RATING REPORT

Haleeb Foods Limited (HFL)

REPORT DATE:
July 29, 2021

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	Negative		Negative	
Rating Date	*29 July'21*		*24th Jun' 2020*	

COMPANY INFORMATION

Incorporated in 1984	External auditors: EY Ford Rhodes, Chartered Accountants
Public Limited (Unlisted) Company	Chairperson: Mr. Aly Khan
Key Shareholders (More than 5%):	CEO: Mr. Syed Mazhar Iqbal
Mega Foods (Pvt.) Limited – 56.0% Mr. Ilyas Muhammad 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

RATING RATIONALE

The ratings assigned to Haleeb Foods Limited (HFL) take into account moderate business risk environment underpinned by presence of the company in fast moving consumer goods segment coupled with positive demand prospects of dairy products in line with population growth & higher per capita consumption. On the other hand, heightened competition in value-added dairy and challenging operating environment of the organized segment leaves limited room for price maneuvering leading to pressure on margins. In addition, owing to presence of two strong market players, constituting around 90% market share of the documented dairy segment, reaping incremental share of the pie is considered an uphill task. Further, the financial risk profile of the company could not present a complete recovery during the rating review period with the company reporting negative bottom line since the last three fiscal years. The liquidity profile remained stressed in line with incurrence of loss leading to negative coverages; the same remains a key rating concern for VIS going forward given revenue generation in FMCG sector is highly correlated with spending on promotions and marketing. On the other hand, liquidity profile continues to be supported by investment in money market mutual funds.

The ratings incorporate erosion of equity base resulting in increase in leverage indicators during the rating review period; however, the leverage indicators still comfortably remain within the benchmark criteria for the assigned rating on account of minimal reliance on long-term debt. The ratings incorporate management's initiatives towards change in revenue mix, product line extensions and revenues diversification that have reflected positively on the operational performance of the company during the rating horizon. The implementation of the aforementioned strategies has put HFL back on the road to recovery; however, complete turnaround of the same will be ascertained over time. Going forward, the ratings are dependent on improvement of brand identity and market penetration leading to revenue growth, mitigation of margin volatility, maintenance of leverage indicators at around current levels and rescuing of cash coverages along with evolution of sector dynamics post ongoing pandemic.

Dairy Industry Dynamics: Pakistan is the fourth largest milk producing country in the world with estimated gross milk production of 61.7m tonnes, approximately 62b liters, during FY20. Cows and buffalos produced the major chunk with 22.5m tonnes and 37.3m tonnes respectively while the remaining was produced by sheep, goats and camels. However, milk available for human consumption was recorded lower around 50.0m tonnes; the 20% haircut applied pertained to subtraction of 15% for faulty transportation and a lack of chilling facilities and 5% for suckling calf nourishment. Unfortunately, the sector has not developed to its maximum potential as currently livestock and dairy constitute around 3.1% country's total exports amounting to mere USD $0.7m in FY20. The underutilization of the sector is attributable to multiple reasons including low productivity, seasonality in milk supply, patchy distribution system, absence of cold chains and unhygienic handling at farm and middleman level leading to poor milk quality and the inability to meet international standards. Another major barrier is that most farmers in the country have low yielding animals; even though Pakistan has more milk-producing animals than the US, its milk production is far lower. If the untapped potential is utilized trough rectification of animal rearing practices and infrastructure issues, the dairy sector can contribute around USD $30b to economy through exports.

The country's milk sector is categorized into two distinct value chains for the post-farmgate

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, fat products and allied dairy products.

Profile of the Chairperson

Mr. Aly Khan is the chairperson of HFL. He graduated with M.Sc. Honors from Northeastern University. He has extensive experience in dairy sector that includes setting up one of the largest dairy businesses producing 600,000 liters per day. He also serves as a director of Hub Power Company Limited and Qasim International Container Terminal.

Profile of the CEO

Mr. Syed Mazher Iqbal is the CEO of HFL and took the charge in April 2020. He has previously served as the CEO from Oct'15 to Sep'17. He 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.

Financial Snapshot

Total Equity: end-May21: Rs. 4.03b; end-FY20: Rs. 4.38b; end-FY19: Rs. 5.16b; end-FY18: Rs. 5.59b

Assets: end-May21: Rs. 7.20b; end-FY20: Rs. 7.14b;

end-FY19: Rs. 8.12b; end-FY18: Rs. 7.92b

Profit After Tax: end-May'21: Rs. (322); FY20: Rs. (792m); FY19: Rs. (410m); FY18: Rs. 169m

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 2020-2029, fresh dairy consumption in Pakistan is projected to increase by 5kg/capita to 40kg/capita by FY29. Moreover, as per the same source it is expected that India and Pakistan will contribute more than half of the growth in world milk production over the next decade, and will account for more than 30% of world's production in FY29. 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.

According to statistics of Dun and Bradstreet, Nestle Pakistan and FrieslandCampina Engro have the largest presence in the UHT-treated milk segment with a collective market share of 90%. Remaining market share is divided among Shakarganj Food Products Limited, HFL, Dairyland (Pvt) Limited and Fauji Foods Limited. Growth potential of packaged milk is restricted on account of national regulations which mandate different requirements of Milk Fat and Non-Fat Milk Solids for different types of liquid packaged milk. The demand of tea whiteners has declined considerably in the last three years due to enforcement of tighter quality regulations on the dairy industry by Pakistan Standards and Quality Control Authority (PSQCA) and labeling o the same as non-dairy product by Punjab Food Authority (PFA).

Quantum of loss declined during the ongoing year owing to change in product mix entailing higher margins: HFL's net revenue took a plunge during FY20 declining to Rs. 7.4b in comparison to Rs. 8.0b in the preceding year primarily as a continued impact of classification of tea whiteners, constituting 70% of the revenue mix, as non-dairy products by FDA. The remaining product mix includes milk, fruit juices and fat products (butter, cream & desi ghee). Tea whiteners in respect to other product lines are the lowest grossing product in terms of margins therefore, on account of revenue mix being dominated by the same historically, margins shrunk to 3.6% (FY19: 8.6%) during FY20. Further, despite increase in cost of production, the management was unable to exercise transfer pricing strategy for tea-whiteners for most part of the previous year owing to negative connotation attached with the product in terms of its categorization. Subsequently on account stunted margins, HFL recorded sizable negative bottom line of Rs. 791.6m (FY19: (Rs. 409.7m)) during FY20.

However, the downward trend in revenues was rescued with significant increase to Rs. 10.4b in line with improved market penetration through introduction of different stock keeping units (SKUs) coupled with moderate rectification of brand image during 11MFY21. In addition, the company diversified its revenue stream through tolling, conversation of milk to powder, for various industry players with utilization of Rahim Yar Khan powder plant which was closed since the last three years. Although the company fetched minimal revenue of around Rs. 100.0m during FY21 the same is expected to increase to Rs. 400.0m for FY22.

Moreover, positive trajectory was also witnessed in margins with noteworthy increase to 13.7% (FY20: 3.6%) during the period under review owing to intentional structural shift in the revenue mix; the proportion of tea whiteners was reduced to 65% (FY20: 70%) while contribution of milk and juices increased to 14% (FY20: 12%) and 10% (FY19: 8%) respectively. On the other hand, the contribution of fat products remained unchanged at 10% (FY19: 10%) of the total revenue generation. As per the management, tea whiteners continue to generate lowest margins in the entire product range, ranging between 7%-8%, due to cumbersome production process; however, the same improved by around 2% on account increase of Rs. 5.0/pack during the review period. The increase in margins is also supported by increase in the price of milk to Rs. 160.0/pack (FY20: Rs. 150.0/pack) during 11MFY21. Fat products have the highest margins at 25% followed by juices and milk with 20% and 10% respectively. Going forward, the company plans on tapering off proportion of tea whiteners to 55% against increase in contribution of milk to 20% followed by juices at 15% by end-FY22. The management plans for product line extension under fat products with introduction of cream cheese during FY22; however, the contribution of fat products is expected to be maintained around 10%. In line with strategic vision, despite highest gross margins reaped under fat product category, the company would continue to keep its prime focus on improving distribution of milk as element of brand identity is present with brand 'Haleeb' being synonymous with 'Haleeb Milk'. Further, tolling service has healthy margins of around 20% so the same will reflect positively on company's margins in FY22.

There was exponential increase in absolute terms in selling and distribution expense to Rs. 1.9b (FY20: Rs. 777.7m) during 11MFY21 on account of significant advertising and promotional spending on re-branding of 'Haleeb Milk'. On the other hand, administrative expenses declined to Rs. 108.5m (FY20: 124.6m) owing to decrease in employee related expenses as the average number of employees were reported lower during the rating review period. Further, other expenses stood lower at Rs. 33.3m (FY20: Rs. 91.7m) during 11MFY21 on account of reduced depreciation of non-operational Rahim Yar Khan plant as the plant had exceeded high depreciable age. The company booked other income of Rs. 73.9m (FY20: Rs. 149.8m) given no dividend income was earned on financial assets during 11MFY21 as opposed to Rs. 128.1m in the preceding year. Despite increased levels of borrowings, HFL's finance cost was rationalized and recorded lower at Rs. 76.9m (FY20: 171.0m) owing to a sharp dip in the benchmark rates during the review period. As a combined impact of positive trajectory of revenues, notable recovery of margins and rationalized finance cost, the quantum of loss was recorded lower at Rs. 322.5m during the period under review as compared to a loss of Rs. 791.6m in the preceding year.

Volatility exhibited in liquidity profile; the same has been a function of profitability indicators: Liquidity profile of the company could not present a stable position during the rating review period on account of incurrence of net loss, although the quantum of loss declined considerably, given funds flow from operations (FFO) were still negative. Subsequently, FFO to total debt was also reported negative. The trend in liquidity indicators is a replication of profitability metrics. Therefore, enhancement in scale of operations and improvement in margins coupled with HFL's limited reliance on long-term debt, debt service coverage ratio (DSCR) was recorded at 0.09x at end-11MFY21; however, the same does not indicate capacity of the company in comfortably meeting the obligations falling due. Going forward, cash flow generation is expected to improve on account of higher business volumes coupled with shift in revenue mix entailing higher margins.

Stock in trade stood higher at Rs. 1.4b (end-FY20: Rs. 0.9b) at end-May'21 with increase manifested in finished goods on account of growth momentum in sales. The slight increase in trade debts to Rs. 127.0m (end-FY20: Rs. 83.2m) was in sync with growth in scale of operations. The aging of receivables is satisfactory as around four-fifths of the receivables pertained to less than three-month overdue bracket. However, collectability of receivables amounting to Rs. 28.4m pertaining to civil services institution is highly unlikely, therefore the company might have to book provisioning against the same in the medium term. Loans and advances were recorded higher at Rs. 126.6m (end-FY20: 51.0m) at end-May'21 on account of higher advance payments to suppliers and contractors; the same is an outcome of increase in scale of operations. Short term investments amounted to Rs. 923.5m (end-FY20: Rs. 1.1b, end-FY19: Rs. 1.1b) comprised investment in cash and money market funds at end-May'21; given there is no liquidity stress, the management does not plan on liquidating the securities during the rating horizon. Further, liquidity of the company is slightly impacted due to sizable sales tax refunds amounting to Rs. 980.7m (end-FY20: Rs. 980.7m) due from government during the rating review period; the company is unable to rectify the situation given it is an exogenous factor and inbuilt in the operating business dynamics.

Trade and other payables were recorded higher at Rs. 1.5b (end-FY20: Rs. 1.2b) on account of higher inventory levels. Payable to gratuity was recorded higher at Rs. 128.9m (end-FY20: Rs. 112.1m) on account of higher contribution payable based on actuarial assumptions. The current ratio was recorded at comfortable level during the rating review period.

Conservative capital structure with minimal dependence on long-term borrowings: The equity base of HFL declined on a timeline basis to Rs. 3.2b by end-May'21 owing to incurrence of loss in the last three financial periods. The debt matrix of the company is heavily tilted towards short term credit owing to limited reliance of the company on long-term borrowings. The utilization of short-term borrowings largely remained at prior year's level of Rs. 1.0b; the facility pertains to running finance facility secured against mutual fund investment in minimal risk with 5% margin and a pari passu charge over all present and future current and fixed assets with 25% margin. The markup charged on the facility is locked at 1-3M-Kibor plus 0.3% per annum with un-availed limit amounting to around Rs. 2.0b at end-May'21. On the other hand, the company procured long term debt amounting to Rs. 256.8m (end-FY20: nil) during the rating review period under SBP's temporary refinance scheme for payment of salaries and wages of employees and workers; the facility is payable in eight equal installments ending in Nov'22 with a markup charge of 0.5%. Out of the total, Rs. 64.2m has already been paid and the next installment of Rs. 32.1m is due in Aug'21. Subsequently, total debt levels of the company increased slightly resulting in increase in gearing and leverage to 0.37x (FY20: 0.29x) and 0.97x (FY20: 0.78x) respectively at end-May'21. The company does not foresee procurement of additional long-term debt for capital expansion in the next 5-7years given the current production capacities are considered sufficient for meeting production requirements. Hence, with improvement envisaged in revenues and profitability, capitalization indicators are expected to improve in the medium to long term rating horizon on account of equity augmentation.

Haleeb Foods Limited Appendix I

FINANCIAL SUMMARY *(amounts in PKR millions)*

BALANCE SHEET	June 30, 2018	June 30, 2019	June 30, 2020	May 31, 2021
Non-Current Assets	4,070	3,982	3,624	3,306
Stock-In-Trade	897	1,530	938	1,367
Trade Debts	60	112	83	127
Tax Refunds Due from Government	981	981	981	981
Financial Assets at Fair Value Through Profit & Loss	1,409	1,070	1,086	924
Cash & Bank Balances	92	80	96	88
Total Assets	7,921	8,123	7,144	7,195
Trade and Other Payables	1,095	1,198	1,209	1,475
Short Term Borrowings	675	1,162	1,011	1,009
Long Term Borrowings	-	-	-	193
Total Debt	675	1,162	1,011	1,202
Total Liabilities	2,332	2,964	2,764	3,162
Paid-Up Capital	279	279	279	279
Tier-1 Equity	4,612	4,260	3,543	3,249
Total Equity	5,589	5,158	4,380	4,032
INCOME STATEMENT	**June 30, 2018**	**June 30, 2019**	**June 30, 2020**	**May 31, 2021**
Net Sales	9,456	7,972	7,379	10,410
Gross Profit	1,506	688	263	1,785
Operating Profit	184	(247)	(581)	(202)
Profit Before Tax	124	(328)	(752)	(279)
Profit After Tax	169	(410)	(792)	(322)
FFO	301	(186)	(616)	(78)
RATIO ANALYSIS	**June 30, 2018**	**June 30, 2019**	**June 30, 2020**	**May 31, 2021**
Gross Margin (%)	15.9	8.6	3.6	17.2
Net Margin (%)	1.8	(5.1)	(10.7)	(3.1)
Current Ratio	1.91	1.56	1.38	1.30
FFO to Total Debt (x)	0.45	(0.16)	(0.61)	(0.07)
FFO to Long Term Debt (x)	-	-	-	(0.44)
Debt Servicing Coverage Ratio (x)	5.48	(1.91)	(2.92)	0.09
ROAA (%)	2.0	(5.1)	(10.4)	(4.9)
ROAE (%)	3.1	(7.6)	(16.6)	(8.4)
Gearing (x)	0.15	0.27	0.29	0.37
Debt Leverage (x)	0.51	0.70	0.78	0.97
Stock+Trade debts/ Short-term Borrowings	1.42	1.41	1.01	1.48

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 Rating				
Rating History	**Rating Date**	**Medium to Long Term**	**Short Term**	**Rating Outlook**	**Rating Action**
			RATING TYPE: ENTITY		
	29-07-2021	A-	A-2	Negative	Reaffirmed
	24-06-2020	A-	A-2	Negative	Downgrade
	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	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**	
	1	Mr. Ghulam Abbas	CFO	18-June-2021	
	2	Mr. Qasim Raza	Senior Executive Treasury	18-June-2021	