The Pakistan Credit Rating Agency Limited

Rating Report

Shabbir Feed Mills (Pvt.) Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
07-May-2018	BBB-	A3	Stable	Maintain	-
29-Dec-2017	BBB-	A3	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Among the largest agro based segments in Pakistan, poultry holds a prominent place. In Pakistan, formal feed manufacturing started in early 1960. With 350 poultry feed mills and home mixtures, country annually produces around 10 MMT of poultry feed. This industry directly drives its demand from poultry – chicken and eggs consumption. With growing income levels and expanding population, the demand for poultry stays robust, in terms of poultry feed as well. The industry is experiencing ~10% growth.

The ratings incorporate Shabbir Feeds strong presence in the southern Punjab in its related fields – poultry feeds, birds and eggs. This is underpinned by strong demand dynamics. Company has lately camped up its capacities and is catching on utilization levels. By achieving stability in production and ensuring efficiencies, margins are likely to benefit. Company is likely to pursue market penetration strategy. It has relatively long working capital cycle due to seasonal nature of inputs that leads to larger holding period, while receivable credit is adequate. Company operates with high leveraging, primarily in the form of short-term borrowings. They are used to fund inventory and advances/financial support to associates. Although, cashflows are adequate, given extended leveraging, coverages are constrained. Strong growth in poultry sector amidst improving macro-economic conditions and increasing population is expected to develop consumer demand.

The ratings are dependent on the management's ability to build profitable volumes while benefiting from positive demand fundamentals. Financial discipline is crucial; Strengthening of governance framework would be beneficial. The management should consider holding debt driven growth and improving debt mix.

Disclosure	
Name of Rated Entity	Shabbir Feed Mills (Pvt.) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating Methodology(Jul-17),Methodology | Criteria Modifiers(Jun-17)
Related Research	Sector Study | Food and Allied | Poultry(Mar-18)
Rating Analysts	Muhammad Shahzad Saleem | shahzad@pacra.com | +92-42-35869504

Shabbir Feed Mills (Pvt.) Limited	
Incorporated	2001
Major business lines	▪ Manufacturing and selling poultry - feed variant ▪ Poultry sheds of layers and broiler for table eggs and chicken meat.
Legal status	Private Limited

Industry Snapshot
▪ Pakistan's annual poultry feed production capacity, from 150 registered and 200 unregistered feed mills, is 10 MMT. ▪ They manufacture feed by using agricultural products and by-products worth PKR 190 billion ▪ Growth in country's overall poultry sector is approximately 10% per annum. ▪ Sector's contribution is 1.4% in GDP for in FY17, employing 1.5 million people.

Profile and Ownership

- **Background:** Shabbir Feeds (Pvt.) Limited was incorporated in 2001 as a venture of Shujabad Group. Group is diversified in textile, edible oil extraction and poultry industry of Pakistan.
- **Operations:** Currently, Shabbir Feeds is producing poultry feed at a capacity of 45 tons per hour. Company maintains a stable feed conversion ratio, utilizing meat giving and egg laying bird placement capacity of above 90%. It supplies poultry feed, poultry and table eggs in Southern Punjab.
- **Ownership:** Company's major shareholding vests with (Late) Mian Shabbir's family (75%) with an equal stake divided among his five sons. Remaining 25% of company's share resides with Mr. M. Akram, one of group's founders.

Governance

- **Board Structure:** Sponsoring family dominates the four member board of Shabbir Feeds. Company's board has no independent director, thus indicating a room for improvement in company's governance framework.
- **Member Profile:** Board's Chairman, Mr. Muhammad Akram has an experience of more than four decades in textile and poultry businesses. Directors, Mr. Qaisar Sahbbir, Mr. Faisal Sahbbir and Mr. Majid Shabbir have acquired Master degrees and have more than 10 years of business experience.
- **Board Effectiveness:** Four board meetings were held with full attendance of board member to discuss operations and approve financial statements. However, board sub-committees must be established to improve company's governance.
- **Financial Transparency:** Internal audit department has not been established by the company indicating weak governance practices. Company's external auditors, Ghazi and Co. - Chartered Accountants, have been QCR rated by ICAP.

Management

- **Organizational Structure:** At Shabbir Feeds, marketing and sales for feeds and poultry are monitored by their respective directors, who reports to the Chief Financial Officer. CFO reports pertinent matters to Chief Executive Officer. However, support functions (finance, IT and purchase) are provided at group level as shared services.
- **Management Profile:** Mr. Qasier Shabbir - (Late) Mian Sahbbir's eldest son, with his experience of fifteen years in poultry and textile businesses, leads the group and the company as its CEO. Management is well-experienced in poultry industry.
- **Effectiveness:** Non-existence of management committees signals a room to improve management policies and practices.
- **Control Environment:** Automated feed manufacturing facility and control breeding sheds are in place at Shabbir Feeds. Moreover, centralized multi-tier credit approval process are also set-upped.
- **MIS:** Customized software is installed at Shabbir Feeds to manage inventory and monitor procurement, receivables and payables position.

Business Risk

- **Performance:** In 9MFY18, Shabbir Feeds generated a topline to PKR 6 billion (9MFY17: PKR 7 billion).
- Company's business margins have increased (gross: 9MFY18: 11%, 9MFY17: 9%). Operating margins remain stable (9MFY18: 9%) despite being close to the end consumer in poultry's supply chain.
- Consistent borrowings to import soybean meal, kept the interest expenses high ~ PKR 387 million (9MFY18). However, company achieved a bottom-line of PKR 170 million in 9MFY18.
- **Sustainability:** Forseeing poultry feed quality concerns, company is settintup its Research and Development facility.

Financial Risk

- **Capital Structure:** Company's current business activity levels and its credit needs kept the leverage significantly high (9MFY18 ~ 70%, 9MFY17 ~ 71%). Major portion of the debt comprises short term borrowings (94%).
- **Working Capital Management:** Shabbir Feeds high inventory days are attributable to maize procured and stored in bulk. Operating on high credit period of 50 - 60 days, surges the average debtor days (70 days). Payments are made in advance, to procure raw materials, abridge the creditor's days (25 days), leading to a net cash cycle of 148 days (9MFY18). Increase in net cash cycle (9MFY17 ~ 105 days) are backed by an increase in inventory holding days. Due to supply shortage, company procured maize, at a high price, in bulk; thus increasing raw material held days.
- **Coverages:** Company's long term borrowings are minimal and declining (9MFY18~142 million, 9MFY17~231 million). However, inclining short term borrowings (9MFY18~4,338 million, 9MFY17~3,401 million), on the back of high cost associated to seasonal raw materials mostly maize, procured & stored in bulk, leaves diminutive room to borrow against net trade assets.
- Interest coverage of 1.5x (9MFY18), associated with larger quantum of short term borrowings, have deteriorated from 2.5x (9MFY17). Company's ability to service the debt also showed a downward trend (9MFY18~1.3x, 9MFY17~2x), leaving the company in a high leverage position.

Shabbir Feed Mills (Pvt.) Limited

PKR mln

BALANCE SHEET	31-Mar-18	30-Jun-17	31-Mar-17	30-Jun-16	30-Jun-15
	9M	FY17	9M	FY16	FY15
Non-Current Assets	**1,641**	**1,722**	**1,380**	**1,387**	**1,236**
Investments (incl. Associates)	**-**	**-**	**-**	**-**	**-**
Equity	-	-	-	-	-
Debt Securities (incl. income funds)	-	-	-	-	-
Current Assets	**6,002**	**5,975**	**4,794**	**4,002**	**2,763**
Inventory	3,462	2,955	2,531	1,585	1,088
Trade Receivables	2,008	2,398	1,630	1,612	1,150
Others	532	622	633	805	525
Total Assets	**7,643**	**7,697**	**6,174**	**5,389**	**4,000**
Debt	**4,595**	**4,478**	**3,739**	**3,028**	**1,962**
Short-term	4,338	4,155	3,401	2,666	1,565
Long-term (incl. Current Maturity of Long-Term debt	257	323	338	361	397
Other Short-term Liabilities	879	1,215	722	944	895
Other Long-term Liabilities	214	221	150	145	116
Shareholder's Equity	**1,954**	**1,784**	**1,564**	**1,272**	**1,027**
Total Liabilities & Equity	**7,643**	**7,697**	**6,174**	**5,389**	**4,000**

INCOME STATEMENT					
Turnover	**6,440**	**9,521**	**7,169**	**6,280**	**5,662**
Gross Profit	692	757	641	677	591
Other Income	56	116	36	59	26
Financial Charges	(387)	(319)	(202)	(248)	(182)
Net Income	**170**	**197**	**291**	**249**	**251**

Cashflow Statement					
Free Cashflow from Operations (FCFO)	591	609	513	601	512
Net Cash changes in Working Capital	(207)	(1,673)	(909)	(1,099)	(10)
Net Cash from Operating Activities	(96)	(1,343)	(655)	(720)	359
Net Cash from InvestingActivities	(16)	(137)	(81)	(261)	(769)
Net Cash from Financing Activities	117	1,450	711	1,066	378
Net Cash generated during the period	5	(30)	(25)	85	(32)

Ratio Analysis					
Performance					
Turnover Growth	-10.2%	51.6%	52.2%	10.9%	13.1%
Gross Margin	10.7%	7.9%	8.9%	10.8%	10.4%
Net Margin	2.6%	2.1%	4.1%	4.0%	4.4%
ROE	31.0%	13.0%	33.1%	19.5%	30.4%
Coverages					
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB)	1.3	1.4	2.0	1.7	2.3
Interest Coverage (x) (FCFO/Gross Interest)	1.5	1.9	2.5	2.4	2.8
Debt Payback (Total LT Debt Including UnCovered Total STBs) / (FCFO- Gross Interest)	0.5	1.1	0.6	1.0	1.2
Liquidity					
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	148	134	105	101	86
Capital Structure (Total Debt/Total Debt+Equity)	70.2%	71.5%	70.6%	70.5%	65.7%

The Pakistan Credit Rating Agency Limited

ENTITY CREDIT RATING SCALE & DEFINITIONS

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity; 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 or 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.** "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.

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. Rating Watch may carry designation – Positive (rating may be raised, negative (lowered), or developing (direction is unclear). A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled.

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 or 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'.

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, a suspended 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, or e) the entity/issuer defaults.

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
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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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(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)
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