RATING REPORT

Adam Sugar Mills Limited

REPORT DATE:
May 17, 2022

RATING ANALYST:
Muhammad Tabish
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RATING DETAILS		
Rating Category	Initial Ratings	
	Long-term	Short-term
Entity	A-	A-2
Rating Outlook	*Stable*	
Rating Date	*May 17, 2022*	

COMPANY INFORMATION	
Incorporated in 1965	**External Auditors:** Rahman Sarfaraz Rahim Iqbal Rafiq Chartered Accountants
Public Listed Company	**Chairman:** Mr. Jawaid Ahmed
Key Shareholders (with stake 5% or more):	**CEO:** Mr. Ghulam Ahmed Adam
Mr. Ghulam Ahmed Adam ~50%	
Adam Pakistan Limited ~20%	
General Public ~25%	
Associate & Related Parties ~5%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: Industrial Corporates (August 2021) *https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf*

Adam Sugar Mills Limited

OVERVIEW OF THE INSTITUTION

Adam Sugar Mills Limited (ASML) was incorporated in Pakistan on Oct, 1965 in the name of Bahawalnagar Sugar Mills Limited as a Public Limited Company under the Companies Act, 1913 (repealed with Companies Ordinance, 1984 and subsequently Companies Act, 2017). In 1985, name of the company was changed to ASML.

Profile of Chairman

Mr. Jawaid Ahmed is a management consultant and has been on the board for over 20 years. As an independent director, he has brought many valuable management advices.

Profile of CEO

Mr. Ghulam Ahmed Adam has been serving as the CEO of ASML for over 45 years. He is the son of Mr. Haji Adam who started trading in various commodities in 1897 and succeeded in building a huge trading network of over 100 branches and offices.

RATING RATIONALE

Adam Sugar Mills Limited (ASML) is principally engaged in manufacturing and sale of sugar and by-products with operating track record of nearly six decades. Major shareholding of the company is vested in Mr. Ghulam Ahmed Adam while members of the Adam family are actively involved in management and supervision of operations. Headquartered in Karachi, ASML has the production unit located at District Bahawalnagar, Punjab. Total staff strength stands at 479 employees as at end-Sept'21.

Regulatory Matter (Update on CCP Penalty)

Ratings have incorporated the developments with regards to penalties imposed by Competition Commission of Pakistan (CCP) on certain sugar mills and legal proceedings for interim relief initiated by the subject company. However, in the meanwhile, uncertainty of the outcome would persist on the sector. The CCP penalty imposed on ASML stands at Rs. 278m.

Operational Performance:

The stated sugarcane crushing capacity on per day basis stands at 4.6K MT. As per management, the capital expenditure is carried out on annual basis mainly to enhance production efficiencies and reduce process bottlenecks; capex of Rs. 250m is planned for the ongoing year.

During the ongoing crushing season for MY22, the mill operated for 143 days (MY21: 130 days; MY20: 114 days) which aligns with the industry trend. The mill crushed 833K MT of sugarcane, which is ~146% higher vis-à-vis previous year. This along with the improvement in sucrose recovery rate led to significant increase in overall sugar production which stood at 82K MT (MY21: 30K MT) in MY22. The sucrose recovery in the previous year was low due to wide spread crop diseases and pest attack in the region.

Figure: Sugar Mill (Capacity & Production)

	MY19	MY20	MY21	MY22
Stated Sugarcane Crushing Capacity (TPD) – *Based on 180 days*	4,589	4,589	4,589	4,589
Total Cane Crushed (Tons)	363,306	312,955	337,875	833,340
Crushing Days	95	114	130	141
Crushing Per Day (Tons)	3,824	2,745	2,599	5,910
Capacity Utilization (%)	83%	60%	57%	79%*
Sugar Produced (Tons)	32,402	31,952	29,543	82,039
Sucrose Recovery (%)	8.92%	10.21%	8.74%	9.84%
Molasses Produced (Tons)	15,885	13,301	18,921	35,899
Molasses Recovery (%)	4.37%	4.25%	5.60%	4.31%

**on the basis of actual capacity which is based on 110 days*

In line with higher cane crushing, molasses production also increased considerably while the molasses recovery rate has returned to its historic levels. Utilization levels have depicted considerable improvement in comparison to the previous crushing seasons.

Key Rating Drivers:

Demand supply dynamics of sugar sector are expected to depict improvement in the ongoing year on the back of higher sugar production levels, improved yields and assurances of minimum support price to farmers. The sugar sector has high business risk profile given inherent cyclicality in crop levels and raw material prices. Moreover, distortion in pricing mechanism of raw material prices and refined sugar also create challenges for sugar mills. Typically, sugarcane production has a 3-5 year cycle, driven largely by government support for farmers and crop yield. During the past two years, government's assurances of paying a minimum support price to farmers has driven the increase in planted area.

As per annual PSMA report, sugarcane production has increased by ~22% to 80.9m MT during MY21 on account of increase in area under cultivation and improvement in crop yield. Based on ~72% utilization by millers and with average recovery rate of 9.61%, the sector has produced 5.6m MT (MY20: 4.8m MT) of sugar in MY21 while the annual domestic consumption stood at 5.8m MT. As per recent industry estimates, total sugar production in the ongoing season has stood significantly higher at 7.7m MT. Given the same, demand supply dynamics are expected to depict improvement in the ongoing year while the government's plan to purchase buffer stock of ~0.5m MT will keep the prices in check. The profitability margins of sugar mills may be curtailed due to increasing trend in procurement prices as the same have been recorded higher against minimum support price.

Sales revenue has registered a strong growth in the ongoing year mainly driven by significant increase in current production volumes.
Sales revenue of the company has remained volatile over the past few years, amounting to Rs. 2.9b (MY20: Rs. 3.5b; MY19: Rs. 2.3b) in MY21. Nevertheless, the same registered a strong growth during 3M'MY22 with almost three-fold increase in revenues, vis-à-vis SPLY, which is mainly attributable to significant increase in production levels. On the flip side, average sugar sale price declined by ~14% in the current marketing year; the same yet remains on the higher side as compared to similar rated peers. Going forward, the management has targeted sales revenue to reach Rs. 7.0b by MY22 on the back sizeable increase in quantity sold for sugar.

More than four-fifth of total revenue is contributed by sugar segment while the remaining sales are associated with molasses. At present, entire sugar sales are channeled to the market through brokers; however, the management plans to initiate institutional sales going forward.

Figure: Sales Data

	MY20	MY21	6M'MY22
Sugar Sold - Quantity (MT)	45,705	29,327	32,057
Sugar Price (Rs. per MT)	81,438	98,442	84,192
Molasses Sold - Quantity (MT)	13,300	18,922	30,000
Molasses Price (Rs. per MT)	15,564	15,470	19,417

Gross margins have depicted weakening; however, strong growth in revenues has translated into improved bottom-line in the ongoing year.
In MY21, gross margins declined to 14.2% (MY20: 19.9%) on account of ~15% jump in average sugarcane procurement cost (MY21: Rs. 243 per 40kg; MY20: Rs. 211 per 40kg). The gross margin has remained at around similar levels in the ongoing year. Given that there is no other mill operating in the mill gate area, the company manages to procure sugarcane on favorable prices.

The increase in administrative overheads in MY21 was mainly attributable to sizeable jump in legal and professional charges, followed by repair and maintenance, while increase in salaries expenses remained in line with inflation. Distribution cost, on the other hand, noted a reduction due to lower handling expenses. Financial charges also declined by ~44% owing to lower average utilization of running finance facility and a similar trend is noted in the ongoing year. Moreover, sizeable growth in revenues has translated into an improved bottom-line during the ongoing year.

Growth in earnings in the ongoing year has improved debt coverage metrics and overall liquidity buffers.
In MY21, Funds from Operations (FFO) were reported lower at Rs. 389.6m (MY20: Rs. 627.6m; MY19: negative cash flow of Rs. 180.8m). However, the cash flow generation has depicted improvement in the ongoing year and thus, positively impacted the debt coverage metrics as reflected by strong growth in DSCR to 5.69x (MY21: 2.88x; MY19: 2.56x) as at end-Dec'21. Moreover, limited debt utilization also results in healthy cash flow coverages. Current ratio continues to remain below 1.0x indicating room for improvement while coverage of short-term borrowings in relation to stock in trade and trade debts is satisfactory. Trade debts have increased due to forward sales and credit given to few brokers with strong business relationships; nonetheless, aging profile is sound with 99% receivable outstanding for less than 90 days.

Leverage and gearing ratios have trended downwards on a timeline basis on account healthy growth in equity base. However, the same remains limited vis-à-vis similar rated peers.
Equity base (excluding revaluation surplus) has nearly doubled over the period of last three marketing years, amounting to Rs. 1.2b (MY21: Rs. 1.1b; MY20: Rs. 0.9b) as at end-Dec'21. Dividend payout ratio was reported at 20% (MY20: 40%) in MY21. Debt profile comprises a mix of short-term and long-term borrowings. At present, total long-term debt financing (inclusive of current portion and loan from chief executive) stood at Rs. 336.6m (MY21: Rs. 294.3m) at end-Dec'21. The loan from chief executive is unsecured, interest-free and payable on demand. Leverage and gearing ratios have trended downwards on a timeline basis on account of healthy growth in equity base. Going forward, ratings remain dependent on managing leverage indicators within prudent levels.

Corporate governance framework is considered sound.
Board of Directors (BoD) comprises 7 members including the CEO, Mr. Ghulam Ahmed Adam. As per best practices, there are two independent directors present on the board along with one female representation. There are two board level committees namely, Board Audit Committee and HR & Remuneration Committee in place for effective oversight. Both the committees are chaired by independent directors. Both independent directors have served for more than 3 consecutive terms and the same director chairs BAC and the Board, hence as per regulations room for improvement exists in the aforesaid areas.

The company is using an ERP-based platform 'VB Software' for reporting purposes while SAP – B1 ERP with six integrated modules is currently in the deployment phase. Data backup is being maintained on daily basis in the crushing season and on a weekly basis during off-season on off-site/on-site locations. Financial statements are audited by Rahman Sarfaraz Rahim Iqbal Rafiq Chartered Accountants, which is classified in 'Category A' of SBP's Panel of Auditors.

FINANCIAL SUMMARY *(amounts in PKR millions)*				Appendix I
BALANCE SHEET	**MY19**	**MY20**	**MY21**	**1Q'MY22**
Property, Plant & Equipment	5,115	4,939	4,841	4,884
Stores & Spares	123	114	110	116
Stock in Trade	929	205	279	572
Trade Debts	28	245	410	421
ST Loans & Advances	88	215	203	129
Cash & Bank Balance	70	100	192	226
Total Assets	**6,433**	**5,857**	**6,078**	**6,395**
Trade & Other Payables	734	522	362	839
Short-term Borrowings	1,194	592	771	482
Long-Term Borrowings *(Including current maturity)*	305	201	294	337
Total Liabilities	**3,117**	**2,212**	**2,308**	**2,541**
Paid-up Capital	173	173	173	173
Share Premium	173	173	173	173
General Reserve	200	200	200	200
Directors' Contribution	9	19	19	19
Retained Earnings	(106)	317	541	650
Total Equity *(Excluding revaluation surplus)*	**448**	**882**	**1,106**	**1,215**
INCOME STATEMENT				
Net Sales	**2,315**	**3,554**	**2,881**	**1,370**
Gross Profit	19	708	410	197
Operating Profit	(87)	601	278	156
Profit Before Tax	**(315)**	**416**	**175**	**144**
Profit After Tax	**(254)**	**319**	**196**	**119**
RATIO ANALYSIS				
FFO	(181)	628	390	173
Gross Margin (%)	0.8%	19.9%	14.2%	14.4%
Net Margin (%)	-11.0%	9.0%	6.8%	8.7%
Net Working Capital	(780)	(312)	(67)	(17)
FFO to Long-Term Debt (x)	(0.59)	3.12	1.32	2.06
FFO to Total Debt (x)	(0.12)	0.79	0.37	0.85
Debt Servicing Coverage Ratio (x)	0.06	2.56	2.88	5.69
ROAA (%)	-5.0%	5.2%	3.3%	7.7%
ROAE (%)	-11.5%	9.2%	5.3%	12.5%
Gearing (x)	3.35	0.90	0.96	0.67
Debt Leverage (x)	6.96	2.51	2.09	2.09
Current Ratio (x)	0.63	0.75	0.95	0.99
Inventory + Receivables to Short-term Borrowings (x)	0.8	0.8	0.9	2.1

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

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: 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.vis.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.vis.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.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'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.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when 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 III
Name of Rated Entity	Adam Sugar Mills Limited (ASML)				
Sector	Sugar				
Type of Relationship	Solicited				
Purpose of Rating	Entity Rating				
Rating History	**Rating Date**	**Medium to Long Term**	**Short Term**	**Rating Outlook**	**Rating Action**
	RATING TYPE: ENTITY				
	17/05/2022	A-	A-2	Stable	Initial
Statement by the Rating Team	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	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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Due Diligence Meetings Conducted	**Name**	**Designation**	**Date**		
	Mr. Omar G. Adam	Director	April 08, 2022		