The Pakistan Credit Rating Agency Limited

Rating Report

Ismail Industries Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
27-Dec-2019	A	A1	Stable	Maintain	-
28-Jun-2019	A	A1	Stable	Maintain	-
31-Dec-2018	A	A1	Stable	Maintain	-
29-Jun-2018	A	A1	Stable	Maintain	-
30-Dec-2017	A	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect the Ismail Industries Limited's (Ismail Industries or 'the Company') strong presence in confectionery, biscuits and plastic film manufacturing through established brands (Candyland, Bisconni, Snackcity and Astro Films). Growing middle class, coupled with timely capacity enhancements, have led to significant growth in revenues of the Company in the recent past. The ratings draw strength from the Company's diversified revenue stream, supported by the plastic film manufacturing segment. The Company was able to maintain the solid growth trend in revenues, owing to aggressive marketing campaigns and introduction of new food products. The Company maintained margins at the gross level, despite increased costs and rupee depreciation. However, high marketing costs, coupled with increased finance costs and a smaller share of profit from its associate company resulted in a relatively low bottom-line. Nonetheless, business profile remains strong. Ismail Industries' strategic investments in its associated companies is expected to support the bottom-line, going forward. Meanwhile, despite a leveraged capital structure, the Company maintains a strong financial profile, through strong working capital management and adequate coverages.

The ratings are dependent on continued revenue growth and maintenance of margins. Prudent management of expansion and investment-related debt in order to meet financial obligations will be important. Decline in coverages and/or erosion of margins may have a negative impact on ratings.

Disclosure

Name of Rated Entity	Ismail Industries Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-19),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria | Rating Modifier(Jun-19)
Related Research	Sector Study | Food Products(Dec-19)
Rating Analysts	Ateeb Riaz | ateeb.riaz@pacra.com | +92-42-35869504

Profile

Legal Structure Ismail Industries Limited (Ismail Industries or 'the Company') was incorporated as a public listed company in 1989 and is listed on the Pakistan Stock Exchange.

Background The Company was founded by Mr. Muhammad Ismail along with his brothers. 'Candyland', which operates in the confectionary segment, is the flagship brand of the Company. The Company established the brand 'Bisconni' in 2002 and 'Snackcity' in 2006. The Company also produces CPP, BOPP and BOPET films under the brand name 'Astro Films'.

Operations The Company's head office is located in Karachi, with eight production facilities concentrated in three locations – Hub, Port Qasim and Sundar.

Ownership

Ownership Structure Major shareholding of the Company lies with the Ismail Family (~99%) through Mr. Muhammad Ismail (~15%), Mr. Miftah Ismail (~31%), Ms. Almas Maqsood, wife of Maqsood Ismail, (~ 33%), Mr. Ahmed Muhammad (~16%) and associates (~5%). Remaining shareholding is held by the general public.

Stability The ownership structure is stable as the Ismail family owns majority shares of the Company. Mr. Muhammad Ismail has been leading the Company for several years and has vast experience in the industry.

Business Acumen The sponsors have been operating in the industry for over three decades and have very strong industry knowledge.

Financial Strength In addition to being a major player in the confectionery, biscuits and snacks industry, the Group has interests in plastic films and wind power sectors.

Governance

Board Structure The Company's Board of Directors is dominated by the sponsoring family and consists of seven members, including the Chairman, two non-executive directors, two executive directors and two independent directors.

Members' Profile The Board members have strong profiles and specialize in diverse fields such as industrial engineering and economics, in addition to having strong knowledge of the confectionery, biscuits and snacks industry.

Board Effectiveness The Company has formed two Board committees, namely, i) Human Resource and Remuneration Committee, and ii) Audit Committee. The board met five times during FY19 with majority attendance. Minutes of the meetings were well recorded and reflected adequate participation and discussion from members including independent directors.

Financial Transparency Grant Thorton Anjum Rehman Chartered Accountants are the external auditors of the Company. They gave an unqualified opinion on the Company's financial statements for the year ended June 30, 2019.

Management

Organizational Structure The Company has a well-defined organizational structure that is divided according to the main brands. Functions such as Accounts & Finance, HR, IT and Supply Chain are common to the entire organization while Sales and Marketing departments are specific for each brand.

Management Team Mr. Munsarim Saifullah is the Group CEO. He is a close associate of the sponsors and has been involved with the Company since its inception. He holds a Bachelor's degree in Engineering, in addition to having significant experience in production and engineering. Moreover, he has been instrumental in the Company's success over the decades. Mr. Saifullah is aided by a team of experienced professionals.

Effectiveness The Company has no management committees in place. However, members of the senior management regularly communicate and discuss ongoing issues and upcoming plans relating to relevant brands and management functions.

MIS The Company has implemented SAP. The transition to SAP is ongoing after its organization wide implementation. The staff is being appropriately trained to use the new system. The proper implementation of SAP is expected to improve the flow of information.

Control Environment The Company employs strict quality control measures at its production facilities, with all products being ISO 22000 certified. The Company has also received Halal certifications from SANHA. The Company has an effective internal audit department which reports to the Audit Committee, reflecting well on the overall control environment.

Business Risk

Industry Dynamics The confectionery, biscuits and snacks industry in Pakistan is largely dominated by domestic players and is highly price elastic. Distinction between products lies in mass marketing. Pakistan has a large retail base though it is highly fragmented and dominated by small retailers, competing in terms of location, personal relationships and product ranges etc. Overall industry is growing at a good pace.

Relative Position Ismail Industries is one of the leading players in the industry with high market penetration and brand recognition. Candyland is the market leader in confectionary. The Company is the third largest manufacturer of biscuits, under the brand name Bisconni, and second largest in potato chips, with its brand SnackCity. Astro Films is one of the major players in the film packaging segment.

Revenues The Company earns its revenue from two segments, namely i) Food, and ii) Plastic films. Major portion of revenue emanates from food sales, which accounted for ~78% of total revenue in FY19. During FY19, the Company's topline clocked in at PKR 30,091mln (FY18: PKR 23,906mln) showing growth of ~26% which was mostly derived from volumetric increase in sales in the food segment on the back of effective marketing campaigns. During 1QFY20, the Company posted revenues of PKR 8,020mln, an increase of ~7% YoY, driven by increase in volumetric sales.

Margins During FY19, the Company's gross margins stood at ~21% (FY18: ~22%). The Company maintained its margins, despite high input costs, through efficiency. Trickle-down effect from gross margin caused operating margin to clock in at 7.4% (FY18: 8.7%). The Company's share of profit from Bank of Khyber declined to PKR 45mln (FY18: PKR 393mln) due to reshuffling of bank's portfolio and low yield. Moreover, finance cost increased significantly to PKR 906mln (FY18: 614mln) due to higher benchmark rate and a significant increase in total borrowings (FY19: PKR 14,602mln, FY18: 11,854mln). As a result, the Company's net profit margin declined to 3.2% (FY18: 5.9%) and net profit stood at PKR 967mln. In 1QFY20, the gross margin remained stable at 21% and operating margin improved to ~9%. Net profit margin further declined to 2.4% due to higher finance costs (1QFY20: PKR 310mln, 1QFY19: PKR 190mln). The Company earned PKR 193mln in 1QFY20.

Sustainability Ismail Industries is currently enhancing its BOPET film production capacity by 36,000MT per annum. The new line is expected to commence operations in June 2020. New production lines are also being added in Bisconni. Moreover, the Company is investing ~PKR 1.5bln in its associated companies, Hudson Pharma and Bank of Khyber, which is expected to support the Company's bottom-line in future.

Financial Risk

Working Capital The Company's inventory days decreased to 61 days (FY18: 75 days) indicating increased efficiency in working capital management. The Company's trade receivables emanate from plastic segment and sales to departmental stores. Trade receivable days and trade payable days remained stable at 26 days (FY18: 23 days) and 14 days (FY18: 13 days), respectively. Consequently, the Company's net working capital days declined to 73 days (FY18: 85 days). The Company had a short term trade leverage of ~24% in FY19 (FY18: ~33%), showing sufficient room to borrow against working capital. In 1QFY20, the Company's net working capital days increased to 79 days due to higher receivables from the plastic segment.

Coverages In FY19, the Company's FCFO increased to PKR 3,078mln (FY18: PKR 2,735mln) on the back of higher sales. Meanwhile, finance cost increased to PKR 906mln, (FY18: PKR 614mln). Consequently, the Company's interest coverage ratio declined to 3.5x (FY18: 4.5x) while the debt coverage ratio improved slightly to 1.1x (FY18: 0.9x). During 1QFY20, the Company's FCFO stood at PKR 981mln (FY18: PKR 905mln). Meanwhile, the finance cost increased to PKR 310mln (1QFY19: PKR 190mln). Therefore, the Company's interest coverage ratio decreased to 3.3x (1QFY19: 4.8x) while the debt coverage ratio remained stable at 1.2x (1QFY19: 1.2x).

Capitalization The Company has a highly leveraged capital structure with a leveraging ratio of ~68% in FY19 (FY18: ~64%). The higher leveraging was due to an increase in total borrowings (FY19: PKR 14,602mln, FY18: PKR 11,854mln), used to finance new production lines in Bisconni and Astro Films. Short term borrowings constituted nearly 41% of total borrowings in FY19. In 1QFY20, the leveraging ratio increased to ~72%. The leveraging may increase in the future as the Company has plans for further expansion. The long-term debt is acquired on SBP concessional rates with low interest cost.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Ismail Industries Limited Food Products	Sep-19 3M	Jun-19 12M	Jun-18 12M	Jun-17 12M
A BALANCE SHEET				
1 Non-Current Assets	15,786	12,888	10,994	10,430
2 Investments	200	-	195	309
3 Related Party Exposure	3,633	3,212	3,365	3,617
4 Current Assets	11,738	10,864	8,518	7,883
a Inventories	*5,599*	*5,112*	*4,970*	*4,864*
b Trade Receivables	*3,172*	*2,746*	*1,566*	*1,443*
5 Total Assets	31,357	26,964	23,072	22,239
6 Current Liabilities	2,755	2,453	1,665	1,217
a Trade Payables	*1,415*	*1,359*	*1,001*	*661*
7 Borrowings	18,362	14,602	11,854	12,635
8 Related Party Exposure	902	902	902	902
9 Non-Current Liabilities	1,790	1,633	1,431	1,213
10 Net Assets	7,548	7,374	7,220	6,272
11 Shareholders' Equity	7,548	7,374	7,220	6,272
B INCOME STATEMENT				
1 Sales	8,020	30,091	23,906	19,605
a Cost of Good Sold	*(6,334)*	*(23,737)*	*(18,545)*	*(15,884)*
2 Gross Profit	1,686	6,354	5,361	3,721
a Operating Expenses	(957)	(4,131)	(3,277)	(1,923)
3 Operating Profit	729	2,223	2,084	1,798
a Non Operating Income or (Expense)	*31*	*86*	*372*	*516*
4 Profit or (Loss) before Interest and Tax	760	2,309	2,456	2,314
a Total Finance Cost	*(310)*	*(906)*	*(614)*	*(671)*
b Taxation	*(258)*	*(437)*	*(426)*	*(477)*
6 Net Income Or (Loss)	193	967	1,416	1,166
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*981*	*3,078*	*2,735*	*2,285*
b Net Cash from Operating Activities before Working Capital Changes	*706*	*2,276*	*2,484*	*1,989*
c Changes in Working Capital	*(1,038)*	*(824)*	*(111)*	*273*
1 Net Cash provided by Operating Activities	(332)	1,452	2,373	2,262
2 Net Cash (Used in) or Available From Investing Activities	(3,601)	(3,156)	(1,398)	(3,145)
3 Net Cash (Used in) or Available From Financing Activities	3,966	1,685	(956)	856
4 Net Cash generated or (Used) during the period	33	(19)	19	(27)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	6.6%	25.9%	21.9%	--
b Gross Profit Margin	21.0%	21.1%	22.4%	19.0%
c Net Profit Margin	2.4%	3.2%	5.9%	5.9%
d Cash Conversion Efficiency (EBITDA/Sales)	13.4%	11.4%	13.0%	13.6%
e Return on Equity (ROE)	10.3%	13.2%	21.0%	18.6%
2 Working Capital Management				
a Gross Working Capital (Average Days)	95	87	98	94
b Net Working Capital (Average Days)	79	73	85	82
c Current Ratio (Total Current Assets/Total Current Liabilities)	4.3	4.4	5.1	6.5
3 Coverages				
a EBITDA / Finance Cost	3.6	3.9	5.1	4.0
b FCFO / Finance Cost+CMLTB+Excess STB	1.2	1.1	0.9	0.8
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	4.6	4.2	4.0	6.0
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	71.8%	67.8%	63.9%	68.3%
b Interest or Markup Payable (Days)	73.2	85.8	61.3	0.0
c Average Borrowing Rate	6.9%	6.2%	4.6%	5.0%

Rating Scale | Corporate

2019

Credit Rating Scale & Definitions

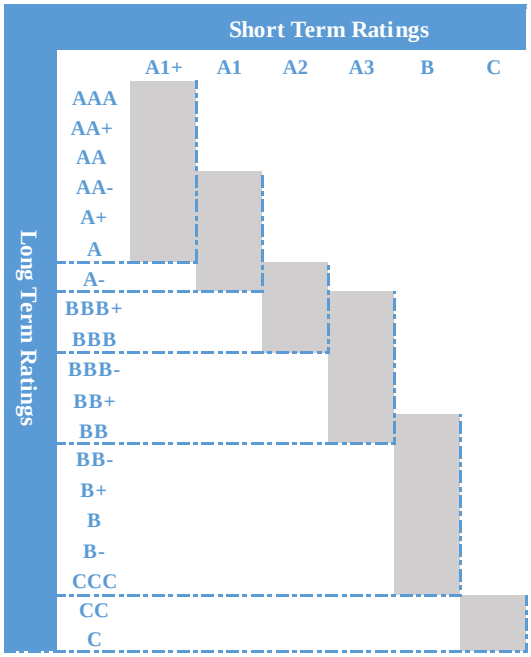
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings

AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short Term Ratings

A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
C	An inadequate capacity to ensure timely repayment.



Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Rating Team Statements
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest
(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)
Probability of Default
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)
Proprietary Information