RATING REPORT

Deharki Sugar Mills (Private) Limited (DSML)

REPORT DATE:

May 02, 2019

RATING ANALYSTS:
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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	*March 13th, '19*		*April 13th, '17*	

COMPANY INFORMATION

Incorporated in 2010	**External auditors:** M/s Riaz Ahmad, Saqib, Gohar & Co., Chartered Accountants
Private Limited Company	**Chairman of the Board:** Mr. Maqsood Ahmed Malhi
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Raheal Masud
JDW Sugar Mills Limited – 100%	

APPLICABLE METHODOLOGY(IES)

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

Deharki Sugar Mills (Private) Limited (DSML)

OVERVIEW OF THE INSTITUTION

DSML was incorporated as a private limited company in July, 2010 under the Companies Ordinance 1984. Primary activities of DSML include manufacturing and sale of crystalline sugar.

Profile of the Chairman

Mr. Maqsood Ahmed Malhi is law graduate and also holds an MBA degree from Pakistan Finance College, Lahore.

Profile of the CEO

Mr. Raheal Masud brings with himself vast experience of the manufacturing sector. He joined JDW Sugar Mills as General Manager in 1991.

Financial Snapshot:

Total equity: 1Q19: Rs. 1.7b; FY18: Rs.1.8b; FY17: Rs. 2.4b; FY16: Rs. 2.2b

Net profit /(loss): 1Q19: (115.6)m; FY18 Rs. (547.5) m; FY17: Rs. 115.8m; FY16: Rs. 860.7m

RATING RATIONALE

Ratings assigned to Deharki Sugar Mills (Private) Limited (DSML) take into account its association with JDW Sugar Mills Limited (JDWSML), the largest sugar manufacturer in the country with the highest installed sugar crushing capacity. Being a wholly owned subsidiary of JDWSML, the company draws various benefits from its parent including operational integration; meanwhile JDWSML has also extended advances to DSML. The ratings remain constrained on account of heightened business risk in line with overall dismal performance of sugar sector translating into weakened financial risk profile the company. The slump in sugar prices adversely impacted the bottom line of the company with negative gross margins recorded during the ongoing year.

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.

Improvement in sucrose recovery resulted in increased production: Given bumper sugarcane crop recorded during FY17, sugarcane crushed during 16-17 crushing season increased by almost 25% and amounted to 1,950,674 MT as compared to 1,559,603 MT tons in the preceding crushing season. In line with increased sugarcane crushed coupled with improved sucrose recovery level to 10.51% (FY16: 10.26%) during FY17, sugar production stood higher at 205,041 MT (FY16: 158,705 MT). The improving trend in sucrose recovery levels continued during the ongoing year and was recorded higher at 10.89%; hence, despite a decline in sugarcane crushed at 1,890,611 MT, sugar production was maintained around the prior year's level (205,788 MT) during crushing season 17-18.

Depressed sugar prices led to negative margins: 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, net revenue of the company declined on account of reduction in sugar sale volume and decline in retail prices. The slump in sugar prices continued during the ongoing year; hence adversely impacting the gross margins of the company. As a result of pressure on margins on a timeline basis, profitability and liquidity position of the company coupled with debt service capacity has been adversely impacted.

Pressure on liquidity position of the company: With distressed profitability position, Funds from Operations (FFO) were recorded negative during FY18. Given negative FFO along with higher debt levels, FFO to total debt was also recorded negative at end-FY18. The situation could not be rectified during the ongoing year; therefore, liquidity indicators remained weak. Further prolongation of the depressed condition of the sugar industry may hamper debt repayment capacity of the company, going forward. However, implicit support from the parent company is expected to be extended in times of contingency. Moreover, stock in trade increased sizably on a timeline basis on account of recent production of sugar coupled with inability to sell the same owing to depressed prices.

High leverage indicators in line with sizeable working capital requirement: Total debt of the company increased on a timeline basis primarily on account of increase in both long and short-term finances. The borrowing mix witnessed a change with short-term finances representing 63% (FY17: 88%; FY16: 12%) at end-FY18. The short-term borrowing is cyclical in nature and is arranged to meet working capital requirement mainly to finance sugar stock. The increase in short-term finances is majorly manifested in cash finance facilities availed from various banks with markup ranging between 1-3M KIBOR plus 0.2%-1.0% markup. The same is secured against pledge of sugar bags and sponsor guarantees. Further, the company has obtained salam/istisna finance facility amounting to Rs. 1.5b during FY18 at markup rate ranging from 3-6M KIBOR plus 1%-3%, which is secured against joint pari passu charge over present and future current assets of the company. The long-term borrowings also increased during period under review on account of Islamic mode of financing availed for the Balancing, Modernization and Replacement (BMR) of the plant. The long-term borrowing, availed during FY18, entails loans from three commercial banks with a tenor of 4 years and markup rate ranging between 3M KIBOR plus 80-100bps. The loans include a grace period of one year with markup payable in quarterly installments while principal payment will be made on annual basis. Subsequently, the gearing and leverage indicators were recorded higher at 4.3x (FY17: 2.1x; FY16: 0.7x) and 5.0x (FY17: 2.6x; FY16: 1.0x), respectively, by end-FY18. In addition, non-current assets increased on a timeline basis mainly on account of investment property representing agriculture land measuring 172.9 acres situated at Bakhar and Sadiqabad. The land has been leased to JDWSML for sugarcane farming. Moreover, deferred tax asset increased while the company has also done some CAPEX on plant and machinery. The CAPEX pertained to improvement in boiler efficiency, construction of additional sugar godown and setting up of three centrifugal machines.

Highly experienced management team: The company enjoys operational integration with its parent company since various functions are shared between JDWSML and DSML including information technology, audit and finance. In addition to this, senior management team of JDWSML is also managing DSML operations.

FINANCIAL SUMMARY *(amounts in PKR millions)*

BALANCE SHEET	FY15	FY16	FY17	FY18	1Q19
Non-Current Assets	3,084.3	3,564.1	4,133.3	4,148.6	4,120.8
Stock-in-Trade	622.0	251.8	3,392.0	4,522.9	3,642.3
Trade Debts	76.8	20.4	353.6	790.0	1,222.8
Cash & Bank Balances	8.8	22.9	33.7	16.2	57.0
Other Assets	864.5	569.9	484.2	1,370.6	2,475.2
Total Assets	4,656.4	4,429.1	8,396.9	10,848.3	11,518.1
Trade and Other Payables	217.1	595.3	948.9	1,077.8	2,335.5
Short Term Borrowings	1,628.4	178.7	4,430.9	4,938.0	4,539.6
Long-Term Borrowings *(Inc. current matur)*	1,397.4	1,284.8	608.0	2,870	2,835
Other liabilities	32.0	128.1	51.1	152.0	113.2
Total Equity	1,381.5	2,242.2	2,358.0	1,810.5	1,694.9

INCOME STATEMENT	FY15	FY16	FY17	FY18	1Q19
Net Sales	8,809.6	9,398.2	7,481.4	8,259.1	2,579.9
Gross Profit	1,035.6	1,690.0	476.3	169.7	48.3
Operating Profit	935.4	1,460.6	345.6	103.3	67.4
Profit After Tax	370.0	860.7	115.8	-547.5	-115.6
FFO	571.1	1,351.1	354.2	-203.7	-91.03

RATIO ANALYSIS	FY15	FY16	FY17	FY18	1Q19
Gross Margin (%)	11.8	18.0	6.4	2.1	1.9
FFO to Long-Term Debt (x)	0.4	1.1	0.6	-0.07	-0.13
FFO to Total Debt (x)	0.2	0.9	0.1	-0.03	-0.05
Debt Servicing Coverage Ratio (x)	1.2	3.8	0.7	-	-
ROAA (%)	7.4	18.9	0.0	-5.7	-4.1
ROAE (%)	30.9	47.5	0.1	-26.3	-26.4
Gearing (x)	2.2	0.7	2.1	4.3	4.4
Debt Leverage (x)	2.2	1.0	2.6	5.0	5.8

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	Deharki Sugar Mills (Private) Limited
Sector	Sugar
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see table below
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.
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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
May-02-2019	A-	A-2	Stable	Downgrade
April-13-2017	A	A-2	Stable	Upgrade
June-08-2016	A-	A-2	Stable	Initial