



The Pakistan Credit Rating Agency Limited

Rating Report

National Foods Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
19-Apr-2022	AA-	A1	Stable	Maintain	-
19-Apr-2021	AA-	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

National Foods Limited ('National Foods' or 'the Company') was established in 1970 with an objective to introduce branded and packaged spices. Over the years, the Company has diversified its product portfolio into 11 product categories and almost 250 SKUs. The Company has shown a strong character by converting its challenges into opportunities. Today, National Foods holds sizeable brand equity in most of its product categories. The Company is Pakistan's leading player in the multi-category food market. The market operates with unbranded segment as a sizeable player. However, an opportunity for expansion exists in the branded segment.

National Foods enjoy a sound risk profile and continues to increase its top-line backed by volumetric growth. The Company has maintained healthy margins and profitability over the years despite its raw materials remaining price sensitive, and increased marketing expenses. Although competition is heating up for its recipe mixes segment, the management is confident to hold current performance pattern. The Company's financial performance witnessed steady growth during FY21 driven by effective cost management, higher selling prices, and increase in exports. Ratings draw strength from the Company's strong financial profile represented by a modestly leveraged capital structure, stable coverages and efficient management of working capital.

National Foods entered the international market through a wholly owned subsidiary, National Foods DMCC (NFL DMCC), a UAE based company. The recent investment in A1 Cash & Carry, through National Epicure Inc. (Canada) - a wholly owned subsidiary of NFL DMCC, provides the requisite diversification. The Company derives strength from its holding company structure and stable international operations, which bodes well for the ratings. Also, the profitability at a consolidated level is significantly promising. Ratings draw comfort from sponsors' business acumen and their widespread reach. Strong governance framework adds strength to the Company's profile.

The ratings are dependent upon the management's ability to sustain margins while improving its market share. Timely commencement of growth activities remain critical. Prudent management of the working capital, maintaining sufficient cash flows and coverages are imperative for the ratings.

Disclosure

Name of Rated Entity	National Foods Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Corporate Rating(Jun-21),Criteria Correlation Between Long-term & Short-term Rating Scales(Jun-21),Criteria Rating Modifiers(Jun-21)
Related Research	Sector Study Food Products(Dec-21)
Rating Analysts	Ahmad Faraz Arif ahmad.faraz@pacra.com +92-42-35869504

Profile

Legal Structure National Foods Limited ('National Foods' or 'the Company') is a public listed company, incorporated in 1970.

Background In 1970, Mr. Abdul Majeed (late) and Mr. Waqar Hasan (late) established National Foods with an idea to introduce branded and packaged spices by acquiring National Foods Laboratories. Later, the Company acquired a new spice mill and packaging plant. In 1986, second production facility was setup in SITE. Over the years, the Company made additions to its product lines. Third new facility was setup in Port Qasim, in 2006. The Company entered in the international market through a wholly owned subsidiary, National Foods DMCC (NFL DMCC), a UAE based company, in 2013. Through NFL DMCC, National Foods has invested in National Epicure Inc. (Canada). In 2015, fourth production facility was setup in Gujranwala. To add diversity in the Company's operation, National Epicure Inc. acquired 60% interest in A-1 Cash & Carry, a company based in Canada.

Operations National Foods is primarily engaged in manufacturing convenience food products with a portfolio of 11 categories and almost 250 SKUs. The production facilities are located in Port Qasim, SITE, Nooriabad, and Gujranwala. Currently, the Company is exporting products to ~ 40 countries across ~ 5 continents, through NF DMCC. During FY21, the Company's total production remained stable at 100,414MT of mixed food products. The Company's registered office is located in Karachi.

Ownership

Ownership Structure National Foods major (~ 57%) ownership lies with sponsors through ATC Holdings (Pvt.) Ltd. (~34%) and individual family members (~23%). Directors and their family members hold ~16% stake while, Foreign Companies hold ~15% shares. While, the remaining ~12% of the shares resides with general public.

Stability Ownership of the Company seems stable as majority shareholding vests with the sponsoring family.

Business Acumen The sponsors have been operating in the industry for over five decades and have very strong industry knowledge. Today, the Company is a leading player in Pakistan's multi-category food segment.

Financial Strength National Foods is prime vehicle for the wealth of sponsoring family. On consolidated basis, the Company has an equity base of ~PKR 7bln with asset base of ~PKR 20bln, as at FY21. The Company generated a consolidated revenue of ~PKR 35bln and posted a PAT of ~PKR 2bln during FY21.

Governance

Board Structure The BoD comprises 7 members. There are four Non-Executive Directors, one Executive Director and two Independent Directors. The BoD is dominated by the Sponsoring family.

Members' Profile Mr. Abdul Majeed, Chairman of National Foods and ATC Holding's BoD, has recently passed away. The vacancy is yet to be filled. All members of the BoD have significantly diversified experience and have been associated with the Company's BoD for a long span of time.

Board Effectiveness During FY21, five BoD meetings were convened with majority attendance. Minutes were formally documented. The BoD is assisted by Board Audit Committee and Human Resource & Remuneration Committee.

Financial Transparency The Company has appointed KPMG Taseer Hadi as its external auditors. The firm has expressed an unqualified opinion on the financial statements of the Company for the year ended Jun-21. The firm has been appointed as the Company's auditor since 2017.

Management

Organizational Structure The Company's organizational structure reflects clear reporting lines and is split between the production site and head office. The Company operates through eight main departments: Finance, HR & Industrial Relations, Supply Chain, Marketing, Sales, Innovation and R&D, IT, and Internal Audit. All functional heads report to the Company's CEO, who then reports to the BoD. However, Head of Internal Audit and HR administratively reports to the CEO and functionally to the Board Audit and HR & Remuneration Committee, respectively.

Management Team Mr. Abrar Hasan, CEO of National Foods, has an overall experience of around 3 decades. He is also on the BoD of ATC Holdings (Pvt.) Ltd. and Cherat Packaging Ltd. Mr. Zahid Majeed, CEO of NFL DMCC, heads the international operations and is associated with the Company since 1987.

Effectiveness The Company's management ensures effectiveness through its Management Committee. The Committee meet periodically to monitor the Company's performance. Minutes of these meetings are well documented.

MIS To generate MIS and operational reports, ERP software, SAP ECC6 is used.

Control Environment The Company has Halal certification and all products are ISO 22000 certified. The internal audit function is co-sourced to EY Ford Rhodes. This ensures compliance and efficiency while reporting to the Audit Committee.

Business Risk

Industry Dynamics The market operates with unbranded segment as a sizeable player. However, an opportunity for expansion exists in the branded segment. Overall performance of the players has improved during FY21. Going forward, cashflow and liquidity is expected to remain stable.

Relative Position The Company has high brand recognition in recipe mixes/spices & ingredients, ketchups, pickles, salt and jellies as they are the market leader. Although, National Foods holds a strong position in the dessert segment, it is yet to establish a notable presence in their newly launched product categories i.e., Scene On & Mayonnaise etc.

Revenues National Foods earns its revenue from two segments, namely i) Kitchen Products (~61%) and ii) Food Products (~39%). Major portion of revenue emanates from Recipe Mixes, Ketchups, and Pickles. During FY21, revenue posted growth of ~20% and stood at ~PKR 23bln (FY20: ~PKR 19bln). Due to rupee devaluation, the export business also witnessed a healthy rise of ~33% and stood at ~PKR 2bln (FY20: ~PKR 1.5bln). During 1HFY22, the Company posted revenue of PKR 11,409mln (1HFY21: ~PKR 10,400mln), an increase of ~10%, driven by higher volumes sold locally and exports.

Margins Gross and operating margin stood at 30.4% and 8.2% in FY21 (FY20: 31.7% and 8.5%), respectively, on the back of efficient cost management. The Company's net profit witnessed an increase of 14.4% and stood at ~PKR 1.3bln (FY20: ~PKR 1.1bln). However, net profit margin witnessed slight decline and stood at 5.5% (FY20: 5.7%) despite higher turnover, mainly due to exchange loss. During 1HFY22, the Company's gross margin increased to ~32% due to higher selling prices compared to 30% during 1HFY21. Moreover, operating margin increased to ~9% (1HFY21: 7%) due to trickle-down effect and better control over operating expenses. Similarly, net profit margin increased to ~7% (1HFY21: ~4%).

Sustainability National Foods is seeking technology-driven growth and has entered into a Joint E-commerce Business Partnership with Google and Amazon.

Financial Risk

Working Capital The Company has a stable working capital cycle despite seasonal procurement of key raw materials. Working capital needs are funded through internal cashflows and short-term borrowings. The Company's net working capital days posted an increase in FY21 and stood at 81 days (FY20: 91 days) owing to decline in receivable days (FY21: 24 days, FY20: 25 days) and inventory held days (FY21: 71 days, FY20: 76 days). Trade payable days posted an increase (FY21: 13 days, FY20: 10 days) due to revision in credit terms. In 1HFY22, the Company's net working capital days stood at 91 days (1HFY21: 81 days).

Coverages Coverages are a function of free cashflows and finance costs. The Company's profitability has improved over the years, and the resulting cashflows remain strong. FCFO stood at ~PKR 2.3bln in FY21 (FY20: ~PKR 2.1bln), with an increase of 9%. Finance cost decreased to PKR 136mln (FY20: 164mln). Subsequently, interest cover improved to 18.9x (FY20: 15.5x). However, debt coverage ratio posted a dip (FY21: 3.5x, FY20: 5.9x) due to higher current maturity. During 1HFY22, the Company's interest coverage ratio increased to 20.8x (1HFY21: 14.2x) due to higher free cash flows. Moreover, debt coverage ratio increased to 3.8x during 1HFY22 (1HFY21: 2.6x).

Capitalization National Foods has a moderately leveraged capital structure with a debt-to-equity ratio of ~42% (FY20: ~25%). As at FY21, Total debt stood at ~PKR 4bln (FY20: ~PKR 1.6bln), comprising 70% of short term debt to fund the working capital requirements. However, low-cost borrowing, Export Refinance Facility from SBP, benefits the Company. As at 1HFY22, the leveraging ratio increased to ~47% compared to ~33% in 1HFY21, primarily driven by funding obtained for capex.



National Foods Limited Food Products	Dec-21 6M	Jun-21 12M	Dec-20 6M	Jun-20 12M	Jun-19 12M
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A BALANCE SHEET

1 Non-Current Assets	5,503	5,192	5,063	4,930	4,697
2 Investments	747	1,031	30	30	-
3 Related Party Exposure	32	33	32	38	33
4 Current Assets	10,402	9,379	6,701	6,675	5,629
a Inventories	5,889	4,945	3,850	4,044	3,956
b Trade Receivables	1,273	1,277	980	1,702	901
5 Total Assets	16,683	15,636	11,826	11,673	10,359
6 Current Liabilities	6,216	5,787	4,612	4,661	3,270
a Trade Payables	1,029	961	666	730	293
7 Borrowings	4,747	4,020	2,238	1,624	2,389
8 Related Party Exposure	139	130	85	93	85
9 Non-Current Liabilities	220	222	255	371	297
10 Net Assets	5,361	5,476	4,636	4,924	4,317
11 Shareholders' Equity	5,361	5,476	4,636	4,924	4,317

B INCOME STATEMENT

1 Sales	11,409	23,116	10,400	19,259	16,602
a Cost of Good Sold	(7,768)	(16,080)	(7,271)	(13,150)	(11,283)
2 Gross Profit	3,641	7,036	3,129	6,108	5,319
a Operating Expenses	(2,604)	(5,148)	(2,409)	(4,468)	(3,928)
3 Operating Profit	1,037	1,888	721	1,640	1,391
a Non Operating Income or (Expense)	127	(38)	(30)	112	129
4 Profit or (Loss) before Interest and Tax	1,164	1,850	691	1,752	1,520
a Total Finance Cost	(68)	(136)	(72)	(164)	(157)
b Taxation	(279)	(449)	(160)	(484)	(272)
6 Net Income Or (Loss)	817	1,265	458	1,105	1,091

C CASH FLOW STATEMENT

a Free Cash Flows from Operations (FCFO)	1,239	2,250	857	2,115	1,840
b Net Cash from Operating Activities before Working Capital Changes	1,172	2,109	807	1,936	1,696
c Changes in Working Capital	(1,419)	49	260	328	(341)
1 Net Cash provided by Operating Activities	(247)	2,158	1,066	2,264	1,356
2 Net Cash (Used in) or Available From Investing Activities	(323)	(1,743)	(402)	(817)	(845)
3 Net Cash (Used in) or Available From Financing Activities	(203)	1,697	(135)	(1,260)	(340)
4 Net Cash generated or (Used) during the period	(774)	2,112	529	187	171

D RATIO ANALYSIS

1 Performance					
a Sales Growth (for the period)	-1.3%	20.0%	8.0%	16.0%	--
b Gross Profit Margin	31.9%	30.4%	30.1%	31.7%	32.0%
c Net Profit Margin	7.2%	5.5%	4.4%	5.7%	6.6%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	-1.6%	9.9%	10.7%	12.7%	9.0%
e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh	30.1%	24.3%	19.2%	23.9%	25.3%
2 Working Capital Management					
a Gross Working Capital (Average Days)	107	94	93	100	107
b Net Working Capital (Average Days)	91	81	81	91	100
c Current Ratio (Current Assets / Current Liabilities)	1.7	1.6	1.5	1.4	1.7
3 Coverages					
a EBITDA / Finance Cost	24.8	22.0	16.1	16.6	14.8
b FCFO / Finance Cost+CMLTB+Excess STB	3.8	3.5	2.6	5.9	9.3
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.4	0.6	0.9	0.5	0.3
4 Capital Structure					
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	47.0%	42.3%	32.6%	24.8%	35.6%
b Interest or Markup Payable (Days)	32.8	28.1	26.7	35.9	80.8
c Entity Average Borrowing Rate	3.7%	5.0%	6.2%	6.8%	5.4%

Credit Rating

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.

Scale	Long-term Rating Definition
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
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.
AA-	
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.
A-	
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.
BBB-	
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.
BB	
BB-	
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.
B-	
CCC	
CC	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.
C	
D	Obligations are currently in default.

Scale	Short-term Rating Definition
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.
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

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 some material identifiable event with indeterminable rating implications. 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 rating 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) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveil the opinion due to lack of requisite information.

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

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

<p>Entities</p> <ul style="list-style-type: none"> a) Broker Entity Rating b) Corporate Rating c) Financial Institution Rating d) Holding Company Rating e) Independent Power Producer Rating f) Microfinance Institution Rating g) Non-Banking Finance Companies (NBFCs) Rating 	<p>Instruments</p> <ul style="list-style-type: none"> a) Basel III Compliant Debt Instrument Rating b) Debt Instrument Rating c) Sukuk Rating
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(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

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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.
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- (10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
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- (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)

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