RATING REPORT

Chashma Sugar Mills Limited (CSML)

REPORT DATE:
15th Nov, 2018

RATING ANALYSTS:

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RATING DETAILS

	Initial Rating	
Rating Category	**Long-term**	**Short-term**
Entity	BBB+	A-2
Rating Outlook	Stable	
Rating Date	*15th Nov'18*	

COMPANY INFORMATION

Incorporated in 1988	**External auditors:** M/s. A.F. Ferguson & Co. Chartered Accountants
Public Limited Company	**Chairman of the Board:** Mr. Abbas Sarfaraz Khan
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Aziz Sarfaraz Khan
The Premier Sugar Mills & Distillery Limited – 47.9%	
Other Group Companies – 18.7%%	
Directors & Relatives – 14.0%	

APPLICABLE METHODOLOGY(IES)

JCR-VIS Entity Rating Criteria: *Industrial Corporates (May 2016)*
http://jcrvis.com.pk/docs/Corporate-Methodology-201605.pdf

Chashma Sugar Mills Limited (CSML)

OVERVIEW OF THE INSTITUTION

CSML was incorporated as public limited company in May, 1988 under Companies Ordinance of 1984 and belongs to 'The Premier Group'. The main line of business of the company is production and sale of white crystalline sugar, industrial ethanol, and bagasse.

Profile of the CEO

Mr. Aziz S. Khan is Chairman at Premier Sugar Mills & Distillery Co. Ltd. He is on the Board of Directors at The Frontier Sugar Mills & Distillery Ltd. and Arpak International Investments Ltd.

Financial Snapshot

Total Equity: end-9M18: Rs. 4.2b; end-FY17: Rs. 4.1b; end-FY16: Rs. 4.1b

Assets: end-9M18: Rs 13.6b; end-FY17: Rs. 10.6b; end-FY16: Rs 10.1b

Profit) After Tax: 9M18: Rs. 185m; FY17: Rs. 92m; FY16: Rs. 297m

RATING RATIONALE

Chasma Sugar Mills Limited (CSML) is a part of "Premier Group" having business interests in sugar, ethanol, high grade polypropylene, tableware and distribution of consumer goods and pharmaceuticals. The ratings draw comfort from sizeable scale of operations and revenue diversification through forward integration in ethanol business providing an adequate cushion in withstanding the impact of cyclicality of sugar sector. The increased contribution of ethanol division towards revenue generation has resulted in enhanced margins offsetting the impact of downturn in average sugar prices. However, the ratings remained constrained of account heightened financial risk owing to increased leverage indicators and weakening of debt coverages. In addition, ratings remain sensitive to the realization of projected targets of the company and evolution of sector dynamics.

Cyclicality in sugar sector resulted in downtrend in sugar prices: Sugar sector is cyclical and vulnerable to price fluctuations. Sugarcane support prices, the major input cost, are regulated by provincial governments. Over the last four years, sugarcane price in Punjab has increased slightly at a CAGR of 1.4%. On the contrary, retail sugar prices are determined by market dynamics with demand and supply forces. The price elasticity in end-product is not correlated with the raw material cost; hence in cycles of depressed sugar prices, the margins of entire sugar sector shrink. Bumper sugarcane crop in the last crushing season led to surplus availability of sugar, resulting in decline in average retail prices to Rs. 53.0/Kg during HY18 vis-à-vis Rs. 61.4/Kg in FY17. As a result of the aforementioned, most players in the sugar sector experienced compression in margins, suppressed profitability and hampered debt repayment capacity. In addition, the sugar sector is exposed to agro-climatic risks which has an impact on the cane output. Nevertheless, the government has recently allowed export of 1.0m tons of sugar, which may help in reducing surplus stock and is expected to have a positive connotation for the overall industry.

Improvement in sucrose and molasses recovery on timeline basis: CSML operates with an installed sugar crushing capacity of 18,000 tons/day and a distillery with an installed production capacity of 125,000 liters/day of ethanol. Sugarcane crushed during crushing season FY17-18 decreased as compared to the previous year's crushing season; therefore, sugar production and capacity utilization were recorded lower. However, sugar and molasses recovery improved on a timeline basis. In addition, ethanol recovery rate also remained healthy and exhibited an improving trend during the latest crushing season. For ethanol production, the company uses both internally produced and market procured molasses in equal proportions. The production statistics of the company are presented in the table below:

Production Statistics			
Crushing Seasons	**17-18**	**16-17**	**15-16**
Installed Capacity (TCD)	18,000	18,000	18,000
Sugarcane Crushed ('000' MT)	2,041.0	2,224.5	1,689.6
Days of Production	134	131	105
Capacity Utilization (%)	75.6	82.4	62.6

Recovery Rate (%)	9.47	9.16	9.20
Sugar Production ('000' MT)	193.3	203.7	155.4
Molasses Produced ('000' MT)	86.3	89.0	68.0
Molasses Recovery Rate (%)	4.2	4.0	4.0
Ethanol Produced ('000' MT)	26.8	23.7	20.7
Ethanol Recovery Rate (%)	18.50	18.32	18.58

Depressed profitability in line with higher operating and taxation expense in FY17: Despite slight increase in the volumetric sales of sugar, net sales of the company largely remained stagnant during FY17 owing to decline average selling price of sugar. Total volumetric sales of sugar were recorded at 192,111 tons (FY16: 188,405 tons). Sugar comprises major portion of company's revenue representing around 87% (FY16: 89.1%) of total sales during FY17. However, revenue contribution from ethanol unit has exhibited improvement on a timeline basis. Ethanol is exported to international buyers; price of the final product ranged between US $ 1.25 to 1.46/gallon during the last six months. The gross margins increased marginally mainly on account of lower average procurement price of sugarcane vis-à-vis preceding year. Nonetheless, improvement in margins did not translate in the operating profit owing to increase in operating costs primarily in line with annual salary increments and higher headcount by end-FY17 as compared to previous year. The income from other sources was also reported lower at Rs. 11.4m (FY16: Rs. 132.8m) on account of sizable income earned on the sale of seeds during FY16. While financial charges decreased slightly, the bottom line was adversely impacted by deferred tax liability amounting to Rs. 40.1m during FY17 as compared to deferred tax asset of Rs. 82.3m during FY16 in line with tax credits received for investment in plant and machinery.

Higher revenue contribution by ethanol division led to improvement in margins during 9M18: With the proportion of ethanol sale comprising one-fourth of the total revenue mix, the gross margins showcased improvement during 9M18 despite ongoing slump in the retail prices of sugar. Partly indigenous molasses consumption for ethanol production led to cost rationalization together with higher retail price of ethanol in the international market has helped in largely sustaining profitability. Higher margins and improved sucrose recovery coupled with streamlining of finance cost (Rs. 352.8m) and enhancement of other income (Rs. 118.5m) pertaining to sale of sugarcane seed resulted in higher profit before tax reported during 9M18. Furthermore, bottom line was also recorded higher owing to lower tax incidence in 9M18.

Volatility in cash flows witnessed on account of tax adjustments: Liquidity profile of the company remained volatile; Funds from Operations (FFO) declined during 9M18 despite improved profitability indicators owing to high income tax paid during the period in comparison to tax rebate received in the preceding year. Given decline in FFO and increase in debt levels, FFO to total debt decreased; moreover, debt service coverage, otherwise adequate, decreased to 1.02x in 9MFY18. While trade receivables stood higher, prepayments and other receivables also increased on a timeline basis mainly due to increase in sugar export subsidy receivable from the government and higher advance sales tax paid. Further, stock in trade increased considerably on a timeline basis on account of recent production of sugar coupled with inability to sell large quantum of produce due to price compression. The trade payables also increased by end-9M18 mainly owing to higher advances received from customers against sale of sugar. The situation is likely to self-correct moderately given the sugar stock held is expected to be sold to customers against which payables are outstanding.

High leverage indicators in line with sizeable working capital requirement: The equity base of the company has steadily strengthened on the back of profit retention. Despite timely contractual repayments of long-term debt, total debt levels of the company have increased on account of higher utilization of short-term credit facilities to meet increased working capital requirements. The increase in short-term credit is cyclical in nature, mainly pertaining to financing of stock inventory and sugarcane procurement. The long-term finances include loans from related parties amounting to Rs. 388.9m; the principal balance of the loans is repayable in 7 equal semi-annual installments commencing Feb'20 and are priced at 1M-KIBOR + 1.25%. Given higher short-term borrowings carried on the balance sheet, gearing and leverage indicators have witnessed an increasing trend on a timeline basis.

Experienced management team: Senior management team of the company comprises experienced resources having relevant experience in the industry. The company has well defined setups of production, finance, marketing, HR, audit and I.T. departments along with adequate board level oversight exhibiting effective management and governance structure.

Chasma Sugar Mills Limited			Appendix I	
BALANCE SHEET	30-Sep-15	30-Sep-16	30-Sep-17	30-Jun-18
Fixed Assets	6,765	8,169	7,803	7,521
Stock-in-Trade	2,045	571	1,354	4,207
Trade Debts	341	143	185	291
Cash & Bank Balances	80	38	84	76
Stores and Spares	268	295	345	341
Trade deposits, prepayments & other receivables	282	260	532	798
Other Assets	483	596	271	382
Total Assets	10,265	10,072	10,574	13,616
Trade and Other Payables	339	805	470	900
Other Liabilities	854	903	874	767
Long Term Debt ***(*incl. current maturity)***	2,634	3,252	2,713	2,219
Short Term Debt	3,817	1,037	2,452	5,524
Tier I Equity	934	1,310	1,461	1,728
Total Equity	2,621	4,075	4,065	4,206
INCOME STATEMENT	**30-Sep-15**	**30-Sep-16**	**30-Sep-17**	**30-Jun-18**
Net Sales	7,560	11,206.	11,412	7,542
Gross Profit	458	1,105	1,191	1,016
Operating Profit	183	584	614	426
Profit(loss) After Tax	174	297	92	185
FFO	447	718	894	537

RATIO ANALYSIS	30-Sep-15	30-Sep-16	30-Sep-17	30-Jun-18
Gross Margin (%)	6.1	9.9	10.4	13.5
Net Working Capital	(1,258)	(728.13)	(946)	(1,113)
FFO to Total Debt (x)	0.07	0.17	0.17	0.09
FFO to Long Term Debt (x)	0.2	0.3	0.33	0.32
Debt Servicing Coverage Ratio (x)	1.93	3.25	1.33	1.0
ROAA (%)	1.8	2.93	0.90	2.0
ROAE (%)	6.90	8.87	2.3	5.9
Gearing (x)	6.91	3.27	3.54	4.48
Debt Leverage (x)	8.18	4.60	4.46	5.45

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: 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 III
Name of Rated Entity	Chasma Sugar Mills Limited (CSML)
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		
11/15/2018	BBB+	A-2	Stable	Initial

Instrument Structure	N/A
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.
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