RATING REPORT

Madina Sugar Mills Limited

REPORT DATE:
June 16, 2023

RATING ANALYSTS:
Abdul Kadir
kadir@vis.com.pk

Tayyaba Ijaz, CFA
tayyaba.ijaz@vis.com.pk

RATING DETAILS				
	Latest Rating		Previous Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	A-	A-2	A-	A-2
Rating Action	Reaffirmed		Reaffirmed	
Rating Outlook	Stable		Stable	
Rating Date	*June 16, 2023*		*Feb 24, 2022*	

COMPANY INFORMATION	
Incorporated in 2007	**External auditors:** Kreston Hyder Bhimji & Co. Chartered Accountants
Public Limited Company – Unquoted	**Chairman:** Mian Muhammad Hanif
Key Shareholders (with stake 5% or more):	**CEO:** Hassan Ahmad
Faisalabad Oil Refinery (Pvt.) Limited – 31.05% Mian Muhammad Hassan Rashid – 29.42% Mian Muhammad Mujtaba Rashid – 17.55% Mian Muhammad Rashid – 10.57% Mrs. Arooj Fatima – 8.86% Miss Mehar Fatima – 1.51% Miss Hira Fatima – 1.03%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: *Corporates (MAY 2023)*
https://docs.vis.com.pk/docs/CorporateMethodology.pdf

VIS Rating Scale
https://docs.vis.com.pk/docs/ratingscale.pdf

OVERVIEW OF THE INSTITUTION

Madina Sugar MillsLimited (MSML) was incorporated in 2007. Theprincipal activity is production and sale of white crystalline sugar and ethanol.

Profile of Chairman

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-MY22: Rs. 8.1b; end-MY21: Rs. 7.2b; end-FY20: Rs. 6.9b.

Assets: end-MY22: Rs. 16.9b; end-MY21: Rs. 14.3b; end-MY20: Rs. 14.2b.

Net Profit: MY22: Rs. 860m; Rs. MY21: Rs. 305m; MY19: Rs. 204m.

RATING RATIONALE

The ratings assigned to MSML take into account its association with Madinah Group, having business interests in various sectors encompassing edible oils, sugar, ethanol, power generation,mass media and steel. The assigned ratings also factor in diversification by the company into ethanol business to curtail the impact of sugar sector cyclicality. The company is also in process of establishment of steel unit in order to capitalize on in-house bagasse and steam production to further diversify its operations. During MY22, net revenues exhibited notable growth largely driven by augmentation in sale of ethanol on account of higher volumetric sales and average selling prices, along with significant increase in quantity of sugar sold. Average sugar prices, on the other hand, have remained suppressed owing to excess sugar stocks available in the country and Government intervention to control sugar prices. During MY22, overall gross margins decreased slightly as an outcome of lower profitability in sugar segment largely underpinned by higher raw material cost relative to average selling prices, despite notable improvement in ethanol margins largely driven by economies of scale and favorable prices in the export market. Liquidity profile of the company is underpinned by adequate debt service coverage and working capital management. The leverage indicators have remained at quite comfortable level despite increase in overall debt levels by end-MY22. The overall risk profile of the company is expected to improve further when the steel billets plant become operational in Jul'23. The ratings will remain dependent on realizing projected growth in revenues and profitability along with maintaining liquidity and capitalization indicators at manageable levels.

Rating Drivers:
Business Risk

Business Risk & Sector Update: Pakistan is the seventh-largest producer and the fifth-largest consumer of sugar. According to the Economic Survey of Pakistan, sugar industry is the country's second-largest agro-based business after the textile industry. In terms of sugarcane production, Punjab produces 67% of the sugarcane, followed by Sindh (25%), Khyber Pakhtunkhwa (KPK) (8%), and Baluchistan (less than 1%). Its production contributes 0.8% to GDP and 3.7% to agriculture's value addition. The country has the capacity to raise production by 4.0 million tons and export USD 2.0b worth of sugar and USD 500m worth of ethanol by using the same land but raising yields by 40 to 50 percent. According to the data collected by the Ministry of Food Security, through September 30, 2022, at least 5.3 million metric tons (MT) of sugar has been removed from inventories or has been consumed. The volume of sugar consumed each day is around 15,980 tons. More than 1.7m MT surplus sugar was available at the start of crushing season MY23. Additionally, exporting this surplus sugar would have generated USD 1.0b in foreign currency. During CY22, almost 33% of the 22 million hectares of total cultivable land were inundated by flood while damage to the sugarcane crops resulted in a loss of USD 273m. On aggregate, direct losses from rice, cotton, and sugarcane were USD 1.30b (rice: USD 543m, cotton: USD 485m, and sugarcane: USD 273m).

The inherent cyclicality in crop yields and raw material prices is believed to have a substantial impact on the business risk profile of the sugar sector. Furthermore, there is a noticeable difference in pricing mechanisms, with the price of the end product, granulated sugar, being set by market forces whereas the cost of sugarcane is being regulated. A typical sugarcane crop has a 3- to 5-year production cycle, with government assistance to farmers and crop productivity playing a major role. In 2022-23 season, the crushing season took off a bit late owing to disagreement between PSMA, which represents the sugar mill owners, and Government of Pakistan, to allow export of 2 million tons of sugar, to cover for the higher costs associated with producing sugar and pulling the industry out of crisis.

According to the most recent USDA semi-annual sugar report, due to the damage brought on by the flood, the estimated harvested area is to contract by 4.7% to 1.23 million hectares. As a result, the forecast sugarcane output in 2022–2023 has decreased to 82.4 million tons (2021-22: 89 million tons-2020-21: 81 million tons). Sugar output in 2022–2023 is also expected to be reduced to 7.0 million metric tons (MT). Meanwhile, due to population growth and demand from the developing food processing industry, sugar consumption is projected to rise by around 3% to 6.1 MT in 2022–2023.

Despite expected modest reduction in output, the Government has approved 250,000 tons on January 30, 2023 for the three provinces of Pakistan (Quota based) in the backdrop of accumulating sugar stocks. Recently, sugar prices have shown rising trend in line with inflationary pressure. Sugar prices are expected to reach around Rs. 140 per kg which would benefit the industry players in realizing inventory gains and increase in gross margins. However, elevated markup rates would likely suppress the bottom line of companies with high leveraged capital structure.

Production and capacity utilization

During MY22, MSML underwent expansion in its operations, entailing increase in sugarcane crushing capacity to 20,000 tpd (MY21: 16,000 tpd) while ethanol capacity remained intact at 300 MT per day. During the 2022- 23 crushing season, the mill remained operational for 99 days from November 25, 2022 to March 3, 2023. The preceding crushing season lasted for 136 days owing to bumper crop; meanwhile, there was a reduction in the cane yield in the 2022-23 season. Accordingly, the cane crushed by the company stood lower at 1.56m tons with a YoY shortfall of 25.4%. Sucrose recovery rate fell to 9.20% (MY22: 9.56%) primarily owing to cane quality. In the 2022-23 season, as a result sugar production declined to 143.4K MT (2021-22: 200.0K MT; 2020-21: 145.7K MT); during 2021-22 season, augmentation in sugar output was on account of higher crushing in line with increase in capacity, higher cane availability and some improvement in sucrose recovery rate.

On the other hand, molasses production during 2022-23 increased by around 4% owing to the improvement in molasses recovery rate to 7.2% (MY22: 5.2%). Molasses production has been on the rise in the recent years due to enhanced focus to reduce dependence on outsourced material for distillery operations. During 150 days of operations in the ongoing year, ethanol production amounted to 40,479 MT per day (MY22: 74,362 MT). Capacity utilization is up to a staggering 99% (MY22: 91.3%) hence full potential of ethanol is being tapped into. A snapshot of sugar and ethanol production and capacity utilization is presented below:

Crushing Season	2020-21	2021-22	2022-23
Crushing Capacity (TPD)	16,000	20,000	20,000
Cane Crushed (Tons)	1,523,662	2,092,350	1,560,944
Crushing Days	116	136	99
Capacity Utilization (%)	82.1	76.9	78.84
Sucrose Recovery Rate (%)	9.56	9.56	9.2
Sugar Produced (Tons)	145,650	200,044	143,391
Molasses Recovery Rate (%)	5.06	5.18	7.22
Molasses Produced (Tons)	77,115	108,425	112,610
Molasses Purchased (Tons)	77,206	217,376	40,000
	MY21	**MY22**	**1HMY23**
Ethanol Capacity (TPD)	300	300	300
Ethanol Production (Tons)	35,104	74,362	40,479
Ethanol Recovery Rate (%)	22.72	22.76	22.9
Capacity Utilization (%)	56.2	90.8	90.0
Operations Days	208	273	150

Steel unit expected to become operational by end-Jul 2023:

In order to capitalize on in-house bagasse and steam production and further diversify business risk, the company has embarked on establishment of steel unit comprising two induction furnaces, each having melting capacity of 15 tons per hour, and a rolling mill having capacity of 30 tons per hour. In-house bagasse produced by the company is used to generate steam from water evaporation process, which would be utilized to generate electricity to run the steel plant for up to 250 days of the year. The complete machinery has been imported from China, and the plant is expected to become operational by end-July 2023. Total project cost is estimated at Rs. 1.5b out of which Rs. 1.2b has already been expensed by end-Mar'23. This includes Rs. 200m spent on civil work for the steel unit's building, Rs. 766m on plant & machinery and Rs. 243m has been paid as advances for plant & machinery; this excludes cost of land which was already owned by the company. The remaining amount largely pertaining to installation cost and auxiliary local components is expected to be incurred further by the time the plant becomes operational. The project cost was initially estimated at Rs. 1.0b, however, the cost escalated owing to local currency devaluation. Around two-thirds of the project cost has been financed by long-term borrowings from the bank while the rest being financed by internal sources.

Sales and Profitability

During MY22, net sales were recorded higher at Rs. 26.5b (MY21: Rs. 16.3b) with a YoY growth of ~63% driven by increase in volumetric sales and higher average prices of ethanol along with higher quantity of sugar sold. Net revenue emanating from sugar sales amounted higher at Rs. 17.1b (MY21: Rs. 11.4b) whereas its contribution in the sales mix decreased to ~59% (MY21: 63%) in the sales mix. The company sold 207.4KMT of sugar (MY21: 133.3K MT), an increase of ~56%, whereas the average selling price of sugar was reported lower at Rs. 82,791/MT (MY21: Rs. 85,501/MT) during MY22. Sugar prices remained suppressed as a result of excess supply in the market and strict regularization of the sugar industry by the government. On the other hand, ethanol contribution in the sales mix increased to ~41% (MY21: 37%) with revenue amounting to Rs. 11.8b (MY21: Rs. 6.5b) on the back of 47% increase in quantity sold and 24% increase in average selling prices. The rupee devaluation continues to benefit the ethanol exports in terms of competitive pricing. Bagasse sales decreased to Rs. 48.7m (MY21: 84.1m) in MY22, now contributing only ~0.2% (MY21: ~0.5%) of the total revenue. Contribution of other by-products remained nominal. The company also sells packing material, comprising polypropylene bags, net sales of which amounted to Rs. 56.5m (MY21: Rs. 70.3m) during MY2. Quantity sold and average selling prices of key products is as follows:

MY21			**MY22**	
	QTY (MT)	**Price/Ton**	**QTY (MT)**	**Price/Ton**
Sugar	133,341	85,500	207,421	82,791
Ethanol	45,993	141,250	67,638	175,218
Bagasse	26,368	3,192	12,184	4,000

Cost of sales was recorded significantly higher at Rs.23.7b (MY21: Rs. 14.5b) during MY22, with increase largely manifested in higher cost associated with sugarcane and molasses purchased from third-parties, both of which accounted for nearly 93% (MY21: 90%) of the cost of goods manufactured. The company procured sugarcane at around 20% higher average cost of Rs. 326/mound (MY21: Rs. 272/mound) owing to higher premium paid over and above the support price announced by the Govt. largely owing to competition among nearby sugar mills to secure the raw material. The company reported higher gross profit of Rs. 2.8b (MY21: Rs. 1.8b) in line with increase in scale of operations while overall gross margins were slightly lower at 10.6% (MY21: 11.1%). The decrease in gross margins was the outcome of lower profitability in sugar segment largely underpinned by higher raw material cost and lower selling prices. Ethanol segment on the other hand, reported higher gross margins largely driven by economies of scale, favorable prices in the export market which more than offset the higher raw material cost. The administrative expenses amounted to Rs. 312m (MY21: Rs. 259m) were largely rationalized with inflationary pressure. The selling and distribution expenses also shot up to Rs. 483m (MY21: Rs. 228m), mainly due to the higher handling and carriage outward expense attributable to increase in ethanol exports. The company incurred financing cost of Rs. 933m (MY21: Rs. 638m), the significant increase is mainly due to increase in interest rates and increase in financing during MY22. The company reported higher net profits of Rs. 860m (MY21: Rs. 305m) while net margins improved to 3.2% (MY21: 1.9%) on the back of higher profitability in ethanol segment and foreign exchange gains on export sales, along with the impact of lower effective tax rate of 26.9% vis-à-vis 55.4% in the preceding year.

In MY23, growth in topline is expected to be largely driven by higher sugar prices and ethanol rates in export markets and some increase in volumetric sales. Resultantly, gross margins are expected to improve. Meanwhile, inflated markup rates are expected to put a drag on bottom-line during the ongoing year. Incremental revenue from steel operations is expected to support the topline and further diversify the business risk emanating from cyclicality of sugar sector.

Liquidity

During MY22, the company generated higher funds flow from operations (FFO) amounting to Rs. 1.64b (MY21: Rs. 1.50b) in line with higher profitability. However, FFO to total debt and long-term debt weakened slightly to 0.21x (MY21: 0.25x) and 0.39x (MY21: 0.50x), respectively, owing to overall increase in borrowings. Debt service coverage ratio (DSCR), albeit decreased to 1.79x (MY21: 2.83x) due to higher interest paid and principal repayments, have remained adequate.

Current ratio has remained adequate (MY22: 1.61x; MY21: 1.63x) on a timeline basis. Stores, spares, and loose items stood higher at Rs. 334m (MY21: Rs. 175m) at end-MY22, this also include items that may comprise of fixed capex. Stock in trade increased to Rs. 1.67b (MY21: Rs. 1.54b) on account of higher ethanol inventory while sugar stocks were reported lower at Rs. 702.9m (MY21: Rs. 1.3b). Trade receivables have increased significantly to Rs. 4.5b (MY21: Rs. 2.8b) which pertained to sugar sales to various parties while these have been recovered in full subsequently. Aging of receivables has remained satisfactory given sugar sales on advance or cash basis while ethanol sales being executed through sight letter of credit. Advances, deposits, prepayments, and other receivables amounted to Rs. 2.08b (MY21: Rs. 1.75b) mainly comprised of Rs. 1.67b paid to growers of sugarcane and Rs. 377.8m paid to deputy registrar of high court on account of the levy of excise duty. Coverage of short-term borrowings via stock-in-trade and receivables remained adequate at 1.47x (MY21: 1.45x) by end-MY22. The cash conversion cycle exhibited notable improvement (MY22: 68 days; MY21: 89 days) in the past few years on account of higher inventory turnover.

Capitalization

Paid up capital of the company remained unchanged at Rs. 4.4b (MY21: Rs. 4.4b) at end-MY22. Equity base augmented to Rs. 8.06b (MY21: Rs. 7.20b) on the back of profit retention. Total liabilities increased to Rs. 8.9b (MY21: Rs. 7.1b) mainly due to a significant rise in short-term and long-term financing. Total long-term loan inclusive of current portion stood higher at Rs. 3.6b (MY21: Rs. 3.0b) at end-MY22. During the outgoing year, the company made principal repayments amounting Rs. 534.6m (MY21: Rs. 132.0m) while long-term financing to the tune of Rs. 1b was mobilized to finance steel project under diminishing musharakah facility against sale and lease back. The facility carries markup payable quarterly @ 3-month KIBOR + 1% per annum. Despite the increase in overall borrowings, debt leverage and gearing have remained at comfortable level at 1.10x (MY21: 0.99x) and 0.97x (MY21: 0.83x), respectively, by end-MY22. Going forward, the company does not intend to mobilize new long-term loan, this, along with scheduled repayment of long-term loans and growth in equity base on the back of internal cash flow generation are expected to further enhance the risk absorption capacity of the company.

Regulatory matter update related to imposed penalty

The ratings have incorporated the developments in relation to penalties imposed by Competition Commission of Pakistan (CCP) on selected sugar mills and the subsequent legal proceedings initiated by the subject company. The company along with other sugar mills has challenged the order of CCP before the Lahore High Court (LHC) in a writ petition. The operation of the said order has been suspended and CCP has been restrained from recovering penalty imposed in terms of the order of the LHC dated August 13, 2021. The matter is pending adjudication before the LHC. Given uncertainty and materiality of the outcome, VIS will continue to monitor further developments in this matter.

Madina Sugar Mills Limited Annexure I

FINANCIAL SUMMARY *(amounts in PKR millions)*			
BALANCE SHEET	**MY20**	**MY21**	**MY22**
Non-Current Assets	7,619	7,422	7,797
Stores, Spares, and Loose Tools	171	175	334
Stock in Trade	3,287	1,543	1,668
Trade Debts	545	2840	4546
Advances, Deposits & Prepayments	2,031	1,752	2,077
Due from Govt.	521	540	480
Cash & Bank Balance	40	72	62
Total Assets	**14,214**	**14,345**	**16,965**
Trade & Other Payables	181	561	443
Short-Term Borrowings	6,315	3,030	4,227
Long-Term Borrowings *(Inc. current maturity)*	518	2972	3578
Directors Loan	93	0	0
Deferred Taxation	70	408	419
Other Liabilities	141	171	236
Total Liabilities	7,317	7,142	8,902
Tier-1/Total Equity	**6,897**	**7,202**	**8,063**
Paid-up Capital	4,360	4,360	4,360
INCOME STATEMENT	**MY20**	**MY21**	**MY22**
Net Revenue	12,686	16,330	26,562
Gross Profit	1,382	1,815	2,820
Finance Cost	714	638	934
Profit Before Tax	354	684	1176
Profit After Tax	204	305	860
FFO	861	1,501	1,636
RATIO ANALYSIS	MY20	MY21	MY22
Gross Margin (%)	10.9%	11.1%	10.6%
Net Margin (%)	1.6%	1.9%	3.2%
Net Working Capital	-211	2671	3458
Current Ratio (x)	0.97	1.63	1.61
FFO to Long-Term Debt (x)	1.66	0.50	0.46
FFO to Total Debt (x)	0.13	0.25	0.21
Debt Servicing Coverage Ratio (x)	1.74	2.83	1.79
Gearing (x)	0.99	0.83	0.97
Debt Leverage (x)	1.06	0.99	1.10
Receivables & Inventory/Short-term borrowings	0.61	1.45	1.47
Cash Conversion Cycle (days)	136	89	68

REGULATORY DISCLOSURES					Annexure 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		
	June 16, 2023	A-	A-2	Stable	Reaffirmed
	Feb 24, 2022	A-	A-2	Stable	Reaffirmed
	Oct 22, 2020	A-	A-2	Stable	Reaffirmed
	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 creditquality or as exact measures of the probability that a particular issuer or particular debt issue will default.				
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. For conducting this assignment, analyst did not deem necessary to contact external auditors or creditors given the unqualified nature of audited accounts and diversified creditorprofile. Copyright 2023 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.				
Due Diligence Meetings Conducted	**Name**	**Designation**	**Date**		
	Mr. Daud Shah	CFO	20 April, 2023		