RATING REPORT

JK Dairies (Private) Limited

REPORT DATE:
Dec 22, 2023

RATING ANALYSTS:
Abdul Kadir
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RATING DETAILS

Rating Category	Latest Rating Long-term	Latest Rating Short-term	Previous Rating Long-term	Previous Rating Short-term
Entity	BBB+	A-2	BBB+	A-2
Rating Outlook	Stable		Stable	
Rating Action	Reaffirmed		Initial	
Rating Date	*December 22, 2023*		*January 04, 2023*	

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. Chartered Accountants
Mr. Ali Khan Tareen – 45%	
Ms. Mariam Tareen Sethi – 14%	
Ms. Meher Khan Tareen – 14%	
Ms. Seher Khan Tareen – 14%	
ATF Farms – 13%	

APPLICABLE METHODOLOGY

VIS Entity Rating Criteria: Corporates (MAY 2023)
https://docs.vis.com.pk/docs/CorporateMethodology.pdf

VIS Rating Scale
https://docs.vis.com.pk/docs/ratingscale.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.

RATING RATIONALE

JK Dairies (Private) Limited (JKD) commenced its dairy farming operations in 2007 with the first lot of 222 heifers imported from Australia through Nestle. The herd size stood at 3,182 (FY22: 3,258) animals at end-FY23 as no new purchase was made during the period under review. The ratings assigned to JKD takes into account its affiliation with the JK Group, which has business interests in sugar, agriculture, power and mining.

JKD is a commercial dairy mega farm project situated in Rang Pur Sadat, near Jamal Din Wali in the Rahim Yar Khan District. The farm infrastructure includes various sheds for milking cows, dry cows, and young calves, complemented by a fully automated milking parlor facility, storage for cow feed, residential areas for staff, and other related facilities. The company's product range encompasses Raw Milk, Whole Milk, Low-Fat Milk, Yogurt, Cream, Hay, and Forage. Desi Ghee is planned to be introduced to the product portfolio in the coming months.

JKD, running a self-sustaining dairy farm, has primarily a business-to-business model with total milk production capacity of around 39,000 liters/ day, out of which 56,000 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 raw milk. The company is seeking organic growth of its herd size and to cater to the expected increase, a 400-cattle capacity shed is being added to the facility in Rahim Yar Khan with increased milking capacity. This expansion is estimated to cost about Rs. 45m for the shed and Rs. 53m for the milking parlor.

Rating Drivers

The packaged milk industry in Pakistan faces intense competition, even though it accounts for around 10% of the overall milk consumption. Untapped loose milk market represents significant growth opportunity for the packaged milk industry players.

The milk industry in Pakistan can be divided into two main segments: loose milk and processed milk. Loose milk accounts for approximately 90% of the market, while processed milk has a relatively low penetration rate of only 10%. In comparison to neighboring countries like India (14%) and Bangladesh (20%), the adoption of processed milk in Pakistan is relatively lower. However, there has been a gradual shift towards packaged milk in recent years, indicating a changing trend. The untapped market for loose milk presents a significant growth opportunity for companies operating in the packaged milk industry. There is considerable potential for growth in the packaged milk industry, driven by increasing consumer awareness regarding food quality. However, packaged milk companies face challenges, including consumer preference for loose milk and the additional costs associated with processing, transportation, and distributor margins.

The demand for milk follows a seasonal pattern, with flush and lean periods occurring in the first and second halves of the year respectively. Despite this, the demand for milk shows low elasticity and remains relatively stable. Factors such as urbanization, an untapped market with significant growth prospects, favorable regulatory policies, and a rising middle class contribute to the increasing demand for packaged milk. Enforcing significant regulatory changes, such as implementing minimum pasteurization laws, could potentially address industry challenges more effectively. VIS is of the opinion that the advantages stemming from marketing initiatives will become evident over the medium to long duration. JKD's exposure to business risk is relatively limited, given its secure contractual agreement with Nestle.

Revenue increased while profitability and margins stood lower due to high inflation and interest rates

During FY23, net revenue reached Rs. 4.6b (FY22: Rs. 3.6b; FY21: Rs. 2.8b) mainly on the back of higher average product price and change in fair value less cost to sell. Production of milk products stood lower at 13.9m liters (FY22: 16.9m liters) during FY23. The introduction of new heifers during this period were not yet at the milking age, along with the occurrence of lumpy skin disease, adversely affected milk production. Milk constituted a dominant portion comprising 73% of the total sales, with hay and livestock sales contributing about 10% each while the rest emanated from sugarcane and wheat.

Despite the overall increase in revenue, the gross margin experienced a decrease to 13.6% (FY22: 15.2%) in FY23 on account of inflated input costs, mainly due to rise in prices of soybean and premixes used in cattle feed. While the company managed to maintain selling and distribution expenses, administrative expenses increased considerably to Rs. 110m (FY22: Rs. 43m) mainly due to rise in salaries and allowances. The finance cost incurred by the company increased to Rs. 158.8m (FY22: Rs. 88.3m) due to higher average borrowings and hike in interest rates. Resultantly, the company recorded a decline in net profit and net margins to Rs. 175.8m (FY22: Rs. 493.4m) and 3.8% (FY22: 13.7%), respectively. During 4MFY24, milk production increased to 3.9m liters (4MFY23: 2.5m liters), with projected improvements in profitability and margins in FY24.

Coverages decreased while liquidity ratios exhibit a mixed trend

The Funds from Operations (FFO) stood lower at Rs. 167.5m (FY22: Rs. 313.0m; FY21: Rs. 100.0m) mainly due to lower operating profits. FFO to long-term debt decreased to 0.26x (FY22: 0.39x) despite decrease in long-term borrowings in FY23. Meanwhile, FFO to total debt stood lower at 0.18x (FY22: 0.35x) with largely maintained overall borrowings. Given inherently low levels of inventory and trade debts in its business model, the company's current ratio and short-term debt coverage ratio remained below the minimum threshold at 0.67x (FY22: 0.84x) and 0.21x (FY22: 0.44x), respectively. The cash conversion cycle remained negative over the years, signifying that working capital is being financed mainly through suppliers' credit.

Leverage indicators remained manageable

The company's equity base increased to Rs. 1.9b (FY22: Rs. 1.8b) by end-FY23 on the back of profit retention. Debt profile of the company comprises a mix of short-term and long-term borrowings. The short-term debt increased to Rs. 264m (FY22: Rs. 119m) by end-FY23 to meet the higher working capital requirement while long-term borrowings decreased to Rs. 643m (FY22: Rs. 794m) by end-FY23 on account of scheduled principal repayments. The gearing and debt leverage remained manageable at 0.49x and 0.84x respectively at end-FY23. Given the absence of any major capital expenditure in the foreseeable future, the management is projecting gradual reduction in long-term borrowings while short-term borrowings are projected to increase, which may result in slightly lower gearing ratio given equity is expanded as per projections. The sponsors have injected Rs.70m in form of equity during October 2023.

REGULATORY DISCLOSURES	**Appendix I**
Name of Rated Entity	JK Dairies (Pvt.) Limited
Sector	Dairy Products
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings
Rating History	

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
22/12/2023	BBB+	A-2	Stable	Reaffirmed
04/01/2023	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 Meetings Conducted

	Name	Designation	Date
1	Abid Ali	General Manager Accounts	Nov 27, 2023
2	Waqas Ahmad	Asst. Manager Account	Nov 27, 2023