RATING REPORT

Mehran Spice & Food Industries (MSFI)

REPORT DATE:
November 28, 2022

RATING ANALYST:
Asfia Aziz
asfia.aziz@vis.com.pk

Muhammad Taha
m.taha@vis.com.pk

RATING DETAILS				
	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A-	A-2	A-	A-2
Rating Outlook	Stable		Stable	
Rating Date	November 28, 2022		December 14, 2021	
Rating Action	Reaffirmed		Initial	

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 one of the leading multi-category food companies with an international presence. However, in comparison to the other establshied companies (Shan and National) the market share of MSFI is still on the lower side in the total branded spice market of Pakistan. MSFI has a strong fooothold in UAE and KSA whereas the other producers have greater presence in USA and Europe. 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	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. A project to expand the capcity of solar panels is currently underway, and is expected to be completed by end-Dec'22 post which solar power output shall meet around 50% of the overall power requirement.

Rating Drivers

Sizeable presence in Middle East; plans to diversify in other regions including USA, Europe and Far East.

In Pakistan, unbranded spices segment continues to enjoy major share of the market at around 60%. In the branded segment, Shan Foods 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. The company has a diversified product range with major portion emanating from sale of spices followed by other items such as pickles, ketchup, and vermicelli in the overall sales mix. With 22% of raw materials being imported (excluding inputs purchased from commercial importers), risk of exchange rate fluctuations is mitigated via export sales and ability to pass on higher input costs to the end consumers.

Around 80% (FY21: 71%) of the sales revenue was contributed by exports in FY22, with growth emanating from a mix of volumes and prices (currency devaluation). The entity has consistently maintained a strong presence in Middle Eastern Countries (primarily KSA-77% of exports sales) and has established a strong distribution network. Countries in rest of the world account for only around

10% of the export sales. However, the management is now looking to expand into other untapped regions, such as European countries and USA, which can offer a substantial uptick in revenue. Forming partnerships and alliances with experienced distributors is considered vital for which MSFI has recently entered into agreements with new distributors in USA, UK and Sweden, who possess sufficient experience in the food industry. On the product mix in export markets other than KSA, management focuses to increase the share of spices (currently 40%) and reduce contribution of rice exports (currently 60%). Rationale for the same include higher comparative brand loyalty for spices against rice ensuring stability in revenue base.

Right-sizing of local sales and distribution network

Local sales contributed 20% (FY21: 29%) in the total sales revenue of the company in FY22; decline being attributable to deliberate strategy of the company to right-size and reduce losses on local sales. Key initiatives with regard to sales and distribution undertaken in the outgoing year include:

- Reduction in sole distributors to 15 from 22
- Regional sales managers were reduced from 6 to 4.
- Reduction in sales officers from 120 to 50
- Lower Direct Sales Representatives (DSRs) from 700 to 200

Objective going forward is to focus more on major cities such as Karachi and Islamabad and capture a relatively higher market share in these areas. All these initiates have helped to bring down operational costs and will likely lead to an improvement in sales in the local market on a gradual basis. MSFI also has a significant presence in HORECA segment with renowned institutions using its products.

Topline of the company depicted a noticeable improvement during FY22, which also translated into higher profitability.

Revenue of the company went up by 15% in FY22. The uptick was mainly attributable to a rise in prices, as higher input costs are passed on to the consumers. As for the sales mix, proportion of revenue from export has grown to 80% (FY21: 71%) and is likely to be maintained at similar levels. However, with the plan to expand into untapped markets across Europe, North America, and Africa, geographic concentration in KSA is expected to reduce on a gradual basis over time.

Gross margin for the year was reported at 39% (FY21: 34%, FY20: 38%) largely attributable to impact local currency devaluation. Administrative expenses grew in line with sales while selling and distribution expenses fell due to the realignment of the sales network. Higher profit on bank balances supported overall profitability of the company (FY22: Rs. 141m, FY21: Rs. 67m). Consequently, net margin for the outgoing year was reported higher at 29% (FY21: 21%, FY20: 19%). Materialization of projected improvement in revenue base and profit levels with planned expansions in different regions for exports sales along with planned growth in domestic sales as a result of right-sizing of the distribution network is considered important.

A healthy liquidity profile.

In line with an uptick in profitability, Fund From Operations (FFO) for FY22 increased substantially, 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. As a result, debt-servicing coverage remained strong. Current ratio also stood significantly above 1.00x while inventory and trade debts provided sufficient coverage against short-term borrowings. Significant cash and bank balances on the books provide support to the liquidity profile of the company. Given no plans to raise debt going forward, liquidity indicators are expected to remain at satisfactory levels.

Low leveraged capital structure

Although one-off sizeable partners' drawing took place during FY22, management's policy to retain a major share of profits in the business has grown equity base on a timeline basis. With no long-term debt on the entity's books, gearing and leverage ratios have remained on the lower side at 0.19x (FY21: 0.26x, FY20: 0.30x) and 0.31x (FY21: 0.38x, FY20: 0.54x) at end-FY22, respectively. Considering that the business has sufficient cash reserves, any capital expenditure in the next few years is likely to be financed by utilizing internal resources, and the entity is expected to stay free of long-term debt over the rating horizon. Maintaining capitalization profile at similar levels is considered important to sustain the ratings.

Governance Framework has room for further improvement

The entity is a partnership concern, with Board composition and oversight having 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 FY22 were audited by Syed Hasan & Co. Chartered Accountants, which do not have satisfactory QCR Rating. The IT system deployed at the organization is integrated Dot Net SuperNova platform. In relation to system and certification, MSFI is compliant with International Quality standards such as:

- 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				
28-Nov-22	A-	A-2	Stable	Reaffirmed
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.
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. VIS is not an NRSRO and its ratings are not NRSRO credit ratings. Copyright 2022 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.

Due Diligence Meetings Conducted

	Name	Designation	Date
2	Mr. Abdul Mateen	Manager Finance	04-Nov-22
3	Mr. Junaid Alvi	Senior Manager Exports	04-Nov-22
4	Mr. Gul Bahar Khan	Head of Local Sales and Marketing	04-Nov-22