The Pakistan Credit Rating Agency Limited

Rating Report

Islamabad Farms

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
29-Oct-2020	BBB-	A3	Stable	Maintain	-
11-May-2020	BBB-	A3	Stable	Maintain	YES
19-Dec-2019	BBB-	A3	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Poultry is one of the largest agro based segment in Pakistan, accounting both domestic & commercial poultry. With an investment of almost PKR 700bln in FY19, the industry has posted an annual growth of ~ 12%. Pakistan is sufficient in poultry meat and egg production. However, per capita protein consumption remains low when compared to the world's average. The industry generates an estimated annual revenue of ~ PKR 300bln - PKR 350bln from local and export sales. Previously, due to Covid-19 outbreak, marriage halls/restaurants were closed. This, along with no exports of poultry products, led to supply glut in local market. Prices of poultry products posted a dip despite being an essential food item due to lower demand with many poultry farms becoming non-operational. However, lately, prices of poultry products have picked up as demand from poultry farms have increased. Industry players are expected to manage liquidity concerns that persisted as farms follow 40-day cycle before new flock is ready. Moreover, SBP measures and interest rate cut provided necessary respite in the short-time.

The ratings reflect Islamabad Farms developing position in poultry industry and sponsor's strong acumen across the integrated poultry supply chain. Islamabad Farms revenue is concentrated towards day old chicks and posted subtle growth during FY20. Procuring feed in bulk from Group’s own company benefited the margins. Profitability remains modest. However, Islamabad Farms remains exposed to price volatility and contingent health risk associated to its product. As poultry demand has started to stabilize and prices of day old chicks have recovered, Islamabad Farms is expected to overcome the uncertainty created during the lock down. Financial risk profile of Islamabad Farms is characterized by moderate leverage and adequate coverage ratios. Loan mix is skewed towards short term borrowings to fulfill the working capital requirements. Islamabad Farms availed debt relief measures announced by SBP to alleviate pressure from its cashflows. Moreover, the ratings incorporate potential support from sponsors and/or group companies.

The ratings are dependent on the management's ability to sustain its operations. Improving margins, in turn, building profitable volumes remain critical for the ratings. Effective changes in governance framework would be beneficial for the ratings. Generating stable operational cashflows is important. Meanwhile, a prudent financial strategy to meet financial obligations is critical.

Disclosure

Name of Rated Entity	Islamabad Farms
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-20),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria | Rating Modifier(Jun-20)
Related Research	Sector Study | Poultry(Jan-20)
Rating Analysts	Faiqa Qamar | faiqa.qamar@pacra.com | +92-42-35869504

Profile

Legal Structure Islamabad Farms is registered as an Association of Persons (AoP) in Pakistan, since 1988.

Background The sponsors started poultry business in 1981 by setting up small poultry farms. Later, they integrated by setting up poultry feed mill, more poultry farms and hatcheries. Today, the Group is a well-known player in the poultry industry of Pakistan.

Operations Islamabad Farms operates 18 breeder farms with placement capacity of 1.5 million parent stock of different breeds and 4 hatcheries producing ~ 10 million day old chicks per month . The Group's registered office is located in Satellite Town, Rawalpindi. Whereas, poultry farms are dispersed across different cities including Multan, Okara, Muree, Hyderabad, Karachi and Attock.

Ownership

Ownership Structure Major ownership of Islamabad Farms resides with Dr. Muhammad Aslam (50%) and Dr. Azhar Mehmood (25%). Remaining shareholding is equally divided among Mr. Muhammad Masood (12.5%) and Mr. Mamoon-u-Rasheed (12.5%). Sponsors have been associated for a long time.

Stability Ownership structure of the business is seen as stable and second generation is gradually being inducted in the business.

Business Acumen Islamabad Farms is a venture of Islamabad Group, which has an established presence in Pakistan’s poultry and poultry feed industry. The Group’s flagship entity, Islamabad Feeds, has grown to become one of the Country’s leading feed mill.

Financial Strength The sponsors have high net worth and their willingness to support the business bodes well for Islamabad Farms.

Governance

Board Structure Sponsors dominate the Board of Islamabad Farms. Absence of independent oversight indicates a room for improvement in Islamabad Farms governance framework.

Members’ Profile The Board's Chairman, Dr. Muhammad Aslam, is a Doctor of Veterinary Medicine, having an overall experience of over four decades in poultry and integrated businesses. He has been Chairman of Pakistan Poultry Association and currently is a member of Punjab Poultry Board.

Board Effectiveness There are no sub-committees of the Board. Board meets informally to discuss pertinent matters. As per requirement minutes are documented informally.

Financial Transparency External auditors of Islamabad Farms are M/s Muniff Ziauddin & Co. and Chartered Accountants. The firm is QCR rated and in ‘Category A’ of SBP panel of auditors.

Management

Organizational Structure Islamabad Farms operates through Production (breeder farms and hatcheries), Finance, Accounts, Sales & Marketing, and Internal Audit function. Breeder farms and hatcheries are monitored by their respective Managers, who report to the GM Production. Support departments work as shared services for the group. All of the department heads eventually report to the Chief Executive Office (CEO), who makes pertinent decisions implemented by his team.

Management Team CEO of Islamabad Farms, Dr. Muhammad Aslam, is a Doctor of Veterinary Medicine with long track record in poultry and integrated businesses. He served as Chairman and member of various Poultry Boards and bodies. Dr. Munnawar Ali, GM Production, has an overall experience of over three decades. He is associated with the Group for 30 years. Mr. Muhammad Sajjad, Chief Financial Officer, has an overall experience of 25 years and has been associated with the Group for almost 20 years.

Effectiveness At Islamabad Farms, different management committees are formally in place; namely, Audit, Finance, Sales and Recovery, and Production covering breeder farms and hatcheries. Pertinent matters are discussed by these committees and minutes are documented informally.

MIS The Company uses Oracle as an enterprise resource software, customised as per the industry needs. This enables the senior management to monitor and generate reports about inventory, sales, receivables and payable side. These reports are generated on daily, weekly and monthly basis.

Control Environment To ensure operational efficiency, an internal audit function has been established at group level to implement the policies and procedures. This function conducts regular monitoring to implement the policies and procedures of Islamabad Farms.

Business Risk

Industry Dynamics Poultry is one of the largest agro based segment in Pakistan, accounting both domestic & commercial poultry. With an investment of almost PKR 700bln in FY20, the industry has posted an annual growth of ~ 12%. Pakistan is sufficient in poultry meat and egg production. However, per capita protein consumption remains low when compared to the world's average. The industry generates an estimated annual revenue of ~ PKR 300bln - PKR 350bln from local and export sales. Previously, due to Covid-19 outbreak, marriage halls/restaurants were closed. This, along with no exports of poultry products, led to supply glut in local market. Prices of poultry products posted a dip despite being an essential food item due to lower demand with many poultry farms becoming non-operational. However, lately, prices of poultry products have picked up as demand from poultry farms have increased. Industry players are expected to manage liquidity concerns that persisted as farms follow 40-day cycle before new flock is ready. Moreover, SBP measures and interest rate cut provided necessary respite in the short-time.

Relative Position Islamabad Farms contributed approximately 5% to the total production of day old chicks in Pakistan.

Revenues Islamabad Farms mainly generates revenue by selling Day Old Chicks (~90%) and Culled birds (~8%) and others (~2%) in the local market. In FY20, Islamabad Farms generated major chunk of its revenue from south region followed by north and central region. During FY20, Islamabad Farms witnessed a growth of 11% in total revenues. The significant growth was witnessed in the sales of day-old chicks (13%). The increase in revenues was driven by the higher prices in the market. In volumetric terms, production of day-old chick reduced to 121.3mln in FY20 (FY19: 122.8mln). Islamabad Farms managed to increase its revenue base despite supply glut during the COVID-19 pandemic.

Margins During FY20, Islamabad Farms experience a decline in its margins despite growth in revenues. Gross profit margin stood at 8.6% in FY20 (FY19:12.5%). The gross profit experience a decline due to the increase 16.5% in its cost of key raw materials (maize and soybean). Consequently, operating margin experience a decline and stood at 2.1% in FY20 (FY19:4%) despite the reduction in operating expenses (FY20; PKR 239mln; FY19: PKR 281mln). Higher finance cost (FY20: PKR 45mln, FY19: PKR 39mln) led to lower net margins (FY20: 0.6%, FY19: 2.3%).

Sustainability Islamabad Farms does not have any plans to enhance its capacity in near future.

Financial Risk

Working Capital Islamabad Farms working capital needs emanate from high finished goods inventory (breeder stock and day old chicks). In FY20, inventory days and trade receivable days increased to 93 days (FY19: 77days) and 6 days (FY19: 4 days). Trade payable increased (FY20: 55 days, FY19: 41 days) leading to elevated net working capital cycle (FY20: 44 days, FY19: 40 days). Islamabad Farms maintains adequate borrowing cushion.

Coverages In FY20, interest coverage declined to 1.3x (FY19: 5x). The decline in interest coverage was the result of lower free cash flows (FY20: PKR 57mln; FY19: PKR 194mln) coupled with the increase of finance cost (FY20: PKR 45mln; FY19: PKR 39mln). Similarly, Core and Total coverage ratios posted a dip (Core and Total Coverage: FY20: 0.6x, FY19: 2.4x).

Capitalization Islamabad Farms has a moderately leveraged capital structure with debt to equity ratio at ~30.5% (FY19:31.3%) on the back of small equity base of PKR 873mln. During FY20, total borrowing increased to PKR 382mln in comparison to PKR 323mln in FY19. The increase in borrowing was the result of higher long term borrowings. Debt mix comprises: short-term debt ~ PKR 200mln (39% of the total debt) and long term borrowing including current maturity ~ PKR 233mln (61% of the total debt). Support from sponsors and/or group entities remains important in current environment.

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Financial Summary

PKR mln

Islamabad Farms	Jun-20	Jun-19	Jun-18	Jun-17	Jun-16
Poultry	12M	12M	12M	12M	12M
A BALANCE SHEET					
1 Non-Current Assets	636	677	484	430	478
2 Investments	-	-	-	-	-
3 Related Party Exposure	-	-	298	-	-
4 Current Assets	1,182	1,064	650	839	777
a Inventories	*1,011*	*862*	*535*	*742*	*626*
b Trade Receivables	*51*	*61*	*7*	*9*	*30*
5 Total Assets	1,818	1,740	1,432	1,269	1,255
6 Current Liabilities	563	708	212	253	198
a Trade Payables	*489*	*616*	*132*	*230*	*157*
7 Borrowings	382	323	377	204	273
8 Related Party Exposure	-	-	-	-	-
9 Non-Current Liabilities	-	-	-	-	-
10 Net Assets	873	709	843	812	784
11 Shareholders' Equity	873	709	843	812	784
B INCOME STATEMENT					
1 Sales	3,676	3,294	4,071	2,773	2,792
a Cost of Good Sold	*(3,359)*	*(2,882)*	*(3,627)*	*(2,419)*	*(2,436)*
2 Gross Profit	318	413	444	354	356
a Operating Expenses	(239)	(281)	(265)	(252)	(267)
3 Operating Profit	78	132	179	101	89
a Non Operating Income or (Expense)	*(1)*	*(1)*	*(3)*	*(1)*	*(1)*
4 Profit or (Loss) before Interest and Tax	78	131	176	100	88
a Total Finance Cost	*(45)*	*(39)*	*(26)*	*(17)*	*(25)*
b Taxation	*(10)*	*(16)*	*(45)*	*(29)*	*(28)*
6 Net Income Or (Loss)	22	76	105	55	35
C CASH FLOW STATEMENT					
a Free Cash Flows from Operations (FCFO)	*57*	*194*	*264*	*136*	*139*
b Net Cash from Operating Activities before Working Capital Changes	*102*	*155*	*238*	*119*	*114*
c Changes in Working Capital	*(245)*	*433*	*(173)*	*9*	*(107)*
1 Net Cash provided by Operating Activities	(143)	588	65	128	8
2 Net Cash (Used in) or Available From Investing Activities	(63)	(303)	(148)	(23)	(1)
3 Net Cash (Used in) or Available From Financing Activities	201	(280)	99	(97)	(14)
4 Net Cash generated or (Used) during the period	(5)	5	16	9	(7)
D RATIO ANALYSIS					
1 Performance					
a Sales Growth (for the period)	11.6%	-19.1%	46.8%	-0.7%	0.0%
b Gross Profit Margin	8.6%	12.5%	10.9%	12.8%	12.7%
c Net Profit Margin	0.6%	2.3%	2.6%	2.0%	1.3%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	-5.1%	19.0%	2.2%	5.2%	1.2%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	2.6%	11.7%	13.3%	6.8%	4.5%
2 Working Capital Management					
a Gross Working Capital (Average Days)	99	81	58	180	7
b Net Working Capital (Average Days)	44	40	42	154	-14
c Current Ratio (Current Assets / Current Liabilities)	2.1	1.5	3.1	3.3	3.9
3 Coverages					
a EBITDA / Finance Cost	2.0	6.3	10.9	10.6	6.8
b FCFO / Finance Cost+CMLTB+Excess STB	0.6	2.4	3.9	3.5	2.2
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	19.4	1.1	1.0	0.5	1.1
4 Capital Structure					
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	30.5%	31.3%	30.9%	20.1%	25.8%
b Interest or Markup Payable (Days)	0.0	0.0	0.0	0.0	0.0
c Entity Average Borrowing Rate	13.3%	11.1%	8.8%	6.9%	9.0%

Credit Rating

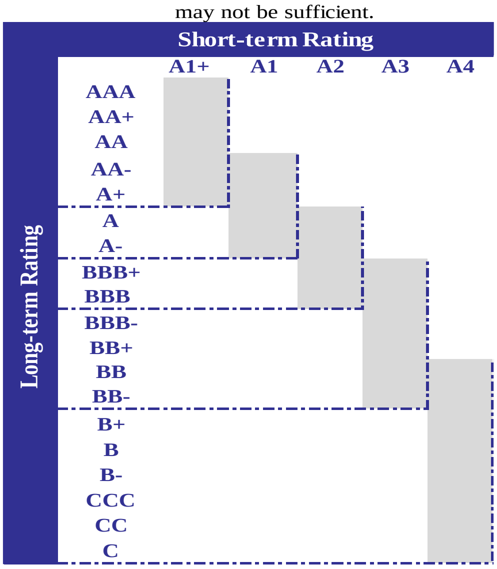
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
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 Rating

Scale	Definition
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
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



The correlation shown is indicative and, in certain cases, may not hold.

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 some material identifiable event with indeterminable rating implications. 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 rating 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) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) 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.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

Entities

a) Broker Entity Rating
b) Corporate Rating
c) Financial Institution Rating
d) Holding Company Rating
e) Independent Power Producer Rating
f) Microfinance Institution Rating
g) Non-Banking Finance Companies (NBFCs) Rating

Instruments

a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk Rating

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