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
29-Jun-2018	A	A1	Stable	Maintain	-
30-Dec-2017	A	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Ismail Industries Limited (IIL) is one of the leading confectionary, snacks and biscuit manufacturing company. The ratings reflect IIL's strong presence in the confectionary industry in particular and in packaged food industry in general. Growing middle class coupled with company's expansion related investments led to doubling of revenues in last 5 years. Ratings also take comfort from the company's related diversification of plastic film manufacturing units which itself is one of the leading plastic film manufacturing unit. IIL has a diverse product range delivered through a strong deep rooted distribution network all over the country. Bisconni – Biscuit Brand, is now the leading food segment of the company with 35% share in total revenues closely followed by Candyland with 30% share. In 9MFY18, the company increased its revenue by 25% YoY while improving its gross margins. Better profitability coupled with lower finance cost led to better coverages YoY. The ratings also incorporate the company's strategic investment in The Bank of Khyber. IIL has a leveraged capital structure due to procurement of expansion related debt.

The ratings are dependent on upholding of the Company's business as well as financial risk profile. The company plans to further increase its product lines by introducing new products to the market. Prudent management of this expansion related debt to meet its financial obligations will remain a key factor for going forward any rating movement.

Disclosure

Name of Rated Entity	Ismail Industries Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating Methodology(Jul-17),Methodology | Correlation between long-term and short-term rating scale(Jun-17),Methodology | Criteria Modifiers(Jun-17)
Related Research	Sector Study | Food and Allied(Dec-17)
Rating Analysts	Muhammad Hassan | muhammad.hassan@pacra.com | +92-42-35869504

ISMAIL INDUSTRIES LIMITED PROFILE	
Incorporated	1988
Major business lines	▪ Confectionary ▪ Biscuits ▪ Snacks ▪ Packaging material
Legal status	Listed
Plant Locations	Lahore & Karachi
Head office	Karachi

INDUSTRY SNAPSHOT

- Pakistan's confectionary, Snacks and Biscuit industry is of ~130bln
- Candyland is the leading market player in Confectionary industry followed by Hilal Foods and Volka foods.
- Fritolays – Lays, is the market leader in snacks industry followed by United Snacks - and SnackCity.
- EBM, LU and Bisconni are three largest biscuit manufacturers of the industry with EBM being market leader.

OWNERSHIP

- Ismail Industries Limited (IIL) is a listed confectionary company incorporated in 1988 by Mr. Muhammad Ismail with his brothers.
- Ismail Industries is majorly owned by Ismail Family. Three brothers through their family owns 98.8% shareholding of the company.
- Mr. Muhammad Ismail – chairman of the company and Miftah Ismail directly owns 29.24% and 30.91% whereas wife of third brother Maqsood Ismail – Ms. Almas Maqsood owns 32.59% shares of the company.
- Mr. Muhammad Ismail, elder of the three brothers, is the chairman of the board and leads Ismail group as well. He has done his B.S. in Industrial Engineering from the University of Florida, USA in 1974.

GOVERNANCE

- The board is dominated by the Ismail family. The board comprises of total 9 members including CEO. The board has three executive members and five non-executive members and one independent director
- Board members have significant industry experience as Ismail Family is involved in the confectionary business for decades.
- The board has formed two committees Audit committee and Human Resource Committee. Audit Committee is chaired by an independent director – Mr. Zubair Motiwala.

MANAGEMENT

- Mr. Munsarim Saifullah – close associate of the sponsors heads the management team of the company as Chief Executive Officer.
- Mr. Munsarim Saifullah has done his Bachelors of Engineering from N.E.D. University of Engineering and Technology, Karachi. He has been associated with the company since the start of the operations.
- IIL has broad management structure comprising many divisions but mainly it has 5 division which includes i) Bisconni & SnackCity (ii) Candyland (iii) Plastic Segment (iv) Finance & Accounts and (v) Supply Chain.
- Mr. Hamid Ismail s/o Maqsood Ismail and Mr. Ahmed Ismail s/o Mr. Muhammad Ismail leads Bisconni & SnackCity Division and Candyland Division respectively.

SYSTEM & CONTROLS

- IIL maintains good IT infrastructure and related controls. The company has in house software but it is in the process of installing SAP. The company plans to install all modules except HR module of SAP by mid-2018.
- The company maintains a comprehensive MIS reporting system for the management to keep track of activities.
- IIL has good quality control systems and all products of Candyland, Bisconni and SnackCity are ISO 22000 certified. The company has availed Halal certifications from SANHA.

BUSINESS RISK

- IIL has a diverse product portfolio. It has primarily four segments under which many products are sold. Candyland is the premium and first segment of the company. Since the launch of Candyland it has become market leader in confectionary industry. Candyland represents 30% of its total revenue as at end March 2018.
- Bisconni sales continued its growth trajectory representing 35% of total sales as two of Bisconni brands Cocomo (34% of Bisconni Sales) and Chocolato (25% of Bisconni Sales) have no direct competitor in market.
- IIL's plastic segment produces CPP, BOPET films which are mainly used in packaging material. IIL is the only manufacturer who provides both CPP and BOPET films. Revenue from IIL's plastic segment increased by 20% YoY.
- IIL managed to increase its overall revenue by 25% YoY while increasing its gross margins (9MFY18: 21.3%, FY17: 18.9%, FY16: 18.3%) on the back of increased Bisconni Sales.
- Income from other sources and share of profit from its associates - The Bank of Khyber also constituted about 23.5% of total bottom line. Overall IIL's net profit increased by 25% and stood firm at PKR 1,081mln (9MFY17 861mln).
- Going forward, IIL is planning for further expansion in all of his segments. Continuing its tradition of introducing new products and being a market leader in confectionary industry it plans to launch its first Cake product under Bisconni brand.

FINANCIAL RISK

- The company meets its working capital needs from a mix of internal cash flow generation and short term borrowing.
- The company has started to deal with its customers on cash basis which led to decrease in net cash cycle (9MFY18: 81days, FY17: 105days, FY16: 117days).
- Increased revenue and profitability led to increase in FCFO however, due to excessive borrowing coverages remained low (9MFY18: 0.7x FY17: 0.9x, FY16:0.56x).
- IIL managed to decrease its short term borrowing which led to decrease in its leveraging (9MFY18: 59.2%, FY17: 63.8%, FY16: 61.78%).

PKR mln

Ismail Industries Limited

BALANCE SHEET	31-Mar-18	30-Jun-17	30-Jun-16	30-Jun-15
	9MFY18	Annual	Annual	Annual
Non-Current Assets	**10,658**	**10,430**	**8,035**	**4,420**
Investments (incl. Associates)	**4,040**	**3,926**	**4,310**	**3,178**
Equity	4,040	3,926	4,310	3,178
Debt Securities (incl. income funds)	-	-	-	-
Current Assets	**8,261**	**7,883**	**8,259**	**6,678**
Inventory	4,810	4,864	5,750	5,196
Trade Receivables	1,701	1,443	1,621	813
Others	1,749	1,577	888	668
Total Assets	**22,959**	**22,239**	**20,604**	**14,276**
Debt	**11,416**	**12,635**	**11,128**	**8,001**
Short-term	3,073	3,783	4,448	4,040
Long-term (incl. Current Maturity of Long-Term debt)	8,343	8,851	6,680	3,961
Other Short-term Liabilities	2,305	1,217	1,774	1,050
Other Long-term Liabilities	1,369	1,213	800	648
Shareholder's Equity	**7,869**	**7,174**	**6,901**	**4,577**
Total Liabilities & Equity	**22,959**	**22,239**	**20,604**	**14,276**
INCOME STATEMENT				
Turnover	**17,986**	**19,605**	**17,008**	**12,242**
Gross Profit	3,825	3,721	3,109	2,476
Other Income	308	516	541	221
Financial Charges	(466)	(671)	(798)	(730)
Net Income	**1,081**	**1,166**	**1,002**	**640**
Cashflow Statement				
Free Cashflow from Operations (FCFO)	2,027	2,285	2,155	1,488
Net Cash changes in Working Capital	(349)	273	(433)	8
Net Cash from Operating Activities	1,186	2,262	1,157	992
Net Cash from InvestingActivities	(909)	(3,145)	(2,237)	(2,686)
Net Cash from Financing Activities	(247)	838	1,110	1,700
Net Cash generated during the period	30	(45)	31	5
Ratio Analysis				
Performance				
Turnover Growth	24.4%	15.3%	38.9%	13.6%
Gross Margin	21.3%	19.0%	18.3%	20.2%
Net Margin	6.0%	5.9%	5.9%	5.2%
ROE	27.9%	16.3%	14.5%	14.0%
Coverages				
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB)	0.7	0.9	0.6	0.8
Interest Coverage (x) (FCFO/Gross Interest)	3.8	3.8	2.7	2.0
Debt Payback (Total LT Debt Including UnCovered Total STBs) / (FCFO- Gross Interest)	4.0	5.5	4.9	5.2
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	81	105	117	163
Capital Structure (Total Debt/Total Debt+Equity)	59.2%	63.8%	61.7%	63.6%

Rating Scale

Credit Rating Scale & Definitions

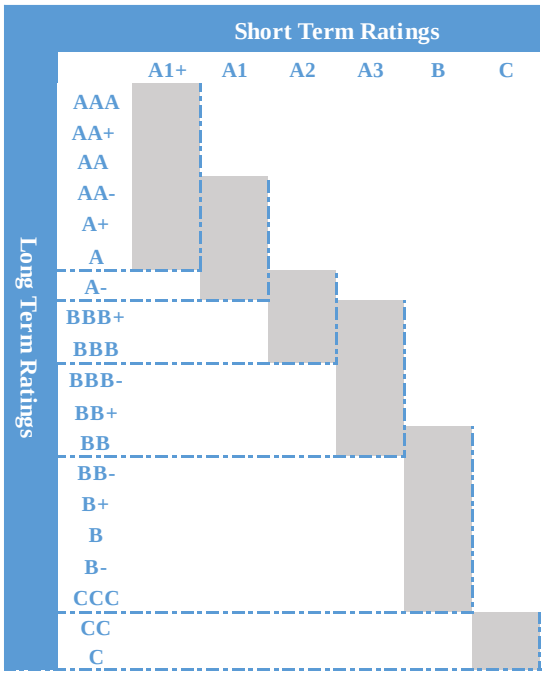
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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