales volume and profitability might be adversely impacted due to decrease in demand of products and/or intensification of competition. High competition from cheaper varieties of imported edible oils and unorganized sector can dampen sales volumes and margins.

Inventory loss due to edible oil price volatility and foreign exchange

Changes in raw material prices and foreign exchange volatility are key risk factors resulting in fluctuations in margins through inventory losses. Ability to manage the same depends on pass through to consumers, which in turn, is linked to degree of competition and operational efficiency.

Raw edible oils are a major component of cost of finished products. Almost 80% of edible oil in the country is imported and sourced from countries like Canada, USA, Argentina, Brazil, Ukraine, Australia, Malaysia, Indonesia, etc. Due long lead times involved in shipping, almost 12 to 16 weeks sales equivalent of edible and products have to be carried in inventory. Raw edible oils are traded on commodity exchanges in these exporting countries. The swings in prices on these commodity exchanges are sharp and frequent. In case of sudden and sustained steep drop or a high spike in prices where the company is not able to adjust the final price of products, there can be a risk of loss or a gain on the high inventory which is required to be kept.

Raw edible oil is bought from international commodity markets located in countries like Canada, USA, Argentina, Brazil, Ukraine, Australia, Malaysia, Indonesia, etc. The currency rate movement between US Dollar and Pak Rupee can have a significant impact upon the landed price of edible oil which the company may not be able to pass on in product prices.

Regulatory risk

Regulatory risks relates to changes in government policies which may affect the industry. Changes in regulatory framework can impact the performance of any sector of the industry, such as the action by the Punjab Government in February 2015 in imposing price controls on banaspati and cooking oil in the province. Changes in duty structure can impact competitiveness.

Financial Profile

	Dalda Foods Limited		Habib Oil Mills Limited		Punjab Oil Mills Limited	
	FY16	9MFY17*	FY16	FY17	FY16	FY17
Net Sales	26,851	29,969	12,267	13,927	4,211	4,441
Gross Margin	19.7%	18.0%	12.8%	9.7%	19.0%	15.7%
Net Margin	6.0%	6.8%	0.4%	-0.5%	3.4%	3.2%
FFO	n/a	n/a	153	(23)	275	152
FFO/Total Debt	n/a	n/a	0.05	(0.01)	11.73	1.61
Gearing	0.65	0.52	2.42	2.99	0.04	0.13
DSCR	n/a	n/a	2.14	0.82	123.00	67.53

	Soya Supreme Oil Mills		Olympia Oils Limited		Sadiq Oil Extraction	
	FY16	9MFY17*	FY16	FY17	FY16	FY17
Net Sales	1,421	2,604	3,462	5,549	2,262	4,416
Gross Margin	7.1%	5.2%	6.5%	5.3%	3.9%	6.8%
Net Margin	0.7%	0.8%	1.6%	1.7%	0.9%	3.8%
FFO	56	40	87	132	n/a	n/a
FFO/Total Debt	0.09	0.13	0.10	0.10	n/a	n/a
Gearing	1.44	0.85	1.26	1.77	0.56	0.60
DSCR	1.00	1.98	1.53	2.68	n/a	n/a

* annualized

Financial profile of edible oil companies is characterized by low to moderate leveraging – primarily to fund working capital needs. Working capital cycle tends to be high because of high inventory holdings. Overall, stiff competition, fragmentation and low value addition in the business often lead to gross margins being in the thin-to-moderate range. In addition, risks of commodity price volatility and forex movements impact gross margins. Some players may further be burdened by high taxation, leading to lower net margins. In order to avail tax benefits under Section 65E of Income Tax Ordinance, a number of companies are pursuing capacity expansions with varying mix of debt and equity. For such firms, gearing levels are likely to increase in proportion with long term debt acquired to fund capex while profitability is likely to improve on the back of lower effective tax rate. Overall, margins of domestic refiners are also influenced by changes in the import duty structure by the Government of Pakistan or modifications in export duty by exporting countries.

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