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
29-Oct-2019	BBB-	A3	Stable	Maintain	-
30-Apr-2019	BBB-	A3	Stable	Maintain	-
01-Nov-2018	BBB-	A3	Stable	Maintain	-
07-May-2018	BBB-	A3	Stable	Maintain	-
29-Dec-2017	BBB-	A3	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The global feed industry can be valued at around ~$460bln, with poultry (~$166bln) constituting ~36% of the total industry. Pakistan produces ~8mln MT of feed annually with a total of ~150 registered feed mills and ~200 unregistered feed mills catering to it.

The ratings reflects Shabbir Feed Mills strong presence in Southern Punjab in its related fields – poultry feeds, broiler meat and table eggs. The Company's topline improved backed by higher volumes. Moreover, procuring raw materials - maize and meal, at relatively low cost benefited the margins. The Company has a long working capital cycle due to seasonal nature of inputs that leads to longer holding period. Financial risk remains high due to significantly leveraged capital structure ans mismatch at trade level as the Company provides financial support to other group companies. Due to high quantum of borrowings, the Company's coverages remain stressed. The ratings incorporates diversified business interests of the sponsors.

The ratings are dependent on the management's ability to build profitable volumes while maintaining its margins. Financial discipline is crucial. Improvement in the debt mix and coverages remain critical. Meanwhile, strengthening of governance framework would be beneficial for the ratings.

Disclosure

Name of Rated Entity	Shabbir Feed Mills (Pvt.) Limited
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 Feed(Mar-19)
Rating Analysts	Ayesha Malik | ayesha.malik@pacra.com | +92-42-35869504

Profile

Legal Structure Shabbir Feed Mills (Pvt.) Limited ('the Company' or 'Shabbir Feeds') was incorporated as a Private Limited Company in 2001.

Background At the time of incorporation, the Company was named Shabbir Edible Oil Industries (Pvt.) Ltd as it was commercially producing Banola Oil. In FY05, the Company began to commercially manufacture poultry feed as well and changed its title to Shabbir Edible Oil and Feed Mills (Pvt.) Ltd. Later, the Company discontinued the extraction of edible oil and limited its operations to poultry feed manufacturing only. The Company also integrated into broiler and layer farms. In FY17, the Company again changed its title to Shabbir Feed Mills (Pvt.) Ltd.

Operations Shabbir Feeds is primarily engaged in the production and sale of poultry feed, poultry broiler farming for meat and poultry layer farming for the production of table eggs. In FY05, the Company started the commercial production of poultry feed at 15 ton per hour. Later, the production capacity was increased to 45 tons per hour. The Company's feed mill is located in Moza Wan Chatah, Muzafarghar Bypass Road, Multan. While, broiler and layer sheds are scattered in the outskirts of Multan.

Ownership

Ownership Structure Shabbir Feeds is majorly owned by Shabbir family (75%), with an equal stake (~ 15%) divided among the five brothers. Remaining 25% shares of the Company vests with Mr. Muhammad Akram, a long time partner in various ventures

Stability Ownership of the Company seems stable as its primarily owned by Shabbir family.

Business Acumen Shujabad Group entered into the business arena in 1980's and began to trade different commodities. Later, they entered into ginning business by hiring a mill on operating lease basis. In 1986, the Group setup its own ginning mill named Shujabad Industries (Pvt.) Limited. Over time, the Group diversified into textile, edible oil and poultry.

Financial Strength Shujabad Group has a modest standing in textile, edible oil and poultry sectors. The Group had an annual turnover of almost PKR 20bln in FY19.

Governance

Board Structure Shabbir Feeds Board, comprising four Directors, is dominated by the sponsoring family. Lack of independent Director on the Board, indicates a room for improvement in the Company's governance framework.

Members' Profile All the BoD members have relevant expertise. The Board's Chairman, Mr. Muhammad Akram, is among the founders of the Group. He has an overall business experience of almost four decades.

Board Effectiveness The Board of Directors meet on an as-required basis. There are no Board level committees. The Directors meet almost daily to discuss Group level activities with limited documentation.

Financial Transparency Shabbir Feeds has appointed M/s Ghazi & Co., Chartered Accountants, as their external auditors. The firm has been QCR rated by ICAP but is not in SBP panel of auditors.

Management

Organizational Structure Shabbir Feeds operate through two divisions: Poultry Feed and Poultry Farms - Broiler and Layer. Marketing and sales of each division is monitored by its respective Director, who reports to the Company's CFO. All pertinent matters are reported by the CFO to the Company's CEO. However, support functions (finance, IT and purchase) are shared at Group level.

Management Team The Company's management comprises professionals having relevant experience in poultry industry. The Company's CEO, Mr. Qaisar Shabbir,has been associated with the Company since inception. He has an overall business experience of 15 years in poultry and textile businesses.

Effectiveness The Company does not have management committees in place.

MIS Shabbir Feeds has installed customized software to periodically monitor the inventory position with receivable and payable cycle. The Company's feed manufacturing facility is fully automated, along with control breeding sheds for broiler and layers.

Control Environment Absence of internal audit function indicates a room for improvement. However, on an operational level, samples of maize, meals, medicines and manufactured feed variants are tested for quality in a well-equipped laboratory.

Business Risk

Industry Dynamics The global feed industry can be valued at around ~$460bln, with poultry (~$166bln) constituting ~36% of the total industry. Pakistan produces ~8mln MT of feed annually with a total of ~150 registered feed mills, and ~200 unregistered feed mills catering to it.

Relative Position The Company has secured a prominent position in the market due to its high Feed Conversion Ratio, culminating in increased demand for their product

Revenues Shabbir Feeds generates revenue by selling Poultry Feed (92%), Table Eggs (5%) and Poultry Live Birds (3%). Revenue remains concentrated in the central region of the country with top ten customers contributing 46% to the Company's topline. In FY19, sales grew by 8% (FY19: PKR8.1bln, FY18: PKR 7.5bln) supported by surge in poultry feed price. Moreover, high FCR attracted substantial demand for the Company's feed from the poultry sector.

Margins The Company's profit margins improved on the back of procuring bulk of raw materials at low price and improved operational efficiency (Gross: FY19: 10%, FY18: 8% and Operating: FY19: 8%, FY18: 6%). Surge in finance cost accompanied by increased rental income from related parties resulted in margins at net level (FY19: 2%, FY18: 2%).

Sustainability Going forward, the Group is planning to consolidate. However, some expansion might be witnessed in poultry feed and broiler/ layer farms.

Financial Risk

Working Capital Shabbir Feeds working capital needs originate from financing and storing inventory in bulk. High inventory levels and receivable days kept the net working capital days on the higher side (FY19: 118 days, FY18: 122 days). The Company gave high credit days to buyers to maintain its market share (FY19: 36 days, FY18: 27). Procuring raw material on cash reduced the creditor days (FY19: 44 days, FY18: 47 days). There is a mismatch at trade level due to excessive short term borrowings for working capital and support to other group companies. Strict discipline in the working capital management is required to improve the short term borrowing buffer.

Coverages The free cash flows (FY19: PKR 890mln, FY18: PKR 735mln) improved on YoY basis. However, higher finance cost (FY19: PKR 560mln, FY18: PKR 405mln) led to a marginal dip in the Company's interest cover (FY19: 1.6x, FY18: 1.8x). Core and Total interest cover improved slightly on back of increased cash flows during the year. In the current high interest rate environment, the Company's ability to service the debt may further deteriorate.

Capitalization Shabbir Feeds capital structure is characterized by high leveraging, with debt to equity ratio standing at 68% in FY19 (FY18: 72%). Equity base remains relatively small. Major portion of debt comprises short term borrowings (97%) to support seasonal procurement of Maize in bulk and increased lending to other Group Companies. Long term loans amount to PKR 155mln in FY19 (FY18: PKR 253mln) after repayments. Going forward, the sponsors intend to segregate inter-company loans. This will reduce leveraging of the Company when implemented.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Shabbir Feed Mills (Pvt.) Limited	Jun-19	Jun-18	Jun-17	Jun-16
Poultry Feed	12M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	1,513	1,637	1,722	1,387
2 Investments	-	-	-	-
3 Related Party Exposure	2,268	2,617	1,864	1,087
4 Current Assets	4,243	4,095	4,111	2,914
a Inventories	*2,687*	*2,908*	*2,955*	*1,585*
b Trade Receivables	*1,004*	*587*	*534*	*761*
5 Total Assets	8,024	8,349	7,697	5,389
6 Current Liabilities	1,240	1,358	1,215	944
a Trade Payables	*878*	*1,061*	*873*	*661*
7 Borrowings	4,481	4,843	4,478	3,028
8 Related Party Exposure	28	8	8	8
9 Non-Current Liabilities	166	205	212	137
10 Net Assets	2,109	1,934	1,784	1,272
11 Shareholders' Equity	2,109	1,934	1,784	1,272
B INCOME STATEMENT				
1 Sales	8,106	7,538	9,521	6,280
a Cost of Good Sold	*(7,288)*	*(6,904)*	*(8,763)*	*(5,603)*
2 Gross Profit	818	634	758	677
a Operating Expenses	(210)	(187)	(153)	(159)
3 Operating Profit	608	447	605	519
a Non Operating Income or (Expense)	*186*	*191*	*88*	*59*
4 Profit or (Loss) before Interest and Tax	794	638	692	578
a Total Finance Cost	*(584)*	*(425)*	*(319)*	*(248)*
b Taxation	*(35)*	*(61)*	*(175)*	*(82)*
6 Net Income Or (Loss)	175	152	199	249
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*890*	*735*	*701*	*655*
b Net Cash from Operating Activities before Working Capital Changes	*218*	*175*	*331*	*379*
c Changes in Working Capital	*(2)*	*(354)*	*(1,673)*	*(1,099)*
1 Net Cash provided by Operating Activities	216	(179)	(1,342)	(720)
2 Net Cash (Used in) or Available From Investing Activities	(14)	(67)	(137)	(261)
3 Net Cash (Used in) or Available From Financing Activities	(343)	365	1,450	1,066
4 Net Cash generated or (Used) during the period	(141)	120	(29)	85
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	7.5%	-20.8%	51.6%	10.9%
b Gross Profit Margin	10.1%	8.4%	8.0%	10.8%
c Net Profit Margin	2.2%	2.0%	2.1%	4.0%
d Cash Conversion Efficiency (EBITDA/Sales)	11.9%	10.8%	8.9%	11.4%
e Return on Equity (ROE)	8.7%	8.2%	13.0%	21.6%
2 Working Capital Management				
a Gross Working Capital (Average Days)	162	169	112	114
b Net Working Capital (Average Days)	118	122	82	74
c Current Ratio (Total Current Assets/Total Current Liabilities)	3.4	3.0	3.4	3.1
3 Coverages				
a EBITDA / Finance Cost	1.7	2.0	2.9	3.1
b FCFO / Finance Cost+CMLTB+Excess STB	0.4	0.3	0.4	0.6
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	4.6	6.4	3.9	2.5
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	68.1%	71.5%	71.5%	70.5%
b Interest or Markup Payable (Days)	149.6	155.4	210.5	203.3
c Average Borrowing Rate	12.0%	8.7%	7.8%	9.3%

Rating Scale | Corporate

2019

Credit Rating Scale & Definitions

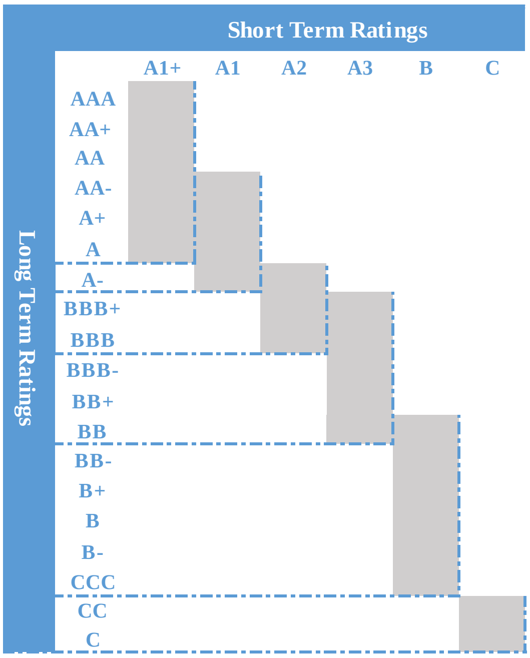
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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.

Regulatory and Supplementary Disclosure

(Credit Rating Companies Regulations,2016)

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