

## RATING REPORT

### JDW Sugar Mills Limited (JDWSML)

**REPORT DATE:**

April 23, 2019

**RATING ANALYSTS:**

Maham Qasim

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#### RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
<b>Entity</b>	A	A-2	A+	A-1
<b>Rating Date</b>	13 Mar'19		31 Oct'17	
<b>Rating Outlook</b>	Stable		Stable	
<b>Rating Action</b>	Downgrade		Reaffirmed	

#### COMPANY INFORMATION

<b>Incorporated in 1990</b>	<b>External auditors:</b> M/s KPMG Taseer Hadi & Co., Chartered Accountants
<b>Public Limited Company</b>	<b>Chairman of the Board:</b> Mukhdoom Syed Ahmed Mahmud
<b>Key Shareholders (with stake 5% or more):</b>	<b>Chief Executive Officer:</b> Mr. Raheel Masud
Directors, CEO and their spouse – 52.8%	
General Public – 38.1%	

#### APPLICABLE METHODOLOGY(IES)

JCR-VIS Entity Rating Criteria : Industrial Corporates (May 2016)

<http://jcrvis.com.pk/docs/Corporate-Methodology-201605.pdf>

## JDW Sugar Mills Limited (JDWSML)

### OVERVIEW OF THE INSTITUTION

JDWSML was incorporated as a private limited company in May, 1990 under the Companies Ordinance, 1984 and was subsequently converted into a public limited company in August, 1991. Principal activities of JDWSML include production and sale of crystalline sugar, electricity and managing corporate farms. Shares of the company are listed on the Pakistan Stock Exchange.

#### Profile of Chairman

Mukhdoom Syed Ahmed Mahmud is a renowned political figure. He served as Governor of Punjab during 2012-2013.

#### Profile of CEO

Mr. Raheel Masud has been appointed as CEO of the company in **during FY17**; he has a vast experience related to the manufacturing sector. He joined JDWSML as General Manager in 1991.

#### Financial Snapshot:

Total equity: 1Q19: Rs. 7.9b; FY18: Rs. 8.2b; FY17: Rs. 8.4b; FY16: Rs. 8.3b  
 Net profit: 1Q19: Rs. (353.4); FY18: Rs. (203.4); FY17: Rs. 1.6b; FY16: Rs. 2b

### RATING RATIONALE

The ratings assigned to JDW Sugar Mills Limited (JDWSML) take into account its leading position in the sugar sector of the country with the highest installed sugar crushing capacity. The ratings derive strength from overall scale of operations along with operational efficiencies reaped over the years on account of consistent availability of sugarcane produce from own farms, relatively high sucrose recovery levels and timely offloading of inventory stocks. In addition, the diversification in revenue streams achieved through forward integration into co-generation has enabled the company to withstand the impact of prevailing downturn in sugar prices. Co-generation revenues provided support to the company's profitability. However, heightened business risk owing to overall dismal performance of sugar sector translated into weakening of financial risk profile the company. In addition, the sizeable decline in margins adversely impacted cash coverage's and funds flow from operations with respect to debt obligations.

#### ***Key Rating Drivers:***

**The impact of depressed margins partially offset by diversification in revenues in FY17:** JDWSML revenues increased during FY17 on account of volumetric increase in local and export sugar sales owing to 35% increase in production volumes coupled with improvement in average retail prices to Rs. 61.4/Kg (FY16: Rs. 54.6/Kg) during FY17. However, the increase in sales did not fully translate into bottom line of the company due to heightened pressure on margins which was, in turn, a function of reduction in sucrose recovery levels to 10.3% (FY15: 10.9%) during crushing season FY16-17. The sucrose recovery was adversely impacted by early start of crushing season, unfavorable weather conditions, early logging of sugarcane crop and sowing of unapproved varieties of cane by some growers. The impact of decline in margins was moderately offset by ongoing improvement in availability of steam percentage to the company leading to saving of more bagasse for its power plants. The saved bagasse was more than the seasonal requirement for both co-generation plants; hence, instead of purchasing bagasse from open market, the company sold extra amounts generating additional revenue. During FY17, electricity sold to (CPPA-G) amounted to Rs. 4.1b in comparison to Rs. 3.9b in preceding year. The increase in molasses sales was supported by setting up of 5 more molasses tanks during FY17 with a capacity of 15,000 tons each to store the product. Previously, molasses was stored in open pits which impacted the storability of the product resulting in its obsolescence which, in turn, used to result in relatively lower sales. The contribution to revenues from sale of molasses was recorded higher at Rs. 2.6b (FY16: Rs. 1.8b) during FY17. In the absence of one-off provision charge booked in FY16 against non-earning investment, Faruki Pulp Mills Limited (FPML), coupled with rationalization of finance and administration costs, profit before tax was recorded around the prior year's level of Rs. 2.3b during FY17.

**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 by 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 shrank. 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 FY18 vis-à-vis Rs. 61.4/Kg in FY17. As a result of the aforementioned, all 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.

**Improved sucrose recovery led to enhanced production level in FY18:** JDWSML has three

production units, two located in Punjab and one in Sindh Province, with a total aggregate annual crushing capacity of 6.6MT tons. During FY17-18 crushing season, sugarcane crushed was 6.4% higher than the previous year at 8.4MT (FY17: 7.9MT) whereas sugar production increased by 9.3%;

the increase was attributable to improvement in combined sucrose recovery by 28bps. The sucrose recovery was recorded higher at 10.6% (FY17: 10.3%) for the outgoing year. Sucrose recoveries of unit-I and II were better than last season whereas reduction in recovery for unit-III has been witnessed due to pest attack on the sugarcane crop. In addition, molasses recovery also registered an increase to 5.04% (FY16: 4.4%) during the FY17-18 crushing season.

**Depressed sugar prices adversely impacted profitability in FY18:** Net sales revenue of the company declined by almost 18% during on account of decline in average selling price of sugar and molasses coupled with decline in quantum sales. The sugarcane procurement price was maintained at Rs. 180/40 Kg in Punjab while the same was reduced to Rs. 160/40 Kg in Sindh. With JDWSML's two units based in Punjab, coupled with slump in retail prices, the gross margins of the company declined to 8.4% (FY17: 10.7%) during FY18 and further to 6.7% during 1Q19. Moreover, sugar price fixed by FBR for sales tax purposes is higher than the actual market price which has also impacted profitability in the current period. The increase in selling expense was mainly a function of higher freight cost related to sugar export; the company, on group basis, exported 2.0 million tons of sugar during FY18. Moreover, financial cost increased due to higher utilization of funding lines in the current period to meet higher working capital requirements along with increase in benchmark interest rates. The adverse impact of low margins was partially mitigated by higher other income primarily including subsidy amounting to Rs. 2.2b from Federal and Provincial Governments on export of sugar. Nevertheless, the company reported net loss during FY18 and 1Q19. Going forward, the performance of the company will be primarily a function of trend in sugar prices.

**Weak liquidity profile due to limited profitability:** In line with reduced earnings, Funds from Operations (FFO) declined considerably during the ongoing year. This along with higher debt levels, FFO to total debt plummeted. The trade debts increased on a timeline basis mainly due to increase in amount receivable from CPPA-G against sale of electricity under EPA. Stock in trade increased sizably on a timeline basis on account of recent production of sugar coupled with inability to sell 25% of produce every quarter due to price compression. The trade payables were also recorded higher at end-FY18 and at end-1QFY19 in line with increased advances from customers against sale of sugar along with higher payments to be made to growers. 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:** Increase in debt levels during the ongoing year are cyclical in nature, mainly pertaining to higher short-term borrowings arranged primarily to finance stock inventory and also for sugarcane procurement. Long term debts mainly pertained to borrowing to setup co-generation plants. Given higher short-term borrowings carried on the balance sheet, gearing and leverage indicators have witnessed an increasing trend despite expansion of equity base. Regular CAPEX requirement in the medium term is projected to be met from internal capital generation.

**Related party transactions:** While further provisioning may be made against investment in FPML, the management does not plan any additional investment in the associated concern in the foreseeable future. The other assets were recorded higher on a timeline basis primarily on account of advance amounting Rs. 700.7m extended to the wholly owned subsidiary, Deharki Sugar Mills limited.

**Highly experienced management team:** Management team of JDWSML comprises seasoned resources carrying sound experience of the sugar and agriculture sector. The company has long-standing relationships with growers which together with research activities in sugarcane development has ensured timely and adequate availability of sugarcane. Support functions have kept up pace with the growing scale of the institution.

**JDW Sugar Mills Limited (JDSML)**
**Appendix I**

<b>Financial Summary (in PKR millions)</b>				
<b><u>BALANCE SHEET</u></b>	<b>FY16</b>	<b>FY17</b>	<b>FY18</b>	<b>1Q19</b>
Property, Plant & Equipment	19,541.7	21,059.0	22,010.2	21,932.4
Stock-in-Trade	5,035.6	7,939.8	19,730.0	19,757.0
Trade Debts	1,025.6	2,941.2	5,471.5	4,899.9
Long Term Investments	2,283.1	2,303.4	2,310.5	2,310.5
Intangibles	622.9	620.9	618.8	618.3
Cash & Bank Balances	6.6	133.8	105.9	190.9
Other Assets	5,630.6	6,946.2	7,566.1	6,781.9
<b>Total Assets</b>	<b>34,146.1</b>	<b>42,362.0</b>	<b>57,813.0</b>	<b>56,491.0</b>
Trade and Other Payables	7,327.7	8,301.0	10,756.3	15,720.6
Short Term Borrowings	3,415.7	10,053.2	23,553.7	18,734.3
Long-Term Borrowings ( <i>Inc. current maturity</i> )	13,213.9	13,161.1	12,891.7	12,033.2
Other liabilities	1,868.0	2,227.1	2,383.8	2,128.7
<b>Total Equity</b>	<b>8,320.8</b>	<b>8,619.6</b>	<b>8,227.5</b>	<b>7,874.1</b>
<b><u>INCOME STATEMENT</u></b>	<b>FY16</b>	<b>FY17</b>	<b>FY18</b>	<b>1Q19</b>
Net Sales	37,287.4	45,432.0	37,264.5	8,170.6
Gross Profit	6,454.5	4,624.5	3,116.4	549.6
Operating Profit	3,979.1	3,845.0	2,129.0	212.2
Profit After Tax	2,033.9	1,588.4	(203.4)	(353.4)
FFO	5,027.7	2,884.2	1,297.4	55.36*
<b><u>RATIO ANALYSIS</u></b>	<b>FY16</b>	<b>FY17</b>	<b>FY18</b>	<b>1Q19</b>
Gross Margin (%)	17.3	10.2	8.4	6.7
FFO to Long-Term Debt (x)	0.38	0.22	0.10	0.005*
FFO to Total Debt (x)	0.30	0.12	0.04	0.002*
ROAA (%)	5.2	4.2	-0.3	-0.6
ROAE (%)	26.4	18.8	-2.4	-4.4
Gearing (x)	2.0	2.7	4.4	3.9
Debt Leverage (x)	3.1	3.9	6.0	6.2

\*Annualized

**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](http://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](http://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](http://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			
<b>Name of Rated Entity</b>	JDW Sugar Mills Limited				
<b>Sector</b>	Sugar				
<b>Type of Relationship</b>	Solicited				
<b>Purpose of Rating</b>	Entity Ratings				
<b>Rating History</b>	<b>Rating Date</b>	<b>Medium to Long Term</b>	<b>Short Term</b>	<b>Rating Outlook</b>	<b>Rating Action</b>
	<b><u>RATING TYPE: ENTITY</u></b>				
	03/13/2019	A	A-2	Stable	Downgrade
	10/31/2017	A+	A-1	Stable	Upgrade
	04/13/2017	A+	A-1	Stable	Upgrade
	10/27/2015	A	A-1	Positive	Reaffirmed
	2/17/2015	A	A-1	Positive	Maintained
	10/7/2013	A	A-1	Stable	Reaffirmed
	9/5/2012	A	A-1	Stable	Reaffirmed
	8/16/2011	A	A-1	Stable	Upgrade
<b>Statement by the Rating Team</b>	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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