RATING REPORT

Haleeb Foods Limited (HFL)

REPORT DATE:
January 30, 2019

RATING ANALYSTS:
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RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A	A-2	A	A-2
Rating Outlook	*Stable*		*Stable*	
Rating Date	*January 11 '19*		*October 31 '17*	

COMPANY INFORMATION

Incorporated in 1984	**External auditors:** EY Ford Rhodes, Chartered Accountants
Public Limited Company – Unquoted	**Chairman of the Board:** Aly Khan **CEO:** Muhammad Memosh Khawaja
Key Shareholders (with stake 5% or more):	
Mega Foods (Pvt) Limited : 56.0%	
Mr. Ilyas M Chaudhry : 27.6%	
Ms. Nasrin Ilyas Chaudhry : 6.0%	

APPLICABLE METHODOLOGY(IES)

JCR-VIS Entity Rating Criteria: Industrial Corporates (May 2016)
http://jcrvis.com.pk/docs/Corporate-Methodology-201605.pdf

Haleeb Foods Limited

OVERVIEW OF THE INSTITUTION

Haleeb Food Limited (HFL) was established in 1984 as a public limited company. HFL is a subsidiary of Mega Foods (Pvt.) Limited, which holds 56% stake in the company. The product portfolio of the company comprises UHT milk, tea whitener, fruit juices, flavored milk, and allied dairy products

Profile of the CEO

Mr. Muhammad Memosh Asghar joined HFL as the Chief Executive Officer (CEO) in September 2017. Mr. Memosh holds an MBA degree from LUMS and has over 25 years of experience in consumer goods industry

RATING RATIONALE

Rating Rationale

Haleeb Foods Limited (HFL) is a subsidiary of Mega Foods (Pvt.) Limited while the remaining shareholding is vested with the Chaudhry family and others. HFL is one of the major dairy companies operating in the packaged milk & dairy products segment of Pakistan's dairy industry. The assigned ratings take into account moderate business risk profile of the company, underpinned by positive demand dynamics of the dairy industry, established brand equity in the tea whitener and UHT milk categories and further diversification into new variants of fruit juices and flavored milk products. The ratings also factor in currently low, though increasing, financial risk of the company as depicted by low leveraged capital structure. The liquidity position of HFL is supported by investments in cash and money market mutual funds. However, the ratings are constrained by increasing intensity of competition in value-added dairy and challenging operating environment of the organized dairy segment. Moreover, the declining trend in sales and profits mainly on account of reduced demand for tea whiteners, which is the major sales driver of the company. Meanwhile, effective implementation of strategic initiatives to halt the declining trend in sales remains to be seen in a scenario where increasing pressure of commodity inflation has been witnessed recently due to devaluation of local currency.

Rating Drivers

Dairy Industry Dynamics

Pakistan ranks among top-five milk producing countries in the world, with estimated gross milk production of 58b tons during FY18. There are two distinct value chains for the post-farmgate supply of milk to consumers; fresh loose milk and packaged milk & dairy products. The proportion of fresh loose milk is about 94% in total available milk for human consumption, while only 6% is collected by 15 milk processing units. More than 50% of total milk collected by the organized sector is processed for the production of Ultra High Temperature (UHT) treated milk, 40% for tea whiteners & creamers, yogurt and other dairy products, and remaining 10% for pasteurized milk. Tea whitener is considered the leading category in terms of retail volumes with category share of around 45%, followed by UHT milk with category share of 35%. Albeit their competitive pricing, the demand for tea whiteners has declined considerably in the past two years due to enforcement of tighter quality regulations on the dairy industry by the Pakistan Standards and Quality Control Authority (PSQCA) and labeling of the same as non-dairy product by the Punjab Food Authority (PFA).

Improved awareness of milk quality and popularity among high-income group have accelerate the demand for pasteurized milk in the recent years, helping it to attain 6% category share. While the demand for pasteurized milk is expected to grow further, its relatively shorter shelf-life, challenging supply chain management, and premium pricing may curtail the momentum. Meanwhile, despite higher price than fresh loose milk, growth in shelf-stable UHT milk is expected to emanate from increasing utilization in the urban and semi-urban areas due to hygiene, convenience, and relative affordability. With category share of just 4%, flavored milk market is still in its nascent stage, though representing reasonable growth avenue for the organized sector. Since 2009, consumption of flavored milk has increased from 27.7m liters to around 50m liters per annum, representing a CAGR of 8%. While the market for flavored milk is currently concentrated mainly in Karachi, the demand is expected to pick-up pace in other major cities as well. While the market share is tightly held by Pakola and Nestle Milo, new quality brands have the potential to grow as demand for health-centric beverages is moving in the upward trajectory.

Milk consumption in Pakistan has increased at an average growth rate of 3.2% over the past five years. Growth momentum is expected to remain intact mainly on account of growing population and favorable age distribution. The organized dairy industry is expected to grow at a higher pace, driven largely by changing eating habits and improving disposable income. The industry imported US$ 168m worth of value-added dairy products during 9MFY18 due to a supply gap of around 3.5b liters of milk equivalent. Growth potential of organized dairy industry, however, is curtailed by many challenges, including milk safety and quality as well as considerable development cost to establish an efficient supply chain system.

Sales trend and its product mix

HFL continues to generate a major portion of sales from tea whiteners, and hence the PFA's awareness campaign against tea whiteners and labelling of the same as non-dairy product negatively impacted the sales performance of its flagship tea whitener brand "Tea Max". The estimation is that 70% of total milk consumed in Pakistan is used in tea. Tea whiteners are considered cost-effective alternative to loose milk for tea preparation and hence hold a large consumer base. However, with the improving awareness about the content composition, which includes milk solids-not-fat or skimmed milk and vegetable oils, a gradual shift from tea whiteners to pure packaged milk category is expected, going forward.

In response to the aforementioned shift, HFL has taken several initiatives under the new leadership to transform its product portfolio, including enhanced focus on UHT milk and diversification into flavored milk and fruit juices. During FY18, HFL experienced a healthy 35% growth in volumetric sales of its flagship UHT milk brand "Haleeb" on the back of new packaging introduced during FY18, supported by enhanced media campaigns and distribution. While the company is targeting to gradually capture reasonable market share in the premium UHT milk category, the company faces a strong competition from Nestle Pakistan Limited and Engro Foods Limited who are the market leaders in the said category. During the 4Q of FY18, HFL also launched a new affordable UHT milk brand with the name of "Asli Milk" to target the masses and make consumer switch over from loose milk through its competitive pricing strategy. During 3Q of FY18, HFL also introduced "Apple Apple" and "Chaunsa Chaunsa"; a line of premium fruit juices, to leverage on the increasing consumption of juices in the country. HFL also made encouraging progress in the flavored milk category on account of volumetric growth in sales of brand "Flava" that was launched in 4Q of FY17. According to the management, the early response to new products seems encouraging while the sustained growth in these products remains to be seen amid challenging operating environment.

HFL continues to maintain low leveraged capital structure

Equity base of the company augmented to Rs. 4.6b (FY17: Rs. 4.4b; FY16: Rs. 3.5b) with the full retention of profits. The debt profile of the company comprised short-term only as it retired all of its long-term debt during FY16. Outstanding balance of short-term borrowings decreased to Rs. 675m (FY17: Rs. 1.3b; FY16: Rs. 0.8b) by end-FY18 on account of lower working capital requirements. The gearing and debt leverage has remained low at 0.15x and 0.51x, respectively, at end-FY18 (FY17: 0.30x and 0.75x; FY16: 0.25x and 1.0x). The said indicators are expected to remain on the lower side as currently there is no plan to raise a long-term debt. As per the management, HFL will continue to finance routine CAPEX by utilizing internally generated funds and may consider divesting its investments in mutual funds to finance any major CAPEX.

Corporate Governance has room for improvement

The Board of Directors comprised ten members, with six representing Mega Foods (Pvt.) Limited and four the Chaudhry family. Senior management team of the company comprises resources having relevant industry experience. The company has re-appointed EY Ford Rhodes to conduct the statutory audit assignment for FY19. The company may include independent directors in the board to improve corporate governance framework.

Future Projects

While assuming sustained tea whiteners sales and growth in UHT milk and new product portfolio especially fruit juices, HFL is projecting a 3-years sales CAGR of around 10%. HFL is also expecting notable improvement in overall profitability over the next three years mainly on the back of gradual increase in sales and partial recovery of gross margins. Moreover, as consumers are relatively more price sensitive to packaged milk and dairy products, along with increasing commodity inflation due to devaluation of rupee, may keep the margins in check. In line with higher sales and profits, HFL is anticipating steady improvements in funds from operations (FFO) and overall liquidity position, which remains to be seen.

ISSUE/ISSUER RATING SCALE & DEFINITIONS Annexure I

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: JCR-VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.jcrvis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details. www.jcrvis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES					Annexure II
Name of Rated Entity	Haleeb Foods Limited				
Sector	Consumer Goods				
Type of Relationship	Solicited				
Purpose of Rating	Entity Rating				
Rating History	**Rating Date**	**Medium to Long Term**	**Short Term**	**Rating Outlook**	**Rating Action**
	RATING TYPE: ENTITY				
	11/01/2019	A	A-2	Stable	Reaffirmed
	31/10/2017	A	A-2	Stable	Initial
Instrument Structure	N/A				
Statement by the Rating Team	JCR-VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.				
Probability of Default	JCR-VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.				
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