RATING REPORT

Shakarganj Food Products Limited

REPORT DATE:
July 23, 2019

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	*Stable*		*Stable*	
Rating Date	*18 Jul'19*		*20 March'18*	
Sukuk (preliminary)	A		A	
Rating Outlook	Stable		Stable	
Rating Date	*18 Jul'19*		*20 March'18*	

COMPANY INFORMATION

Incorporated in 2001	**External auditors:** EY Ford Rhodes, Chartered Accountants
	Chairman of the Board: Mr. Anjum M. Saleem **Chief Executive Officer:** Mr. Anjum M. Saleem
Public Limited Unlisted Company	
Key Shareholders (with stake 5% or more):	
Shakarganj Limited- 52.4%	
Bank Islami Pakistan Limited- 36.4%	
Crescent Steel and Allied Products Limited – 8.4%	

APPLICABLE METHODOLOGY

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

Shakarganj Food Products Limited

OVERVIEW OF THE INSTITUTION

Shakarganj Food Products Limited is an unlisted public limited company setup by initially acquiring a fruit juice concentrate plant from A.M. Fruits in 2005 and later acquiring a dairy facility from Dairy Crest Limited in 2006. Principal activity of SFPL involves manufacturing, processing and sale of food products including dairy, fruit pulps, and concentrate juices.

Profile of Chairman/CEO:

Mr. Anjum A. Saleem is the Chairman/CEO of SPFL and carries over 30 years of international and local diverse corporate management experience. Mr. Anjum holds a Chartered Accountant qualification from ICAEW (Institute of Chartered Accountants, England & Wales) and also serves as CEO of Shakarganj Limited.

RATING RATIONALE

The ratings assigned to Shakarganj Food Products Limited (SFPL) take into account company's continuous business growth, adequate liquidity profile and debt coverages. The ongoing enhancement of milk processing packing capacities will bode well for the company. The ratings also derive strength from strong sponsor profile, comprising renowned business concerns including Sharkarganj Limited, Bank-Islami Pakistan Limited and Crescent Steel and Allied Products Limited. Business risk profile of the company is considered moderate on account of increasing competition in value-added dairy and challenging operating environment of the organized dairy segment, leading to range bound margins. Moreover, the industry margins remain sensitive to exchange rate risk and regulatory changes in taxes and duties on import of skimmed milk powder and edible oils.

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 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%.

Improved awareness of milk quality and popularity among high-income group have accelerated the demand for pasteurized milk in the recent years, helping it to attain 10% 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.

Asset Mix

The augmentation of asset base by end-1HFY19 was led by capital expenditure on milk processing and filling machines. The capex was mainly funded through sukuk, equity injection and lease assets subject to financing agreement. Capital work in progress mainly pertained to production enhancement. After the completion of said expansion, SFPL will witness 41% increase in milk processing capacity.

Sales and Profitability

SFPL registered a 27% increase in net sales during FY18, largely driven by a notable volumetric gains in liquid tea whitener and UHT milk as well as across the board improvement in selling price. Tea-creamer remained the leading revenue contributor in overall sales mix during FY18, followed by UHT Milk. In line with the higher production activity and input cost inflation, cost of sales. Fuel & power expenses also increased during FY19 mainly on account of higher production levels and electricity price.

Distribution and selling expenses were recorded higher during FY18 as the company increased the sales promotion & advertisement spending to support top-line growth momentum. Sales promotion & advertisement spending as a percentage of net sales, is considered lower than the peer companies. Finance cost increased slightly owing to higher utilization of debt financing during the period. Net income of the company increased to Rs. 418m (FY17: Rs. 261m) with slightly higher net margin of 2.6% (FY17: 2.1%).

Net sales were recorded higher as the witness double-digit increase in tea whitener and UHT milk volumes during 1HFY19, while the formation of Juice, Nectar and Still Drinks' division (JNSD) positively impacted juices sales despite seasonality factor. Major raw materials procured by the company include skimmed milk powder and palm oil, and hence the increase in input costs due to recent rupee devaluation coupled with the higher fuel and transportation expenses are projected to keep profit margins under check during FY19. However, the management intends to pass on impact of cost escalation onto the consumers. Moreover, the energy efficiency gains and economies of scale with big batch production mainly emanating from capacity enhancement is expected to bode well for the company.

Liquidity and Capitalization

In line with the higher profits, cash flows generation of the company improved notably during FY18. Funds from operations increased on account of higher cash before working capital changes and lower tax payment. Current ratio improved marginally to 1.1x by end-FY18 (FY17: 1.0x).Total equity augmented to Rs. 2.8b by end-1HFY19 (FY18: Rs. 2.7b) with the continued retention of profits. The sponsors while showing their commitment also injected equity during FY18. The debt profile of the company comprises a mix of short-term and long-term borrowings. Going forward, the scheduled repayments of long-term loans and augmentation of equity base may positively impact the leverage indicators.

ISSUE/ISSUER RATING SCALE & DEFINITIONS Annexure I

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 — Annexure II

Name of Rated Entity	Shakarganj Food Products 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				
July 18, '19	A-	A-2	Stable	Reaffirmed
Mar 20, '18	A-	A-2	Stable	Initial
RATING: SUKUK				
July 18, '19	A		Stable	Final
Mar 20,'18	A		Stable	Preliminary

Instrument Structure

Sukuk is of amount Rs. 725m.Tenor of the Sukuk will be 6 years including 1-year grace period. Principal will be repaid in 20 quarterly installments starting from 15th month from the date of issuance.

The facility shall be secured by first pari passu charge over moveable & immoveable fixed assets of the company with 25% margin plus any other security mutually agreed or as advised by the legal counsel. Moreover, the company will maintain a Debt Service Account (DSA) with accounts bank, which will be held under exclusive lien of investment agent/trustee (for the benefit of the sukuk investors). The company shall ensure that during each month (and in any case not later than the fifteenth (15th) day of each month), it shall deposit the amount equivalent to the 1/3rd of the upcoming installment amount (principal + profit/rental) into DSA so that the aggregate amount in the DSA on the due date is equal to the installment amount of the relevant period due for payment.

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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