

RATING REPORT

Golden Harvest Foods (Private) Limited

REPORT DATE:

November 28, 2022

RATING ANALYSTS:

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| RATING DETAILS | | | | |
|----------------|-------------------|------------|------------------|------------|
| | Latest Rating | | Previous Rating | |
| | Long-term | Short-term | Long-term | Short-term |
| Entity | BBB+ | A-2 | BBB+ | A-2 |
| Rating Outlook | Stable | | Stable | |
| Rating Date | November 28, 2022 | | October 25, 2021 | |
| Rating Action | Reaffirmed | | Initial | |

COMPANY INFORMATION

| | |
|---|--|
| Incorporated in 2000 | External Auditors: Crowe Hussain Chaudhury & Co. |
| Private Limited Company | Chairman & Chief Executive Officer: Mr. Ghulam Hussain |
| Key Shareholders (with stake 5% or more): | |
| Mr. Ghulam Hussain & Family – 100% | |

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Corporate Rating Methodology (August 2021)

<https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf>

Golden Harvest Foods (Private) Limited

OVERVIEW OF THE INSTITUTION

RATING RATIONALE

Golden Harvest Foods (Private) Limited (Dawn Bread) emerged as a small venture in 1981. The registered office of the company is situated at Plot No. 33, Sector 24, Korangi Industrial Area, Karachi, Pakistan.

In 1990, Dawn Bread developed a relationship with Campden & Chorlywood Food Research Association, which allowed the Company to achieve ISO 9001:1994 compliance. The Company has a longstanding history of exports and meets all relevant food safety guidelines as per international standards.

Profile of Chairman & CEO

Mr. Ghulam Hussain started his carrier in sales and worked for travel industry with domestic and international airlines; thereafter Mr. Hussain formed his own travel agency from 1980-1984, simultaneously under his leadership the Dawn Bread first manufacturing plant was launched in Karachi, in year 1981, which today is the market leader in Bread Industry and bakery products in Pakistan and largest exporter of frozen ready to eat meals.

Golden Harvest Foods (Private) Limited (‘GHFL’ or ‘the Company’) was incorporated in 2000, as a private limited company. Shareholding of the Company is vested with the Ghulam Hussain Family. The Company is principally involved in the business of manufacturing and trading bakery products and ready to eat frozen meals. GHFL is authorized to produce and distribute product suite of bakery products and ready to eat frozen meals under the brand name of ‘Dawn Bread’, in the jurisdiction of Karachi and Baluchistan (domestically) as per family settlement agreement.

GHFL has 2 production facilities situated in Karachi. In addition, the Company’s also has an in-house distribution network comprising more than 200 company owned vehicles, which provide the Company with outreach of more than 20,000 retail outlets. Presently, export markets of the Company include USA, Canada, UK, Norway, Netherlands, Germany, Switzerland, Japan, UAE, South Africa & Saudi Arabia. Exports products are sold under a separate brand name, ‘Mezban’ in USA while in other parts of the world products are exported under brand names of both Mezban and Dawn Bread. Sales in the domestic market also uses brand names of Dawn Bread and Mezban and also another brands namely Cake Shake and Bake My Day.

Provision of consistent quality, market leadership in the domestic bread market, self-distribution ability and geographically diversified export base are key competitive advantages

The assigned rating incorporates the market positioning of the ‘Dawn Bread’ brand, which holds approximately 35% of the consolidated market share of all bread products in Pakistan. In domestic sales main competitors include Bake Parlor, Breadys, Classic and approximately more than 20 small manufacturers not in corporate setup such as more, classic, Brisko, Toasty etc. On the exports front, main competition is with Malaysian, Indian and Bangladesh regions. The brand’s long operational history and broad product suite are viewed as rating strengths. Provision of consistent quality products and fleet size of 200+ vehicles for distribution across Karachi provides competitive advantage to the company against other competitors. Furthermore, the Company has a sizable export clientele, which contribute about half of the Company’s topline. Country-wise concentration is high towards Saudi Arabia and USA with both these countries accounting for three-fourth of export revenue. Plans of diversification in geographic regions is on the cards, as per management.

Rating incorporates medium business risk for FMCG sector

The Company operates in the Consumer – FMCG segment, which VIS classifies as a Medium risk, being characterized by low cyclicality, high to medium competition, capital intensity & technology risk, medium regulatory risk and low energy sensitivity.

Topline growth in FY22 was attributable to increase in local market sales as a deliberate corporate strategy due to challenges faced on the exports front. Subdued net profit margins due to incomplete transfer of input price increases, higher financial cost and tax charges.

Sales revenue of the company has grown consistently at a four year CAGR of 21% in FY18-FY22 to Rs. 3.3b (FY21: Rs. 2.7b, FY20: Rs. 2.2b) in FY22. Growth in revenue during the outgoing year was provided largely by higher volumes in local sales as a deliberate sales-mix shift due to commencement of a new depot in Karachi. Domestic sales contribution to total revenue inched up to 58% (FY21: 50%) in FY22. Subdued growth in exports was a function of inflationary pressures in the export market, primarily in USA. Going forward, geographic sales mix is projected to tilt back towards exports as seasonal demand increase before Ramadan and resumption of Umrah in the key export markets, respectively.

Gross margins of the company declined to 17.5% (FY21: 18.1%) in FY22 largely on account of high raw material prices and escalated energy costs which cumulatively contribute around 70% of the cost of goods sold. Going forward, management expects margins to improve in view of expected gradual stabilization in raw material prices. Materialization of the same amidst increasing cost of wheat together with restricted supply and recent floods impact may affect margins in the medium term. Net margins of the company shrunk to 1.6% (FY21: 4.7%) due to higher finance costs and tax charges incurred. Improving profitability profile is contingent on stabilization of market dynamics going forward. Meeting projected targets is considered important from a ratings perspective.

With lower profit levels and incremental borrowings, cash flow coverages against obligations reduced in the outgoing year. Gearing levels also trended upwards.

With lower net profitability in FY22, cash flows against total debt was reported at 9% (FY21: 31%). The Company's business model requires credit period of at least 3 days, which can extend up to 60 days in cases of hypermarkets. However, the Company has an effective collection mechanism in place, which is reflected by the absence of any doubtful debt provisions historically. Furthermore, a review of the aging of trade debts is indicative of sound credit quality. Over the last 4-year period (FY19-FY22), year-end cash conversion cycle has averaged 68 days. As of Jun'22, mainly owing to an uptick in stock in trade, the cash conversion cycle stood elevated at 92 days. Overall cash conversion cycle is viewed as moderate and manageable. Current ratio was reported at 1.00x at end-June'22 with inadequate coverage of short term borrowings at 98% (FY21: 104%). During FY21, the Company's Board approved investment of Rs. 275m in associated undertaking, M/s Lyallpur Foods Industries (Pvt.) Limited (LFIL). LFIL commenced operations in Nov'21

with key business activity including manufacturing and trade of baked products under a different brand name in Faisalabad and adjoining areas. At end-June'22, the investment exposure in LFIL amounted Rs. 228.2m (FY21: Rs. 204m). As per management, no additional funding is required for the same.

During FY22, the company incurred capex to the tune of Rs. 208m for machinery additions in the value chain; with the same being financed through debt and internal cash generation. In addition, with extended working capital cycle, the short-term borrowing utilization also increased at end-FY22. Hence, leverage and gearing levels were reported higher at 1.54x (FY21: 1.05x) and 1.28x (FY21: 0.78x), respectively at end-June'22. Over the rating horizon (by FY25), the company plans to add additional debt of Rs. 250m for solar panel installation and expansion in burger line. Improving leverage levels in lieu of the same is critical for the ratings.

Corporate Governance reflective of Company's operational status as a family-owned unlisted entity

Corporate Governance infrastructure in place is reflective of GHFLs operational status as a family-owned unlisted entity. At present, the Board Chairman and CEO position is held by the same individual. Furthermore, there is an audit committee in place and an audit function, which routinely carries internal audits of all functional areas.

ISSUE/ISSUER RATING SCALE & DEFINITIONS

Appendix II

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 | | Appendix III |
|---|---|----------------------------|
| Name of Rated Entity | Golden Harvest Foods (Private) Limited | |
| 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 | BBB+ |
| | A-2 | Stable |
| | 25-Oct-21 | BBB+ |
| | A-2 | Stable |
| | | Reaffirmed |
| | | 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. | |
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| Due Diligence Meetings Conducted | Name | Designation |
| | Date | |
| | Mr. Hatim Rangwala | Group Financial Controller |
| | Mr. Amir Sohail | Head of Sales |
| | | November 07, 2022 |