RATING REPORT

Two Star Industries (Pvt.) Limited

REPORT DATE:
August 20th, 2021

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	BBB+	A-2
Rating Outlook	Stable		Stable	
Rating Date	*August 20, 2021*		*May 16, 2020*	

COMPANY INFORMATION

Incorporated in 2016	**External auditors:** M/s Mushtaq & Co Chartered 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://docs.vis.com.pk/docs/Corporate-Methodology-201904.pdf

Two Star Industries (Pvt.) Limited (TSIPL)

OVERVIEW OF THE INSTITUTION

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 MY20 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.

RATING RATIONALE

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, and SW 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 stood higher at around 1.6m MT per year. Recovery rate witnessed a downward trend and stood at 9.39% (MY19: 9.70%) during MY20 and has further declined during the ongoing crushing season to 8.91% due to impact of pesticides and white-fly incident destroying crops. Overall sugar production declined by 22% in MY20 due to lower crane crushed; however the same increased by 25% in the ongoing year due to gradual improvement in overall demand dynamics. In quantity terms, sugar production for the HY21 season was reported at 128,000 MT. Going forward, given indication of a good crop size, attractive sugarcane prices available for the farmers along with projected improvement in recovery rate, the production of sugar is likely to grow further during MY22.

	MY19	MY20
Total Crushing Capacity (M.Ton)	1,600,000.0	1,600,000.0
Cane Crushed (M.Ton)	1,356,644.0	1,091,394.0
Sugar Production (M.Ton)	131,553.0	102,492.0
Average Recovery %	9.70%	9.39%

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. However, sector's risk profile draws support from diversification into distillery, power and steel segments.

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. 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 68% 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 higher against the minimum support price of Rs. 202 per mound. However, sector's risk profile draws support from diversification into distillery, power and steel segments.

Financial Profile

Revenue of the company escalated substantially during the outgoing year due to selling of carry-overstock.

Net Sales of the company escalated by 75.5% during the outgoing year (MY20: Rs. 11.6b: MY19: Rs. 6.6b) due to selling of carry-over stock. More than four-fifth of the revenues pertain to the sugar segment while the remaining sales have been generated from Molasses, Bagasse and Mud. During the preceding year, the Government banned sugar exports resulting in a decline in quantity exported. Revenue during HY21 was recorded at Rs. 3.6b.

	MY19		MY20	
Local	**Rs. In Million**	**%**	**Rs. In Million**	**%**
Sugar	4,058.8	61.4%	9,426.1	81.6%
Molasses	0.3	0.01%	23.4	0.2%
Bagasse	5.5	0.1%	66.7	0.6%
Mud	-	0.0%	13.1	0.1%
	4,064.6	61.5%	9,519.3	82.5%
Export				
Sugar	1,814.0	27.5%	1,219.2	10.6%
Molasses	550.0	8.3%	799.5	6.9%
Export rebate	179.6	2.7%	-	0.0%
	2,543.7	38.5%	2,018.7	17.5%
Net Sales	6,608.2	100.0%	11,548.0	100.0%

Overall profitability profile depressed in MY20 largely because of reduction in gross margins attributable to inventory losses. Going forward, projected growth in profitability shall be contingent on timely selling of carry-over stock at attractive average selling prices.

Gross profit margin witnessed a downward trend during MY20 (MY20:11.0%; MY19: 24.8%) attributable to inventory losses. However, the same improved to 32.9% during 1H21 led by inventory gains on sizeable carryover stock. Due to decline in margins and exchange losses on account of return of advance export proceeds subsequent to export ban, overall net profit took a downward hit and was reported at Rs 5.0m in MY20 (MY19: Rs. 100.3m). On the flip side, owing to higher gross margins during HY21, net profit margin in HY21 was reported higher at 19.0% (MY20: 0.04%). Going forward, projected growth in profitability shall be contingent on timely selling of carry-over stock at attractive average selling prices.

Liquidity profile is considered weak due to limited cash flow coverage vis-à-vis outstanding debt obligations while working capital cycle also has room for improvement.

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 MY20 was reported at negative Rs. 85m (MY19: Rs. 435.7m) in MY20 due to higher finance charges paid than incurred. 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) further declined and stood at 0.7 (x) (MY19: 1.4 (x)) during MY20. Stock in trade & trade debts represented 80% of outstanding short-term borrowings while current ratio was reported below 1(x) at end-MY20. Around 80,000 MT of stock is held as unsold inventory at end-Mar'21, timely selling of which is contingent on price hike. Improvement in liquidity indicators is considered important from a ratings perspective.

Elevated leverage indicators vis-à-vis rating benchmarks whereas equity base witnessed an increase due to capital injection and profit retention.

Equity base (excluding revaluation) of the company stood higher at Rs. 3.3b (MY20: Rs. 2.1b; MY19: Rs. 2.1b) at end-HY21 due to profit retention. The company plans to add its seventh evaporator in the ongoing year financed through internal casflows costing around Rs. 80m. TSIPL has also planned an equity injection of Rs. 2.0b, out of which Rs. 500m has already been injected in the ongoing year for reducing long term borrowing. Remaining is expected to be received monthly over the rating horizon. TSIPL's total debt amounted to Rs. 16.0b (MY20: 8.6b; MY19: Rs. 11.9b) at end-HY21. The increase in total debt was mainly associated with the rise in short term borrowing to fund higher stock levels. More than three-fifth of the total debt is short term in nature mobilized for working capital needs (HY21: Rs. 9.4b; MY20: 2.0b; MY19: Rs. 5.2b). Long term debt has remained at a similar level and was obtained to finance acquisition of the Company. Due to the increase in total-debt of the company, gearing and leverage ratio observed an upward trend and stood higher at 4.9x (MY20: 4.1x; MY19: 5.7x) and 5.1x (MY20: 4.8x; MY19: 6.3x) respectively at end-HY21. Capitalization indicators are weak but are expected to depict some improvement over the rating horizon due to the planned equity injection and projected reduction in stock levels.

Financial Summary (amounts in PKR millions)			Appendix I		
	MY17	MY18	MY19	MY20	1H21
BALANCE SHEET					
Fixed Assets	826.3	8,706.0	9,059.7	9,045.9	9,000.2
Other non-current assets	-	458.3	433.3	411.7	397.9
Stock-in-Trade	3,105.7	3,007.7	5,067.9	1,603.5	9,578.4
Trade Debts	8.2	3.1	76.1	40.5	146.5
Cash & Bank Balances	10.7	6.8	17.7	38.1	165.5
Total Assets	6,313.6	13,395.3	15,236.9	12,163.8	20,108.7
Trade and Other Payables	413.1	535.6	809.1	1,209.4	489.0
Long Term Debt (including current maturity)	-	6,712.5	6,712.5	6,652.5	6,655.3
Short Term Debt	4,357.7	3,934.9	5,169.9	1,954.0	9,368.8
Total Debt	4,357.7	10,647.5	11,882.5	8,606.6	16,024.1
Total Liabilities	4,829.8	11,396.8	13,138.4	10,063.4	16,828.1
Paid Up-Capital	0.04	0.04	0.04	0.04	0.04
Total Equity (without surplus revaluation)	1,483.7	1,998.5	2,098.5	2,100.5	3,280.5
INCOME STATEMENT					
Net Sales	5,379.6	8,704.8	6,608.2	11,548.0	3,570.8
Gross Profit	(197.5)	859.9	1,639.5	1,266.1	1,174.2
Profit Before Tax	(452.4)	102.2	122.6	62.7	726.8
Profit After Tax	(516.3)	19.3	100.3	5.0	680.1
RATIO ANALYSIS					
Gross Margin (%)	-3.7%	9.9%	24.8%	11.0%	32.9%
Net Profit Margin (%)	-9.6%	0.2%	1.5%	0.0%	19.0%
Current Ratio	1.14	0.91	0.84	0.72	1.02
Net Working Capital	669.2	(425.9)	(1,133.9)	(1,033.3)	230.1
FFO	(455.8)	448.1	435.7	(85.0)	825.6
FFO to Total Debt (%)	-10.5%	4.2%	3.7%	-1.0%	10.3%
FFO to Long Term Debt (%)	N/A	6.7%	6.5%	-1.3%	24.8%
Debt Servicing Coverage Ratio (x)	(1.5)	1.8	1.4	0.7	2.1
ROAA (%)	-16.4%	0.2%	0.7%	0.0%	8.4%
ROAE (%)	-69.6%	1.1%	4.9%	0.2%	50.6%
Gearing (x)	2.9	5.3	5.7	4.1	4.9
Leverage (x)	3.3	5.7	6.3	4.8	5.1

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
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				
08/20/2021	**BBB+**	**A-2**	**Stable**	**Reaffirmed**
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	16-July-2021
2	Mr. Anwar Hussain	Group CFO	16-July-2021