

RATING REPORT

Engro Foods Limited

REPORT DATE:

January 6, 2017

RATING ANALYSTS:

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RATING DETAILS

Rating Category	Latest Rating	Previous Rating
	Rating	Rating
TFC	A+	A+
Rating Date	Dec' 30, 2016	Dec' 14, 2015
Rating Outlook	Stable	Stable

COMPANY INFORMATION

Incorporated in 2006	External auditors: A.F. Ferguson & Co. Chartered Accountants
Public Listed Company	Chairman of the Board: Abdul Samad Dawood
Key Shareholders (with stake 5% or more):	Chief Executive Officer: Babur Sultan
Engro Corporation Limited – 87.1%	
Financial Institutions – 5.6%	

APPLICABLE METHODOLOGY(IES)

JCR-VIS Entity Rating Criteria: Industrial Corporates (May 2016)
 Rating the Issue (June 2016)

Engro Foods Limited

OVERVIEW OF THE INSTITUTION

Initially, Engro Foods Limited (EFL) was incorporated as a wholly owned subsidiary of Engro Corporation Limited (E Corp) in 2006. Later, it was listed on the Pakistan Stock Exchange (PSX).

RATING RATIONALE

EFL is primarily engaged in manufacturing, processing and selling of dairy products & beverages which represent around 90% of its sales revenue; the company also sells ice cream and operates a dairy farm. EFL is primarily sponsored by E Corp, which ranks among Pakistan's largest conglomerates. Flagship brands of the company include Olper's Milk, Omore Ice Cream, Dairy Omung (UHT dairy liquid) and Tarang Tea Whitener.

On March 3, 2016, EFL received an announcement of intention from Royal FrieslandCampina International Holding B.V (RFC), stating RFC's intention to acquire up to 51% of ordinary shares of the company cumulatively through an agreement with E Corp and a public offer. As of September 30, 2016, all required regulatory clearances have been obtained. Subsequently, RFC has launched a tender offer, as required under applicable takeover laws. As per latest financial statements, the transaction is expected to complete by end-CY16.

EFL issued a Sukuk in July 2009 amounting to Rs. 950.00m with a tenor of 8 years. The first principal repayment was completed in July 2015 (Rs. 71.25m) while two payments were made in CY16 (accumulating to Rs. 475.00m). The Sukuk is expected to mature in January 2017 with final repayment amounting to Rs. 403.75m.

Rating Drivers

- **Capital Structure:** Debt is largely long term in nature; borrowings also include short term running finance facilities obtained from various banks. The company has trended towards adopting a more conservative capital structure as evidenced by notable balance sheet deleveraging. In view of lower overall size of debt and growth in equity base by way of profit retention, leverage indicators showcased significant improvement.
- **Profitability:** Assigned ratings take into account market share and position of the company in the consumer goods sector. During 9M16, net sales of EFL declined largely due to reduced turnover in Dairy & Beverages segment while gross margin was largely maintained around prior year's level. In view of substantial debt reduction, along with drop in interest rates, finance cost decreased. Despite reduced turnover, a lower expense base allowed the company to maintain its bottom line and improve its net margin.
- **Liquidity:** Liquidity profile draws support from sizeable cash flows in relation to outstanding obligations, adequate working capital cycle and ageing profile of trade debts. In contrast to preceding year, better profitability resulted in higher funds from operations (FFO). Notable improvement in internal cash generation has augmented the company's ability to meet debt servicing payments. The same supported enhancement of debt servicing coverage ratio to 1.87x (CY15: 2.33x; CY14: 1.41x) at end-9M16. Thus, ability to meet obligations is considered strong.
- **Corporate Governance:** Overall corporate governance framework remains strong as indicated by adequate board composition and oversight, presence of stable and professional management team, implementation of strong internal controls and emphasis on transparency and disclosures.

Engro Foods Limited

Appendix II

FINANCIAL SUMMARY			
	<i>(amounts in PKR millions)</i>		
BALANCE SHEET	SEPT 30, 2016*	DEC 31, 2015	DEC 31, 2014
Fixed Assets <i>(Property, plant and equipment)</i>	13,289.51	13,860.27	15,021.52
Stock-in-Trade	4300.36	3,071.38	3,697.79
Trade Debts	69.80	117.57	95.96
Cash & Bank Balances	300.98	289.05	196.90
Total Assets	26,207.46	26,285.39	25,699.51
Trade and Other Payables	3,852.00	3,778.57	3,519.18
Long Term Debt <i>(*incl. current maturity)</i>	2,907.81	5,367.41	7,082.59
Short Term Debt	301.8	409.76	2,331.89
Total Equity	17,369.12	14,912.80	11,577.62
INCOME STATEMENT			
	SEPT 30, 2016*	DEC 31, 2015	DEC 31, 2014
Net Sales	45,748.04	51,188.52	43,027.38
Gross Profit	11,528.87	11,531.09	7,676.32
Operating Profit	5,846.42	5,193.53	2,216.50
Profit After Tax	3,459.71	3,162.46	888.83
FFO	6,288.6	5,078.6	1,951.3
RATIO ANALYSIS			
	SEPT 30, 2016*	DEC 31, 2015	DEC 31, 2014
Gross Margin (%)	25.20%	23.14%	18.02%
Net Working Capital	5,714.51	3,695.29	2,028.68
FFO to Total Debt (x)	1.96	0.88	0.25
Debt Servicing Coverage Ratio (x)	1.87	2.33	1.41
ROAA (%)	13.18%	17.38%	3.57%
ROAE (%)	21.43%	34.10%	7.97%
Gearing (x)	0.18	0.39	0.81
Debt Leverage (x)	0.51	0.76	1.22
*interim figures have been annualized			

ISSUE/ISSUER RATING SCALE & DEFINITIONS

Appendix III

Medium to Long-Term

AAA

Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-

High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-

Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-

Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-

Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-

Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC

Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC

A high default risk

C

A very high default risk

D

Defaulted obligations

Short-Term

A-1+

Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1

High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2

Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3

Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B

Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C

Capacity for timely payment of obligations is doubtful.

Rating Watch: JCR-VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.jcrvis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details. www.jcrvis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities

and not on the basis of the credit quality of the issuing entity alone.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES					Appendix IV
Name of Rated Entity	Engro Foods Limited				
Sector	Consumer Goods				
Type of Relationship	Solicited				
Purpose of Rating	TFC rating				
Rating History	Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
	RATING TYPE: TFC				
	12/30/2016	A+		Stable	Reaffirmed
	12/14/2015	A+		Stable	Reaffirmed
	12/31/2014	A+		Stable	Reaffirmed
	1/21/2013	A+		Stable	Upgrade
	4/26/2011	A		Stable	Upgrade
	1/7/2010	A-		Positive	Maintained
	1/6/2009	A-		Stable	Final
8/13/2008	A-		Stable	Preliminary	
Instrument Structure	Instrument was issued in July 2009 with certificates amounting to Rs. 950m at a mark-up rate of 6M-KIBOR plus 0.69% and a tenor of 8 years. The issue is secured by a first pari passu floating charge over all present and future fixed assets of the company with a 20% margin. Principal repayments are to be made in four semi-annual unequal installments which began from July 2015.				
Statement by the Rating Team	JCR-VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.				
Probability of Default	JCR-VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.				
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