RATING REPORT

Shakarganj Food Products Limited

REPORT DATE:
November 27, 2020

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	A-	A-2
Rating Outlook	*Negative*		*Stable*	
Rating Date	*23 Nov'20*		*18 Jul'19*	
Sukuk	BBB+		A	
Rating Outlook	*Negative*		*Stable*	
Rating Date	*23 Nov'20*		*18 Jul'19*	

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 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 assigned to Shakarganj Food Products Limited (SFPL) take into account 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 price risk pertaining to imported skimmed milk powder and edible oils.

The company's net revenue was recorded lower during 9MFY20 largely due to depressed volumes and selling prices for the key products, particularly in the tea whitener category. Besides a gradual shift from tea whiteners to UHT and pasteurized milk categories, volumetric sales of tea whiteners were also impacted by the supply chain disruption and closure of offices, schools, colleges, tourist spots, and dhabas owing to the outbreak of COVID-19. The ratings also factor in contraction of profit margins due to significant increase in raw material prices, including skimmed milk powder, raw milk and vegetable fats, coupled with largely stagnant selling prices of key products owing to strong competition amongst major players to retain market share and growth. Resultantly, liquidity and debt coverage indicators have weakened due to operating losses during 9MFY20. Due to increase in overall debt burden and higher trade payables, the gearing and debt leverage ratios have also increased by end-9MFY20; the said indicators are projected to improve as there is no plan to mobilize further long-term borrowings over the medium-term.

Rating Drivers

Dairy Industry Dynamics

Pakistan is the fourth largest milk producer country 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. Remaining market share is divided among SFPL, Haleeb Foods Limited, 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.

Sales and Profitability

Net sales, in comparison to the corresponding period last year, decreased by 14% mainly on account of depressed volumes and selling prices, particularly in the tea whitener category. Volumetric sales of tea whiteners were also impacted by the supply chain disruption and closure of offices, schools, colleges, tourist spots, and dhabas owing to the outbreak of COVID-19. The impact of lower tea whitener sales was partially offset by higher UHT milk sales which increased on a timeline basis during 9MFY20. Juices volumes also improved and accounted for 14% of volume mix (FY19: 9%; FY18: 7%) during 9MFY20.

Cost of sales was recorded at Rs. 10.1b during 9MFY20 (FY19: Rs. 14.5b; FY18: Rs. 12.9b). Gross margin stood lower at 8.5% during 9MFY20 (FY19: 12.5%; FY18: 18.1%). account of escalation in input cost largely due to higher skimmed milk powder price in the international markets and rupee deprecation.

Selling and distribution cost, in comparison to corresponding period last year, decreased by 7% 9MFY20 as the impact of slightly higher promotional spending was more than offset by decrease in freight & forwarding, staff salaries and rents, rates & taxes. Administrative expenses, in comparison to corresponding period last year, increased by 12% mainly on account of higher fee & subscription expense and marginal increase in salaries & other benefits.. Financial charges increased on a timeline basis mainly on account of increased interest rate in the period under review. . Despite tax benefit, the company reported net loss of Rs. 667m during 9MFY20 vis-à-vis net profit of Rs. 105m during FY19 (FY18: Rs. 418m).

During FY21, growth in revenue is expected to emanate from recovery in volumetric sales and repositioning of the company's key tea whitener brand 'Qudrat'. Projected increase in revenue also derives support from the continued growth of the company's juices, nectar and pulp business. The restoration of pulp orders from local as well as international clients, which were deferred during the COVID-19, is also expected to positively impact the top-line to some extent during FY21. Meanwhile, economical procurement of skimmed milk powder, reduction interest rate is expected to bode well for bottom-line of the company.

Liquidity

Liquidity indicators have weakened considerably on account of sharp decline in cash flows generation during FY19 and 9MFY20. Due to operational losses and higher finance cost, the company reported net outflow of funds from operations (FFO) amounting to Rs. 673m during 9MFY20 vis-à-vis an inflow of Rs. 149m during FY19 (FY18: Rs. 634m). Current ratio also remained low at 0.5x at end-9MFY20 (FY19: 0.6x; FY18: 1.1x) on account of increasing trend in trade & other payables. Inventory plus trade receivables to short-term borrowings stood at 4.4x (FY19: 5.1x; FY18: 3.7x) as trade payables are being used to finance working capital.

Capitalization and Funding

Total liabilities increased on a timeline basis to Rs. 7.1b by end-9MFY20 (FY19: Rs. 6.9b; FY18: Rs. 4.5b). The debt profile comprises a mix of short-term and long-term, with later being the major component. Outstanding balance of long-term borrowings, inclusive of current maturity, amounted to Rs. 1.6b at end-9MFY20 (FY19: Rs. 1.8b; FY18: Rs. 1.4b). It is pertinent to note that restructuring of Sukuk was approved in July2020 & effective fromApril'2020 whereby principal repayment amounting to Rs. 145m has been deferred for one year under the COVID-19 relief.

Paid-up capital stood at Rs. 1.8b (FY19: Rs. 1.8b; FY18: Rs. 1.8b) while core equity base decreased on account of reported loss. During FY19, Bankislami provided funds of Rs. 280m in the form of Musharrakah financing for a period of 5 years period. The amounts carries zero markup rate. Moreover, an Equity Warrant Option was also issued under which BIPL may opt for conversion into ordinary shares of the company at a fixed price of Rs. 15 per share. This facility holds same rights as rights of shareholders.

Due to increase in overall debt burden and trade payables, the gearing and debt leverage ratios increased to 0.82x (FY19: 0.70x; FY18: 0.66x) and 2.96x (FY19: 2.27x; FY18: 1.70x), respectively by end-9MFY20. Gearing is projected to improve due to largely stagnant debt levels and higher equity, though leverage would remain on the higher side owing to higher trade payables.

Shakarganj Food Products Limited Annexure I

Financial Statement (*Amount in Million)*			
BALANCE SHEET	**FY18**	**FY19**	**9MFY20**
Total Assets	7,196	10,972	10,499
Total Liabilities	4,532	6,903	7,080
Total Equity	2,664	4,069	3,418
Paid-Up Capital	1,676	1,676	1,676
INCOME STATEMENT	**FY18**	**FY19**	**9MFY20**
Net Sales	15,776	16,588	11,006
Gross Profit	2,861	2,071	931
Profit/(Loss) Before Tax	594	10	(849)
Profit/(Loss) After Tax	418	105	(667)
FFO	634	149	(673)
RATIO ANALYSIS	**FY18**	**FY19**	**9MFY20**
Gross Margin (%)	18.1	12.5	8.5
FFO to Total Debt	0.36	0.14	n.m
Debt Servicing Coverage Ratio (x)	1.05	0.6	n.m
Gearing (x)	0.66	0.70	0.82
Debt Leverage (x)	1.70	2.27	2.96
Current Ratio	1.1	0.6	0.5
Inventory + Receivables/Short-term Borrowings	3.7	5.1	4.4

ISSUE/ISSUER RATING SCALE & DEFINITIONS Annexure 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 Annexure III

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		
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		
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. Restructuring of Sukuk was approved in July2020 & effective fromApril'2020 whereby principal repayment amounting to Rs. 145m has been deferred for one year under the COVID-19 relief.
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.
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. For conducting this assignment, analyst did not deem necessary to contact external auditors or creditors given the unqualified nature of audited accounts and diversified creditor profile.

Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Naguib Saigal	CFO	October 15, 2020
Mr. Shoaib Afzal	Senior Financial Analyst	October 15, 2020