RATING REPORT

Dairyland (Private) Limited (DPL)

REPORT DATE:
October 21, 2019

RATING ANALYSTS:

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RATING DETAILS		
	Initial Rating	
Rating Category	**Long-term**	**Short-term**
Entity	A-	A-2
Rating Outlook	Stable	
Rating Date	*October 15, 2019*	

COMPANY INFORMATION	
Incorporated in February 2009	**External auditors:** Munaf Yusuf & Co. Chartered Accountants
Private Limited Company	**Chairman of the Board:** Mr. Javed Akhtar
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Sulaiman Monoo
Akhtar Textile (Pvt.) Limited – 45.9%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: Industrial Corporates (May 2016)
https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Corporate-Methodology-201904.pdf

Dairyland (Private) Limited (DPL)

OVERVIEW OF THE INSTITUTION

Dairyland (Pvt.) Limited was incorporated in February 2009 as a Private Limited Company. The registered office of the company is located in Karachi. The company is a part of Akhtar Group of Companies

Akhtar Group of companies includes Dairyland Private Limited, ACT Wind Private Limited, Indigo Textile Private Limited and Akhtar & Sons

RATING RATIONALE

Dairyland (Private) Limited (DPL) is engaged in manufacturing and sales of dairy products, especially processed milk. The company is a part of Akhtar Group of Companies with majority shareholding vested with Akhtar Textile (Pvt.) Limited. The company has developed a comprehensive value chain ranging from its own farm containing livestock for milk production to the final packaged products for the end-consumer. As per management, no human interaction is involved during the milk collection and processing. The company owns one farm which is located in Dhabeji, Karachi. Currently, the company has a herd of approximately 4000 Australian cows for milk production. DPL deals under the brand name of 'Dayfresh' with a product portfolio encompassing Homogenized & Pasteurized milk, UHT Milk, Flavored Milk, Tea Whitener, Yogurt & Raita. The following table depicts the diversified product portfolio and different SKUs of each product of the company:

Figure 1: Product portfolio

UHT Milk	Pasteurized Milk	Flavoured Milk	Yogurt	Tea Whitener	Raita
Dayfresh UHT Milk (1 liter and 235 ml packs)	Dayfresh Pasteurized Milk – Full Cream (1 liter bottle)	Dayfresh Mango Flavoured Milk (235ml pack)	Low Fat Yogurt (400g cup)	Mann Chai (250 ml & 190ml)	Zeera Raita (250g & 80g)
	Lite Pasteurized Cow Milk (1 Litre bottle)	Dayfresh Banana Flavoured Milk (235ml pack)	Mast Dahi (200g cup)		Podina Raita (25g and 80g)
	Dayfresh Pouch Milk (1 Liter)	Dayfresh Coffee Flavoured Milk (235ml pack)	Mast Dahi (1kg, 400g & 200g pouches)		
		Dayfresh Chocolate Flavoured Milk (235ml pack)	Sweetened yogurt (80g and 400g cup)		
		Dayfresh Strawberry Flavoured Milk (235ml pack)	Frogurt (80g cup)		
		Dayfresh Pista Zafraan Flavoured Milk (235ml pack)	Fruit Yogurt Strawberry (80g cup)		

DPL has eight branded shops in Karachi, which offer the company's products via home delivery services to the customers. The company also has distribution arrangements with nine other major distributors through which its products are supplied to more than 4000 shops in five major cities in the country. Shareholding of DPL is primarily vested with Akhtar Group of Companies, with Akhtar Textile (Pvt.) Limited holding a majority stake of 45.9% in the company.

Capacity utilization

Figure 2: Machinery details

Details of Machinery	Function of Machinery	Production Capacity	Capacity Utilization		
			2019	2018	2017
Milk Processing Plant	Milk Processing	5000 Liters per hour	50%	40%	35%
Bottle Filler (Filling & Capping Machine)	Milk Filling and Packing	1200 Bottles per hour	25%	19%	19%
Prepack click (Packing Machine)	Milk Filling and Packing	1800 Liters per hour	18%	14%	14%
Prepack Machine	Milk Filling and Packing	1800 Liters per hour	20%	14%	14%
Tetra Mik UHT Plant	Milk Processing	5000 Liters per hour	58%	25%	25%
Tetra Pack Filling Machine	Milk Filling and Packing	8000 Packs per hour	31%	16%	30%
Tetra Pack Filling Machine	Milk Filling and Packing	9000 Packs per hour	67%	44%	-
TBA19 - Filling line	Milk Filling and Packing	7500 Packs per hour	61%	-	-

As per management, capacity utilization is on the lower side because the processing and packaging capacity is higher than the milk production capacity. This was a deliberate decision on the part of management to invest in processing and packaging facilities keeping in view future demand. Management will gradually increase the milk production capacity in line with growth in demand.

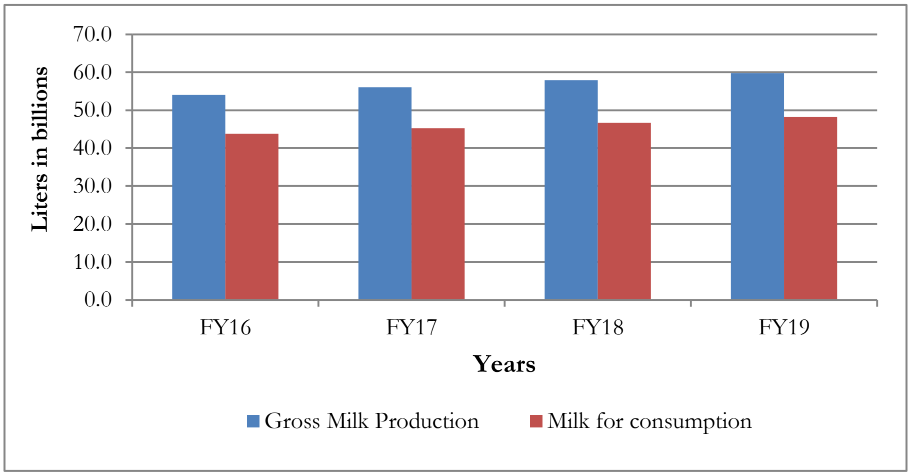
Rating Drivers

Business risk is characterized by significant competition in the packaged milk industry, which comprises only one-tenth of the overall milk consumption in Pakistan. Loose milk constitutes 90% of the total milk consumption in the country. Transition of consumers from loose milk to packaged milk continues to remain a challenge but at the same time untapped loose milk market represents significant growth opportunity for the packaged milk industry players. Business risk profile of DPL is supported by diversification into other dairy variants among which flavored milk has gained significant traction over the past few years

Livestock sector carries significant importance in the Pakistan's economy as it is the largest contributor to the agriculture sector with a share of 60.5%[1] in overall agricultural production. Overall contribution of the livestock sector to Pakistan's GDP was reported at 11.2% in FY19[1]. Milk and meat are the major products of the livestock sector. Pakistan is among top 5 milk producers in the world with gross milk production of 59.8 billion liters in FY19[1]. With increase in demand, milk production in the country has also increased on timeline basis as indicated in the following chart:

[1] *Economic Survey of Pakistan 2018-19*

Figure 3: Gross milk production and milk for consumption[1]



Processed milk penetration is on the lower side in Pakistan

Milk industry in Pakistan can be broadly segregated into two segments: loose milk and processed milk. Loose milk constitutes around 91% of the overall market while penetration of processed milk is only 9%. 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%). Hence, significant opportunity exists for the processed milk industry players provided customer sophistication, consumer income levels and demand for nutritional products increases over time.

Consumer perception of packaged milk will require time and significant efforts to evolve

Although significant market share of loose milk represents an opportunity, but at the same time convincing consumers to shift from loose milk to packaged milk has proven to be a challenge. One key reason for slow transition is that the consumers perceive packaged milk to be of inferior quality and contaminated with chemicals and preservatives. Moreover, some companies continue to sell packaged milk of low quality which further reinforces this negative perception. For example, the Pakistan Council of Scientific and Industrial Research (PCSIR) found that only six out of sixteen packaged milk brands that are given Ultra High Temperature (UHT) and pasteurization treatment are safe for consumption in 2017. Educating consumers regarding the benefits of pasteurization (particularly health and safety benefit) through marketing campaigns is essential for improving perception of packaged milk. VIS believes that benefits of such 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.

Loose milk represents a cheaper alternative to packaged milk

Packaged milk producers procure raw milk from farmers, transport it to their processing facilities, process it and distribute it though several distribution channels. Accordingly, the additional cost of transportation, processing and distributor margin is passed on to the end consumer in the form of higher prices. At present, the price of packaged milk is approximately 20-25% higher than the loose milk. Resultantly, price conscious customers, especially those in the rural areas, continue to prefer loose milk on account of lower price despite health hazards associated with it.

Presence of significant competition in the packaged milk sector represents another challenge for DPL but DPL's foray into milk variants and other related products have provided diverse growth avenues

Nestle Pakistan and FrieslandCampina Engro Pakistan have the largest presence in the packaged milk segment through their brands MilkPak and Olper's, respectively. MilkPak and Olper's commanded market shares of 45% and 44% of the overall packaged milk market in FY19, while the remaining proportion was shared among four other brands (Dayfresh, Haleeb, Good Milk, Nurpur). Market share of Dayfresh was reported at 2% in FY19. Given the sound sponsor profile and strong brand equity of the largest two brands, growth in market share of Dayfresh will depend on expansion in retail footprint and marketing activities undertaken to establish brand equity.

With time, DPL has expanded its product portfolio to diversify its revenue sources. The company has become the second largest market player in the flavored milk segment with a market share of 13% in FY19. Pakola remains the market leader with a share of 65%. Given that flavored milk sales of DPL have grown by more than twelve times in the period from FY16 to FY19, management foresees this segment as a major revenue driver going forward. Furthermore, the company has also launched tea whitener and first ever lactose free milk in Pakistan in FY18, which also offer significant growth potential going forward.

Sales of DPL have depicted healthy year on year growth during the last three years on account of both price and volumetric increase. Addition of new products in product portfolio has also aided increase in topline of the company. Growth in topline has translated to higher bottom-line of the company albeit net margins have declined during the last three years due to expenses incurred to build brand reputation

Net sales of the company have grown at a CAGR of 38.6% during the last three outgoing years (FY17-FY19). Net sales were reported at Rs. 1,462.8m (FY18: Rs. 1,517.4m; FY17: Rs. 1,013.8m; FY16: Rs. 788.1m) in 9M'FY19. Growth in net sales was a function of both increase in average prices and increase in volumes. Introduction of additional SKUs within a product line coupled with diversification in product portfolio have also contributed to growth in topline of the company. Within the dairy segment, the company has witnessed considerable diversification over the years. As per management, an increasing inclination of consumers to opt for healthier beverages has contributed to sizeable growth in the flavored milk sales. In order capitalize on trend for healthier alternatives, management also launched lactose free milk in FY19. 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. Management is targeting growth in this market as well through product diversification. Management plans to launch two new products, going forward. The following figure depicts the product mix of the company:

Figure 4: Sales mix

Products	FY16	FY17	FY18
Pasteurized Milk	13.0%	21.5%	14.9%
UHT Milk	28.6%	28.6%	19.5%
Sterilized Milk	2.1%	0.2%	0.0%
Flavoured Milk	7.7%	28.6%	33.4%
Yogurt & Raita	2.7%	3.4%	2.7%
Eggs	12.5%	1.3%	11.2%
Raw Milk	33.4%	16.4%	18.4%
Cheese	0.0%	0.0%	0.0%
Net Sales (Rs. in millions)	**788.1**	**1,013.8**	**1,517.4**

Gross Margins of the company have remained stable during the last two years as any increase in prices of raw materials was transferred in the form of higher product prices. Selling and distribution expenses have increased have more than doubled during the last three years primarily on account of higher promotion expenses and higher salaries and wages. Management believes that promotion expenses are essential to increase market penetration and build brand equity, while expansion in distribution network to cater to that increasing demand was the reason for sizeable increase in headcount of the company. At end-FY18, total headcount of employees was 433 (FY17: 95; FY16: 72). In view of higher expenses, operating margins of the company have depicted a declining trend over the years (9M'FY19: 7.2%; FY18: 9.4%; FY17: 10.6%; FY16: 14.1%). Bottom-line of the company is supported by gain in the value of biological assets (9M'FY19: Rs. 34.8m; FY18: Rs. Rs. 43.5m; FY17: Rs. 39.1m; FY16: Rs. 5.3m). Net profit and net margin were reported at Rs. 71.8m (FY18: Rs. 73.1m; FY17: Rs. 54.2m; FY16: Rs. 45.2m) and 4.9% (FY18: 4.8%; FY17: 5.3%; FY16: 5.7%), respectively. Going forward, management expects growth in topline to persist at a similar pace as the last few years due to increase in market penetration, while selling and distribution expenses will grow but at a lower rate as the management has already incurred sizeable capex on developing infrastructure. Hence, bottom-line of the company is expected to increase while improvement in net margins is also projected.

Liquidity profile has witnessed improvement in line with improvement in profitability

With higher bottom-line, Funds from Operations (FFO) has also improved on timeline basis. FFO amounted to Rs. 195.9m (FY18: Rs. 257.5m; FY17: Rs. 190.1m; FY16: Rs. 130.8m) in 9M'FY19. FFO is considered adequate to service outstanding obligations as indicated by debt servicing coverage ratio of 1.18x (FY17: 1.25x) in FY18. FFO in relation to long term debt and FFO in relation to total debt has also registered improvement to 31.8% (FY17: 22.3%; FY16: 13.8%) and 21.3% (FY17: 16.3%; FY16: 10.6%), respectively in FY18. Stock in trade and trade debts provide adequate coverage for short term borrowings, while current ratio is also considered satisfactory as it remained above 1.0x at end-9M'FY19. With projected growth in profitability of the company, liquidity indicators are also expected to improve, going forward.

Leverage indicators have remained manageable due to support from sponsor in the form of sizeable interest free loan

Sponsor has continued to inject interest free loan (9M'FY19: Rs. 4.0b; FY18: Rs. 3.2b; FY17: Rs. 2.2b; FY16: Rs.1.5b) which is convertible into ordinary shares of the company at the discretion of the management. Equity base of the company has registered sizeable increase on timeline basis primarily on account of injection of interest free loan coupled with modest contribution from profits of the company which were retained. As total debt was sustained at approximately similar level during the last few years, while equity base has improved, both leverage (9M'FY19: 0.33x; FY18: 0.45x; FY17: 0.57x; FY16: 0.72x) and gearing (9M'FY19: 0.23x; FY18: 0.31x; FY17: 0.41x; FY16: 0.61x) have decreased on timeline basis. Going forward, modest increase may be witnessed in the long term borrowings in the short run for capex requirements but leverage indicators are expected to remain at manageable levels due to projected growth in profitability and sizeable equity base. Management has committed to retain Rs. 3.0b interest free sponsor loan in the company for the operations of the company over the rating horizon.

Corporate governance framework is adequate but depicts room for further improvement

Board and management's oversight of operations is considered thorough with detailed discussion conducted on every aspect of the business during the meetings. Management team comprises of seasoned professionals and a management committee has been established which meets on a monthly basis. However, formalization of board and management committee meeting minutes may be undertaken to ensure greater transparency. In line with best practices, management may consider inclusion of independent directors on the board. Furthermore, establishment of a separate and independent internal audit in line with management plans is also considered important from governance perspective.

Dairyland (Pvt.) Limited Appendix I

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	FY16	FY17	FY18	9M'FY19
Non-Current Assets	3,388.6	4,484.1	5,379.0	5,901.1
Stock-in-Trade	369.3	471.6	680.8	762.4
Trade Debts	45.0	64.4	78.6	147.1
Biological assets held for sale	11.5	21.9	28.0	34.1
Cash & Bank Balances	2.3	2.8	4.4	3.4
Total Assets	4,160.7	5,373.6	6,523.0	7,247.2
Trade and Other Payables	198.8	286.3	371.6	297.0
Short Term Debt	293.1	318.2	400.7	475.9
Long Term Debt	945.9	851.0	810.7	641.4
Total Debt	1,239.0	1,169.2	1,211.4	1,117.3
Total Liabilities	1,458.6	1,626.2	1,759.9	1,588.9
Total Equity (excluding revaluation surplus)	2,038.6	2,830.0	3,889.5	4,815.7
Total Equity (including revaluation surplus)	2,702.1	3,747.4	4,763.1	5,658.2
INCOME STATEMENT	FY16	FY17	FY18	9M'FY19
Net Sales	788.1	1,013.8	1,517.4	1,462.8
Cost of Sales	527.9	717.4	1,075.4	1,038.6
Gross Profit	260.3	296.4	442.1	424.2
Selling and Distribution Expenses	(103.2)	(130.6)	(223.2)	(267.0)
Administrative Expenses	(46.3)	(58.3)	(75.8)	(52.0)
Operating Profit	110.8	107.5	143.1	105.2
Finance Cost	(57.3)	(79.1)	(78.4)	(65.1)
Profit before Tax	48.3	15.1	29.6	37.0
Taxation	(8.4)	-	-	-
Profit After Tax	39.9	15.1	29.6	37.0
Gain on revaluation of biological assets	5.3	39.1	43.5	34.8
Net Profit	45.2	54.2	73.1	71.8
RATIO ANALYSIS	FY16	FY17	FY18	9M'FY19
Gross Margin (%)	33.0%	29.2%	29.1%	29.0%
Operating Profit Margin (%)	14.1%	10.6%	9.4%	7.2%
Net Margin (%)	5.7%	5.3%	4.8%	4.9%
Gearing (x)	0.61	0.41	0.31	0.23
Leverage (x)	0.72	0.57	0.45	0.33
FFO	130.8	190.1	257.5	195.9
FFO to Long Term Debt (%)	13.8%	22.3%	31.8%	30.5%
FFO to Total Debt (%)	10.6%	16.3%	21.3%	17.5%
Debt Servicing Coverage Ratio (x)	N/A	1.25	1.18	0.88
ROAE (%)	N/A	2.2%	2.2%	2.2%
ROAA (%)	N/A	1.1%	1.2%	1.4%
Current Ratio (x)	1.20	1.07	1.04	1.32
(Stock in trade +Trade Debts)/ Short Term Borrowings	1.41	1.68	1.90	1.91

ISSUE/ISSUER RATING SCALE &DEFINITIONS Appendix II

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	Dairyland (Private) Limited
Sector	Dairy
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	
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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Rating History:

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
15/10/2019	A-	A-2	Stable	Initial