RATING REPORT

Madina Sugar Mills Limited (MSML)

REPORT DATE:
July 31, 2019

RATING ANALYSTS:
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RATING DETAILS				
	Latest Rating		Previous Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	A-	A-2	A-	A-2
Rating Date	*July 24, 2019*		*June 29, 2018*	
Rating Outlook	Stable		Stable	

COMPANY INFORMATION	
Incorporated in 2007	External auditors: Kreston Hyder Bhimji & Co. Chartered Accountants
Public Limited Company – Unquoted	Chairman of the Board/CEO: Mian Muhammad Hanif
Key Shareholders (with stake 5% or more):	
Mian Muhammad Usman Saleem – 36.47%	
Faisalabad Oil Refinery (Pvt.) Ltd. – 36.34%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: Corporates (May 2016) **https://www.vis.com.pk/kc-meth.aspx**

OVERVIEW OF THE INSTITUTION

Madina Sugar Mills Limited (MSML) was incorporated in 2007. The principal activity is production and sale of white crystalline sugar and ethanol.

Profile of the Chairman/CEO

Mr. Mian Muhammad Hanif has more than 25 years of experience in edible oils, sugar, steel, and education sectors. He is also acting chairman of Pakistan Edible Oils Refiners Association.

Financial Snapshot

Total Equity: end-FY18: Rs. 5.8b; end-FY17: Rs. 5.4b; end-FY16: Rs. 4.7b

Assets: end-FY18: Rs. 12.0b; end-FY17: Rs. 9.7b; end-FY16: Rs. 8.5b

Profit After Tax: FY18: Rs. 324.7m; FY17: Rs. 370.1m; FY16: Rs. 221.6m

RATING RATIONALE

The ratings assigned to MSML take into account its association with Madinah Group, having business stake in various sectors encompassing edible oils, sugar, ethanol, power generation, mass media and steel. The assigned ratings take into account positive momentum in sales and enhanced diversification in ethanol business to curtail the cyclicality in sugar sector. Further, the ratings derive strength from positive impetus in profitability, sound coverages and adequate liquidity profile. The ratings also incorporate minimal reliance of the company on long-term financing, therefore gearing and leverage indicators have remained at comfortable levels, supported by growth in equity. However, the ratings remained constrained due to inherent business risk present in sugar sector leading to depressed sugar prices.

Production and Capacity Utilization: Following the enhancement of sugarcane crushing capacity during FY17, total crushing capacity increased to 2.1m M.T based on 150 days crushing. However, in the backdrop of slump in sugar sector, the company has reduced the production of sugar, accordingly, the sugar unit remained operational for 131 days (FY17: 153 days), resulting in decrease in total actual crushing to 1.08m M.T (FY17: 1.21m M.T) during the review period. The sucrose recovery rate stood lower at 9.52% as compared to 9.57% in the preceding year.

The capacity of distillery unit increased to 200 M.T per day (FY17: 100 M.T per day) on account of addition of distillery unit-II in October'18. As a result of enhanced capacity, total ethanol production stood higher at 61,972 M.T (FY17: 31,018 M.T) during FY18, while the capacity utilization stood at 94% (FY17: 95%). As per management, distillery unit-III with a capacity of 125,000 liters per day, has been added, the same has started production during March'19. Further, due to installation of new Falling Film Evaporators (FFE), 25% more bagasse was saved as compared to previous season, which may reduce fuel cost going forward.

Augmentation in sales supported by diversified revenue stream: During FY18, company's net sales stood higher at Rs. 9.5b (FY17: Rs. 7.2b; FY16: Rs. 4.6b). Albeit sugar sales have remained the major revenue driver, the contribution of the same has notably decreased to 54.2% from 81.4% in the preceding year. On the other hand, contribution of ethanol to the total sales mix has increased to 45.6% (FY17: 18.5%) during FY18. No export revenue was generated from sale of sugar during FY18 as compared to Rs. 136.2m in preceding year. However, the export revenue emanating from sale of ethanol has increased to Rs. 4.5b (FY17: Rs. 1.4b) during outgoing year. Moreover, export sales solely constitute ethanol sales of which 68% export revenue originated from Asia and 32% from Europe (FY17: 92% and 8% respectively) during FY18.

Given surplus supply of sugar, local retail prices driven by market demand and supply dynamics, have remained depressed. Meanwhile, average selling price decreased to Rs. 51.14 per kg (FY17: Rs. 51.27 per kg) during FY18, however, the same has increased to Rs. 59.57 per kg till May'19. Given that company reduced the sugar production and offloaded the withheld inventory, cost of sales decreased to Rs. 4.4b (FY17: Rs. 5.6b), resulting in improvement in margins to 10.2% (FY17: 2.9%) during FY18. Meanwhile, on account of lower production of molasses consistent with lower sugar production, around 90% of the total molasses requirement was fulfilled by external sources, which lead to a substantial increase in cost of sales to Rs. 4.0b (FY17: Rs. 871.9m) attributable to ethanol production. Accordingly, gross margins from ethanol sales decreased notably to 12.8%

(FY17: 39%) during FY18. Overall profitability improved as gross margins stood higher at 11.5% (FY17: 10.2%). Further, foreign exchange gain arising out of ethanol sales amounting to Rs. 84.9m (FY17: Rs. 1.17m) has provided impetus to bottom-line. However, net margins declined on account of elevated finance cost resulting from increased short term borrowings along with higher taxation.

Adequate liquidity supported by healthy cash flows in relation to outstanding obligations: Overall liquidity profile has remained intact. Despite reduced profitability, FFO increased during FY18 in line with higher non-cash adjustments made during the year. The tax expense was recorded lower during the review period, as the company has carried forward tax rebate amounting to Rs. 556.3m (FY17: Rs. 218.6m) and carried forward unused tax losses amounting to Rs. 809.7m (FY17: 1011.3m). Further FFO to long term debt was sizeable as a result of relatively lower reliance on long term financing. On the other hand, in line with higher utilization of short term borrowings, FFO to total debt stood slightly lower at end-FY18. Stock in trade was recorded higher due to accumulation of sugar in finished goods inventory. Trade and other payables stood lower as the same were financed through short term borrowings. Advances, prepayments and other receivables stood higher mainly on account of higher advances made to suppliers and security deposits made to deputy registrar on account of the levy of tax duty on manufacturing of ethanol. Trade debts have decreased during the outgoing year due to higher recoveries. Moreover, nearly three-fourth of the receivables fall due within three months. Debt service coverage ratio improved on timeline basis on back of increase in Funds from Operations (FFO). Capex amounting to Rs. 1.1b was made during FY18, which majorly entailed addition of a distillery plant- Unit II. Another distillery Unit-III costing Rs. 500m has been added during ongoing year. According to management, additional capex of Rs. 200m pertains to a boiler which will be added by the end-FY19. The aforementioned capex is primarily funded by own sources. Going forward, the management plans to add boilers and machinery in line with increase in business operations.

Augmentation in equity on back of profit retention: Equity base has steadily strengthened on back of profit retention and equity injection by sponsoring directors and associated company, *Faisalabad Oil Refinery (Pvt.) Limited (FORL),* in the form of deposit for purchase of shares. FORL has increased its stake to 36.3% (FY17: 31.2%) in MSML, in respect of which it has made an additional investment of Rs. 292m. during FY18. Meanwhile, sponsors injected further capital in the form of deposit for purchase of shares amounting to Rs. 635.0m to meet capex and working capital requirements. The same will be converted into share capital of the company after compliance of legal formalities in this regard have been finalized. However, loan from directors amounting to Rs. 873.2m was repaid during the year under review. MSML has total available short term credit lines of Rs. 9.3b out of which Rs. 5.7b pertains to short term running finance. Total short term borrowings stood higher at Rs. 5.5b (FY17: Rs. 3.1b) in line with increase in working capital requirements. Cash finance amounting to Rs. 1.5b was availed to finance the procurement of sugar cane and molasses. Mark up on such facilities was payable quarterly at rate of 3-months KIBOR+ 0.25%. In line with higher debt levels, albeit gearing and leverage indicators have increased, the same stood at acceptable levels at 1.04x and 1.07x (FY17: 0.66x & 0.80x) respectively by end-FY18, on back of augmentation in equity.

Internal Audit & IT: An internal audit team of 8 employees oversees the audit related matters on group level. The company uses ERP platform with integrated modules and other applications to manage its business processes.

Corporate Governance: The Board of Directors of MSML comprises four members, all being the family members of the sponsoring family. The senior management team comprises well experienced staff who plays an active role in establishing the future strategy. The corporate governance framework of the company has significant room for improvement.

FINANCIAL SUMMARY *(amounts in PKR millions)*

BALANCE SHEET	Sep 30, 2016	Sep 30, 2017	Sep 30, 2018
Non-Current Assets	5,734.5	6,403.4	6,893.9
Stock-in-Trade	2,112.4	2,347.9	3,735.0
Trade Debts	201.9	268.9	210.4
Cash & Bank Balances	53.6	6.4	101.3
Total Assets	8,506.2	9,702.1	11,957.3
Trade and Other Payables	228.8	286.2	56.7
Short Term Borrowings	2,667.5	3,093.9	5,501.8
Long-Term Borrowings *(Inc. current maturity)*	783.9	845.0	507.4
Tier-1 Equity/ Total Equity	4,677.3	5,398.4	5,774.9
INCOME STATEMENT	**Sep 30, 2016**	**Sep 30, 2017**	**Sep 30, 2018**
Net Sales	4,558.5	7,163.4	9,461.3
Gross Profit	687.0	729.9	1,087.8
Operating Profit	491.9	572.6	822.9
Profit After Tax	221.6	370.1	325.9
FFO	498.9	682.8	1,044.7
RATIO ANALYSIS	**Sep 30, 2016**	**Sep 30, 2017**	**Sep 30, 2018**
Gross Margin (%)	15.1	10.2	11.5
Net Working Capital	-458.4	-507.5	-870.9
Current Ratio (x)	0.86	0.87	0.85
FFO to Long-Term Debt(x)	0.98	1.48	2.06
FFO to Total Debt (x)	0.16	0.19	0.17
Debt Servicing Coverage Ratio (x)	1.54	1.76	1.90
ROAA (%)	2.8	4.1	3.0
ROAE (%)	5.1	7.3	5.8
Gearing (x)	0.68	0.66	1.04
Debt Leverage (x)	0.82	0.80	1.07

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	Madina Sugar Mills Limited
Sector	Consumer Goods
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
July 31, 2019	A-	A-2	Stable	Reaffirmed
June 29, 2018	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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