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
28-Jun-2019	A	A1	Stable	Maintain	-
31-Dec-2018	A	A1	Stable	Maintain	-
29-Jun-2018	A	A1	Stable	Maintain	-
30-Dec-2017	A	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Ismail Industries Limited is one Pakistan's leading confectionery, snacks and biscuit manufacturing company. The ratings reflect the Company's strong presence in confectionery, biscuits, BOPET and CPP film manufacturing through established brands (Candyland, Bisconni and Astro Films). Growing middle class, coupled with timely capacity enhancements, have led to significant growth in revenues in the recent past. The ratings draw strength from the Company's diversified revenue stream, supported through plastic film manufacturing units with plans in place for further expansion. Moreover, the Company is expected to make additional investments in associated companies. The Company was able to maintain a solid growth trend in revenues, owing to aggressive marketing campaigns and introduction of new food products, amid an economic slump. The Company maintained margins at the gross level, despite increased costs and a spiraling exchange rate. However, high marketing costs, coupled with increased finance costs and a share of loss from its associate resulted in a squeezed bottom-line. Nonetheless, a solid business profile was maintained. Meanwhile, despite a leveraged capital structure, the Company maintains a strong financial profile, through strong working capital management and adequate coverages.

The ratings are dependent on upholding of the Company's business as well as financial risk profile. Prudent management of expansion and investment related debt to meet financial obligations will remain a key factor for future rating movement.

Disclosure

Name of Rated Entity	Ismail Industries Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-18),Methodology | Criteria | Rating Modifier(Jun-18),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
Related Research	Sector Study | Consumer Goods(Dec-18)
Rating Analysts	Silwat Malik | silwat.malik@pacra.com | +92-42-35869504

Profile

Legal Structure Ismail Industries Limited (the Company) is a public listed company.

Background The Company was founded by Mr. Muhammad Ismail, along with both his brothers. It was incorporated in June, 1988 as a private limited company and was subsequently converted into a public listed company in November, 1988. The Company commenced operations by launching its flagship brand 'CandyLand' and has since been able to expand, both, horizontally and vertically. It entered the biscuits market in 2002 and has set-up two Cast Polypropylene manufacturing plants under 'Astroflims'. The first plant became operational in 2003, whereas the second came online in 2014. Additionally, a BOPET (Biaxially-Oriented Polyethylene Terephthalate) plant was set up in 2010. Moreover, the Company penetrated the snacks industry in 2006.

Operations The Company has its head office located in Karachi with eight production facilities concentrated in three locations – HUB, Port Qasim and Sundar.

Ownership

Ownership Structure Major shareholding of the Company lies with Ismail Family (99%) through Mr. Muhammad Ismail (29%), Mr. Miftah Ismail (31%), Ms. Almas Maqsood (33%) and associates (6%). Remaining shareholding is split between the general public.

Stability During the year the board decided to convert Sponsors' outstanding loan worth ~PKR 902mln into equity by way of further issue of shares. The matter is in process and is expected to be completed by June 2019.

Business Acumen Sponsors have been operating in the industry for over three decades and are considered to have a strong business acumen.

Financial Strength In addition to being one of the major players in the confectionery, biscuits and snacks industry, the Group has interests in plastic films and wind power. During 9MFY19, the Company had a consolidated asset base of ~PKR 25,594mln.

Governance

Board Structure The Company's Board of Directors is dominated by the sponsoring family and consists of nine members, including, the Chairman, four non-executive directors, three executive directors and one independent director.

Members' Profile The Board members have strong profiles and specialize in industrial engineering and economics, in addition to confectionery, biscuits and snacks.

Board Effectiveness The Company has in place two Board committees, namely, Human Resources and Remuneration Committee and Audit Committee. During FY18, the Board met eight times, with high attendance of members.

Financial Transparency Grant Thorton Anjum Rehman Chartered Accountants are the auditors of the Company. They have given an unqualified opinion on the Company for the financial statements ending in June, 2018.

Management

Organizational Structure The Company's organizational structure is divided into five main departments, all of whom are reportable to the CEO. Management is split based on brands and three major functions, which are supply chain, sales and finance & accounts. Operations of Bisconni and Snackcity are headed by one individual, whereas Candyland is headed by a separate individual.

Management Team Mr. Munsarim Saifullah acts as the Chief Executive Officer of the Company. He has been associated with the Company since its inception and is a close associate of the sponsors'. He holds a bachelors in engineering and has been a vital component in establishing the Company's state-of-the-art production facility. He is aided by Mr. Ghulam Farooq, who acts as executive director finance and company secretary. He has been with the Company for more than 15 years and is a fellow of the Chartered Institute of Secretaries.

Effectiveness The Company has no management committees in place. However, financial accounts are discussed among management to review monthly activity.

MIS The Company maintains a comprehensive MIS reporting system to facilitate effective management. It recently deployed SAP as its Enterprise Resource Planning system with implementation of all modules except the Human Resources module.

Control Environment The Company's internal audit department has basic internal controls required to ensure compliance and efficiency. Moreover, the Company employs strict quality control measures at its production facilities, with all products being ISO 22000 certified.

Business Risk

Industry Dynamics The confectionery, biscuits and snacks industry in Pakistan is largely dominated by domestic players and is highly price elastic. Distinction between products lies in mass marketing. Pakistan has a large retail base though highly fragmented and dominated by small retailers, competing in terms of location, personal relationships and product ranges etc.

Relative Position Ismail Industries Limited is one of the leading players in the industry with high market penetration and brand recognition. The Company's confectionery brand 'CandyLand' is the market leader in the industry. Moreover, it is the third largest manufacturer of biscuits which are sold under the brand 'Bisconni' and the second largest in snacks with its brand 'SnackCity', after Lays.

Revenues The Company sources its revenue from two segments – food and plastic films. Major portion of revenue emanates from food sales which accounted for ~79% of total revenue in 9MFY19. During the nine months, net sales clocked in at ~PKR 23,050mln, depicting ~28% growth over the preceding year. Growth can be attributed to higher volumetric sales. Revenue from foods grew by 29% primarily, on the back of higher sales made in the domestic market and relatively lower discounts offered. Additionally, aggressive advertising of recently launched products helped augment revenues. During 9MFY19, the Company enhanced revenue from plastic films by ~26%, owing to strong local sales. Segmental revenue from plastic films totaled to ~PKR 4,927mln.

Margins During 9MFY19, the Company was able to improve gross margins to 23% (9MFY18: 21%). Increased margins can be explained by a reduction in the price of some raw materials (sugar) during 9MFY19 and various costs cutting strategies implemented by the Company, such as, reformulation and alteration of the net weight of products. However, due to aggressive marketing campaigns to promote the launch of new products, operating margins remained under pressure and remained at ~8%. Moreover, the Company's profitability is supported by supplementary dividend income from associates and scrap sales. However, during 9MFY19, a share of loss was borne by the Company, from its associate Bank of Khyber, of ~PKR 75mln in conjunction with high finance costs, owing to higher utilization of credit lines, eroding profitability. During 9MFY19, net profit stood at ~PKR 849mln (9MFY18: ~PKR 1,081), translating into a margin ~4% (9MFY18: 6%).

Sustainability Going forward, the Company plans to enhance its BOPET film production capacity by 36,000 tons per year, bringing total capacity to 54,000 tons per year. The plant is expected to commence operations in 2020 – 2021 and will be financed through long-term loans. Moreover, the Company is expected to invest ~PKR 1.5bln in its associates.

Financial Risk

Working Capital The Company maintains a strong position on working capital management and finances it through a mix of internal cash generation and short-term borrowings. Effective stock management has enabled the Company to improve Net Working Capital Days to 68 days in 9MFY19 (FY18: 85 days; 3MFY18: 84 days). Additionally, the Company's ability to maintain a healthy cushion to borrow additional funds throughout the years reflects positively on working capital management.

Coverages The Company was able to maintain coverages at an adequate level during 9MFY19, despite a 27% increase in finance costs, with the help of maintained cashflows. During the period, interest coverage declined slightly and stood at 4.6x (9MFY18: 4.9x). On the other hand, lower current maturity of long-term debt helped the Company improve total debt coverage to 1.2x during 9MFY19 (9MFY18: 0.8x). Going forward, higher utilization of credit lines, amid a rising interest rate scenario is likely to pressurize coverage ratios.

Capitalization The Company has an aggressive capital structure, represented by a leveraging ratio of ~64% in 9MFY19. Total debt taken up by the Company stood at ~PKR 12,391mln, rising by ~4% as compared to FY18 (~PKR 11,854mln). Debt taken up is marginally inclined towards short-term borrowings, representing 51% of total debt. Additionally, the Company's debt mix comprises a sizable portion of discounted lines such as LTFF and export refinance. The Company has utilized long-term borrowings to finance various capacity enhancements and investment opportunities.

Food & Allied
Financials (Summary) in PKR mln
The Pakistan Credit Rating Agency Limited

PKR mln

Ismail Industries Limited
Listed Public Limited

BALANCE SHEET	Mar-19	Jun-18	Jun-17	Jun-16
	9M	12M	12M	12M
a Non-Current Assets	**12,211**	**10,994**	**10,430**	**8,035**
b Investments (Incl. Associates)	**2,866**	**3,560**	**3,926**	**4,310**
Equity Instruments	2,866	3,560	3,926	4,272
Debt Instruments	-	-	-	37
c Current Assets	**9,632**	**8,518**	**7,883**	**8,259**
Inventory	4,727	4,970	4,864	5,750
Trade Receivables	2,635	1,566	1,443	1,621
Others	2,270	1,982	1,577	888
d Total Assets	**24,709**	**23,072**	**22,239**	**20,604**
e Debt/Borrowings	**12,319**	**11,854**	**12,635**	**11,128**
Short-Term	4,793	4,191	3,783	4,448
Long-Term (Incl. Current Maturity of Long-Term Debt)	7,527	7,663	8,851	6,680
Other Short-Term Liabilities	2,684	1,665	1,217	1,774
Other Long-Term Liabilities	1,473	1,431	1,213	800
f Shareholder's Equity	**8,233**	**8,122**	**7,174**	**6,901**
g Total Liabilities & Equity	**24,709**	**23,072**	**22,239**	**20,604**
INCOME STATEMENT				
a Turnover	**23,050**	**23,906**	**19,605**	**17,008**
b Gross Profit	5,274	5,351	3,721	3,109
c Net Other Income	(146)	372	516	541
d Financial Charges	(591)	(618)	(671)	(798)
e Net Income	**848**	**1,402**	**1,166**	**1,002**
CASH FLOW STATEMENT				
a Free Cash Flow from Operations (FCFO)	2,355	2,735	2,285	2,155
b Total Cashflows (TCF)	2,355	3,098	2,647	2,457
c Net Cash changes in Working Capital	(237)	(111)	273	(433)
d Net Cash from Operating Activities	1,629	2,376	2,262	1,157
e Net Cash from InvestingActivities	(1,799)	(1,401)	(3,145)	(2,237)
f Net Cash from Financing Activities	179	(956)	856	1,110
g Net Cash generated during the period	8	19	(27)	31
RATIO ANALYSIS				
a Performance				
Turnover Growth	29%	22%	15%	39%
Gross Margin	23%	22%	19%	18%
Net Margin	4%	6%	6%	6%
ROE	16%	21%	19%	20%
b Coverages				
Debt Service Coverage (X) (FCFO/Gross Interest+CMLTD+Uncovered STB)	1.2	0.9	0.8	0.7
Interest Coverage (X) (FCFO/Gross Interest)	4.1	4.5	3.4	2.8
Debt Payback (Years) (Total Debt (excluding Covered Short Term Borrowings) / FCFO)	3.6	4.0	6.0	5.5
c Working Capital Management				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	68	85	106	151
d Capital Structure (Total Debt/Total Debt+Equity)	64%	64%	68%	67%

Ismail Industries Limited
Jun-19

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.

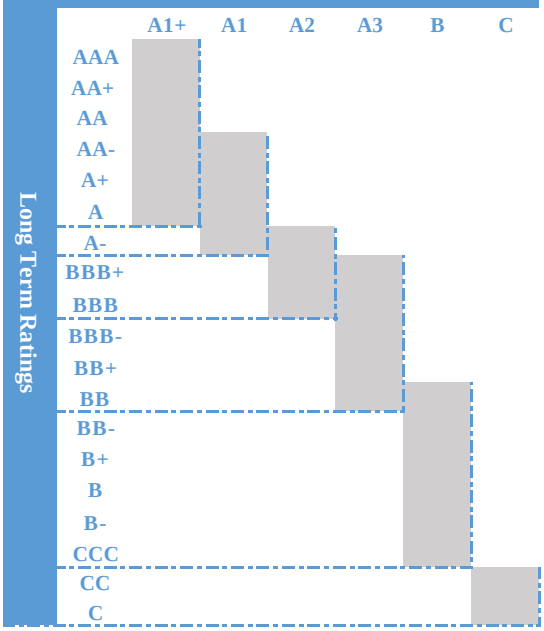
Long Term Ratings

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.

Short Term Ratings



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