RATING REPORT

Haleeb Foods Limited

REPORT DATE:
June 29, 2020

RATING ANALYSTS:
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RATING DETAILS

	Latest Rating		Previous Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	A-	A-2	A	A-2
Rating Outlook	*Negative*		*Stable*	
Rating Date	*June 24 '20*		*January 11 '19*	

COMPANY INFORMATION

Incorporated in 1984	**External auditors:** EY Ford Rhodes, Chartered Accountants
Public Limited (Unlisted) Company	**Chairman:** Aly Khan **CEO:** Syed Mazhar Iqbal
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)

VIS Entity Rating Criteria: Corporates (May 2019)
https://www.vis.com.pk/kc-meth.aspx

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

Syed Mazher Iqbal took the charge as CEO in April 2020. Mr. Mazher is a fellow member of the Institute of Chartered Accountants of Pakistan and has over three decades of experience. He has previously served as the MD/CEO of Pioneer Cement Limited and deputy MD of General Tyre & Rubber Company of Pakistan Limited.

RATING RATIONALE

HFL is a subsidiary of MEGA Foods (Pvt.) Limited, with majority shareholding. The assigned ratings take into account increasing, albeit moderate, business risk profile of the company, underpinned by overall positive demand dynamics of the dairy sector amid stiff competition. However, financial risk profile has weakened over the review period on account of continuing decline in sales mainly due to reduced demand and intense competition for tea whiteners, an established segment of HFL, along with incurring losses primarily on account of higher operational expenses.

Liquidity position is supported by investment in money market mutual funds, though internal cash generation from operations has weakened. With the erosion in equity base on account of losses and higher utilization of short-term borrowings, some increase in leverage indicators has been witnessed during the period under review. Recent decline in interest rates, fuel cost and international skimmed milk prices are expected to bode well for the company in near future. The management has taken various initiatives to arrest the declining trend in sales and become profitable; efficacy and effective implementation of these strategic initiatives remain to be seen. remain to be seen.

<u>Rating Drivers</u>

Dairy Industry Dynamics

Pakistan is the fourth largest milk producer in the world, with estimated gross milk production of 60b liters during FY19. The country's milk sector is categorized into two distinct value chains for the post-farmgate supply of milk to consumers; fresh loose milk and packaged milk & dairy products. Loose milk is the raw milk collected from the animals without any further processing and accounts for 90% of total milk available for human consumption. Organized sector processes remaining 10% milk by employing Ultra-High Temperature (UHT) where milk is heated above 135 °C for 2 to 5 seconds and High-Temperature/Short-Time (HTST) pasteurization where milk is heated to 72 °C for at least 15 seconds. In the packaged milk business, tea whitener is considered the leading category in terms of retail volumes, followed by UHT milk, and pasteurized milk.

Consistently growing population and prevalence of high malnutrition rate indicate that there is significant growth potential in Pakistan's milk industry. As per the Food and Agriculture Organization's (FAO) agricultural outlook 2019-2028, fresh dairy consumption in Pakistan is projected to increase by 42kg/capita to 274kg/capita by 2028, representing nearly 30% of total daily per capita protein availability. Penetration of packaged milk in Pakistan is low vis-à-vis regional peers and its growth potential is hindered mainly by considerable price premium over loose milk due to additional cost of transportation, processing and distributor margin.

Nestle Pakistan and FrieslandCampina Engro Pakistan have the largest presence in the packaged milk segment, having collective market share of 90%. Remaining market share is divided among Shakarganj Food Products Limited, HFL, Dairyland (Pvt) Limited and Fauji Foods Limited. Given the sound sponsor profile, established distribution network and strong brand equity of the largest two brands, to increase market share remains a challenge for the other market players. Growth potential of packaged milk is also restrained by national regulations which mandate different requirements of Milk Fat and Non-Fat Milk Solids for different types of liquid packaged milk. While such regulations are currently not applied on loose milk producers, implementation of minimum pasteurization law could be a significant growth driver for packaged milk.

Decreasing trend in sales and profitability

Product mix of the company is led by tea whiteners, followed by UHT milk, packed cream and fruit juices. The downtrend in top-line continued, though at a slower rate, during FY19 as the company reported lower on account of decrease in overall volumes. UHT milk volume sales were also under pressure despite enhanced marketing spending, mainly due to strong competition from two leading brands Olper's and MilkPak.

Gross profit remained largely as the impact of lower sales was offset by some recovery in gross margin. Improvement in gross margin was mainly due to bulk import of SMP at lower rates and increase in product prices during FY19. Distribution & selling expenses were recorded higher mainly on account increased advertising and promotional spending. Other major components of distribution & selling expenses, such as freight & handling, staff salaries, and travelling costs, remained largely stable during FY19.

Administrative expenses remained largely stable during the year. Despite higher dividend income pertaining to investment in mutual funds, other income was recorded lower in the absence of re-measurement gain on financial assets and farm rental income. In line with higher utilization of short-term borrowings and higher interest rates, increase in financial charges was witnessed. Resultantly, HFL reported net loss during FY19 as compared to net profit in the corresponding period.

Net sales of the company stood marginally lower 9MFY20, though net loss remained sizeable. Going forward, profitability of the company is expected to improve on account of decrease in raw material price without any corresponding adjustment in product prices along with reduction in financial charges due to decline in interest rates. Moreover, in the past year, the company made considerable expenditure in promoting and distributing new products. With no new product in the pipeline along with reduction in fuel prices, distribution and selling expenses are also likely to decrease, having some positive impact on profitability.

Weakening cash flows generation from operations

In line with the reported losses, funds from operations (FFO) remained negative amounting Rs. (425m) during 9MFY20 (FY19: (Rs. 279m); FY18: Rs. 301m). Current ratio decreased to 1.37x by end-9MFY20 (FY19: 1.56x; FY18: 1.91x) mainly on account of higher trade & other payables and increased utilization of short-term borrowings. Liquidity position continues to be supported by money market mutual funds investments. However, given the stressed internal cash generation ability along with increasing short-term borrowings to finance working capital requirements, the company's debt servicing capacity has weakened considerably.

Trade receivables as a percentage of net sales remained low around 1% due to effective implementation of delivery against cash payment. Inventory plus trade receivables to short-term borrowings ratio, however, decreased to 0.93x by end-9MFY20 (FY19: 1.41x; FY18: 1.42x).

Increased leverage indicators due to increased short-term borrowings

Tier-1 equity of the company decreased by end-9MFY20 owing to incurred losses. Total liabilities stood higher at end-9MFY20 mainly due to increased short-term borrowings for working capital requirements. The debt profile of the company comprises short-term borrowings only. Resultantly, gearing and debt leverage ratios increased to 0.40x (FY19: 0.27x; FY18: 0.15x) and 0.87x (FY19: 0.70x; FY18: 0.51x) respectively, by end-9MFY20. Currently, there is no plan by the management to mobilize long-term borrowings.

Board and management

The Board of Directors comprised ten members, with six representing Mega Foods (Pvt.) Limited and four the Chaudhry family. No change in Board and shareholding structure was witnessed during the period under review. Syed Mazher Iqbal took the charge as CEO in April 2020 after the departure of Mr. Memosh Asghar. The company has re-appointed EY Ford Rhodes to conduct the statutory audit assignment for FY20.

Financial Statement (*Amount in Million)*

BALANCE SHEET	FY17	FY18	FY19	9MFY20
Total Assets	8,631	7,921	8,123	7,830
Total Liabilities	3,254	2,332	2,964	3,251
Total Equity	5,377	5,589	5,158	4,579
Paid-Up Capital	279	279	279	279
INCOME STATEMENT	**FY17**	**FY18**	**FY19**	**9MFY20**
Net Sales	12,322	9,456	8,789	6,488
Gross Profit	2,510	1,506	1,495	1,054
Profit Before Tax	1,046	124	(328)	(550)
Profit After Tax	793	169	(410)	(579)
FFO	913	301	(279)	(425)
RATIO ANALYSIS	**FY17**	**FY18**	**FY19**	**9MFY20**
Gross Margin (%)	20.4	15.9	17.0	16.2
FFO to Total Debt	0.71	0.45	n.a	n.m
Debt Servicing Coverage Ratio (x)	15.0	5.5	n.m	n.m
Gearing (x)	0.30	0.15	0.27	0.40
Debt Leverage (x)	0.75	0.51	0.70	0.87
Current Ratio	1.63	1.91	1.56	1.37

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

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: 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.vis.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.vis.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.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'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.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when 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	Appendix III
Name of Rated Entity	Haleeb Foods Limited
Sector	Consumer Goods
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings
Rating History	

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
		RATING TYPE: ENTITY		
24/06/2020	A-	A-2	Negative	Downgrade
11/01/2019	A	A-2	Stable	Reaffirmed
31/10/2017	A	A-2	Stable	Initial

Statement by the Rating Team	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	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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Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Hasan Omer	CFO	June 3, 2020
Mr. Jan Muhammad	Head – Accounting & Finance	June 3, 2020