RATING REPORT

JK Dairies (Private) Limited

REPORT DATE:
Jan 04, 2023

RATING ANALYSTS:
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RATING DETAILS		
Rating Category	Initial Rating	
	Long-term	Short-term
Entity	BBB+	A-2
Rating Date	*Jan 04, 2023*	
Rating Outlook	Stable	

COMPANY INFORMATION	
Incorporated in 2007	**Chairperson of the Board:** Ali Khan Tareen
Private Limited Company	**Chief Executive Officer:** Ms. Seher Khan Tareen
Key Shareholders (with stake 10% or more):	**External Auditors:** Riaz Ahmad, Saqib, Gohar & Co. Chattered Accountants
Mr. Ali Khan Tareen –52%	
Ms. Mariam Tareen Sethi –16%	
Ms. Meher Khan Tareen –16%	
Ms. Seher Khan Tareen –16%	

APPLICABLE METHODOLOGY(IES)
Applicable Rating Criteria: Corporates (August 2021)
https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

J.K. Dairies (Private) Limited

OVERVIEW OF THE INSTITUTION

JK Dairies is a private commercial dairy mega farm project located at Rang **Pur** Sadat, Near Jamal Din Wali in Rahim Yar Khan District.

The company was incorporated under the companies' ordinance 1984 on February 26, 2007.

Financial Snapshot

Total Equity:
end-FY22: Rs. 1,757.1m; end-FY21: Rs. 1,263.7m; end-FY20: Rs. 1,144.1m

Total Assets:
end-FY22: Rs. 3,152.8m; end-FY21: Rs. 2,323.0m; end-FY20: Rs. 2,067.7m

Profit after Tax:
end-FY22: Rs. 493.4m; end-FY21: Rs. 104.6m; end-FY20: Rs. 219.3m

RATING RATIONALE

The rating assigned to JK Dairies (Private) Limited (JKD) takes into account the company's association with JK Group having business interests in sugar, agriculture and power. The shareholding of the company is vested with four individuals of the Tareen family. The ratings incorporate moderate business risk environment underpinned by in-elastic demand of milk coupled with positive demand prospects of dairy products in line with population growth & higher per capita consumption. Business risk for JKD is comparatively on the lower side given its business-to-business model entailing locking of contractual orders with major customer contributing around 54% of revenue. Assessment of financial risk profile incorporates improvement in profitability, liquidity and leverage indicators. Revenue of the company increased during the outgoing year mainly on account of fair value gain booked at point of milking/harvest and biological transformation along with higher price renewal of raw milk in new agreement. Gross margins have depicted improvement on the back of organic growth in herd size yielding economies of scale, revision in rates with buyer and higher retail prices of other products including sugarcane, Rhodes Grass Hay and livestock sold by the company. The backward integration in mechanized farming for livestock feed yields benefits in margins also. The liquidity position in terms of cash generation has remained volatile; however, the same witnessed improvement during the outgoing year and is considered adequate with cash flows providing fair coverages against outstanding obligations. Moreover, leverage indicators have depicted improvement on a timeline basis on account of profit retention; however, the same continue to be higher than peers. In addition, the leverage indicators are further expected to increase going forward in order to finance expansion in herd size, purchase land for the construction of sheds and milking parlors, and to fund BMR and working capital requirements. The ratings will remain sensitive to maintaining capitalization and liquidity profiles at acceptable levels while improving debt service coverages, going forward.

Business Model & Revenue Streams

JKD is a private commercial dairy mega farm project located at Rang Pur Sadat, Near Jamal Din Wali in Rahim Yar Khan District. The company commenced its dairy farming operations in 2007 with the first lot of 222 heifers imported from Australia through Nestle to assess the impact of summer season on milk production and reproduction. Given heifers successfully acclimatized, the herd size in line with indigenous growth reached to 3,258 animals by end-FY22 as no new purchase was made during this period. The farm setup comprises of multiple sheds for milking cows, dry cows, young calves along with fully automated milking parlor facility, cow feed storage, staff residential areas and other allied facilities. The product portfolio of the company comprises of milk and allied products, Rhodes Grass Hay, forage, livestock and sugarcane. JKD, running a self-sustaining dairy farm, has primarily a business-to-business model with total milk production capacity of around 50,000 liters/ day out of which 10,000 liters is pasteurized and sold under companies own brand name 'JK Dairies' in nearby cities including Rahim Yar Khan, Sukkur, Multan, Sadiqabad, Bahawalpur etc. For the remaining, the company has inked an annual contract with 'Nestle' for sale of ex-factory raw milk. As per the management, prior to the ongoing contract the company had a three-year contract with Engro. JKD follows a quotation-based system wherein quotations from main UHT milk producers including Nestle, Engro, Haleeb, Shahkarganj etc. are taken and the best price quote is approved. As per the agreement, the supplier chosen has to purchase all the milk left after in house processing. There is currently no competition in the pasteurized milk segment in South Punjab region as cold chain is required for delivery given the shelf-life of the product ranges between 5-7 days; however, competition is present from loose milk producers.

The other revenue stream includes Rhodes Grass Hay, Maize and Alfalfa used for fodder of animals for which the seed is procured locally and cultivated on 900-acre. The product is cut, dried and made into bales and sold on ex-factory basis to local exporters. Further, to supplement the revenue generation, the company also cultivates sugarcane on around 500-600 acres of land surrounding the farm; the same is supplied to the nearby associated sugar mills. In addition, JKD also undertakes sale of livestock as an optimal quantity of animals needs to be maintained at all times based on their milking capacity to avoid unnecessary carrying cost. As per the management, the pregnant heifers are sold at around Rs. 700,000 while male animals used for insemination and beef purposes generate a revenue of Rs. 350,000 and Rs. 100,000 respectively.

Dairy Industry Dynamics:

Pakistan is the fourth largest milk producing country in the world with estimated gross milk production of 61.7m tonnes, approximately 62b liters, during FY20. Cows and buffalos produced the major chunk with 22.5m tonnes and 37.3m tonnes respectively while the remaining was produced by sheep, goats and camels. However, milk available for human consumption was recorded lower around 50.0m tonnes; the 20% haircut applied pertained to subtraction of 15% for faulty transportation and a lack of chilling facilities and 5% for suckling calf nourishment. As per the estimates of Pakistan Institute of Development Economics, the total annual milk production is expected to reach 63m tonnes in FY22. Unfortunately, the sector has not developed to its maximum potential as currently livestock and dairy constitute only a miniscule proportion of total exports of the country. The underutilization of the sector is attributable to multiple reasons including low productivity, seasonality in milk supply, patchy distribution system, absence of cold chains and unhygienic handling at farm and middleman level leading to poor milk quality and the inability to meet international standards. Another major barrier is that most farmers in the country have low yielding animals; even though Pakistan has more milk-producing animals than the US, its milk production is far lower. If the untapped potential is utilized through rectification of animal rearing practices and infrastructure issues, the dairy sector can contribute around USD $30b to economy through exports.

Milk industry in Pakistan can be broadly segregated into two segments: loose milk and processed milk with loose milk constituting 92% of the market share while penetration of processed milk is only 8%. 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%). 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 noncyclical. 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 and there is no quick solution for changing perception in the short run unless significant regulatory changes such as minimum pasteurization law are enforced.

Profitability

JKD's net revenue increased by 29% to Rs. 3.6b (FY21: Rs. 2.8b) was largely contributed by the changes in fair value gain at the point of milking/harvest for livestock and crops amounting to Rs. 1.5b coupled with fair value gain recorded to the tune of Rs. 494.2m due to biological transformation. The growth in revenue was also partially supported by increase in sale price of milk. The proportion of sugarcane in the total revenue also increased in line with higher support price decided by the government for the outgoing year. The revenue from sale of milk and allied products was recorded at Rs. 1.3b (FY21: Rs. 1.0b) during FY22; the same is expected to increase to Rs. 2.5b and Rs. 3.7b in FY23 and FY24 respectively in line with increase in milk prices and growth in herd size of milking animals both contributed indigenously and through planned import.

The company's gross margins also improved to 15.2% (FY21: 12.1%) during FY22. attributable to overall increase in price of raw milk as a result of which the new annual contract signed with Nestle was signed at a higher price of Rs. 124/liter as opposed to Engro contract last year at Rs. 108/liter. As per the management, the company has a price revision clause in the sale agreement under which prices are revised as per the market conditions on quarterly basis. Moreover, post-FY22 the price for raw milk has further exhibited an increasing trajectory with the current price of sale contract recorded higher at Rs. 134/liter at end-Dec'22. Further, the GP margin increase is also supported by higher Rhodes Grass Hay price of Rs. 72,000/ Mound (FY21: Rs. 32,000/Mound) during FY22. Going forward, the management expects the margin to increase and range between 18-20% for FY23 as an uptick is expected in milk prices coupled with higher support price announcement of sugarcane to Rs. 300/ Mound and increased livestock sale gains. Furthermore, the livestock prices are indirectly linked with dollar as it serves as a cost benchmark therefore any increase in dollar rendering the imported livestock expensive is partially added in the locally available livestock for sale also.

The selling and distribution expenses decreased sizably to Rs. 27.8m (FY21: Rs. 81.9m) on account of reduction in advertisement and marketing expenses to Rs. 1.8m (FY21: Rs. 55.2m) during FY22. On the other hand, administrative and general expenses remained stable at Rs. 43.3m (FY21: Rs. 41.0m) during FY22 with increase in employee related expenses offset by decrease in utilities, travel expenses and other expenses. Further, other expenses stood higher at Rs. 17.7m (FY21: 13.0m) mainly attributed to increased contribution towards the workers profit participation and welfare fund due to high profit recorded during the outgoing year. The company booked other income of Rs. 12.3m during FY22 as compared to Rs. 26.9m in the preceding year mainly due to decrease in markup received on advance extended to JK Sugar Mills (Pvt) Limited (JKSM) owing to conversion of the same into equity in May'22. In line with increase in quantum of borrowings coupled with benchmark interest rates being at the higher end of the spectrum, the finance cost incurred by the company was recorded higher at Rs. 88.3m (FY21: Rs. 65.8m) during FY22. Furthermore, the company booked notable share of profit amounting to Rs. 220.5m (FY21: Rs. 70.9m) during the outgoing year. Subsequently, as a combined impact of positive trajectory of revenue, growth in margins, rationalized selling & distribution expenses and higher profit from associated companies, the company reported a healthy bottom line of Rs. 493.4m during FY22 as compared to Rs. 104.6m in the preceding year.

Long-term Investments:

JKD has made long-term investment worth Rs. 833.4m (FY21: 512.9m) in two associated companies namely JKSM and Indus Mining (Private) Limited amounting to Rs. 716.1m and Rs. 117.3m respectively at end-FY22. The company holds equity stake of 15.9% (FY21: 15.8%) in JKSM with additional equity injection of Rs. 100m equity made during FY22. Moreover, the share of profit received from JKSM amounted to Rs. 198.4m during the outgoing year. Apart from the equity investment, JKD has also extended an advance to the tune of Rs. 100.0m (FY21: Rs. 6.7m) to JKSM to meet working capital requirements. Mark-up is receivable quarterly at the weighted average borrowing rate of the company. The proportionate ownership held in IML remained constant at 44.8% (FY21: 44.8%) during FY22.

Liquidity

Liquidity position albeit remaining volatile has improved during the outgoing year; the same has been a function of profitability indicators. On the other hand, significant maturity mismatch exists. Liquidity profile of JKD has exhibited positive trajectory with improvements during the outgoing year in line with the growth in revenue and margins. The Funds from Operations (FFO) were recorded to be sizable at Rs. 313.0m (FY21: 100.0m) during FY22.On the flip side, cash flow generation shows volatility on a timeline as the FFO was recorded higher in FY20 at R. 430.4m on account of high margins and no employee related expense paid. As a result, despite increase in total borrowings FFO to total debt and FFO to long-term debt were recorded higher at 0.34x (FY21: 0.14x) and 0.39x (FY21: 0.16x) respectively at the end-FY22. Moreover, with the increase in profitability and higher share of profit from associates the debt service coverage ratio (DSCR) improved to 1.19x (FY21: 0.85x) and was recorded adequate; the same indicates that the company is comfortably placed in meeting the obligations falling due. Going forward, cash flow generation is expected to improve on account of growth in business volumes along with higher gross margins. The current assets of the company mainly comprise of stores & spares that include stocks kept for feed, fertilizer, chemicals etc. to meet the needs of the growing business. Trade debts increased to Rs. 43.3m (FY21: Rs. 28.5m) during the outgoing year in line with growth in scale of operations. However, the aging of the trade debts represents an overdue of 49% of receivables for over six months therefore the timely recovery of the same is considered important from the ratings perspective. Furthermore, the advances, prepayments and other receivables were recorded higher at Rs. 127.1m (FY21: 22.4m) on account of a short-term interest-bearing unsecured advance extended to JKSM. Notable maturity mismatch exists on the company's books on account of long-term investment made in associated companies along with capex incurred during the last two years as a result of which current ratio and short-term borrowing coverages remained lower than 1.0x. On the other hand, the short-term borrowing coverage is also lower on account of sizable feed, fertilizer, medicine stock etc. classified in stores & spares as per the accounting policy for the company's business model. Moreover, JKD's cash conversation cycle has also remained negative for the last three financial periods implying that the suppliers are financing the company's day to day operations.

Plans Going Forward

Out of the total animal herd size of 3,258, the company currently has around 1,322 milking animals. Going forward, the management has planned to increase the milking herd to 5,000 animals with an annual milk production of 70m liters by end-FY28. As per the plan, JKD would import 1,200 pedigree black & white Holsten heifers from United States in the next two to three years; 800 animals are expected to be imported by end-FY24 and the remaining 400 in FY25. The remaining increase is expected to be manifested by indigenous growth as within a span of twenty-four months a baby calf becomes capable of milking. The total CAPEX to be incurred on procurement of cows is estimated at Rs. 1.3b. For inhabitation of the growing heard, the company has also planned to procure additional land with establishment of two new milking parlors and erection of cow sheds within the next three years costing around Rs. 1.0b and Rs. 1.9b respectively. In addition, a solar system of 1MW is also planned to be installed in FY25 to meet the energy requirements of the whole expansion plan. For the aforementioned CAPEX aggregating to Rs. 4.0b, the company plans to procure long-term funding amounting to Rs. 3.0b while the remaining Rs. 1.0b will be contribute by own sources. Apart from capacity expansion, JKD is also planning for product line extensions with addition of new products with high margins.

Capitalization

The equity base of the company augmented to Rs. 1.8b (FY21: Rs. 1.3b) at end-June'22 on account of internal capital generation. Debt profile of the company comprises a mix of short-term and long-term borrowings. The short-term borrowings increased slightly to Rs. 119.3m (FY21: 91.2m) during the outgoing year in order to meet the working capital requirements of the growing business. Short-term funding mainly comprises of loans secured from a commercial conventional bank and associated undertaking. The commercial borrowings facility is secured by first pari passu charge of Rs. 267m over the company's present and future current and fixed assets, lien on import documents and personal guarantee of one ex-director and one present director of the company. The markup charged on the facility is locked in at 1M-KIBOR plus 250 bps per annum, repayable quarterly; the un-availed limit stood at Rs. 20.4m at end-FY22. The loan from associate is repayable as and when the funds are available with the company or on demand of the lender. On the other hand, slight increase was also evidenced in the long-term borrowings to Rs. 793.8m (FY21: Rs. 635.7m) during the outgoing year on account of new facility amounting to Rs. 200m secured from a consortium of banks to finance the CAPEX incurred on installation of solar system and normal BMR on plant and machinery. The facility is payable in twenty equal quarterly installments ending in Jun'26 with a markup charge of 3-M KIBOR plus 125 bps per annum. Despite increase in overall debt levels, gearing and leverage improved on a timeline basis to 0.52x (FY21: 0.58x; FY20: 0.61x) and 0.79x (FY21: 0.84x; FY20: 0.81x) respectively on account of growth in equity base. The company plans on procuring addition long-term debt worth Rs. 3.0b for its expansion plan in FY23 therefore leverage indicators are expected to trend upwards in the medium term.

JK Dairies (Pvt.) Limited — Appendix I

FINANCIAL SUMMARY (Amounts in PKR millions)			
BALANCE SHEET	**FY20**	**FY21**	**FY22**
Property, Plant and Equipment	611.1	660.5	640.2
Long Term Investments	172.0	512.9	833.4
Right of use Assets	151.7	206.7	324.6
Stock-in-Trade	109.8	6.6	9.7
Biological Assets (Inc. Current Portion)	481.7	623.5	806.3
Stores & Spares	130.8	214.7	311.8
Trade Receivables	18.4	28.5	43.3
Advances, Prepayments & other receivables	354.1	22.4	127.1
Cash & Bank Balances	10.9	18.3	19.4
Total Assets	2,067.7	2,323.0	3,152.8
Trade and Other Payables	139.7	145.0	218.0
Short Term Debt	77.0	91.2	119.3
Long Term Debt	615.8	635.7	793.8
Total Debt	692.8	726.9	913.0
Total Liabilities	923.6	1,059.4	1,395.7
Tier-1 /Total Equity	1,144.1	1,263.7	1,757.1
INCOME STATEMENT	**FY20**	**FY21**	**FY22**
Net Revenue	2,615.5	2,796.1	3,597.8
Cost of Revenue	2,199.1	2,457.9	3,051.8
Gross Profit	416.4	338.2	546.1
Finance Cost	76.5	65.8	88.3
Profit before Tax	252.2	234.2	601.7
Profit After Tax	219.3	104.6	493.4
FFO	430.4	100.0	313.0
RATIO ANALYSIS	**FY20**	**FY21**	**FY22**
Gross Margin (%)	15.9	12.1	15.2
Net Margin	8.4	3.7	13.7
Net Working Capital	315.5	(126.1)	(173.9)
Trade debts/Sales	0.7	1.0	1.2
FFO to Total Debt (x)	0.62	0.14	0.34
FFO to Long Term Debt (x)	0.70	0.16	0.39
Current Ratio (x)	1.93	0.86	0.84

Debt Servicing Coverage Ratio (x)	2.10	0.85	1.19
Gearing (x)	0.61	0.58	0.52
Leverage (x)	0.81	0.84	0.79
(Stock in Trade+Trade Debts)/STD	1.66	0.38	0.44
ROAA (%)	20.1	4.8	18
ROAE (%)	10.6	9.2	34.2
CCC	(1)	(10)	(17)

ISSUE/ISSUER RATING SCALE & DEFINITIONS Annexure II

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	Appendix III
Name of Rated Entity	JK Dairies
Sector	Dairy Products
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see table below
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	see table below

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
29/12/2022	BBB+	A-2	Stable	Initial

Due Diligence Meetings Conducted

	Name	Designation	Date
1	Abid Ali	General Manager Accounts	Nov 21, 2022
2	Waqas Ahmad	Asst. Manager Account	Nov 21, 2022