RATING REPORT

Deharki Sugar Mills (Private) Limited

REPORT DATE:
July 27, 2021

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 Action	Reaffirmed		Reaffirmed	
Rating Date	*27th July'21*		*27th April'20*	

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 **Chief Executive Officer:** Mr. Raheal Masud
Key Shareholders (with stake 5% or more):	
JDW Sugar Mills Limited – 100%	

APPLICABLE METHODOLOGY(IES)
Applicable Rating Criteria: Corporates (April, 2019) ***http://vis.com.pk/kc-meth.aspx***

Deharki Sugar Mills (Private) Limited

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

Installed sugarcane crushing capacity of the company stands at around 13,000 MT per day. During MY21, the mill operated for 110 days (MY20: 99 days) primarily due early start of crushing season and increase in the sugarcane crop production in the adjacent areas. The company crushed 1.27m MT (MY20: 1.22m MT) of sugarcane during the season at a capacity utilization of 65.1% (MY20: 62.6%). Overall sugar production increased steadily to 125,757 MT (MY20: 122,831 MT) as the impact of higher crushing was partially offset by lower sucrose recovery rate of 9.90% (MY20: 10.06%). Going forward, the forecasted increase in sugarcane crop to 83m MT is expected to bode well for the company in terms of sugar production during MY22.

	MY20	MY21
Capacity per day (MT)	13,000	13,000
Crushing Period (Days)	99	110
Total Crushing Capacity (MT)	1,950,000	1,950,000
Cane Crushed (MT)	1,220,644	1,270,152
Capacity Utilization (%)	62.60%	65.14%
Sugar Production (MT)	122,831	125,757
Recovery Ratio (%)	10.06%	9.90%
Molasses Produced (MT)	55,253	59,724
Molasses Recovery (%)	4.53%	4.63%

Business Risk

Risk profile of sugar sector is considered high given inherent cyclicality in the crop levels and raw material prices. Moreover, distortion in pricing mechanism of raw material prices and refined sugar also creates challenge for sugar mills. Typically, sugarcane production has a 3-to-5 year cycle, driven largely by government support for farmers and crop yield. Sugarcane production has increased by 22% to 81m MT on account of increase in area under cultivation and improvement in crop yield during MY21. Based on around 78% crushing and an average recovery rate of 10.2%, the sector has produced 5.62m MT of sugar in MY21. Meanwhile, sugar demand is projected at 5.9m MT for the period. While narrow demand and supply dynamics may lead to high sugar prices, government may intervene by importing sugar in order to control prices. Meanwhile, margins may also be curtailed by increasing trend in sugarcane prices. During MY21, sugarcane procurement prices have been recorded as high as Rs. 350 per mound in Punjab and Rs. 275 per mound in Sindh against the minimum support price of Rs. 200 per mound and Rs. 202 per mound in respective provinces. However, sector's risk profile draws support from diversification into distillery, power and steel segments.

Recovery in revenue and profitability supported by increase in volumetric sales and selling price

Net revenue of the company was decreased to Rs. 8.8b (MY19: Rs. 13.2b) as the impact of increase in sugar price was more than offset by lower volumetric sales during MY20. Revenue from sugar sales amounted to Rs. 7.0b (MY19: Rs. 11.7b) with lower volumetric dispatches of 120,408 MT (MY19: 247,107 MT) at a higher average selling price of Rs. 58.4/kg (MY19: Rs. 47.6/kg) during MY20. Revenue from molasses increased to Rs. 820m (MY19: Rs. 513m) due to higher selling price in the international market, bagasse revenue amounted to Rs. 657m (MY19: Rs. 582m) while revenue from agri inputs was recorded at Rs. 286m (MY19: Rs. 424m) during the outgoing year.

Cost of sales also declined to Rs. 7.8b (MY19: Rs. 11.4b) due to lower crushing during MY20, though the average sugarcane procurement price was recorded higher at Rs. 215/mound (MY19: Rs. 183/mound). Resultantly, gross profit was reported lower at Rs. 1.0b (MY19: Rs. 1.8b) with the decrease in gross margins to 11.4% (MY19: 13.3%) during MY21. Administrative expenses increased to Rs. 278m (MY19: Rs. 170m) mainly on account of higher staff salaries & benefits. Other expenses amounted to Rs. 132m (MY19: Rs. 136m) which mainly pertained to impairment of sugar export subsidy of Rs. 99m (MY19: nil), workers' profit participation expense of Rs. 23m (MY19: 55m) and workers welfare expense of Rs. 9m (MY19: Rs. 20m). Meanwhile, other income increased to Rs. 442m (MY19: Rs. 321m) primarily due to higher markup income on advance to group companies with markup ranging 8.05% to 14.86% (FY19: 9.44% to 13.53%). The company incurred finance cost of Rs. 598m (MY19: Rs. 769m). Net profit declined to Rs. 161m (MY19: Rs. 928m) with a lower net margin of 1.8% (MY19: 7.0%).

During HY21, net revenue of the company increased to Rs. 6.0b (HY20: Rs. 4.7b), driven primarily by sugar volume sales of 69,928 MT at a higher average selling price of Rs. 67.8/kg and molasses volume sales of 59,724 MT at an average selling price of Rs. 16,316/MT. Cost of sales also increased to Rs. 5.3b (HY20: Rs. 4.2b) owing to higher volumes crushed and increase in average sugarcane procurement price of Rs. 258/mound during HY21. Gross profit was reported higher at Rs. 785m (HY20: Rs. 410m) with higher gross margins of 13% (HY20: 8.8%). Finance cost stood lower to Rs. 209m (HY20: Rs. 323m) due to decrease in average interest rates. Accounting for taxation, the company reported net profit of Rs. 200m (HY20: Rs. 41m) with improved net margins of 3.3% (HY20: 0.9%) during HY21.

Liquidity profile has room for improvement while debt repayment capacity remains adequate
In line with the profits, funds from operations (FFO) declined to Rs. 460m (MY19: Rs. 1.2b) in MY20 and amounted to Rs. 269m in HY21. Despite pressure on cash flows, the company's capacity to meet its financial obligations remained adequate as reflected in the debt service coverage ratio of 2.0x (MY20: 0.5x). However, FFO-to-total debt ratio stood lower at 0.08x (MY20: 0.13x) due to increase in debt levels by end-HY21. Current ratio stood at 1.25x (MY20: 1.35x) with adequate inventory & receivables in relation to short-term borrowings.

Increase in leverage indicators due to higher debt levels mainly due to seasonality factor
Equity base of the company has augmented to Rs. 3.1b (MY20: Rs. 2.9b) by end-HY1 on account of profits retention. DSML's total debt stood higher at Rs. 6.5b (MY20: Rs. 3.4b) owing to increase in short-term borrowings to Rs. 3.8b (MY20: Rs. 992m) for elevated working capital requirements towards the end of crushing season and increase in long-term borrowings to Rs. 2.7b (MY20: Rs. 2.4b) due to mobilization borrowings of Rs. 307m (MY20: Rs. 1.7b), out of which Rs. 56m pertained to payment of wages & salaries and remaining for re-profiling of previous loans. Due to higher debt levels, gearing and leverage ratios stood at 2.09x (MY20: 1.18x) and 2.83x (MY20: 2.05x), respectively at end-HY21. With the sale of sugar stock, gearing is expected to decrease by end-MY21.

Deharki Sugar Mills (Private) Limited **Annexure I**

FINANCIAL SUMMARY *(amounts in PKR millions)*			
BALANCE SHEET	**MY19**	**MY20**	**HY21**
Property Plant and Equipment	3,491	3,338	3,257
Investment Property	539	539	539
Investment in Associate	12	-	-
Stock-in-Trade	613	724	4,589
Trade Debts	1,098	291	374
Advances, Deposits, and Other Receivables	1,653	3,426	2,572
Short-term Investment	-	12	12
Cash & Bank Balances	11	188	201
Other Assets	341	311	335
Total Assets	**7,758**	**8,829**	**11,879**
Trade and Other Payables	465	569	740
Advances from Customers	737	1,837	1,465
Long-Term Debt *(including current maturity)*	2,261	2,432	2,683
Short-Term Debt	1,464	992	3,799
Total Debt	3,725	3,424	6,482
Other Liabilities	92	100	92
Total Liabilities	5,019	5,930	8,779
Tier-I/Total Equity	**2,739**	**2,900**	**3,100**
Paid Up-Capital	1,050	1,050	1,050
INCOME STATEMENT	**MY19**	**MY20**	**HY21**
Net Sales	13,189	8,793	6,045
Gross Profit	1,755	1,006	785
Finance Cost	769	598	206
Profit Before Tax	994	434	226
Profit (Loss) After Tax	928	161	200
FFO	1,180	460	269
RATIO ANALYSIS	**MY19**	**MY20**	**HY21**
Gross Margin (%)	13.3	11.4	13.0
Net Profit Margin (%)	7.0	1.8	3.3
Net Working Capital	120	1,291	1,603
Current Ratio (x)	1.03	1.35	1.25
FFO to Long-Term Debt (x)	0.52	0.19	0.20*
FFO to Total Debt (x)	0.32	0.13	0.08*
Debt Servicing Coverage Ratio (x)	1.40	0.50	1.99
Gearing (x)	1.36	1.18	2.09
Leverage (x)	1.83	2.05	2.83
Inventory plus Receivables/Short-term Borrowings	1.17	1.02	1.31

**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: 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 Ratings

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
27/07/2021	A-	A-2	Stable	Reaffirmed
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

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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Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Ali Saeed	Sr. GM Accounts	June 15, 2021
Mr. Muhammad Jaffar	Sr. Manager Accounts	June 15, 2021