

Assessment of industry risk is an essential part of credit rating process. The industry risk assessment sets the ceiling for ratings of individual entities within a given industry. It focuses on the degree of cyclicity and the strength of competitive forces along with the extent of capital intensity, vulnerability to technological change, level of regulatory interference and energy sensitivity. All these factors are assessed on a scale ranging from High to Low to assign an overall risk level to each industry. Industry risk categorization for different industries is available on our website under Sector Updates "Industry Risk Analysis" (<https://docs.vis.com.pk/docs/Industryrisk062021.pdf>).

This document explains VIS approach to assess industry risk of Confectionary industry of Pakistan.

Confectionary Industry in Pakistan

Confectionary food items are classified as edible products rich in sugar and carbohydrates. It can be classified into two broad categories; Baker's confections and Sugar confections. Baker's confectionary include flour confections. It includes sweet pastries, cakes and similar baked goods. Sugar confectionary includes candies/sweets, candied nuts, chocolates, chewing gum and other confections that are made primarily of sugar.

OVERALL INDUSTRY RISK

High
High to Medium
Medium
Medium to Low
Low

Cyclicity Risk

The confectionary industry is characterized with medium cyclicity despite the increase in demand for confectionary over the years. The factor driving the rating is business risk which is considered to be moderate in view of significant competition and price elastic nature of products (non-essential food items). Confectionary industry is price elastic and fragmented industry dominated by domestic players, with few prominent large-scale players having sizable market share.

The growth outlook for the confectionary companies is expected to remain sound going forward given the increasing young population in the country. Hence, demand risk is low. However, industry imports palm oil and some specialized chemicals (Gum Base for chewing gums) which exposes the players to FX risk and exert pressure on gross margins. To control rising input costs and preserve margins, the Companies alter/shrink the quantity mix while keeping at the same price points. Players have limited pricing power but prices are variable as well and depend on factors such as brand, quantity, quality and scale of operations

Ismail Industries commands a significant market share in confectionary industry with its notable brands under the name Candyland, Bisconni and Snack city, Hilal Foods also commands decent market share with its product line ranging from cupcakes to chewing gums.

Competitive Risk

The risk of effectiveness of barriers to entry is high because the Confectionary market is highly fragmented with various small players and few large players having sizable market share. Regulatory requirements are low. The provinces have their own food authorities working on the food safety and hygiene in the respective provinces. There is no need of high end research and technological know-how. Most of the raw material is readily available at local level. The most crucial barrier to entry is the intense competition and fragmentation in the industry.

Moreover, overall substitution risk is medium to low. Food items with high nutritional value coupled with low fat content are comparatively expensive (for e.g baked crisps price is much more than a regular crisps). However, growing concerns about obesity and other lifestyle related diseases have directed attention towards curbing confectionary items and seek more healthy options. Going forward, substitution can take place in form of replacing confectionary items with food items with more nutritional value and less proportion of fat. Nevertheless, consumer habits for confectionary items seem sticky.

With respect to the growth trends, the demand in the confectionary sector is derived by an increasing population, more specifically the growth in the young population. However, there are still growing concerns in the youth about the nutritional value of the confectionary items, with an increased awareness about the healthy living habits. Hence, the risk in growth trends is considered to be 'Medium'.

Based on medium to low risk of substitution along with high risk of effectiveness of barriers to entry and growth trends, 'competitive risk' of the industry is assessed as medium.

Capitalization Levels and Technology Risk

The capital intensity risk is 'low'. Minimum capital requirements are low in comparison to other capital intensive industries. Due to this low capital requirement, access to capital through debt or equity financing is relatively easier than that of other industries. Trade debts of the sector are generally low. Short term product life cycle and cash sales generally lead to low short-term borrowing requirement.

Due to cash based nature of the business, smaller working capital cycle has been observed. Industry is considered to be leveraged from moderate to high depending on the capex requirements of the Company. The average capital recovery cycle is of about 3-5 years.

Product innovation risk is considered low. Companies have invested to enhance automation in a bid to improve operational efficiencies.

Regulatory Practices

Pakistan Biscuit & Confectionary Manufacturers Association' and 'Pakistan Food Association' represent the confectionary industry, voicing the concerns of the industry. Provisionsal Food Authorities regulate food safety and hygiene in the respective province. With less stringent regulatory requirements, the regulatory risk is considered to be low.

Energy Consumption

Energy costs carry a decent proportion in total costs; fuel and power accounts for ~10% in cost of sales. Raw material (grain and commodities) cost comprise major portion (more than two-third) within confectionary industry. Impact of electricity break outs is comparatively smaller within large scale producers with electricity backups as compared to small fragmented companies.

On overall basis, based on the factors discussed above, industry risk of Confectionary sector is assigned as Medium to Low

Table 1: Summary of Industry Risk Factors

CONFECTIONARY									
Cyclicality	Competition				Capital Intensity	Technology Risk	Regulatory Framework	Energy Sensitivity	OVERALL RISK
	Risk of Effectiveness of barrier to entry	Risk of Substitutes	Risk in Growth Trends	Overall					
Medium	High	Medium to low	Medium	Medium	Low	Low	Low	Low	Medium to Low

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