RATING REPORT

Chashma Sugar Mills Limited

REPORT DATE:
November 10, 2020

RATING ANALYSTS:
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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	*10th Nov'20*		*18th Oct'19*	
Rating Action	*Reaffirmed*		*Upgrade*	

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 **Chief Executive Officer:** Mr. Aziz Sarfaraz Khan

Key Shareholders (with stake 5% or more):

- The Premier Sugar Mills & Distillery Limited – 47.9%
- Other Group Companies – 18.7%
- Directors & Relatives – 15.4%

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Corporates (May 2019)
https://www.vis.com.pk/kc-meth.aspx

Chashma Sugar Mills Limited

OVERVIEW OF THE INSTITUTION

CSML was incorporated in May 1988 as a public company, under the repealed Companies Ordinance 1984 (now the Companies Act, 2017). The company is engaged in production and sale of white crystalline sugar and other allied products. The head office of the company is situated in Islamabad, while manufacturing facilities are located at Dera Ismail Khan, KP.

Profile of Chairman
Mr. Abbas Sarfaraz Khan is CEO of The Premier Sugar Mills & Distillery Co. Ltd., Arpak International Investments Ltd. and Syntronics Limited. He is also on board of seven other companies.

Profile of CEO
Mr. Aziz S. Khan is Chairman BoD of Premier Sugar Mills & Distillery Co. Ltd. He is also a board member of The Frontier Sugar Mills & Distillery Ltd. and Arpak International Investments Ltd.

Financial Snapshot
Tier-1 Equity: end-9MFY20: Rs. 3.8b; end-FY19: Rs. 2.6b; end-FY18: Rs. 1.8b

Net Profit: 9MFY20: Rs. 1.1b; FY19: Rs. 578.6m; FY18: Rs. 193.6m

RATING RATIONALE

The assigned ratings to Chashma Sugar Mills Limited's (CSML) take into account sizeable scale of sugarcane crushing operations and diversified revenue stream through forward integration into ethanol manufacturing. Increase in retail prices of sugar has resulted in notable increase in revenues and profit margins. While ethanol prices have also increased sharply as an outcome of surge in demand of sanitizing products due to Covid-19, distillery margins decreased owing to relatively higher cost of molasses. Liquidity position has also improved on back of higher profitability, as reflected by adequate cash flows in relation to outstanding obligations. Improving trend has been witnessed in leverage indicators. Gross margins are projected to remain largely intact on the back of marginal increase in Ethanol prices in rupee terms and stable sugar prices, going forward. Meanwhile, the ratings remained constrained on account of high business risk emanating from inherent cyclicality in crop levels, raw material prices and any adverse changes in regulatory duties. Management of leverage and liquidity indicators along with additional contribution margins from the ethanol segment would be important, going forward.

Business risk is considered high due to inherent cyclicality in crop levels and raw material prices: According to Pakistan Economic Survey 2019-20, sugarcane crop contributes about 0.6% to GDP and 2.9% of the total value addition in agriculture. During 2019-20, sugarcane production decreased by 0.4% to 66.880 million tons vis-à-vis 67.174 million tons of preceding year. Lower output is mainly the result of decrease in area of cultivation i.e 1,040 thousand hectares in MY20 as compared to 1,102 thousand hectares in MY19, a decrease of 5.6%. Meanwhile, the yield has improved by 5.5% compared to MY19. Average sugar prices have increased by 19% in MY19 and 16% in MY20. In order to control sugar prices and to maintain a strategic reserves of sugar, the GoP has allowed import of 300,000 tons of refined sugar, starting from Sep'20. Further, Economic Coordination Committee (ECC) has recently allowed exemption of sales tax on supply of sugar, imported through Trading Cooperation of Pakistan. Contrarily no support or subsidy was awarded for sugar export. While business risk is considered high, diversification of major industry players into ethanol business provides some cushion to profitability of the companies.

Balancing, Modernization and Replacement (BMR) to enhance production efficiencies: The company has added plant and machinery of Rs. 356.7m in 9MFY20, entailing Falling Film Evaporators (FFE) leading to improvement in steam consumption while reducing in-house consumption of bagasse. Capital work in progress of Rs. 507.3m, comprising fiberizers for improved recovery of sugar and upgradation of three boilers, has been capitalized during 9MFY20 Management expects an average saving of around Rs. 45m per year in bagasse consumption and some improvement in recovery rate due to aforementioned BMR in coming years. Property, plant & equipment stood at Rs. 8.9b (FY19: Rs. 9.2b; FY18: Rs. 9.5b) at end-9MFY20. The company has recorded right-of-use assets amounting Rs. 209.8m (FY19: Nil) as a result of adoption of IFRS 16 during 9MFY20. Further, CSML investment in Whole Foods (Pvt.) Limited (WFL – a wholly owned subsidiary) remained at Rs. 100m at end-9MFY20.

Operational performance: The production capacity of sugar crushing units and distillery remained intact at 18,000 tons per day (tpd) and 125,000 litres of ethanol per day (lpd) respectively. During crushing season 2019-20, sugar units were operational for 103 days (2018-19: 99 days; 2017-18: 129 days). The company crushed 13,904 tpd of sugarcane during 2019-20 (2018-19: 15,782 tpd; 2017-18: 15,820 tpd), resulting in overall lower capacity utilization of 74% (2018-19: 89%; 2017-18: 88%). Total sugar production was recorded lower at 151.0k MT (2018-19: 166.3k MT; 2017-18: 193.3k MT) during the outgoing crushing season. Sucrose recovery rate decreased slightly to 10.55% (2018-19: 10.64%; 2017-18: 9.47%).

The distillery was operational for 354 days during FY20 (FY19: 355 days; FY18: 357 days) with a capacity utilization of 100% (FY19: 97%; FY18: 100%). Total ethanol production was recorded at 43.5m liters (FY19: 43.3m liters; FY18: 44.6m liters) with a recovery rate of 18.35% (FY19: 18.07%; FY18: 19.37%) during FY20. Molasses production during the outgoing season decreased to 60,136 MT vis-à-vis 65,702 MT in line with lower crushing. Meanwhile, the company procured 162,589 MT of molasses in 9MFY20 as compared to 93,741 MT in the previous year.

	FY18	FY19	FY20
Crushing Capacity – tpd	18,000	18,000	18,000
Cane Crushed – tpd	15,820	15,782	13,904
Crushing Days	129	99	103
Capacity Utilization – %	88	89	74
Sucrose Recovery – %	9.47	10.64	10.55
Sugar Produced – tons	193,322	166,252	151,013
Molasses Produced-Tons	86,300	65,702	60,136
Molasses Recovery Rate-%	4.2	4.5	4.2
Ethanol Capacity – tons	125,000	125,000	125,000
Ethanol Produced – liters	44,617,163	43,260,426	43,462,330
Ethanol Recovery rate- %	19.37	18.07	18.35
Capacity Utilization – %	100	97	100
Operating Days	357	355	354

Higher profitability on back of increase in sugar and ethanol prices: The company reported net revenue of Rs. 14.2b (FY19: Rs. 12.4b; FY18: Rs. 10.4b) during 9MFY20. Around three-fourth of the sales pertained to sugar, while around 20% emanated from ethanol sales. Other by-products sale constituting cleaning molasses and bagasse remained marginal. During 9MFY20, the company sold 168,527 MT (FY19: 175,296 MT; FY18: 168,654 MT) of sugar at a higher average selling price of Rs. 75,205 per ton (FY19: Rs. 56,497 per ton; FY18: Rs. 46,493). Ethanol volumetric sales were recorded at 32.5m liters during 9MFY20 (FY19: 45.5m liters; FY18: 44.6m liters) with an average selling price of Rs. 99 per liter (FY19: Rs. 73 per liter; FY18: 57 per liter). The management expects the sugar prices to remain range bound on account of increase in demand and largely stagnant sugar production. Ethanol prices have increased sharply as an outcome of surge in demand of sanitizing products due to Covid-19. Ethanol prices are expected to remain largely intact in the short-term given sustained demand of sanitizing products.

Rs. Million	FY18	FY19	9MFY20
Sugar Sold (MT)	168,654	175,296	168,527
Sugar Price/MT	46,493	56,497	75,205
Ethanol Sold (Million Liters)	44.6	45.5	32.5
Ethanol Price/Liter	57	73	99

Increase in average selling prices have resulted in improvement in gross margins to 21.0% (FY19: 18.0%; FY18: 13.3%) during 9MFY20. Despite increase in Ethanol prices, gross margin of ethanol division deceased due to significant increase in cost of molasses (9MFY20: Rs. 17,250 per ton; FY19: Rs. 9,085 per ton; FY18: 6,040 per ton). This along with increase in sugarcane procurement cost to Rs. 209.2 per Kg (FY19: Rs. 175.6 per Kg; FY18: Rs. 151 per Kg) during 9MFY20 led to overall increase in cost of sales to Rs. 11.2b (FY19: Rs. 10.2b; FY18: Rs. 9.0b). Selling and distribution expenses increased to Rs. 553.9m (FY19: Rs. 344.7m; FY18: Rs. 324.2m) mainly due to higher freight (also includes cost related to sugar deliveries to local utility stores amounting Rs. 118m) & other export related expenses amounting Rs. 252.3m (FY19: Rs. 312.0m; FY18: Rs. 289.1m) during 9MFY20. Further, commission charges of Rs. 133.6m were recorded in management accounts for 9MFY20, which were part of indirect taxes in audited accounts in prior years. Administrative expenses amounted to Rs. 452.2m (FY19: Rs. 509.6m; FY18: Rs. 397.3m) during 9MFY20. Other income of Rs. 58.0m (FY19: Rs. 44.0m; FY18: Rs. 98.1m) mainly pertained to gain on sale of fertilizers/pesticides, scrap sale and sale of press mud during 9MFY20. Meanwhile, other expenses stood higher at Rs. 85.6m (FY19: Rs. 40.7m; FY18: Rs. 18.1m) which were mainly related to WWF and WPPF during 9MFY20. Despite higher annualized financial charges, net margins increased to 7.9% (FY19: 4.7%; FY18: 1.9%) on the back of higher sales, gross margins, and lower effective tax; the company reported net profit of Rs. 1.1b (FY19: Rs. 578.6m; FY18: Rs. 193.6m) during 9MFY20.

Adequate liquidity supported by health cash flows in relation to outstanding obligations: Funds from Operations (FFO) increased to Rs. 1.8b (FY19: Rs. 1.4b; FY18: Rs. 835.7m) mainly on back of higher profitability during 9MFY20. Resultantly, annualized FFO to long-term debt and FFO to total debt ratios improved to 1.10x (FY19: 0.59x; FY18: 0.36x) and 0.34x (FY19: 0.26x; FY18: 0.14x) respectively. Debt service coverage ratio (DSCR) increased to 2.72x (FY19: 2.67x; FY18: 1.31x); the increase in DSCR compared to preceding year was marginal, as long-term repayments were relatively higher in 9MFY20.

Stock in trade stood higher at Rs. 2.5b (FY19: Rs. 1.7b; FY18: Rs. 2.2b) at end-9MFY20 due to higher stock of molasses while sugar stock was considerably lower as a result of higher offtake. Sugar stock at end-9MFY20 was recorded lower at 13,267 MT (FY19: 30,782 MT), whereas molasses stock was higher at 97,559 MT (FY19: 24,510 MT). In addition to the reason that the company has to maintain molasses stock for six months' production i.e. July to December, stock value was higher due to increased cost and inventory build-up anticipating higher demand. Trade debts increased significantly to Rs. 1.9b (FY19: Rs. 57.0m; FY18: Rs. 219.1m) at end-9MFY20. While CSML sells sugar in the open market on cash basis, a sizeable portion of these trade debts amounting Rs. 1.4b, pertained to contract with utility stores for which the company provided a credit period of 15 days. However, some delays were encountered due to extensive documentation involved. On the other hand, ethanol is exported to foreign clients on a 3 – 4 months' supply contract. As of September 30, 2020, total outstanding receivables reduced considerably to Rs. 237.7m. Loans and advances of Rs. 1.7b (FY19: Rs. 1.4b; FY18: Rs. 331.7m) mainly constituted advances to suppliers and contractors amounting Rs. 1.2b (FY19: Rs. 999.2m; FY18: Rs. 241.9m) at end-9MFY20. The increase in advances to suppliers in FY19 and onward was due to higher purchase of molasses from outside. This also included amount due from related parties of Rs. 434.8m (FY19: Rs. 216.4m; FY18: Rs. 107.9m). Trade deposits, prepayments and other receivables amounted to Rs. 318.8m (FY19: Rs. 338.9m; FY18: Rs. 812.0m) at end-9MFY20. Trade and other payables increased to Rs. 1.1b (FY19: Rs. 689.0m; FY18: Rs. 712.3m) due to higher creditors and employees related payables. Current ratio increased to 1.09x (FY19: 0.92x; FY18: 0.80x) by end-9MFY20. Coverage of short-term borrowings via trade debts and stock in trade also improved to 0.91x (FY19: 0.57x; FY18: 0.65x). Going forward, overall liquidity position is projected to remain sound on back of adequate cash flows.

Augmentation in equity on back of profit retention Tier-1 equity augmented to Rs. 3.8b (FY19: Rs. 2.6b; FY18: Rs. 1.8b) by end-9MFY20. Revaluation surplus on property, plant & equipment was Rs. 3.5b (FY19: Rs. 3.7b; FY18: Rs. 4.0b) at end-9MFY20. The company paid cash dividend of Rs. 143.5m (FY19: Rs. 43.0m; FY18: Rs. 43.0m) during 9MFY20. Debt profile of the company comprises a mix of long-term and short-term borrowings. Total long-term borrowings amounted to Rs. 2.1b (FY19: Rs. 2.3b; FY18: Rs. 2.3b) at end-9MFY20. Around three-fourth of these facilities represented term and demand finance with a markup of KIBOR *Plus* 1.1-2% per annum and are repayable in 3-5 years. These debt facilities will be completely paid off till 2023. Related party debt amounted to Rs. 358.0m (FY19: Rs. 385.3m; FY18: Rs. 465.1m) with markup of 1 month KIBOR *Plus* 1.25%, at end-9MFY20. Further, finance lease amounted to Rs. 153.1m (FY19: Rs. 136.5m; FY18: Rs. 58.8m) at end-9MFY20.

The utilization of short-term borrowings has increased in line with working capital requirements. Short-term borrowings amounted to Rs. 4.8b (FY19: Rs. 3.1b; FY18: Rs. 3.8b) at end-9MFY20. These facilities represent cash finance and export re-finance carrying markup in a range of KIBOR plus 1%-1.75% per annum. With higher equity base, gearing and debt leverage improved on timeline basis to 1.83x (FY19: 2.08x; FY18: 3.43x) and 2.38x (FY19: 2.76x; FY18: 4.48x) respectively by end-9MFY20. As per management, capitalization indicators are projected to improve on back of equity expansion coupled with scheduled long-term debt repayments.

Corporate governance: There have been no changes at board and senior management level over the rating horizon. Presently, the board comprises nine members including two independent directors and three female directors. Overall corporate governance framework is supported by adequate board composition and oversight.

Chashma Sugar Mills Limited Annexure I

FINANCIAL SUMMARY *(amounts in PKR millions)*			
BALANCE SHEET	**FY18**	**FY19**	**9MFY20**
Property, Plant & Equipment	9,531.8	9,224.0	8,885.9
Right of Use Assets	-	-	209.8
Long-term Investment	100.0	100.0	100.0
Stores, Spare & Loose Tools	342.7	469.7	462.8
Stock in Trade	2,242.6	1,724.8	2,505.9
Trade Debts	219.1	57.0	1,861.5
Loans, Advances & Tax Refund	364.8	1,392.9	1,747.5
Deposits, Prepayment & Others	825.9	354.0	333.9
Cash & Bank Balance	188.8	203.9	216.9
Total Assets	**13,815.7**	**13,526.3**	**16,324.2**
Trade & Other Payables	712.3	689.0	1,078.9
Deferred Taxation	1,154.8	1,056.9	979.9
Other Liabilities	8.0	29.5	46.4
Short-term Borrowings	3,796.2	3,100.9	4,778.6
Long-Term Borrowings *(Including current maturity)*	2,339.0	2,328.6	2,134.9
Total Liabilities	**8,010.3**	**7,204.9**	**9,018.7**
Paid-Up Capital	286.9	286.9	286.9
Tier-1 Equity	1,786.5	2,608	3,784.8
Total Equity	5,805.5	6,321.5	7,305.4
INCOME STATEMENT	**FY18**	**FY19**	**9MFY20**
Net Sales	10,383.8	12,420.7	14,218.6
Gross Profit	1,379.0	2,237.1	2,985.1
Operating Profit	737.5	1,386.0	1,951.3
Finance Cost	484.4	749.5	702.2
Profit Before Tax	253.2	636.5	1,249.1
Profit After Tax	193.6	578.6	1,127.4
FFO	835.7	1,385.1	1,758.6
RATIO ANALYSIS	**FY18**	**FY19**	**9MFY20**
Gross Margin (%)	13.3	18.0	21.0
Net Margin (%)	1.9	4.7	7.9
Net Working Capital	(1,014.6)	(344.9)	609
FFO to Long-Term Debt (x)	0.36	0.59	1.10*
FFO to Total Debt (x)	0.14	0.26	0.34*
Debt Servicing Coverage Ratio (x)	1.31	2.67	2.72
ROAA (%)	1.6	4.2	10.3*
ROAE (%)	11.9	26.3	55.1*
Gearing (x)	3.43	2.08	1.83
Debt Leverage (x)	4.48	2.76	2.38
Current Ratio (x)	0.80	0.92	1.09
Inventory + Receivables to Short-term Borrowings (x)	0.65	0.57	0.91

**Annualized*

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	Chashma Sugar Mills Limited
Sector	Sugar
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings
Rating History	

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
11/10/2020	A-	A-2	Stable	Reaffirmed
10/18/2019	A-	A-2	Stable	Upgrade
11/15/2018	BBB+	A-2	Stable	Initial

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.
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Due Diligence Meetings Conducted

	Name	Designation	Date
1	Mr. Wajahat Qamar	Asst. General Manager Tax & Finance	4th September, 2020