RATING REPORT

Mehran Spice & Food Industries (MSFI)

REPORT DATE:
December 14, 2021

RATING ANALYST:
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RATING DETAILS		
Rating Category	**Initial Rating**	
	Long-term	**Short-term**
Entity	A-	A-2
Rating Outlook	Stable	
Rating Date	December 14, 2021	

COMPANY INFORMATION	
Incorporated in 1975	**External auditors:** Syed Hasan & Co. Chartered Accountants
Partnership Concern	**Chairman:** Mr. Gul Muhammed
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Gul Muhammed
Mr. Gul Muhammed – 60%	
Mr. Kashif Gul – 10%	
Mr. Shan Gul – 10%	
Mr. Ameer Gul – 10%	
Ms. Ameera Gul – 10%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria Methodology – Industrial Corporates (August 2021)
https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

Mehran Spice & Food Industries (MSFI)

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

Mehran Spice & Food Industries was incorporated as a partnership concern in 1975. Financial Statements of the company for FY21 were audited by Syed Hasan & Co. Chartered Accountants

Mehran Spice & Food Industries (MSFI), established in 1975, is a family owned bsuiness involved in the manufacturing and sale of food products. They initially started with recipe mixes and spices in their product portfolio which has now diversified into other products such as salt, pickles, vermicelli, sauces, rice and kheer mixes. MSFI is a leading multi-category food company with an international presence. Compared to the other establshied companies (Shan and National) the market share of MSFI is still on the lower side in the total branded market of Pakistan. However, it has a strong fooothold in international markets, such as UAE and KSA. The entity has production and packaging facilities in Karachi, Saudi Arabia and UAE. Related companies include Pure Food Limited (Dubai), Thar Roller Flour Mill Naukot (Tharparkar, Sindh), and Mehran Arabia Trading (Jeddah, KSA).

Product Portfolio	
Recipes	Ketchup & Sauces
Spices	Paste/Chutneys
Salt	Rice
Pickles	Canned Items
Vermicelli	Kheer Mix

The power requirement of the organization is fulfilled via mix of KE santioned load and solar power panels (provides efficiency of around 20%-25%), with diesel powered generators in place for back-up.

Rating Drivers

Market share has been increasing on a timeline basis

In Pakistan, unbranded spices segment continue to enjoy major share of the market at around 60%. In the branded segment, Shan and National Foods hold a significant proportion of the market share. In terms of overall revenues, MSFI is the 3rd largest player in the spices category in the branded segment. Furthermore, the company's diversification in the rice segment and an improving market position in the deserts and paste segment is noted positively. In other segments, the company's market share is considered to be on the lower side but is increasing on a timeline basis.

Given around 60% of the raw material being imported (25% directly and 75% through commercial importers) in nature, risk of exchange rate fluctuations are traded off with exports sales and also passed on to the local consumers.

Established distribution network

The company has a presence in 432 towns via 37 distributors. MSFI has segregated its operations into North, Central and South for effective monitoring while sales officers and order bookers are managed through a third party. The company has warehouses situated in Karachi and Lahore, whereas the management intends to add another 2 warehouses. A sizeable chunk of the local sales are generated through modern trade. MSFI also has a significant presence in HORECA segment with renowned institutions using its products.

On a timeline basis, the topline of the company has depicted an upward trend

Revenue of the business has grown by more than 75% over the last 3 years . The substantial increase in FY20 was largely on account of consumers buying products in bulk as a result of pandemic related uncertainty. During FY21, slight decline in sales revenue was on account of excess inventory in hands of the consumers and worldwide inflation. Around 66% (FY20: 73%) of the company's revenues comprise exports sales with the remaining sold in the local market during FY21. Management targets proportion of exports sales to increase going forward. Product wise mix depicts concentration towards spices with the same comprising around 69% (FY20: 69%) of the revenue base in FY21 followed by rice sales contributing 11% (FY20: 15%) in the sales mix. Geographic concentration in exports sales is considered on the higher side with around 84% (FY20: 85%) of the sales towards Middle East countries. Management has tapped new markets in the outgoing year including Japan, Singapore, Malaysia, South Korea and Indonesia. Geographic mix in exports sales is expected to diversify, going forward as per management.

Margins have remained at around last year levels at 39% (FY20: 38%) during FY21. Maintenance of margins depict effective cost management despite significantly higher transportation charges as compared to the last year. The impact of currency devaluation on the business' performance is minimal, as the impact of increasing cost of imported raw materials is largely off-set by higher prices for export orders. Gross margins witnessed improvement in 4MFY22 to 47% as a result of PKR depreciation. Overall profitability was supported by other income- profit on bank deposits due to greater accumulation of cash balances. Net margins of the company were maintained at 19% during FY21. Going forward, the entity is expected to regain the growth momentum in sales as it looks to expand its network in other countries across Asia, Africa, and North America.

A healthy liquidity profile on the back of a substantial growth in profit

Fund From Operations (FFO) for FY21 remained on the higher side, with cash flows providing sufficient coverage against outstanding obligations. Due to MSFI's conservative policy regarding borrowings, only short term financing lines have been utilized, which results in sufficient coverage for debt servicing as reflected by debt service coverage ratio of 164x (FY20: 255x) in FY21. Current ratio has continued to improve and was reported at 3.2x at end-FY21 (FY20: 2.5x, FY19: 2.0x, FY18: 1.6x), with inventory and trade debts providing adequate coverage for short-term borrowings. Considering the relatively short cash conversion cycle and no plan to raise any substantial amount of debt going forward, liquidity indicators are expected to remain at satisfactory levels.

Consistent improvement depicted in the equity base

Equity base of the business has grown significantly over the last few years. This consistent increase has been ensured by the management's policy to reinvest a major proportion of profits in to the entity.

Gearing and leverage ratios have remained on the lower side at 0.23x (FY21: 0.3x, FY20: 0.3x; FY18: 0.8x; FY17: 0.1x) and 0.32x (FY21: 0.38x, FY20: 0.5x; FY19: 0.7x; FY18: 1.0x) at end-Oct'21, respectively. Considering that no significant capital expenditure is expected in the next few years, the organization is likely to stay free of long-term debt in near future. This, coupled with expected increase in profit over the years is projected to maintain leverage indicators on the lower side over the rating horizon.

Corporate Governance Framework shows room for improvement

The company is a partnership concern; however, the management intends to convert MSFI into a private limited company over the medium term. Board composition and oversight has room for improvement through inclusion of independent directors and documentation of board minutes. Moreover, position of Chairman and CEO should also be segregated. In line with best practices, internal audit department should be a separate independent department rather than being part of the finance department. Financial Statements of the company for FY21 were audited by Syed Hasan & Co. Chartered Accountants, which do not have satisfactory QCR Rating from The Institute of Chartered Accountants of Pakistan (ICAP). The IT system deployed at the organization is integrated Dot Net SuperNova platform. As far as compliance with international quality standards is concerned, MSFI has obtained the following certifications:

- Halal Certification (MSFI products are certified by Shariah Advisors)
- PSQCA Registration
- QMS ISO 9001: 2015 (Relates to Quality Management System)
- US FDA Registration
- FSSC 22000 (Food Safety Certification Scheme)
- BRC (MSFI 8 production lines are certified by BRC Global Standard for Food Safety. BRC certification is an internationally recognized mark of food safety and quality)

ISSUE/ISSUER RATING SCALE &DEFINITIONS Appendix I

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 II
Name of Rated Entity	Mehran Spice & Food Industries				
Sector	Food				
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				
	14-Dec-21	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.				
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Due Diligence Meetings Conducted		Name	Designation	Date
	2	Mr. Abdul Mateen	Manager Finance	01-Dec-21
	3	Mr. Muneer Ahmed	Head of International Sales and Marketing	01-Dec-21
	4	Mr. Syed Waqar Haider Rizvi	Head of Local Sales and Marketing	01-Dec-21