RATING REPORT

Shakarganj Food Products Limited

REPORT DATE:
August 18, 2023

RATING ANALYSTS:
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RATING DETAILS

	Latest Rating		Previous Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	BBB-	A-3	BBB+	A-2
Rating Outlook	Negative		Stable	
Rating Date	*18 Aug'23*		*02 March '23*	

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 2023)
https://docs.vis.com.pk/docs/CorporateMethodology.pdf
Rating the Issue (Nov 2021)
https://docs.vis.com.pk/docs/Notchingtheissue202007nov.pdf
VIS Rating Scale
https://docs.vis.com.pk/docs/ratingscale.pdf

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 SFPL and carries over 30 years of international and local corporate management experience. Mr. Anjum is a qualified Chartered Accountant from ICAEW (Institute of Chartered Accountants, England & Wales) and also serves as CEO of Shakarganj Limited.

RATING RATIONALE

The ratings review of SFPL take into account SFPL's pre-tax margins dipped during the outgoing year on account of significant promotional expenses incurred to maintain market share coupled with increased financial expense borne by the company. Incurrence of high promotional expense remains a function of the Company operating in fast moving consumer goods sector. Further, the ratings incorporate weakening in liquidity position evidenced from reduced cash flow generation and debt service coverage reported lower than 1.0x. On the flip side, CCC is quite low and the short-term borrowing coverage is healthy at over 2x; however, the policy of using payables as a zero-cost financing source is putting stress on the current ratio. Owing to decline in overall debt utilization, gearing and leverage improved during the rating review period. Given no new debt drawdown is expected as all capex plans have been shelved, the gearing indicators are expected to improve during the rating horizon.

However, the strong sponsor profile, comprising renowned business concerns including Shakarganj Limited, Bank-Islami Pakistan Limited, and Crescent Steel & Allied Products Limited. The ratings incorporate moderate business risk environment underpinned by in-elastic demand of milk coupled with positive demand prospects of dairy products in line with population growth & higher per capita consumption. Moreover, the ratings reflect largely sustained market share despite high competition in value-added dairy and challenging operating environment of the organized segment. However, 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. Moreover, the industry margins remain sensitive to exchange rate risk and price risk pertaining to imported skimmed milk powder and edible oils.

Going forward, the ratings are dependent on consolidation of current market share, upward trajectory of revenue, mitigation of margin volatility, and improvement of debt service coverage while surviving through the present challenging economic situation.

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. As per the estimates of Pakistan Institute of Development Economics, the total annual milk production is expected to reach 63m tonnes in FY22. Unfortunately, the sector has not developed to its maximum potential as currently livestock and dairy constitute only a miniscule proportion of total exports of the country. 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 through rectification of animal rearing practices and infrastructure issues, the dairy sector can contribute around USD $30b to economy through exports.

Milk industry in Pakistan can be broadly segregated into two segments: loose milk and processed milk with loose milk constituting 92% of the market share while penetration of processed milk is only 8%. Processed milk penetration in Pakistan is considered to be on the lower side compared to the regional peers such as India (14%), and Bangladesh (20%). Demand for milk is seasonal, with the flush and the lean period, which occur in the first and second half of the year, respectively. However, due to low elasticity demand for milk is noncyclical. Increasing urbanization, under-penetrated milk market with great upside potential, favorable laws introduced by regulatory authorities and rising middle class contribute to the uprising aggregate demand for packaged milk. However, the key business risks include regulatory risk and the challenge of changing perceptions. VIS believes that benefits of marketing campaigns will be reflected in the medium to long term and there is no quick solution for changing perception in the short run unless significant regulatory changes such as minimum pasteurization law are enforced.

Heightened Business Risk Profile amid Current Economic Situation

Pakistan nowadays faces mountainous issues: spiraling inflation, massive devaluation of the Pakistani rupee against major world currencies, increasing fuel prices, and the drying-up of foreign currency reserves. The inflation is in the double digits while the consumer price index (CPI) is currently hovering around 25%. Business community has warned that high cost of production amid a volatile rupee-dollar parity, uncertainty in the political and economic environment and high-interest rate would further dampen overall business activities and crush small and medium enterprises. If timely government intervention is not made, sizable export orders would not be serviced resulting in lay-offs, reduction in tax revenue collection and halt of industrial development.

Due to unavailability of dollars with banks, imports and thousands of containers are awaiting clearance on the port due to the foreign exchange crisis. Moreover, the suspension of opening of letters of credit (LCs) has caused supply chain disruptions in the country. The businesses are facing issues in procurement of imported raw materials due to which shortage of essential goods is expected in the near future. Moreover, Russia's invasion of Ukraine has also resulted in a record surge in fuel prices; the same has in turn led to global supply chain being also marked with disruptions. Stemming from global aspects, the availability and prices of fossil fuel – oil, LNG and coal – have been adversely impacted. Future fuel price hikes would be detrimental to Pakistan as the forex reserves would deplete further. In addition, national exports to Ukraine have also ceased, impacting local industries and overall economy.

Sukuk Payments

SFPL due to volatile macro-economic conditions and the implications they are facing some liquidity challenges. It is in the process of restructuring /re-profiling the outstanding Sukuk after it was not able to fulfill its sukuk obligations. The Trustee, Pak Oman has informed VIS in writing that Initially in March 2023, company submitted a restructuring request to the lenders. The request involved the deferral of principal payments for a duration of one year, beginning from the 19th redemption i.e., April 10, 2023, and an extension in the tenor of the Sukuk for a corresponding period. After the request was circulated to investors, a meeting was held on April 5, 2023, wherein investors recommended that SFPL settle its principal payment for the 19th redemption, and agreed to consider the restructuring request for a one-year deferment starting from the 20th redemption i.e., July 10, 2023, onwards.

Subsequently, SFPL settled the principal payments to all investors with delay for the 19th redemption, and submitted a revised restructuring request for the deferral of principal payments for one year beginning from the 20th redemption. The profit component for the 20th redemption has also been settled by the Company, while principal is to be part of the restructuring request as in principally agreed by the lenders. At present three investors have confirmed their approvals for the principal deferment for one year, namely Al Meezan Investments, Faysal Funds, and Dawood Family Takaful Limited. Based on the expected timeframe given by remaining investors, two investors namely Pak Libya Holding Company and NBP Funds, are expected to convey their approvals next week, while PAIR Investment Company Limited expects to convey its approval after its Board meeting scheduled in the last week of August. As per the trustee the restructuring expected to be completed by end of August 2023.

Shakarganj Food Products Limited — Annexure I

Financial Statement *(Amount in Million)*

BALANCE SHEET	**FY19**	**FY20**	**FY21**	**FY22**	**1QFY23**
Fixed Assets	7,837	7,834	7,784	7,572	7,424
Store and Spare Parts	213	196	194	220	233
Stock in Trade	1,407	1,224	1,608	1,028	1,063
Trade Debts	120	124	137	158	198
Loans and Advances	227	142	80	49	63
Income and Sales Tax	691	745	384	0	0
Cash & Bank Balances	431	322	282	47	21
Total Assets	**10,972**	**10,607**	**10,495**	**10,705**	**10,900**
Trade and Other Payables	3,147	4,149	4,089	4,000	4,474
Short Term Borrowings	299	349	349	450	440
Long-Term Borrowings *(Inc. current matur)*	1,840	1,516	1,449	1,113	1,010
Total Borrowings	2,140	1,865	1,798	1,563	1,450
Retirement Benefit	246	280	336	392	386
Contract Liabilities	794	663	844	1,017	585
Total Liabilities	**6,903**	**7,389**	**7,125**	**7,067**	**6,996**
Tier-1 Equity	3,042	2,238	2,426	2,506	2,785
Total Equity	**4,069**	**3,217**	**3,360**	**3,638**	**3,904**
Paid-Up Capital	1,676	1,676	1,676	1,676	1,676

INCOME STATEMENT	**FY19**	**FY20**	**FY21**	**FY22**	**1QFY23**
Net Sales	16,588	15,383	18,024	18,027	5,479
Gross Profit	2,071	1,230	2,353	2,448	1,073
Operating Profit/(Loss)	192	-612	619	470	491
Profit/(Loss) Before Tax	10	-1,028	300	72	396
Profit/(Loss) After Tax	105	-886	124	123	260
FFO	149	-709	654	189	0

RATIO ANALYSIS	**FY19**	**FY20**	**FY21**	**FY22**	**1QFY23**
Gross Margin (%)	12.5	8	13.1%	13.6%	19.6%
Net Margin (%)	0.6	-5.8	0.7%	0.7%	4.7%
FFO to Long-Term Debt	0.08	-0.38	0.45	0.17	-
FFO to Total Debt	0.07	-0.47	0.36	0.12	-
Debt Servicing Coverage Ratio (x)	0.6	-0.38	1.53	0.74	-
Gearing (x)	0.7	0.83	0.74	0.62	0.52
Debt Leverage (x)	2.27	3.3	2.9	2.8	2.5
Current Ratio	0.6	0.5	0.5	0.5	0.6
Inventory + Receivables/Short-term Borrowings	5.1	3.9	5.0	2.6	2.9

Shakarganj Food Products Limited — Annexure II

Financial Projections *(Amount in Million)*

BALANCE SHEET	**PFY23**	**PFY24**	**PFY25**
Fixed Assets	7,192	7,034	6,869
Store and Spare Parts	255	326	389
Stock in Trade	1,310	1,551	1,775
Trade Debts	159	201	241
Loans and Advances	65	75	88
Income and Sales Tax	0	0	0
Cash & Bank Balances	70	86	408
Total Assets	**10,557**	**10,502**	**10,334**
Trade and Other Payables	3,912	3,730	3,111
Short Term Borrowings	292	0	0
Long-Term Borrowings *(Inc. current matur)*	1,054	953	885
Total Borrowings	1,346	953	885
Retirement Benefit	408	465	541
Contract Liabilities	924	1,075	946
Total Liabilities	**6,609**	**6,241**	**5,629**
Tier-1 Equity	2,831	3,194	3,686
Total Equity	**3,947**	**4,260**	**4,705**
Paid-Up Capital	1,676	1,676	1,676

INCOME STATEMENT	**PFY23**	**PFY24**	**PFY25**
Net Sales	25,107	31,755	38,078
Gross Profit	3,801	4,541	5,656
Operating Profit/(Loss)	956	1,089	1,454
Profit/(Loss) Before Tax	650	857	1,311
Profit/(Loss) After Tax	199	304	446
FFO	555	871	1,482

RATIO ANALYSIS	**PFY23**	**PFY24**	**PFY25**
Gross Margin (%)	15.1%	14.3%	14.9%
Net Margin (%)	0.8%	1.0%	1.2%
FFO to Long-Term Debt	0.53	0.91	1.67
FFO to Total Debt	0.41	0.91	1.67
Debt Servicing Coverage Ratio (x)	1.84	2.79	5.40
Gearing (x)	0.48	0.30	0.24
Debt Leverage (x)	2.3	2.0	1.5
Current Ratio	0.6	0.7	0.8
Inventory + Receivables/Short-term Borrowings	5.0	-	-

REGULATORY DISCLOSURES — Annexure IV

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		
Aug 18, 23	BBB-	A-3	Negative	Downgrade
Mar 02, '23	BBB+	A-2	Positive	Upgrade
Jan 04, '22	BBB+	A-3	Stable	Maintained
Nov 23, '20	BBB+	A-3	Negative	Downgrade
July 18, '19	A-	A-2	Stable	Reaffirmed
Mar 20, '18	A-	A-2	Stable	Initial
		RATING: SUKUK		
Aug 18, 23		Suspended		
Mar 02, '23	BBB+		Positive	Maintained
Jan 04, '22	BBB+		Stable	Maintained
Nov 23, '20	BBB+		Negative	Downgrade
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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Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Naguib Saigal	CFO	23rd January 2023

	Mr. Nasir Ismail	Senior Financial Analyst	23rd January 2023