RATING REPORT

Everfresh Farms (Pvt.) Limited

REPORT DATE:
July 15, 2022

RATING ANALYSTS:
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Rating Category	Initial Rating
Entity	BBB+/A-2
Rating Date (Entity)	July 15, 2022
Rating Outlook	Stable
Rating Action	Initial

COMPANY INFORMATION	
Incorporated in 2008	**External auditors:** Malik Haroon Shahid Safder & Co
Private Limited Company	**Chairman and Chief Executive Officer:** Mr. Muhammad Haleem
Key Shareholders (with stake 5% or more):	
Shafi Gluco-Chem Pvt. Limited- 55.7%	
Muhammad Shafi Tanneries (Pvt.) Ltd- 11.4%	
Others- 32.9%	

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

Everfresh Farms (Pvt.) Limited

OVERVIEW OF THE INSTITUTION

Everfresh Farms (Pvt.) Limited (EFPL) was incorporated in 2008 under the repealed Companies Ordinance, 1984 (now Companies Act, 2017) as a private limited company. The principal business activity of the company is to run the business of farming, dairies, cultivation of food grains, seeds, foods and manufacturing of products associated with the farming interest.

RATING RATIONALE

Company Overview

Everfresh Farms (Pvt.) Limited (EFPL) commenced its dairy farming operations in 2008 and was incorporated as a private limited company under the repealed Companies Ordinance, 1984 (now Companies Act, 2017). The principal business activity of the company entails running a dairy farm for the production and processing of milk and agricultural products. The company belongs to Shafi Group of Companies which has presence in the textile (Shafi Texcel Limited-STL), food (Everfresh Farms-EFPL, Shafi Foods- SFPL, Shafi Gluco Chem Private Limited), Leather (Shafi Tanneries Private Limited), and footwear sectors. EFPL is a family owned organization. The registered office and dairy farm is situated in Lahore, Pakistan. Product portfolio of the company comprises raw milk, cheese, imported vegetables, frozen fries and seeds & food grains.

Herd size of the company stood at 3,600 at end-May'22 comprising 1,725 milking cows with the remaining comprising Holstein cows which are not milking. The management plans to the stretch the size of herd over the medium-term to 5,500 through organic growth and reach milking cows capacity to 3,000. Given intensive duty structure, the company plans to shift their strategy of importing cattle to in-house organic breeding. With better yields and growing herd size, milk processing capacity was reported at 53MT/ day in FY21 (FY20: 45MT/day, FY19: 37MT/day).

Shareholding pattern of the company is vested with corporate group companies and individuals with the major share held by Shafi Gluco-Chem Pvt Ltd (55.7%) followed by Muhammad Shafi Tanneries (Pvt.) Ltd (11.4%). Mr. Muhammad Haleem also owns 3.9% of the company's equity and spearheads the management team at EFPL as the CEO. Following is the pattern of shareholding of EFPL at end-April'22:

Key Shareholders	%
Shafi Gluco-Chem Pvt. Limited	55.70%
Muhammad Shafi Tanneries	11.40%
Others	32.90%

The BoD has formed two committees for effective quarterly oversight, namely Executive Committee and Farm-level Committee. The company has engaged Malik Haroon Shahid Safder & Co. for the statutory external audit which lie in C category on the SBP Panel of Auditors.

The company has also obtained the following ISO certifications:

- Food Authority Certificate for raw milk
- HACCEP Certificate 2017
- EPA certificate for Operation and Construction

Business Model

EFPL's business model primarily revolves around operating a dairy farm for the production of milk, manufacturing of dairy products, and managing cold chain (chiller capacity of 55MT) and its logistics. The dairy farm spanning 120 acres of land is located at Bhera, Sargodha and is of free stall layout with dirt lots. It comprises multiple sheds for the milking cows, a shed for dry cows, a shed for young animals, a fully automated milking parlor, sheds for storage of cow feed, staff residential areas, and other allied facilities.

EFPL's Plant & Machinery list includes milking parlours that work with 40 animals per batch, have a batch time of 12 minutes and conducts cow milking three times on a daily basis. It also employs chillers, silo and bunkers that have a 55 tons, 4,800 tons, and 10,000 tons capacity, respectively. In addition to the list, the company also holds two Keenan Wagon, tractors, harvestors, food stationary mixer, Lacto fans and a cooling & showering system to support to the operations of the business.

During FY21, milk production capacity increased to 53MT/day (FY20: 45 MT/day) on account of growth in milking herd size. Going forward, the company plans to grow organically through breeding and gradually increase size of milking cows to 3,000 over the next two to three years with total her size targeted at 5,500. Post achieving this size, the company may look for options on importing additional cows. Furthermore, the management also plans to add 400 acres of land for cropping. Land acquisition will be a mix of owned and leased. Under cropping segment, management targets to backward integrate and manufacture mechanized feed for the cattle reducing reliance on imported feed. However, as per management, raw milk processing will remain the principal business of the company.

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 around 91% of the total milk consumption in the country. Untapped loose milk market represents significant growth opportunity for the packaged milk industry players.

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%). Due to increase in awareness on importance of greater food quality, there is a huge potential for packaged milk in the industry. However, the main challenges faced by the packaged milk players include consumer's favorable perception towards loose milk and additional costs (transportation, processing and distributor margin) added to packaged milk operations.

Demand for milk is seasonal, with the flush and the lean period, which occur in the first and second half of the year, respectively. However, due to low elasticity demand for milk is non-cyclical. Increasing urbanization, under-penetrated milk market with great upside potential, favorable laws introduced by regulatory authorities and rising middle class contribute to the uprising aggregate demand for packaged milk. However, the key business risks include regulatory risk and the challenge of changing perceptions. VIS believes that benefits of marketing campaigns will be reflected in the medium to long-term given recent enforcement of minimum pasteurization law in Punjab. Business risk for EFPL is comparatively on the lower side given contractual orders locked with major customer-Nestle.

Growing asset base

Total assets of the company amounted to Rs. 2.2b at end-Mar'22 (FY21: Rs. 2.0b, FY20: Rs. 1.8b), with non-current assets accounting for 78% of overall asset mix. Property, plant & equipment increased to Rs. 1.1b (FY21: Rs. 1.0b; FY20: Rs. 0.8b) as the company made capex for enhancing machinery efficiencies and expanding land properties. Biological assets increased to Rs. 603.8m (FY21: Rs. 561.4m; FY20: Rs. 572.7m) at end-Mar'22 owing to organic addition of cattle in the farm. Given the nature of business model, the company has relatively moderate working capital requirements. Although increasing in line with growing business operations, trade receivables as a proportion of sales remain on the lower side at 1.6% (FY20: 3.1%) in FY21 as majority sales are made on cash basis. Everfresh Farms allows an average credit period of 10 – 15 days against major institutional client contributing more than 95% of sales revenue.

Net revenue of the company increased by 47% in FY21 due to higher volumetric sales underpinned by growing milking herd size. Gross Margins have depicted improvement on the back of organic growth along with revision in rates with major buyer. Going forward, management expects gradual uptick in profitability through economies of scale.

Net revenue of the company increased by 47% to Rs. 1.3b (FY20: Rs. 0.9b) during FY21 largely contributed by higher volumetric sales underpinned by growing milking herd size. Proportion of raw milk in total sales mix continued to remain on the higher side with the same contributing more than 95% of the total sales mix.

Nestle has signed a contractual agreement with the company for sales of raw milk. Around 45-60 MT of milk per day is provided to Nestle as per the contract. Hence, client-wise concentration is high with Nestle consuming major production of raw milk on a daily basis. However, comfort is drawn from Nestlé's financial strength and market position. As per management, need-based negotiations are convened with Nestle for price revisions. Recently, the selling price for raw milk has been increased by 10% amidst inflationary pressures.

Projected backward integration in mechanized farming is expected to yield benefits in margins. Going forward, revenue is projected to increase mainly due to volumetric growth of milk and higher price renewal of raw milk in Nestlé's agreement.

Sales (PKR mlns)	2019	%	2020	%	2021	%
Raw Milk	678.5	89.6%	868.1	95.6%	1,268.1	94.8%
Cheese	73.8	9.7%	31.8	3.5%	56.0	4.2%
Mushroom, olives & jalepenos	-	0.0%	1.3	0.1%	5.8	0.4%
Frozen Fries	4.9	0.7%	0.9	0.1%	0.0	0.0%
Crops	-	0.0%	6.0	0.7%	7.6	0.6%
Gross Sales	**757.2**		**908.0**		**1,337.6**	

Gross Margins has improved significantly to 14.1% (FY20: 6.1%; FY19: 15.0%) in FY21. The increase in the same is on account of organic growth in revenue along with revision in rates with Nestle. In 9MFY22, gross margin was reported higher at 17.9% reflecting revised average selling price in Nestlé's contract. Going forward, the company plans to further improve its gross margins on the back of higher projected revenue, backward integration and cost efficiency.

Higher other expenses mainly comprised workers' profit participation fund, impairment of building and loss of disposal of fixed assets during the period. Finance cost incurred amounted to Rs. 18.8m (FY20: Rs. 27.7m; FY19: Rs. 5.3m) on account of lower quantum of debt led by repayments. Overall profitability profile was further supported by realized and unrealized gain on investment in shares along with some liabilities written off. The net profit of the company was reported higher at Rs. 112.6m (FY20:Rs. 20.7m; FY19: Rs. 32.5m) during FY21. Similarly supported by higher revenues, profitability during 9MFY22 further strengthened due to higher margins. With backward integration in process, cost of feed is expected to gradually decline supporting profitability profile. Going forward, management expects gradual uptick in profitability through economies of scale; however rising interest cost on additional projected debt may cause a drag on the overall profit levels.

Liquidity profile has witnessed improvement and is considered adequate

In line with the higher profits, the company generated improved funds from operations (FFO) in FY21 to the tune of Rs. 154.5m (FY20: Rs. 22.4m; FY19: Rs. 96.4m). Cash flows in FY20 were impacted by COVID-19 led slowdown. FFO-to-total debt and debt service coverage ratios have improved to 80% (FY21: 54.4%, FY20: 6.0%; FY19: 19.7%) and 2.8x (FY21: 2.8x, FY20: 2.2x; FY19: 9.9x) at end-Mar'22. Liquidity profile of the company is also supported by short-term investments on the books to the tune of Rs. 41m (FY21: Rs. 25m, FY20: Rs. 48m) at end-Mar'22 comprising exposure in mutual funds and shares listed on the stock market. Working capital cycle of the company is on the lower side given receipt from customers realized earlier (7-10 days) and average inventory holding & payment terms being around 120-150 days. Maintenance of liquidity coverages is considered important from a ratings perspective.

Leverage indicators have depicted improvement on a timeline basis on account of profit retention and interest-free loan from associates; however the same are expected to increase going forward to fund land for the cropping division, BMR and working capital requirements. Maintaining the same within manageable levels for the assigned ratings is considered important.

Paid up capital of the company remain unchanged on a timeline basis at Rs. 958.6 at end-Mar'22. Adjusted equity base (including loan from related parties) augmented to Rs. 1.4b (FY21: Rs. 1.3b; FY20: Rs. 0.8b) on account of loans from associates (Shafi Tanneries) and retention of profits. Total liabilities increased to Rs. 743.2m (FY21: Rs. 718.1m; FY20: Rs. 940.7m) at end-Mar'22 mainly on account of higher deferred tax expense, payables and debt utilization. Debt profile of the company comprises 100% long-term borrowings. Leverage and gearing indicators have improved steadily over the past three years. The same were reported lower at 0.52x (FY21: 0.55x; FY20: 1.12x) and 0.19x (FY21: 0.22x; FY20: 0.45x) respectively. Capitalization indicators are expected to increase going forward to fund land for the cropping division, BMR and working capital requirements. Maintaining the same within manageable levels for the assigned ratings is considered important.

Corporate Governance Structure depicts room for improvement.

Given the company's ownership vested with family members, there is no formal Board structure in place. However, discussions with the senior management are convened on need basis. Room for improvement exists in formation of a formalized BoD with induction of external members in accordance to best practices.

EFPL uses Core Dairy farming (Dairy Com) system that installs all cow records in the system. On the audit front, there is a separate internal audit function in EFPL comprising four members; three at Karachi Head office and one at Lahore Head office. On the IT front, the company is currently using Sidat Hyder Financials, which constitutes modules for various administrative departments. As per management, the company is currently in the process of evaluating other ERP systems. On an overall basis, corporate governance and internal controls depicts room for improvement.

ISSUE/ISSUER RATING SCALE & DEFINITIONS Annexure III

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 IV
Name of Rated Entity	Everfresh Farms (Pvt.) 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				
	15-07-2022	BBB+	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.				
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Due Diligence Meeting Conducted	Name	Designation	Date		
	Mr. Zahid Haleem	Director/CFO	01 June, 2022		
	Mr. Mubeen Iqbal	Senior Deputy Manager	01 June, 2022		