The Pakistan Credit Rating Agency Limited

Rating Report

Islamabad Farms

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
11-May-2020	BBB-	A3	Stable	Maintain	YES
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, the 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 industry generates an estimated annual revenue of ~ PKR 250bln from local and export sales. Lately, due to Covid-19 outbreak, marriage halls/restaurants have been closed. This, along with no exports of poultry products, have led to supply glut in local market. Prices of poultry products have posted a dip despite being an essential food item due to lower demand with many poultry farms becoming non-operational. Low sales and liquidity problems may persist as farms follow 40-day cycle before new flock is ready. Recent SBP measures will provide some respite in the short-time. However, prolonged lock down will affect sales in the entire poultry chain.

The ratings reflect Islamabad Farms developing position in poultry industry and sponsor's strong acumen across the integrated poultry supply chain. Islamabad Farms revenue is concentrated towards day old chicks and posted a dip. Procuring feed in bulk from Group’s own company benefited the margins. Profitability remains modest. Islamabad Farms remains exposed to price volatility and contingent health risk associated to its product. This was evident in recent times when prices of day old chicks crashed. 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 Company intends to avail debt relief measures announced by SBP to alleviate pressure on cashflows. The ratings incorporate potential support from sponsors and/or group companies.

The ratings have been put on "Rating Watch" due to uncertainty created by prevailing lock down and its implications on industry prospects as demand has contracted. PACRA will monitor the situation as it is still evolving and update the ratings accordingly.

The ratings are dependent on the management's ability to sustain its operations in prevailing challenging economic conditions. Generating operational cashflows is important. Meanwhile, a prudent financial strategy to meet financial obligations is critical.

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(Jan-20)
Rating Analysts	Faiqa Qamar | faiqa.qamar@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, more 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, 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 shareholding is equally divided among Mr. Muhammad Masood (12.5%) and Mr. Mamoon-u-Rasheed (12.5%). Sponsors have been associated for a long time.

Stability Ownership structure of the business is seen as stable 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 mill.

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

Governance

Board Structure Sponsors dominate the Board of Islamabad Farms. Absence of independent oversight 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 over four decades in poultry and integrated businesses. He has been Chairman of Pakistan Poultry Association and currently is a member of Punjab Poultry Board.

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

Financial Transparency External auditors of Islamabad Farms are M/s Muniff Ziauddin & Co. and Chartered Accountants. The firm is QCR rated and 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 makes pertinent decisions implemented by his team.

Management Team CEO of Islamabad Farms, Dr. Muhammad Aslam, is a Doctor of Veterinary Medicine with long track record in poultry and integrated businesses. He served as Chairman and member of various Poultry Boards and bodies. Dr. Munnawar Ali, GM Production, has an overall experience of over 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 has been 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 covering breeder farms and hatcheries. Pertinent matters are discussed by these committees and minutes are documented informally.

MIS The Company uses Oracle as an enterprise resource software, customised as per the industry needs. This enables the senior management to monitor and generate reports about inventory, sales, receivables and payable side. These reports are generated on daily, weekly and monthly basis.

Control Environment To ensure operational efficiency, an internal audit function has been established at group level to implement the policies and procedures. This function conducts regular monitoring to implement the policies and procedures of the Company.

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, the 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 industry generates an estimated annual revenue of ~ PKR 250bln from local and export sales. Lately, due to Covid-19 outbreak, marriage halls/restaurants have been closed. This, along with no exports of poultry products, have led to supply glut in local market. Prices of poultry products have posted a dip despite being an essential food item due to lower demand with many poultry farms becoming non-operational. Low sales and liquidity problems may persist as farms follow 40-day cycle before new flock is ready. Recent SBP measures will provide some respite in the short-time. However, prolonged lock down will affect sales in the entire poultry chain.

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

Revenues Islamabad Farms mainly generates revenue by selling Day Old Chicks (~90%) and Culled birds (~10%) in the local market. In FY19, 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 6MFY20, Islamabad Farms reported a dip in top line that stood at PKR 2,052 mln (3MFY20: PKR 1,130 mln). The decline was mainly attributable to low prices of day old chicks. Furthermore, prices of day old chicks are expected to remain under pressure due to outbreak of COVID-19, hampering sales of the Company in ongoing period as poultry demand has been low. However, some recovery in prices has been observed lately.

Margins Gross profit margin of Islamabad Farms deteriorated in 6MFY20 to 8.8% (FY19: 12.5%) due to reduced day old chick prices. High overhead costs led the operating profit margin to decline (6MFY20: 2.3%, FY19: 4.0%). Significant increase in finance costs limited bottom line, in turn, net profit margin posted a dip to 1.2% in (FY19: 2.3%). The Company posted net income of PKR 25mln in 1HFY20 (FY19: PKR 76mln)

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

Financial Risk

Working Capital Islamabad Farms working capital needs emanate from high finished goods inventory (breeder stock and day old chicks). In 6MFY20, inventory days and trade receivable days remained stable at 77 days (FY19: 77 days) and 4 days (FY19: 4 days). Trade payable increased (6MFY20: 51 days, FY19: 41 days) leading to the decline in net working capital cycle (6MFY20: 29 days, FY19: 40 days). Islamabad Farms maintains adequate borrowing cushion.

Coverages In 6MFY20, the interest coverage declined to 1.7x (FY19: 5x) due to the decrease in free cash flows (6MFY20: PKR 39mln FY19: PKR 194mln). Similarly, Core and total coverage ratios posted a dip (Core and Total Coverage: 6MFY20: 0.8x, FY19: 2.4x).

Capitalization Islamabad Farms has a moderately leveraged capital structure with debt to equity ratio of ~28% on the back of small equity base of PKR 760mln, in 6MFY20. Debt mix mainly comprises of short-term debt of PKR ~200mln (65% of the total debt). Support from sponsors and/or group entities will be important in current environment.

The Pakistan Credit Rating Agency Limited

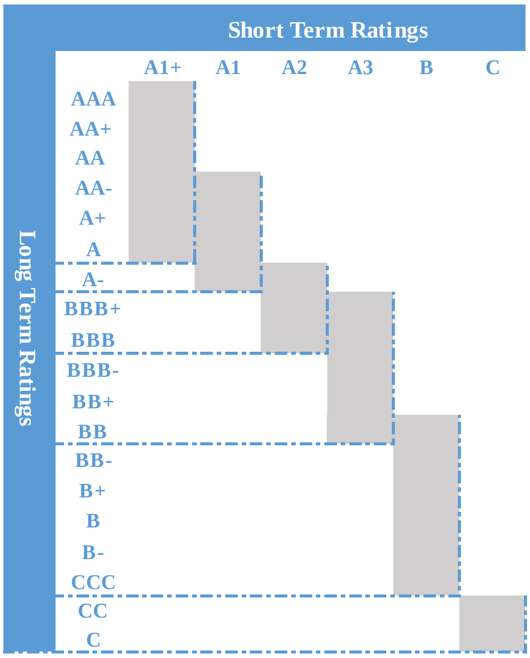
Islamabad Farms	Dec-19	Jun-19	Jun-18	Jun-17
Agriculture and Allied	6M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	687	677	484	430
2 Investments	-	-	-	-
3 Related Party Exposure	-	-	298	-
4 Current Assets	1,008	1,064	650	839
a Inventories	*869*	*862*	*535*	*742*
b Trade Receivables	*18*	*61*	*7*	*9*
5 Total Assets	1,695	1,740	1,432	1,269
6 Current Liabilities	601	708	212	253
a Trade Payables	*539*	*616*	*132*	*230*
7 Borrowings	301	323	377	204
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	33	-	-	-
10 Net Assets	760	709	843	812
11 Shareholders' Equity	760	709	843	812
B INCOME STATEMENT				
1 Sales	2,052	3,294	4,071	2,773
a Cost of Good Sold	*(1,871)*	*(2,882)*	*(3,627)*	*(2,419)*
2 Gross Profit	181	413	444	354
a Operating Expenses	(133)	(281)	(265)	(252)
3 Operating Profit	48	132	179	101
a Non Operating Income or (Expense)	-	*(1)*	*(3)*	*(1)*
4 Profit or (Loss) before Interest and Tax	48	131	176	100
a Total Finance Cost	*(23)*	*(39)*	*(26)*	*(17)*
b Taxation	-	*(16)*	*(45)*	*(29)*
6 Net Income Or (Loss)	25	76	105	55
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*39*	*194*	*264*	*136*
b Net Cash from Operating Activities before Working Capital Changes	*62*	*155*	*238*	*119*
c Changes in Working Capital	*(43)*	*433*	*(173)*	*9*
1 Net Cash provided by Operating Activities	19	588	65	128
2 Net Cash (Used in) or Available From Investing Activities	(62)	(303)	(148)	(23)
3 Net Cash (Used in) or Available From Financing Activities	37	(280)	99	(97)
4 Net Cash generated or (Used) during the period	(6)	5	16	9
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	24.6%	-19.1%	46.8%	-0.7%
b Gross Profit Margin	8.8%	12.5%	10.9%	12.8%
c Net Profit Margin	1.2%	2.3%	2.6%	2.0%
d Cash Conversion Efficiency (EBITDA/Sales)	2.6%	7.4%	6.8%	6.3%
e Return on Equity (ROE)	6.7%	9.7%	12.7%	6.9%
2 Working Capital Management				
a Gross Working Capital (Average Days)	81	81	58	93
b Net Working Capital (Average Days)	29	40	42	67
c Current Ratio (Total Current Assets/Total Current Liabilities)	1.7	1.5	3.1	3.3
3 Coverages				
a EBITDA / Finance Cost	2.3	6.3	10.9	10.6
b FCFO / Finance Cost+CMLTB+Excess STB	0.8	2.4	3.9	3.5
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	4.6	1.1	1.0	0.5
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	28.4%	31.3%	30.9%	20.1%
b Interest or Markup Payable (Days)	0.0	0.0	0.0	0.0
c Average Borrowing Rate	14.7%	11.1%	8.8%	6.9%

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.

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(Credit Rating Companies Regulations,2016)

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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**
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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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(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.
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(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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(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)
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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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