RATING REPORT

Two Star Industries (Pvt.) Limited

REPORT DATE:
May 16th, 2020

RATING ANALYSTS:

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RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	BBB+	A-2	A-	A-2
Rating Outlook	Stable		Stable	
Rating Date	*May 16, 2020*		*April 22, 2019*	

COMPANY INFORMATION

Incorporated in 2016	**External auditors:** M/s Mushtaq & Co Chatered Accountants
Private Limited Company	**Chairman of the Board:** Mian Muhammad Saleem
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Muhammad Shakeel Umer
Umer Group & Associates – 50%	
RYK Group & Associates – 50%	

APPLICABLE METHODOLOGY(IES)

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

Two Star Industries (Pvt.) Limited (TSIPL)

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

TSIPL was incorporated as a private limited company in 2016 under the Companies Ordinance, 1984 (now Companies Act, 2017).

Financial Statements of the company for MY19 were audited by Mushtaq & Co. Chartered Accountants

Profile of CEO
Mr. Shakeel is the CEO and director of the company with over 37 years of experience. He has been on the board of directors of other group companies including Bhanero Textile Mills Limited, Blessed Textile Mills Limited and Faisal Spinning Mills Limited.

Two Star Industries (Pvt.) Limited (TSIPL) is co-owned by Umer Group of Companies and RYK Group. The company is principally engaged in the manufacturing and sale of sugar. Head office of the company is based in Lahore, whereas the manufacturing facility is situated in District Toba Tek Singh.

Umer Group of Companies established in 1982, has a presence in Textile, Power Generation, Footwear manufacturing/Retail, Leather manufacturing, Leather Garments, and construction activities. The overall group annual turnover stands at around $350m. RYK Group has extensive experience in the sugar sector and owns R.Y.K, Alliance, Etihad Sugar Mills. The group is primarily engaged in production & manufacturing of sugar, power generation, bagasse and molasses. Both sponsors have extensive industry experience with Umer Group being a leading player in the textile sector while RYK being one of the largest players in the sugar sector.

Operating Performance

The company's installed sugarcane crushing capacity stands at around 18,000 MT per day. During the outgoing year, the mill operated fewer days in relation to MY18 primarily due to non-availability of raw material. Recovery rate has witnessed an upward trajectory and stood at 9.70% (MY18: 9.57%) during MY19 but has declined during the ongoing crushing season to 9.4%. Overall sugar production declined by 19.1% and 22% during MY19 and MY20, respectively. In quantity terms, sugar production for the MY20 season was reported at 102,492 M.Tons.

	MY18	MY19
Total Crushing Capacity (M.Ton)	1,800,000.0	1,800,000.0
Cane Crushed (M.Ton)	1,698,598.0	1,356,644.0
Sugar Production (M.Ton)	162,514.0	131,553.0
Average Recovery %	9.57%	9.70%

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 and the resultant decline in sugar production alongwith sizeable exports, average sugar prices have increased by 19% in MY19 and 16% in the ongoing year. 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 in the ongoing year. While demand and supply dynamics are expected to result in an increase in sugar prices, significant politicization of sugar prices may cap increase in sugar prices. The recent decline in international sugar prices ($339.9/ton as of 9th April vis-à-vis average price of $413.9/ton in the month of February) is also expected to cap increase in domestic sugar prices given the threat of imports. Going forward, given the attractive prices for the farmer, area under cultivation is expected to increase from MY21 onwards.

Financial Profile

Sales Mix

Net Sales of the company declined by 24.1% during the outgoing year (FY19: Rs. 6.6b: FY18: Rs. 8.7b). More than four-fifth of the revenues pertain to the sugar segment while the remaining sales have been generated from Molasses and Bagasse. During the outgoing year, the Government reduced the export quota resulting in a decline in quantity exported.

	MY18		MY19	
Local	**Rs. In Million**	**%**	**Rs. In Million**	**%**
Sugar	2,723.3	31.3%	4,058.8	61.4%
Molasses	-	-	0.3	0.01%
Bagasse	-	-	5.5	0.1%
	2,723.3	31.3%	4,064.6	61.5%
Export				
Sugar	4,263.4	49.0%	1,814.0	27.5%
Molasses	501.2	5.8%	550.0	8.3%
Export rebate	1,216.9	14.0%	179.6	2.7%
	5,981.5	68.7%	2,543.7	38.5%
Net Sales	8,704.8	100.0%	6,608.2	100.0%

Profitability

Gross profit margin witnessed an upward trend during the outgoing year (MY19: 24.8%; MY18: 9.9%). Improvement in gross margin can be attributed to an increase in average selling prices of sugar. Despite the sizeable increase in finance cost, overall profitability improved due to an increase in revenues and improvement in margins. Net Profit of the company was reported at Rs. 100.3m (MY18: Rs. 19.3m) during MY19 but remained well below projected levels. Going forward, profitability of the company will be a function of sizeable carryover stock (at lower cost), significant increase in cost of sugar production due to higher sugar cane cost and average selling price of sugar for MY20.

Liquidity

Liquidity profile of the company is weak given low cash flow coverages, limited debt servicing cushion and current ratio being below 1(x). Fund From Operation (FFO) for the outgoing year was reported at Rs. 435.7m (MY18: Rs. 448.1) in MY19. Cash flow coverages are on the lower side given low quantum of cash generated and sizeable debt on the balance sheet. Debt servicing coverage ratio (DSCR) stood at 1.4 (x) (MY18: 1.8 (x)) during MY19. Stock in trade & trade debts represented 100% of outstanding short-term borrowings while current ratio was reported below 1(x) at end-MY19. Comfort is drawn from regulatory relief granted by SBP which the management expects to result in no principal repayments over the next 1 year.

Capitalization

Equity base (excluding revaluation) of the company stood at Rs. 2.13b (MY19: Rs. 2.1b; MY18: Rs. 2.0b) at end-1QMY20. TSIPL's total debt amounted to Rs. 11.9b (MY18: Rs. 10.6b) at end-MY19. The increase in total debt can be mainly associated with the rise in short term borrowing to fund higher stock levels. More than two-fifth of the total debt is short term borrowing mobilized for working capital needs (MY19: Rs. 5.2b; MY18: Rs. 3.9b). Long term debt has remained at a similar level and was obtained to fund acquisition of the Company. Due to the increase in total-debt of the company, gearing and leverage ratio observed an upward trend which stood at 5.7x (MY18: 3.9x) and 6.3x (MY18: 5.7x), respectively at end-MY19. Capitalization indicators are weak but are expected to depict some improvement over the rating horizon as short-term borrowings as stock levels reduce. Nevertheless, leveraging indicators will continue to remain elevated.

Financial Summary (amounts in PKR millions)				Appendix I
	MY17	**MY18**	**MY19**	**Q1MY20**
BALANCE SHEET				
Fixed Assets	826.3	8,706.0	9,059.7	9,072.4
Other non-current assets	-	458.3	433.3	422.9
Stock-in-Trade	3,105.7	3,007.7	5,067.9	4,463.3
Trade Debts	8.2	3.1	76.1	58.6
Cash & Bank Balances	10.7	6.8	17.7	73.9
Total Assets	6,313.6	13,395.3	15,236.9	14,556.7
Trade and Other Payables	413.1	535.6	809.1	1,576.1
Long Term Debt (including current maturity)	-	6,712.5	6,712.5	6,712.5
Short Term Debt	4,357.7	3,934.9	5,169.9	3,807.6
Total Debt	4,357.7	10,647.5	11,882.5	10,520.1
Total Liabilities	4,829.8	11,396.8	13,138.4	12,418.6
Paid Up-Capital	0.04	0.04	0.04	0.04
Total Equity (without surplus revaluation)	1,483.7	1,998.5	2,098.5	2,138.2
INCOME STATEMENT				
Net Sales	5,379.6	8,704.8	6,608.2	2,467.9
Gross Profit	(197.5)	859.9	1,639.5	464.2
Profit Before Tax	(452.4)	102.2	122.6	51.6
Profit After Tax	(516.3)	19.3	100.3	39.7
RATIO ANALYSIS				
Gross Margin (%)	-3.7%	9.9%	24.8%	18.8%
Net Profit Margin (%)	-9.6%	0.2%	1.5%	1.6%
Current Ratio	1.14	0.91	0.84	0.82
Net Working Capital	669.2	(425.9)	(1,133.9)	(1,093.4)
FFO (Q1'20 Annualised)	(455.8)	448.1	435.7	(152.9)
FFO to Total Debt (%)	-10.5%	4.2%	3.7%	-1.5%
FFO to Long Term Debt (%)	N/A	6.7%	6.5%	-2.3%
Debt Servicing Coverage Ratio (x)	(1.5)	1.8	1.4	0.8
ROAA (%)	-16.4%	0.2%	0.7%	1.1%
ROAE (%)	-69.6%	1.1%	4.9%	7.5%
Gearing (x)	2.9	5.3	5.7	4.9
Leverage (x)	3.3	5.7	6.3	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: 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	Two Star Industries (Pvt.) 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.
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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
05/16/2020	BBB+	A-2	Stable	Downgrade
04/22/2019	A-	A-2	Stable	Initial

Due Diligence Meetings Conducted

	Name	Designation	Date
1	Mr. Ahmad Subhani	Chief Finance Officer	07-April-2020
2	Mr. Muhammad Salim	Group Chairman	07-April-2020