RATING REPORT

Deharki Sugar Mills (Private) Limited (DSML)

REPORT DATE:
April 27, 2020

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	*April 27, 2020*		*March 13, 2019*	

COMPANY INFORMATION

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

APPLICABLE METHODOLOGY(IES)

Applicable Rating Criteria: Corporates (April, 2019)
https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Corporate-Methodology-201904.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.

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.

RATING RATIONALE

Deharki Sugar Mills (Private) Limited (DSML) is a wholly-owned subsidiary of JDW Sugar Mills Limited. The company is principally engaged in manufacturing and selling of crystalline sugar. Head office of the company is based in Lahore, whereas manufacturing unit is situated in Ghotki, Sindh.

Operating Performance

Sugar

The company's installed sugarcane crushing capacity stands at around 13,000 MT per day. During the outgoing year, the mill operated only 100 days (MY18: 132) primarily due to limited availability of raw material. Recovery rate has witnessed an upward trajectory and stood at 11.2% (MY18: 10.9%) during MY19. Overall sugar production declined by 28.5% during MY19. Management expects sugar production to decline further in the ongoing year due to limited availability of sugar cane coupled with decline in recovery rate.

	MY18	MY19
Operating Data of cane crushing, sucrose & molasses recovery		
Capacity per day (Tons)	13,000	13,000
Crushing Period in days (Numbers)	132	100
Total Crushing Capacity (Tons)	1,950,000	1,950,000
Cane Crushed (Tons)	1,890,612	1,316,226
Capacity Utilization (%)	97.0%	67.5%
Sugar Production (Tons)	205,788	147,213
Recovery Ratio (%)	10.9%	11.2%
Molasses Produced (Tons)	82,177	53,137
Molasses Recovery (%)	4.3%	4.0%

Business risk

The business risk profile of the sugar sector is considered high given the inherent cyclicality in crop levels and raw material prices. Moreover, distortion in the pricing mechanism of raw material prices and refined sugar also creates challenges for sugar mills. Given the decline in area under cultivation in MY19 and the ongoing year, sugar production has declined and prices have trended upwards. However, increase in profitability is expected to be limited (barring those players that have sizeable carryover stock) due to significant jump in sugar cane prices and decline in recovery ratio (Tiddi Dal pest attack) in the ongoing year. Business risk profile draws support from diversification in revenue streams achieved through forward integration into co-generation segment which has consistently contributed to profitability over the years. While the crushing season has largely ended, disruption in operations/sales due to coronavirus outbreak remains a business risk factor.

Financial Profile

Sales Mix

Net sales of the company grew by 59.7% during the outgoing year (FY19: Rs. 13.2b: FY18: Rs. 8.3b). Higher revenues were on account of volumetric growth coupled with increase in average selling price. During the outgoing year, sugar export quota was reduced resulting in a decline in quantity exported. Going forward, DSML sugar sales are expected to decline on account of lower production (decline in recovery ratio and lower availability of sugar cane).

	Unit	MY18		MY19	
Annual volume of sugar sold:			%		%
Local	Tons	148,405	89.0%	237,107	96.0%
Export	Tons	18,336	11.0%	10,000	4.0%
		166,741	100.0%	247,107	100.0%

Profitability

Gross profit margin of the company has trended upwards during the outgoing year (MY19: 13.3%; MY18: 2.0%). Significant improvement in gross margin can be mainly attributed to growth in volumetric sales coupled with increase in selling prices. Despite higher finance cost, net profit of DSML was reported at Rs. 0.9b (MY18: Rs.-0.5b) during MY19. Growth in net profit is attributable to increase in quantity sold, improvement in margins and higher other income. While sugar cane procurement cost is on the lower side vis-à-vis other players in the sector reflecting efficient procurement, profitability for MY20 will be a function of higher sugar cane procurement cost relative to MY19, relatively low carryover stock (which is at low cost), lower recovery ratio vis-à-vis preceding year and higher average sugar prices in MY20 vis-à-vis MY19.

Liquidity

Funds From Operations (FFO) has increased significantly on back of growth in profitability. Healthy cash flow generation has resulted in improvement in debt servicing ability as reflected by a debt servicing coverage ratio of 1.4x (MY18: 0.4x) for MY19. Current ratio of the company was reported at 1.03x (MY18: 1.00x) at end-MY19. Given the reprofiling of long-term debt, debt servicing capacity is expected to remain comfortable over the rating horizon.

Capitalization

Equity base (excluding revaluation) of the company has grown to Rs. 2.7b (MY18: Rs. 1.8b) at end-MY19 on the back of profit retention. DSML's total debt amounted to Rs. 3.7b (MY18: Rs. 7.8b) at end-MY19. The decline in total debt is a combination of reduction in both short and long term borrowing. Nearly, three-fifth of the total debt is long term debt for BMR. The remaining quantum of total debt comprises short-term funding for working capital requirement and has declined considerably (MY19: Rs. 1.5b; MY18: Rs. 4.9) due to lower stock levels. Leverage indicators have improved considerably on a timeline basis. Gearing and leverage ratio stood at 1.4x (MY18: 4.3x) and 1.8x (MY18: 5.0x), respectively at end-MY19.

Financial Summary (amounts in PKR millions)			Appendix I
	MY17	**MY18**	**MY19**
BALANCE SHEET			
Property Plant and Equipment	3,556.0	3,603.4	3,490.8
Other non-current assets	577.3	545.2	634.2
Stock-in-Trade	3,392.0	4,522.9	613.4
Trade Debts	353.6	790.0	1,098.5
Cash & Bank Balances	33.7	16.2	11.1
Total Assets	8,396.9	10,848.3	7,757.6
Trade and Other Payables	948.9	373.7	464.5
Long Term Debt (including current maturity)	608.0	2,870.0	2,261.3
Short Term Debt	4,430.9	4,938.0	1,464.1
Total Debt	5,038.9	7,808.0	3,725.4
Total Liabilities	6,038.9	9,037.8	5,018.9
Paid Up-Capital	1,050.0	1,050.0	1,050.0
Total Equity (without surplus revaluation)	2,358.0	1,810.5	2,738.7
INCOME STATEMENT			
Net Sales	7,481.4	8,259.1	13,189.1
Gross Profit	476.3	161.2	1,754.8
Profit Before Tax	54.3	(390.6)	993.8
Profit After Tax	115.8	(547.5)	928.2
RATIO ANALYSIS			
Gross Margin (%)	6.4%	2.0%	13.3%
Net Profit Margin	1.5%	-6.6%	7.0%
Net Working Capital	(1,405.3)	(32.8)	119.9
Current Ratio	0.75	1.00	1.03
FFO	107.8	(174.3)	1,180.5
FFO to Total Debt (%)	2.1%	-2.2%	31.7%
FFO to Long Term Debt (%)	17.7%	-6.1%	52.2%
Debt Servicing Coverage Ratio (x)	0.4	0.4	1.4
ROAA (%)	1.8%	-5.7%	10.0%
ROAE (%)	5.0%	-26.3%	40.8%
Gearing (x)	2.1	4.3	1.4
Leverage (x)	2.6	5.0	1.8

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: 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	Deharki Sugar Mills (Private) Limited
Sector	Sugar
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see 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				
27/04/2020	A-	A-2	Stable	Reaffirmed
13/03/2019	A-	A-2	Stable	Downgrade
04/13/2017	A	A-2	Stable	Upgrade
06/08/2016	A-	A-2	Stable	Initial

Due Diligence Meetings Conducted

	Name	Designation	Date
1	Mr. Muhammad Jaffar	Senior Manager Accounts	03/10/20
2	Mr. Muhammad Ashar	Assistant Manager Accounts	03/10/20