



The Pakistan Credit Rating Agency Limited

Rating Report

Islamabad Farms

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
19-Dec-2019	BBB-	A3	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Poultry is one of the largest agro based segment in Pakistan, accounting both domestic & commercial poultry. With an investment of almost PKR 700bln in FY19, industry has posted an annual growth of ~ 12%. Pakistan is sufficient in poultry meat and egg production. However, per capita protein consumption remains low when compared to the world's average.

The ratings reflect Islamabad Farms developing position in poultry industry and sponsors strong acumen across the integrated supply chain. Islamabad Farms revenue showed concentration towards day old chicks and posted a dip. Procuring feed in bulk from Group's own company benefited the margins and remain in line with industry players. Profitability remain modest. Islamabad Farms remains exposed to price volatility and contingent health risk associated to its product. Financial risk profile of Islamabad Farms is characterized by moderate leverage and adequate coverage ratios. Loan mix is skewed towards short term borrowings to fulfill the working capital requirements.

The ratings are dependent on the management's ability to prudently manage the working capital requirements. Improving margins, in turn, building profitable volumes remain critical for the ratings. Effective changes in governance framework would be beneficial for the ratings. Significant deterioration in coverages and/or margins will have negative impact on the ratings.

Disclosure

Name of Rated Entity	Islamabad Farms
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 Poultry(Mar-19)
Rating Analysts	Ayesha Malik ayesha.malik@pacra.com +92-42-35869504

Profile

Legal Structure Islamabad Farms is registered as an Association of Persons (AoP) in Pakistan, since 1988.

Background The sponsors started poultry business in 1981 by setting up small poultry farms. Later they integrated by setting up poultry feed mill, poultry farms and hatcheries. Today, the Group is a well-known player in the poultry industry of Pakistan.

Operations Islamabad Farms operates 18 breeder farms with placement capacity of 1.5 million parent stock of different breeds and 4 hatcheries producing ~ six million day old chicks per month. The Group's registered office is located in Satellite Town, Rawalpindi. Whereas, the poultry farms are dispersed across different cities including Multan, Okara, Muree, Hyderabad, Karachi and Attock.

Ownership

Ownership Structure Major ownership of Islamabad Farms resides with Dr. Muhammad Aslam (50%) and Dr. Azhar Mehmood (25%). Remaining shares are equally owned by, Mr. Muhammad Masood (12.5%) and Mr. Mamoon-u-Rasheed (12.5%).

Stability Ownership structure of the business is seen and second generation is gradually being inducted in the business.

Business Acumen Islamabad Farms is a venture of Islamabad Group which has an established presence in Pakistan's poultry and poultry feed industry. The Group's flagship entity, Islamabad Feeds, has grown to become one of the Country's leading feed mills catering to its clients in the poultry industry.

Financial Strength The sponsors have high net worth and their willingness to support the business bodes well for the Company.

Governance

Board Structure Sponsors dominate the Board of Islamabad Farms comprising of four executive directors. Absence of non-executive directors and independent oversight and indicates a room for improvement in Islamabad Farms governance framework.

Members' Profile The Board's Chairman, Dr. Muhammad Aslam, is a Doctor of Veterinary Medicine. Having an overall experience of above four decades in poultry and integrated businesses. He has remained Chairman of Pakistan Poultry Association and currently member of Punjab Poultry Board.

Board Effectiveness There are no sub-committees of the Board. During FY19, the Board met informally to discuss pertinent matters. As per requirement minutes are documented informally.

Financial Transparency External auditors of Islamabad Farms, M/s Muniff Ziauddin & Co. and Chartered Accountants, have expressed an unqualified opinion on the financial statements for the year ended June 30, 2019. The firm is QCR and also in 'Category A' of SBP panel of auditors.

Management

Organizational Structure Islamabad Farms operates through Production (breeder farms and hatcheries), Finance, Accounts, Sales & Marketing, and Internal Audit function. Breeder farms and hatcheries are monitored by their respective Managers, who report to the GM Production. Support departments work as shared services for the group. All of the department heads eventually report to the Chief Executive Office (CEO), who make pertinent decisions implemented by his team.

Management Team CEO of Islamabad Farms, Dr. Muhammad Aslam, is a Doctor of Veterinary Medicine. He has overall experience of above four decades in poultry and integrated businesses. He was the Chairman of Pakistan Poultry Association and currently, is a member of Punjab Poultry Board. Dr. Munnawar Ali, GM Production, has an overall experience of above three decades. He is associated with the Group for 30 years. Mr. Muhammad Sajjad, Chief Financial Officer, has an overall experience of 25 years and associated with the Group for almost 20 years.

Effectiveness At Islamabad Farms, different management committees are formally in place; namely, audit, finance, sales and recovery, and production including breeder farms and hatcheries. Pertinent matters are discussed by these committees and minutes are documented informally.

MIS Sidat Hyder has installed Oracle as an enterprise resource software, customized as per the industry needs. This enables the senior management to monitor and generate reports about inventory, sales, receivables and payables side. These reports are generated on daily, weekly and monthly basis.

Control Environment To ensure operational efficiency, an internal audit function has been established group level to implement the policies and procedures. This function conducts regular pre- and post-audits to monitor the policies and procedures implemented at Islamabad Farms.

Business Risk

Industry Dynamics Poultry is one of the largest agro based segment in Pakistan, accounting both domestic & commercial poultry. With an investment of almost PKR 700bln in FY19, industry has posted an annual growth of ~ 12%. Pakistan is sufficient in poultry meat and egg production. However, per capita protein consumption remains low when compared to the world's average.

Relative Position In FY19, Islamabad Farms contributed approximately 5% to the total production of day old chicks in Pakistan.

Revenues Islamabad Farms is mainly generates its revenue by selling Day Old Chicks (~89%) in the local market. Islamabad Farms generated almost 51% of its total revenue from South region, followed by 28% and 21% of revenue received from North and Central region of the Country, respectively. In FY19, top-line witnessed a decline of 19% amounting to PKR 3.3bln (FY18: PKR 4.1bln). This dip was due to the decline in prices of Day Old Chicks in the local market.

Margins Gross profit margin of Islamabad Farms has improved in FY19 to 12.5% (FY18: 10.9%) due to the benefit of procuring raw material at lower costs from the Group Company. High overhead costs led the operating profit margin to post a dip (FY19: 4.0%, FY18: 4.4%). Significant increase in finance costs limited bottom line, in turn, net profit margin posted a dip to 2.3% (FY18: 2.6%).

Sustainability Islamabad Farms does not have any plans to enhance its capacity in near future.

Financial Risk

Working Capital Islamabad Farms working capital needs emanates from high finished goods inventory (breeder stock and day old chicks). In FY19, inventory days have increased significantly to 77 days (FY18: 57 days). Sales are generally made on cash basis (Receivable Days in FY19: 4days). Average creditors days increased to manage the working capital cycle (FY19: 41days, FY18: 16days). Despite, high working capital cycle, Islamabad Farms maintains adequate borrowing cushion.

Coverages In FY19, the interest coverage declined (FY19: 5.0x, FY18: 10.4x) due to the decrease in free cash flows of Islamabad Farms (FY19: PKR 264mln FY18: PKR 194mln) coupled with the increase in finance cost (FY19: PKR 39mln, FY18: PKR 25mln). Similarly, Core and total coverage ratios posted a dip (Core and Total Coverage: FY18: 3.9x, FY19: 2.4x).

Capitalization Islamabad Farms have a moderately leveraged capital structure with debt to equity ratio of ~32% on the back of small equity base of PKR 693mln. Debt mix mainly comprises of short-term debt of PKR 195mln (60% of the total debt). Long-term debt declined in FY19 to PKR 128mln (FY18: PKR 202mln) due to repayment.



The Pakistan Credit Rating Agency Limited

Financial Summary

PKR mln

Islamabad Farms Agriculture and Allied	Sep-19 3M	Jun-19 12M	Jun-18 12M	Jun-17 12M	Jun-16 12M
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A BALANCE SHEET

1 Non-Current Assets	676	677	484	430	478
2 Investments	-	-	-	-	-
3 Related Party Exposure	-	-	298	-	-
4 Current Assets	1,060	1,064	650	839	777
a Inventories	803	862	535	742	626
b Trade Receivables	77	61	7	9	30
5 Total Assets	1,736	1,740	1,432	1,269	1,255
6 Current Liabilities	645	708	212	253	198
a Trade Payables	577	616	132	230	157
7 Borrowings	342	323	377	204	273
8 Related Party Exposure	-	-	-	-	-
9 Non-Current Liabilities	-	-	-	-	-
10 Net Assets	749	709	843	812	784
11 Shareholders' Equity	749	709	843	812	784

B INCOME STATEMENT

1 Sales	1,130	3,294	4,071	2,773	2,792
a Cost of Good Sold	(1,011)	(2,882)	(3,627)	(2,419)	(2,436)
2 Gross Profit	119	413	444	354	356
a Operating Expenses	(76)	(281)	(265)	(252)	(267)
3 Operating Profit	43	132	179	101	89
a Non Operating Income or (Expense)	-	(1)	(3)	(1)	(1)
4 Profit or (Loss) before Interest and Tax	43	131	176	100	88
a Total Finance Cost	(11)	(39)	(26)	(17)	(25)
b Taxation	-	(16)	(45)	(29)	(28)
6 Net Income Or (Loss)	32	76	105	55	35

C CASH FLOW STATEMENT

a Free Cash Flows from Operations (FCFO)	37	194	264	136	139
b Net Cash from Operating Activities before Working Capital Changes	26	155	238	119	114
c Changes in Working Capital	(19)	433	(173)	9	(107)
1 Net Cash provided by Operating Activities	7	588	65	128	8
2 Net Cash (Used in) or Available From Investing Activities	(24)	(303)	(148)	(23)	(1)
3 Net Cash (Used in) or Available From Financing Activities	27	(280)	99	(97)	(14)
4 Net Cash generated or (Used) during the period	10	5	16	9	(7)

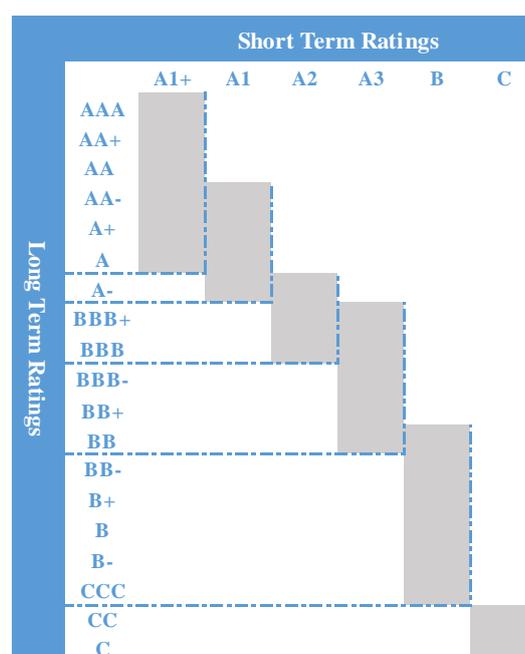
D RATIO ANALYSIS

1 Performance					
a Sales Growth (for the period)	37.2%	-19.1%	46.8%	-0.7%	14.3%
b Gross Profit Margin	10.6%	12.5%	10.9%	12.8%	12.7%
c Net Profit Margin	2.8%	2.3%	2.6%	2.0%	1.3%
d Cash Conversion Efficiency (EBITDA/Sales)	6.0%	7.4%	6.8%	6.3%	6.0%
e Return on Equity (ROE)	17.5%	9.7%	12.7%	6.9%	4.3%
2 Working Capital Management					
a Gross Working Capital (Average Days)	73	81	58	93	210
b Net Working Capital (Average Days)	25	40	42	67	165
c Current Ratio (Total Current Assets/Total Current Liabilities)	1.6	1.5	3.1	3.3	3.9
3 Coverages					
a EBITDA / Finance Cost	6.0	6.3	10.9	10.6	6.8
b FCFO / Finance Cost+CMLTB+Excess STB	1.7	2.4	3.9	3.5	2.2
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	1.5	1.1	1.0	0.5	1.1
4 Capital Structure (Total Debt/Total Debt+Equity)					
a Total Borrowings / Total Borrowings+Equity	31.3%	31.3%	30.9%	20.1%	25.8%
b Interest or Markup Payable (Days)	0.0	0.0	0.0	0.0	0.0
c Average Borrowing Rate	13.6%	11.1%	8.8%	6.9%	9.6%

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		Short Term Ratings	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
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.	A1	A strong capacity for timely repayment.
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.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial 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.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
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.	C	An inadequate capacity to ensure timely repayment.
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.		



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 surveil the opinion due to lack of requisite information.

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

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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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- (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.
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- (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)

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- (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)
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- (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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