RATING REPORT

Adam Sugar Mills Limited

REPORT DATE:

June 12, 2023

RATING ANALYST:

Hannan Athar
hannan.athar@vis.com.pk

Tayyaba Ijaz, CFA
tayyaba.ijaz@vis.com.pk

RATING DETAILS				
Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A-	A-2	A-	A-2
Rating Outlook	*Stable*		*Stable*	
Rating Date	*June 12, 2023*		*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
Adam Pakistan Limited ~20%	
Sarah Adam ~ 18%	
Mr. Junaid G. Adam ~ 14%	
Mrs. Humera Diwan ~14%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Industrial Corporates (May 2023)
https://docs.vis.com.pk/docs/CorporateMethodology.pdf

VIS Rating scale (2023)
https://docs.vis.com.pk/docs/VISRatingScales.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on Oct, 1965 in the name of Bahawalnagar Sugar Mills Limited as a Public Limited Company under the Companies Act, 1913 (repealed with Companies Ordinance, 1984 and subsequently Companies Act, 2017).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.

Financial Snapshot

Tier-1 Equity:

1H'MY23; Rs. 1.4b; MY22: Rs. 1.3b; MY21: Rs. 1.1b; MY20: Rs. 882.0m

Assets:

1H'MY23; Rs. 11.2b; MY22: Rs. 6.85b; MY21: Rs. 6.1b; MY20: Rs. 5.85b;

Profit After Tax:

1H'MY23; Rs. 63.5m; MY22: Rs. 141.5m; MY21: Rs. 195.7m; MY20: Rs. 318.6m

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 with the Adam family while members of the family are actively involved in management and supervision of operations. Headquartered in Karachi, ASML has the production unit located at District Bahawalnagar, Punjab.

Key Rating Drivers:

Business Risk & Sector Update: Pakistan is the seventh-largest producer and the fifth-largest consumer of sugar. According to the Economic Survey of Pakistan, sugar industry is the country's second-largest agro-based business after the textile industry. In terms of sugarcane production, Punjab produces 67% of the sugarcane, followed by Sindh (25%), Khyber Pakhtunkhwa (KPK) (8%), and Baluchistan (less than 1%). Its production contributes 0.8% to GDP and 3.7% to agriculture's value addition. The country has the capacity to raise production by 4.0 million tons and export USD 2.0b worth of sugar and USD 500m worth of ethanol by using the same land but raising yields by 40 to 50 percent. According to the data collected by Ministry of Food Security, through September 30, 2022, at least 5.3 million metric tons (MT) of sugar has been removed from inventories or has been consumed. The volume of sugar consumed each day is around 15,980 tons. More than 1.7m MT surplus sugar was available at the start of crushing season MY23. Additionally, exporting this surplus sugar would have generated USD 1.0b in foreign currency. During CY22, almost 33% of the 22 million hectares of total cultivable land were inundated by flood while damage to the sugarcane crops resulted in a loss of USD 273m. On aggregate, direct losses from rice, cotton, and sugarcane were USD 1.30b (rice: USD 543m, cotton: USD 485m, and sugarcane: USD 273m).

The inherent cyclicality in crop yields and raw material prices is believed to have a substantial impact on the business risk profile of the sugar sector. Furthermore, there is a noticeable difference in pricing mechanisms, with the price of the end product, granulated sugar, being set by market forces whereas sugarcane cost being regulated by the government. A typical sugarcane crop has a 3- to 5-year production cycle, with government assistance to farmers and crop productivity playing a major role. In 2022-23 season, the crushing season took off a bit late owing to disagreement between PMSA, which represents the sugar mill owners, and Government of Pakistan, to allow export of 2 million tons of sugar, to cover up for the higher costs associated with producing sugar and pulling the industry out of crisis.

According to the most recent USDA semi-annual sugar report published on October 3, 2022, due to the damage brought on by the flood, the estimated harvested area is to contract by 4.7% to 1.23 million hectares. As a result, the forecast for sugarcane output in 2022–2023 has decrease to 82.4 million tons (MY22: 89 million tons-MY21: 81 million tons). Sugar output in 2022–2023 is expected to reduce to 6.657m tons. Meanwhile, due to population growth and demand from the developing food processing industry, sugar consumption is projected to rise by around 3% to 6.1 MT in 2022–2023. In view of accumulating sugar stocks, the Govt. has so far allowed 250,000 tons of sugar in the ongoing year. Recently, sugar prices have shown rising trend. However, elevated markup rates are likely to suppress bottomline of companies with high leveraged capital structure.

Production and capacity utilization update:
ASML's crushing season for 2022-23 started on Nov 27, 2022, compared to Nov 15, 2021 in the previous season, and lasted for a total of 106 days (MY22: 142 days; MY21: 130 days). Sugarcane crushed was recorded lower at 590,048 tons (MY22: 833,340tons; MY21: 337,875 tons) on account of contraction in cane yield due to floods. Despite the crushing season started a bit late, average sucrose recovery rates were slightly lower at 9.79% (MY22: 9.84%; MY21: 8.74%) due to quality of cane. Resultantly, sugar production fell by nearly 29.6% in 2022-23 season due to the combined impact of lower crushing and sucrose recovery rates. Molasses produced decreased by ~25% to 27,805 tons (MY22: 37,060 tons; MY21: 18,921 tons) while molasses recovery rates were slightly higher at 4.7% (MY22: 4.45%; MY21: 5.60%). During the period under review, ASML reported higher crushing capacity of 16,000 tpd (MY22: 16,000 tpd; MY21: 4,589 tpd) on account of revision in installed capacity on the basis of inspection report by deputy director planning Directorate General of Industries , Prices, Weights & Measures, Lahore dated 10/11/2015. A snapshot of production related information is presented below:

	2019-2020	2020-2021	2021-2022	2022-2023
Crushing Capacity – tpd	4,589	4,589	16,000	16,000
Cane Crushed	312,955	337,875	833,340	590,048
Crushing Days	114	130	142	106
Capacity Utilization – %	60%	57%	37%	34.8%
Sucrose Recovery – %	10.21%	8.74%	9.84%	9.79
Sugar Produced – tons	31,952.0	29,543.0	82,039.0	57,790
Molasses Produced-Tons	13,301	18,921	37,061	27,805
Molasses Recovery Rate-%	4.25%	5.60%	4.45%	4.7%

Property, plant and equipment (PP&E) stood at Rs. 6.66b (MY22: Rs. 4.96b, MY21: Rs. 4.8b) at end-1H'MY23. The company carries out balancing, modernization and replacement (BMR) on regular basis to improve operational efficiency. During 1H'MY23 and the outgoing year, additions in plant and machinery amounted to Rs. 211.9m and Rs. 143.9m, respectively, which largely pertained to new conventional mill, mill roller, steam turbine, cane feeding table, and electrical installations to reach an optimal level of capacity utilization. The BMR has been financed through a mix of both long-term borrowings and own cash flows. Going forward, the management plans to diversify its revenue stream by entering into lysine production that would use molasses as a raw material. Lysine is an essential amino acid involved in protein synthesis, which helps optimize animal growth or increase milk production. Total outlay of this project is estimated at Rs. 2.1b while payback period is expected to be around 4 years. The management intends to pursue this project as soon as the economic conditions of the country become viable.

Sales and Profitability:

Revenue mix of the company comprised sugar and allied products, with sugar contributing around 86% (MY21: 90%) of the sales. Entire sugar sale is channeled to the market through brokers while molasses sales, accounting for around 14% of the sales mix, are made to institutional clients involved in ethanol production. During MY22, topline registered sizeable growth of 88.2% amounting to Rs. 5.4b (MY21: 2.9b) in line with higher production volumes. Average selling prices of sugar, on the other hand, were lower by ~18.9% owing to excess sugar stocks available in the country and intervention of Govt. to control sugar prices. Net molasses sales increased to Rs. 745.0m (MY21: Rs. 292.7m) on account of higher quantity sold and average selling prices. Breakdown of the sugar and molasses sales in terms of volume and average selling prices is presented below:

Rs. Million	2019-20	MY21	MY22
Sugar Sold (MT)	45,705	29,327	65,217
Sugar Price/MT	81,438	88,242	71,547
Molasses Sold (MT)	13,300	18,922	37,061
Molasses Price/MT	15,564	15,470	20,103

During MY22, cost of sales increased notably to Rs. 4.7b (MY21: Rs. 2.5b) largely in line with increase in scale of operations. Raw material consumed accounted for 89% (MY21: 81%) of the cost of goods manufactured due to increase in average sugarcane procurement prices. The company paid an average per maund cost of Rs. 241.5/maund (MY21: Rs. 243/ maund) vis-à-vis government support price of Rs. 225/maund (MY21: Rs. 200/maund). Gross margins decreased during the outgoing year, primarily due to higher average procurement prices while the selling prices remained depressed. Administrative expenses increased to Rs. 158.5m (MY21: Rs. 110.7m) mainly due to adjustments in salaries of directors, executives and CEO of the company, through a resolution passed in the annual board meetings. Selling and distribution expenses increased mainly due to higher commissioning expenses. Other income of Rs. 10.8m (MY21: Rs. 6.0m) majorly included profit on term deposit receipts and saving accounts. Other operating expenses increased to Rs. 58.9m (MY21: Rs. 21.2m) primarily due to assets written off related to cash given to cane growers and increase in provisions for employees related fund contributions. Finance cost increased largely on account of higher markup rates coupled with higher utilization of short-term borrowings. In addition, effective tax rate was 51.8% vis-à-vis tax credit in preceding year. As a result of increase in tax charge, financial charges and operating expenses, bottomline remained subdued despite strong growth in revenues. Net profit was recorded lower at Rs. 141.5m (MY21: Rs. 195.7m) with decline in net margins to 2.6% (MY21: Rs. 6.8%) in MY22.

During 1H'MY23, net sales amounted to Rs. 2.58b (1H'MY22: Rs. 2.57b) which majorly included revenue from sugar offtake while average selling prices of sugar further depressed as the carry over sugar stock weighed down the local market in first quarter of the ongoing year. ASML has been allowed an export quota of 2,376 MT which has largely been exported at an average price of $515/MT recently. Average per maund procurement price of sugarcane during the 2022-23 stood at Rs. 302.9 against the support price of Rs. 300. Given that there is no other mill operating in the mill gate area, the company manages to procure sugarcane on relatively favorable rates. However, gross margins were notably lower at 8.4% (1H'MY22: 17.7%) due to the combined impact of lower selling rates of sugar and higher average procurement cost. Finance cost was also higher at Rs. 120.1m (1H'MY22: Rs. 55.6m) Accordingly, the company recorded a net profit of Rs. 63.5m in comparison to a profit of Rs. 224.7m SPLY The company held 52,000 MT of sugar stock at end-May'23 (Mar'23: 55,073 MT). Given higher retail prices of sugar, topline is expected to strengthen in full year. Meanwhile, despite higher average recovery rates in the ongoing season, gross margins are unlikely to return to prior levels given high procurement cost in relation to selling prices. Net profitability is also expected to remain under pressure owing to higher financial charges amidst inflated markup rates.

Liquidity:

Liquidity position of the company has remained adequate in terms of cash flows in relation to outstanding obligations. The company generated higher funds from operations (FFO) amounting Rs. 519.0m (MY21: Rs. 389.6m) in line with increase in profitability. Resultantly, FFO to long-term debt and FFO to total-debt improved to 2.14x (MY21: 1.32x) and 0.43x (MY21: 0.37x), respectively. Debt service coverage ratio (DSCR) remained adequate at 2.80x (MY21: 3.90x) although higher principal repayments coupled with higher interest repayments were made during the outgoing year.

Stores and spares stood at Rs. 112.7m (MY21: Rs. 109.7m). Stock in trade increased sizably to Rs. 1.2b (MY21: Rs. 278.8m), on account of higher sugar inventory out of which Rs. 350.0m worth of sugar was pledged against bank borrowings at end-MY22. Stock in trade amounted to Rs. 3.9b by end-1H'MY23. Short term investments remained at Rs. 25.2m (MY22: Rs. 25.2m; MY21: Rs. 25.3m) at end-1H'MY23 and comprised investments in Term Deposit Receipts (TDRs). Trade debts stood lower at Rs. 23.6m (MY22: Rs. 317.7m; MY21: Rs. 410.0m) at end-1H'MY23. Open market sales are carried out on cash or advance payment basis; aging profile of receivables remained healthy given nearly entire receivables were outstanding for less than 15 days as of Mar 31, 2023. At end-MY22, short term loans and advances stood lower at Rs. 73.8m (MY21: Rs.202.6m) due to decrease in advances made to suppliers. Other receivables largely included rebate due from Trade Development Association of Pakistan (TDAP) in relation to exports made by the company in 2012-13, which has remained stable. Trade and other payables were recorded higher at Rs. 778.6m (MY21: Rs. 361.9) at end-MY22, primarily in line with higher sales tax payable amounting to Rs. 433.9m (MY21: Rs. 179.4m). The same increased to Rs. 1.5b at end-1H'MY23, mainly due to higher advances from customers amounting to Rs. 657.6m (MY22: Rs. 130.5m; MY21: Rs. 69.6m) coupled with higher trade creditors amounting to Rs. 683.3m (MY22: Rs. 88.3m; MY21: Rs. 33.0m). The increase in trade debts and trade and other payable is largely attributable to seasonality in sugar business.

Current ratio stood at 0.91x (MY21: 0.95x) at end-MY22. Short term borrowings coverage improved to 1.57x (MY21: 0.89x). Despite slower inventory turnover, net operating cycle has remained quite manageable at 76 days (MY21: 66 days) on account of improvement in receivables turnover. Cash flow coverages are expected to remain under pressure in full year owing to lower profitability. Maintaining debt service coverage at adequate levels and improvement in other liquidity indicators will be considered important from ratings perspective.

Capitalization: Tier-1 equity increased to Rs. 1.3b (MY21: Rs. 1.1b) due to internal capital generation. The company paid final cash dividend of Rs. 34.6m @ 20% in MY22. Long term financing (including current portion) stood at Rs. 223.7m (MY21: Rs. 277.6m) at end-MY22. These included long-term financing obtained to conduct BMR activities priced at 3 to 6 months/matching KIBOR plus 2 to 3%. In addition, this also included loan obtained during the outgoing year of Rs. 35.5m under the SBP Islamic financing facility for renewable energy (IFRE) carrying markup rate of SBP rate + 2.5% with semi-annual principal repayment. The company has installed a solar panel of 509.22 KW capacity on company's land in Bahawalnagar. Short term borrowings increased to Rs. 963.2m (MY21: Rs. 770.6m) by end-MY22, in line with higher working capital requirements. These include an unsecured loan form Adam Lubricants Limited (related party) amounting to Rs. 502.5m (MY21: Rs. 176.0m); the loan is interest free and payable on demand. Gearing, adjusted for interest-free related party loans, improved to 0.51x (MY21: 0.77x) reflecting strong risk absorption capacity. Whereas debt leverage remained relatively on a higher side at 2.27x (MY21: 2.09x) amid accumulated deferred tax liabilities and sales tax payables.

During 1H'MY23, the company obtained Rs. 295.6m in long-term financing at 3MK plus 2% with quarterly principal repayments, pertaining to the BMR. Subordinated loan from CEO amounted to Rs. 19.4m (MY22: Rs. 18.5m MY21: Rs. 16.7m) at end-1H'MY23, was fully amortized till Sep 30th 2020, however, the company renegotiated the terms of loan and extended the contractual maturity for 5 years. Due to seasonality in sugar sector leverage indicators mounted upwards by end-1H'MY23 in line with higher working capital requirements while the same are expected to recede end in line with majority of the stock being lifted by year end Going forward, in the medium term, the company does not intend to obtain additional long-term financing. Maintaining leverage indicators at comfortable levels will be key rating sensitivity, going forward.

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. The CCP penalty imposed on ASML stands at Rs. 278m. The Company has filed Constitutional Petition before the Honorable Lahore High Court against legality, correctness, propriety and legitimacy of the Casting Vote of Chairperson of CCP along with application seeking stay of demand against the impugned order. The Honorable Lahore High Court vide its order dated October 18, 2021, has restrained the Competition Commission of Pakistan from recovering the impugned demand, till the next date of hearing and restrained the authorities from recovering any amounts from the Company till the next date of hearing. The case is pending adjudication.

Considerable room for improvement in the Corporate governance framework. At present Board of Directors (BoD) comprises seven members including the CEO. There are three female member representations on the board, including one recently elected independent director. Certain compliance issues were presented in the Annual Report that were not in line with the regulations. At end-MY22, no independent director served on the board. The company elected its new board members on 27th Jan, 2023, with Mrs. Humera Diwan and Ms. Sarah Adam replacing Lt Col. (R.) Muhammad Mujtaba and Mustafa G. Adam respectively.

Two board level committees namely, Board Audit Committee (BAC) and HR & Remuneration Committee are being chaired by the Mrs. Humera Diwan and Mrs. Nabiah Omar Adam, respectively. As per corporate governance best practices majority of the members of HR & Remuneration committee should be non-executive directors and there should be at least one independent director as member. The audit committee meets every quarter to discuss internal controls while the HR & Remuneration Committee meets annually to review board compensation and HR policies and practices. Financial statements are audited by Rahman Sarfaraz Rahim Iqbal Rafiq Chartered Accountants, which are classified in 'Category A' of SBP's Panel of Auditors.

FINANCIAL SUMMARY *(amounts in PKR millions)*

BALANCE SHEET	MY20	MY21	MY22	1H'MY23
Property, Plant & Equipment	4,939.0	4,840.7	4,966.6	6,658.0
Long-Term Advances	0.0	0.0	84.4	0.0
Stores, Spares. And Loose Tools	114.0	109.7	112.7	147.9
Stock-in-Trade	204.9	278.8	1,240.4	3,941.4
Trade Debts	244.7	410.0	317.7	23.6
Short-term Loans & Advances	214.8	202.6	73.8	51.6
Trade Deposits & Short-term Prepayments	0.7	1.5	0.5	2.9
Cash and Bank Balances	100.0	191.8	64.8	375.9
Other Assets	38.6	42.4	40.7	41.0
Total Assets	**5,856.7**	**6,077.5**	**6,901.6**	**11,242.3**
Long-Term Borrowings *(Inc. current maturity)*	185.8	277.6	223.7	459.9
Loan from CEO	15.1	16.7	18.5	19.4
Deferred Liabilties (inc. current portion)	845.4	794.5	883.0	1,084.9
Short-term Borrowings	332.2	594.6	460.7	1,986.5
Related Party Loans	260.0	176.0	502.5	757.5
Trade and Other Payables	521.8	361.9	781.5	1,525.0
Accrued Mark-Up	15.1	20.3	38.3	79.0
Other Liabilties	14.8	16.8	14.8	15.3
Total Liabilities	**2,212.2**	**2,308.4**	**2,991.4**	**5,981.5**
Paid-Up Capital	172.9	172.9	172.9	172.9
Tier-1 Equity	881.8	1,105.8	1,340.7	1,415.3
Total Equity	**3,644.5**	**3,769.2**	**3,910.1**	**5,260.8**

INCOME STATEMENT	MY20	MY21	MY22	1H'MY23
Net Sales	3,554.0	2,880.6	5,422.5	2,580.8
Gross Profit	708.0	410.3	678.6	216.3
Finance Cost	185.6	103.2	164.8	120.1
Other Income	17.1	6.0	10.8	11.4
Profit Before Tax	415.8	174.8	293.7	(16.2)
Profit After Tax	318.6	195.7	141.5	63.5
FFO	627.6	389.6	387.2	98.1

RATIO ANALYSIS	MY20	MY21	MY22	1H'MY23
Gross Margin (%)	19.9%	14.2%	12.5%	8.4%
Net Margin (%)	9.0%	6.8%	2.6%	2.5%
Current Ratio (x)	0.75	0.95	0.93	1.02
Net Working Capital	-311.9	-66.9	-129.0	98.0
FFO to Long-Term Debt	3.12	1.32	1.60	0.41*
FFO to Total Debt**	1.18	0.44	0.55	0.08*
Debt Servicing Coverage Ratio (x)	2.67	3.90	3.29	2.25
ROAA (%)	5.2%	3.3%	2.2%	1.3%*
ROAE (%)	9.2%	5.3%	3.7%	2.8%*
Gearing (x)**	0.60	0.80	0.52	1.74
Debt Leverage (x)**	2.51	2.09	2.23	4.23
Inventory + Receivable/Short-term Borrowings (x)**	1.35	1.16	3.38	2.00

**Annualized*

*** Adjusted for non- markup bearing short-term loan from related parties*

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				
	12/06/2023	A-	A-2	Stable	Reaffirmed
	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. Faisal Habib	CFO	April 19, 2023		