RATING REPORT

Al-Noor Sugar Mills Limited

REPORT DATE:
February 27, 2019

RATING ANALYSTS:

Talha Iqbal
talha.iqbal@vis.com.pk

Muhammad Hamza Amir
hamza.amir@vis.com.pk

RATING DETAILS

Rating Category	Latest Rating Long-term	Latest Rating Short-term	Previous Rating Long-term	Previous Rating Short-term
Entity	A-	A-2	A-	A-2
Rating Outlook	Stable		Stable	
Rating Date	*February 18, 2019*		*November 30, 2017*	

COMPANY INFORMATION

Incorporated in 1969	**External auditors:** Kreston Hyder Bhimji & Co., Chartered Accountants
Public Limited Company	**Chairman of the Board:** Mr. Yusuf Ayoob
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Ismail H. Zakaria
CDC-Trustee National Investment Trust Fund– 9.9%	
Noori Trading Corporation (Private) Limited – 9.2%	
Mr. Zaki Zakaria – 6.0%	

APPLICABLE METHODOLOGY(IES)

Applicable Rating Criteria: Corporates (May, 2016)
https://www.vis.com.pk/kc-meth.aspx

Al-Noor Sugar Mills Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

ASML was incorporated in 1969 as a part of the Al-Noor Group, which has presence in diverse industries. The company is principally engaged in production and sale of sugar and medium density fiber board. Its shares are quoted on the Pakistan Stock Exchange. Financial statements for FY15 have been audited by Kreston Hyder Bhimji & Co.

In 1969, Al-Noor Sugar Mills Ltd. (ASML) was incorporated as a public limited company. ASML belongs to Al-Noor Group (ANG), involved in the manufacturing of sugar, rice, power, ethanol and board products along with limited presence in financial sector. ASML is primarily engaged in the business of manufacturing and selling of sugar and medium density fiber (MDF) board. In order to overcome electricity shortages, the company is also involved in power generation primarily for its internal use. ASML is listed on the Pakistan Stock Exchange (PSX).

Industry Dynamics

<u>Sugar</u>

Local demand supply dynamics projected to depict some improvement in MY19; slight upward pressure expected in local prices

Over the last two years excess supply of sugar has prevailed on the back of sugar production outpacing the overall consumption. Significant increase in production and lower allowable export quota set by the Government resulted in a sizeable increase in ending inventory at end-FY17. While production continued to outpace supply, higher export quota of 1.5m tons (with subsidy benefit by federal government and an additional subsidy by Sindh government for sugar mills in Sindh) has facilitated in reducing inventory levels which continued to remain at elevated levels at end-MY18. Decline in production for MY19 (expected to be significantly lower at around 6m tons but still higher than domestic consumption for MY19) along with export quota of 1.1m tons allowed is expected to improve local demand supply dynamics (resulting in lower ending inventory) and result in some upward pressure on prices. However, profitability of sugar mills will remain dependent on quantum of increase in domestic prices along with quantity of sugar exported. Subsidy allowed by Punjab Government is significantly lower vis-à-vis prior year while no subsidy has been announced by the Federal Government.

Mn Tons	MY16	MY17	MY18
Opening Inventory	0.849	0.777	2.326
Sugar Production	5.1	7.048	6.5
Sugar Available	5.949	7.825	8.826
Domestic Consumption	4.9	5.1	5.4
Exports	0.272	0.399	1.5
Ending Inventory	0.777	2.326	1.926

Global oversupply situation to persist; prices expected to remain under pressure in MY19

Baring two years (MY16 & MY17), global production of sugar has outpaced consumption over the last decade resulting in sizeable global sugar ending inventory. Resultantly, ending inventory has stood at over 50% of the total consumption over the last 5 years. The demand-supply dynamics have kept international sugar prices on the lower side during MY18 (Average sugar prices were $357.5/tonne in MY18 vis-à-vis $477.4/tonne in MY17). Going forward, global stock levels are projected to rise as higher production from India is expected to offset decline in production in Brazil and European Union. Resultantly, international prices are expected to remain bearish during

MY19 with exports for local producers being only profitable with subsidy support from government. India is forecasted to become the largest sugar producer (due to enhanced yields and increase in area under cultivation) in the world in MY19 overtaking Brazil for the first time in the last fifteen years. Other major sugar producers include Brazil, Thailand, China, USA, Mexico, and Pakistan.

Mn Tons	MY16	MY17	MY18
Opening Inventory	96.40	91.21	88.06
Sugar Production	164.20	168.30	179.44
Sugar Available	260.60	259.51	267.50
Consumption	169.09	171.40	174.40
Import Demand	66.00	60.04	57.40
Exports	66.30	60.10	61.09
Ending Inventory	91.21	88.06	89.41

Existing pricing dynamics are a drag on the profitability of the sector. Based on current international prices and existing exchange rate, exports are still at a discount to local prices
Local retail prices which are driven by market forces have remained depressed on account of surplus supply of sugar. Higher fixed sugarcane prices (including the impact of quality premium which is estimated to range between Rs. 5 to Rs. 12 per mound for mills in Sindh) set by the government to facilitate growers and farmers coupled with depressed retail prices have compressed margins for the industry. Based on current sugar cane prices announced by the government and assuming average recovery ratio for the industry, cost of production of sugar is slightly higher vis-à-vis local prices. Given the expected increase in sugar prices, this trend is expected to reverse in MY19 with retail prices expected to be higher vis-à-vis cost of production. However, margins and profitability are expected to remain depressed. On the export front, current international prices (assuming exchange rate of 140) translate into a 10% discount vis-à-vis local prices. Break even international prices accounting for freight and sales tax advantage at existing exchange rate are $370 vis-à-vis existing prices of $339.

Per Kg Prices	MY14	MY15	MY16	MY17	MY18
Average Local Prices (Rs)	54.8	58.91	63.77	61.43	53.57
Average International Prices (USD)	0.459	0.377	0.461	0.474	0.358

Sugar

Capacity Utilization: Despite higher number of days in operations vis-à-vis last year (MY18: 139; MY17: 129), crushing volume of sugarcane was recorded at 1,108,106 MT during MY18 vis-à-vis 1,315,682 MT last year due to water shortage.

Recovery Rates: A slight reduction in sugar production was witnessed this year on account of lower cane crushed in MY19. Recovery rates exhibited a slight increase on a timeline basis (MY18: 10%; MY17: 9.71%) but have room for further improvement. Management has undertaken a number of initiatives in this regard.

MDFB

Capacity Utilization: The MDFB division has 2 production lines installed which are the Mande Line and Sunds Line. Overall capacity of Mande Line stands at 120 tons per day whereas capacity of Sunds Line stands at 122 tons per day. Sunds line has been operating at above 100% capacity from the last few years (MY18: 110%; MY17: 101%; MY16: 107%) whereas the capacity utilization of Mande Line has also improved on a timeline basis (MY18: 88%; MY17: 61%; MY16: 84%). Combined production from both lines clocked in at 70,561 cubic meters in MY18 vis-à-vis 56,879 in MY17 due to higher operating days and strong demand.

Power Generation: In house bagasse based power generation by ASML is 18 MW per day which is in excess of its requirement. Out of the total generation, 10 MW is required for sugar production, 3.5 MW for MDFB production and the remaining power generated is sold to WAPDA.

Financial Profile

Sales Mix

Sugar: Sugar segment represents the major proportion overall sales mix comprising two-third of total revenues. Sales mix shifted towards the export market on the back of higher export quota allowed by Government with export sales representing 72% of aggregate sugar sales. Sugar sales clocked in at Rs. 5.6b in FY18 vis-à-vis Rs.4.3b in MY17 registering a growth of 25%. Given the absence of subsidy on export quota allowed, proportion of local sales in sales mix is projected to increase, going forward.

MDFB: The company has been operating in this segment from 1989 and enjoys a strong franchise for its products. MDFB sales represented 35% of the total sales mix (MY17: 34%) in MY18 with local sales dominating the sales mix. This segment recorded sales of Rs. 3.4b in MY18 vis-à-vis Rs.2.5b in MY17. Given the improved brand strength of the product, sales have depicted healthy growth on a timeline basis. With the Company operating at high utilization levels, growth in sales will primarily be a function of increase in prices. As per management, the Company enjoys strong pricing power for its products in the market given its brand strength and strong demand for its products in the market.

Despite improved profitability of the MDFB segment, overall profitability profile weakened due to higher losses in the sugar segment. Turnaround in sugar segment and growth in profitability of the MDFB segment expected to result in improvement in profitability indicators

Overall net sales of the Company increased by 32% with growth recorded from both sugar and MDFB segment. With cost of MDFB being fixed due to long-term arrangement and increasing selling prices, gross profitability of the MDFB segment witnessed healthy growth. However, with limited control over sugar production cost due to high fixed sugarcane indicative prices set by the government along with surplus sugar supply keeping a check on retail prices, ASML reported an overall gross loss during MY18. Operating expenses were fueled by higher export related expenses on the back of increase in sugar exports registered during MY18. However sizeable export subsidy booked in other income coupled with share of profit from subsidiary companies supported profitability. Given the sizeable gross loss, the company incurred a higher loss after tax of Rs. 120.8m (MY17: loss after tax of Rs. 30.3m) in MY18.

Liquidity profile remains stressed given negative cash flows. Projected improvement in cash flows is expected to result in cash flows being sufficient for timely debt servicing. Subsidy

receivable from GoP if materializes is planned to reduce outstanding borrowings

Pressure on sugar sector dynamics have constrained cash flow generation as the company recorded negative funds from operations (MY18: -213m; MY17: 35m; MY16: 361m) in MY18. Projected cash flows are expected to remain sufficient to meet long-term debt payments while receivable and stock in trade provide significant cushion against short-term debt obligations. At end-MY18, receivable and stock in trade represented 175% (MY17: 131%) of short-term debt obligations. Reduction in subsidy receivable primarily from the federal government will facilitate in supporting cash flows.

Weak capitalization indicators but are expected to reduce

Consistent losses have resulted in equity attrition to Rs. 1.32b (MY17: 1.5b; MY16: 1.6b) at end-1QMY19. Borrowing levels have witnessed significant increase over the last two years. Resultantly, leverage indicators continue to remain elevated. Gearing and debt leverage was reported at 3.14x (MY17: 3.68x; MY16: 1.71x) and 4.37x (MY17: 4.49x; MY16: 2.67x) at end-MY18.

Al-Noor Sugar Mills Limited **Appendix I**

FINANCIAL SUMMARY *(amounts in Rs. in millions)*

BALANCE SHEET	SEP 30, 2016	SEP 30, 2017	SEP 30, 2018
Fixed Assets	4,391	4,691	5,374
Investments	272	265	523
Stock-in-Trade	1,968	3,928	2,219
Trade Debts	63	205	374
Cash & Bank Balances	137	129	93
Total Assets	7,007	9,520	9,442
Trade and Other Payables	861	631	1,388
Long Term Debt *(*incl. current maturity)*	2,048	2,477	2,699
Short Term Debt	691	3,190	1,931
Total Equity	1,600	1,542	1,474
INCOME STATEMENT	**SEP 30, 2016**	**SEP 30, 2017**	**SEP 30, 2018**
Net Sales	8,103	6,896	9,081
Gross Profit	964	705	(653)
Operating Profit	468	181	(1,378)
Profit After Tax	171	(30)	(121)
RATIO ANALYSIS	**SEP 30, 2016**	**SEP 30, 2017**	**SEP 30, 2018**
Gross Margin (%)	11.9	10	(7.19)
Net Working Capital	481	652	86
FFO to Total Debt (x)	0.13	0.01	(0.05)
FFO to Long Term Debt (x)	0.18	0.01	(0.08)
Debt Servicing Coverage Ratio (x)	0.86	0.45	0.18
Gearing	1.72	3.68	3.14
Leverage	2.67	4.49	4.37
ROAA (%)	2	(0.37)	(1.27)
ROAE (%)	11	(1.93)	(8.01)

ISSUE/ISSUER RATING SCALE & DEFINITIONS — Appendix II

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	Al-Noor Sugar Mills Limited
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		
02/27/2019	A-	Stable	A-2	Reaffirmed
11/30/2017	A-	Stable	A-2	Reaffirmed
04/27/2016	A-	Stable	A-2	Reaffirmed
12/31/2014	A-	Stable	A-2	Reaffirmed
11/25/2013	A-	Stable	A-2	Reaffirmed
8/27/2012	A-	Stable	A-2	Reaffirmed

Instrument Structure	N/A
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.
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. VIS is not an NRSRO and its ratings are not NRSRO credit ratings. Copyright 2019 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.