The Pakistan Credit Rating Agency Limited

Rating Report

Mumtaz Feed Mills (Pvt.) Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
27-May-2019	BB	A3	-	Initial	-

Rating Rationale and Key Rating Drivers

The global feed industry is valued at ~$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 reflect Mumtaz Feed Mills developing business profile in the Poultry Feed Industry. The Company entered the feed manufacturing business in 2017 and is engaged in sales of Broiler and Layer Feed in the Central and Southern region of the country. The Company has a relatively small top-line and lower margins in comparison to it's peers. Utilization rates have been improving but remain on the lower side. The Company remains exposed to inherent risks in the feed industry emanating from raw material price changes and disease risk for its buyers. The Company's working capital remains in check on account of procuring raw materials on cash and prudent debtor management. The Company enjoys synergies, in this regard as it procures raw material (mainly soya meal) from associated concern. Mumtaz Feed Mill's financial profile is characterized by an aggressively leveraged capital structure. Comfort can be drawn from Sponsors support in the form of Director's loan. The leveraging may rise in future in line with expanding operations.

The ratings are dependent on the management's ability to gain market share, improving margins, and in-turn, profitability. Maintaining strict working capital discipline and ensuing borrowings remains critical. Any significant deterioration in margins and/or coverage's will have an impact on the ratings.

Disclosure	
Name of Rated Entity	Mumtaz Feed Mills (Pvt.) 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 | Poultry Feed(Mar-19)
Rating Analysts	Adnan Dilawar | adnan@pacra.com | +92-42-35869504

Profile

Legal Structure Mumtaz Feed Mills (Pvt.) Ltd ('the Company') was incorporated as a private limited company on March 11, 2016.

Background The Company started its production in 2017. Primary business activity of the Company involves the manufacture and sale of Poultry Feed.

Operations Mumtaz Feed deals solely in Poultry Feed, as it offers sixteen products falling under the category. The Company employs ~70 employees and has a total annual production capacity of 109,500 MT, with plans to further expand it to 292,000 MT. The head office and production plant are located in Multan.

Ownership

Ownership Structure Major shareholding of the Company is held by Mr. Aamir Ali Khan and Mr. Malik Nasir, both hold 35% each. Remaining shareholding is held by Dr. Muhammad Aslam (10%) and Mr. Muhammad Umer (20%).

Stability The Company's shareholding structure is divided among four sponsors. However, there is no formal succession plan regarding succession of ownership.

Business Acumen Sponsors of the Company have strong profiles relating to the poultry feed industry, with at least 15 years of relevant experience.

Financial Strength The Company's financial strength is represented through the support of its sponsors and its associated entities who have vested business interest in the poultry feed industry. During FY18, the sponsors of the Company had a collective total net asset base of ~PKR 80mln.

Governance

Board Structure The Company's Board of Directors consists of four members, including the Chief Executive, with one executive director and two non-executive directors. High presence of executive members and lack of Independent oversight signifies a weak governance structure.

Members' Profile Mr. Aamir Ali Khan, the CEO, has more than two decades of relevant expertise with past experiences in the sale of poultry feed and trading Soya meal.

Board Effectiveness Board has formed two committees, namely, Audit & Risk Management and Procurement & Development. During FY18, several meetings of the BoD and Committee meetings were held with high participation. However, lack of documentation of minutes and dominance of executive directors indicate room for improvement.

Financial Transparency Waqas & Co., Chartered Accountants, not rated by SBP nor QCR rated, are the external auditors of the Company. Significant room for improvement exists in financial transparency. They have expressed an unqualified opinion on the financial statements of the Company ending in June 2018.

Management

Organizational Structure The Company has developed a horizontal organizational structure with core functions such as Production, Marketing, Procurement fully established and are headed by General Managers that report to the CEO. However, other functions such as Accounts, HR and IT are not segregated as yet. The Company also lacks an internal audit function.

Management Team The Company's management comprises experienced individuals who possess significant market knowledge and technical know-how. General Manager of Production, holds an Msc (Hons) in Animal Nutrition with over 15 years of experience in feed manufacturing, feed formulation, and quality control. General Manager Sales and Logistics also have over 15 years of experience feed industry.

Effectiveness Reports on financial statements and cashflow statements are prepared on a quarterly basis, while reports adhering to production, sales, receivables, and stock are prepared on a weekly and monthly basis. However, there are no management committees in place to monitor effectiveness.

MIS The Company developed an in-house software designed to meet it's needs for accounting and inventory management purposes. It operates three modules namely, Financial Accounting, Sale Purchase and Software Security.

Control Environment The Company places increased emphasis on quality control and food safety with strict policies and quality testing procedures in place to maintain quality and compliance with regulatory framework. The Company lacks an internal audit function which heightens the operational risk.

Business Risk

Industry Dynamics From a Global perspective, the feed industry is valued at ~$460bln. Poultry constitutes 36% of the total industry ~ $166bln. Pakistan produced ~ 8mln MT of Feed production in FY18. There a total of ~150 registered feed mills, with ~200 unregistered feed mills catering to Pakistan's feed industry.

Relative Position The Company is a new and relatively small player in the Poultry feed industry as it contributes just 109,500 MT out of the total 8mln MT of Feed production. This translates into ~1.4% market share.

Revenues The Company has a relatively small topline, which is a function of its capacity and low utilization. The Company sources its revenue from sixteen different poultry feed products. The Company's top four product's make up a significant portion (~75%) of the revenue. Sales are divided among the country's Central and Southern region, with Southern region capturing the majority share (~58% of total sales). Sales have witnessed consistent growth since inception. Mumtaz Feed Mills recorded sales of ~PKR 428mln in FY18, and ~PKR 808mln in 2QFY19 on the back of increased capacity utilization as well as better price over the periods observed.

Margins Mumtaz Feeds has registered increasing margins since its inception. During FY18, the Company's gross margins stood at 4.1%, with it furthering in 1QF19 (5.3%) and 2QF19 (5.9%) owing to rise in sale prices and operational efficiencies gained from higher capacity utilization. Similarly, operating margins stood at 1.4% during FY18 and marginally improved to 1.8% in 2QFY19 due to a drop in marketing costs. Bottom-line closed in at ~PKR 2mln during FY18 and ~PKR 10mln in 2QFY19. Despite the increasing trends, margins remain lower than industry averages, while the Company focuses on expanding it's customer base.

Sustainability Going forward, Mumtaz Feeds plans to focus on increasing its market share in the poultry feed industry by focusing on quality and pricing. The Company has increased it's production capacity by an additional 25MT per hour and corresponding increase in its storage capacity.

Financial Risk

Working Capital The Company's working capital management is a function of its inventories. In a bid to purchase raw-materials at lower prices and to maintain sufficient stock levels, resulted in elevated average raw material days. However, effective control on stock of finished goods have helped average inventory levels float around 63 days in 2QFY19. Prudent management of debtors is reflected in average debtor days as they range between 11 - 27 days over the past three corresponding financial periods (FY18 – 2QFY19). Payable days have also come down (2QFY19: 26 days, FY18: 80 days) as the Company has been paying its suppliers on cash. Therefore, during 2QFY19, effective working capital management led to an improvement of 14 days in the Company's net working capital days, bringing the figure down to 49 days in 2QFY19 from 63 days in FY18.

Coverages The Company's cashflows increased based on better profitability. FCFO during 2QFY19 stood at ~PKR 19mln, double since FY18. Lower short-term borrowings and interest free loans from the sponsor have helped the Company to maintain strong coverages. During 2QFY19, interest coverage stood at ~8.3x, coming down from 83x in FY18 owing to higher interest costs and lower cash flows. Debt coverage ratio was further impacted during 2QFY19, coming down to 6.9x, due to higher utilization of short-term borrowings. Going forward, additional debt and rising interest rate scenario would negatively impact cashflows and coverages.

Capitalization The Company has an aggressively leveraged capital structure, represented by a debt-to-equity ratio of ~62% in FY18. Debt taken up by the Company majorly (75%) comprises of long-term borrowings from the sponsor, which were needed to fulfill working capital requirements. During 2QFY19, total debt stood at ~PKR 364mln, expanding by ~ 208% as compared to FY18, as the Company took further long-term debt from its sponsor and increased short-term borrowings to fund its higher sale volumes. The leveraging may rise in-line with the growing operations of the Company.

Poultry Feeds
Financials (Summary) in PKR mln
The Pakistan Credit Rating Agency Limited

Mumtaz Feed Mills (Pvt.) Ltd.
Private Limited

BALANCE SHEET	Dec-18	Sep-18	Jun-18
	Management Accounts	Management Accounts	Audited Accounts
a Non-Current Assets	**173**	**164**	**62**
b Investments (Incl. Associates)	**-**	**-**	**-**
Equity Instruments	-	-	-
Debt Instruments	-	-	-
c Current Assets	**524**	**381**	**233**
Inventory	423	263	137
Trade Receivables	70	83	31
Others	30	36	64
d Total Assets	**697**	**545**	**295**
e Debt/Borrowings	**92**	**17**	**3**
Short-Term	89	15	-
Long-Term (Incl. Current Maturity of Long-Term Debt)	2	2	3
Other Short-Term Liabilities	147	104	104
Other Long-Term Liabilities	273	244	117
f Shareholder's Equity	**186**	**180**	**71**
g Total Liabilities & Equity	**697**	**545**	**295**
INCOME STATEMENT			
a Turnover	**808**	**376**	**428**
b Gross Profit	48	20	18
c Net Other Income	1	2	0
d Financial Charges	(2)	(1)	(0)
e Net Income	**10**	**4**	**2**
CASH FLOW STATEMENT			
a Free Cash Flow from Operations (FCFO)	19	7	12
b Total Cashflows (TCF)	19	7	12
c Net Cash changes in Working Capital	(296)	(195)	(76)
d Net Cash from Operating Activities	(277)	(188)	(64)
e Net Cash from InvestingActivities	(119)	(106)	(28)
f Net Cash from Financing Activities	351	247	118
g Net Cash generated during the period	(45)	(47)	25
RATIO ANALYSIS			
a Performance			
Turnover Growth	277%	252%	-
Gross Margin	6%	5%	4%
Net Margin	1%	1%	0%
ROE	15%	11%	3%
b Coverages			
Debt Service Coverage (X) (FCFO/Gross Interest+CMLTD+Uncovered STB)	6.9	5.7	10.9
Interest Coverage (X) (FCFO/Gross Interest)	8.3	7.1	83.4
Debt Payback (Years) (Total Debt (excluding Covered Short Term Borrowings) / FCFO)	8.1	10.2	10.0
c Capital Structure (Total Debt/Total Debt+Equity)			
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	49	38	63
d **Capital Structure** (Total Debt/Total Debt+Equity)	66%	59%	62%

Rating Scale

Credit Rating Scale & Definitions

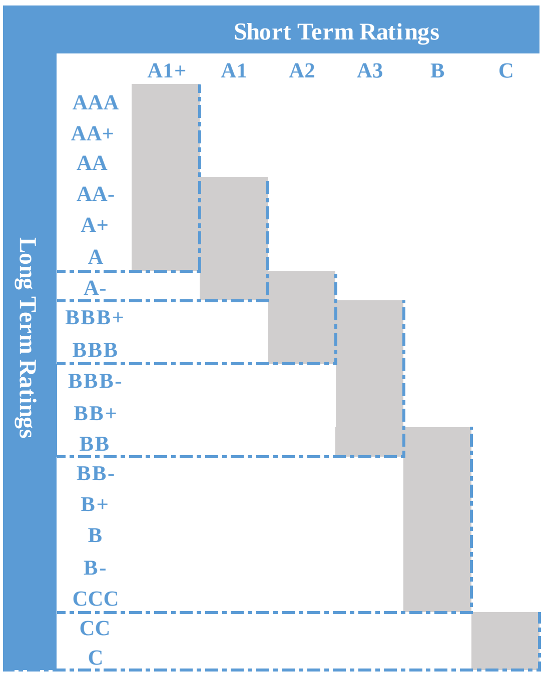
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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.

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