RATING REPORT

TWO STAR INDUSTRIES (PVT) LIMITED

REPORT DATE:
October 18, 2022

RATING ANALYST:

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RATING DETAILS				
Rating Category	Latest Ratings		Previous Ratings	
	Long-term	Short-term	Long-term	Short-term
Entity	BBB+	A-2	BBB+	A-2
Rating Date	*October 18, 2022*		*August 20, 2021*	
Rating Action	Reaffirmed		Reaffirmed	
Rating Outlook	Stable		Stable	

COMPANY INFORMATION	
Incorporated in 2016	**External Auditors:** Mushtaq and Co. Chartered Accountants
Private Limited Company	**Chairman of the Board:** Mian Muhammad Saleem
Key Shareholding	**Chief Executive Officer:** Muhammad Shakeel Umer
Umer Group & Associates – 50%	
RYK Group & Associates – 50%	

APPLICABLE METHODOLOGY(IES)
Applicable Rating Criteria: Corporates (August,2021)
https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

TWO STAR INDUSTRIES (PVT) LIMITED

OVERVIEW OF THE INSTITUTION

Two Star Industries (Pvt) Limited was incorporated in November 14, 2016 under the Companies Ordinance, 1984 (now Companies Act, 2017). The principal business activity of the company is manufacturing and selling of White Refined Sugar.

Profile of CEO

Mr. Shakeel is the CEO and director of the company with over 38 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

Incorporated in 2016, Two Star Industries (Pvt) Limited ('TSIPL' or 'the Company') is co-owned by Umer Group of Companies and RYK Group. The principal business of the Company is manufacture and sale of white refined sugar. The registered office of the Company is located in Lahore, Punjab, whereas the manufacturing facility is situated in District Toba Tek Singh.

Sector Update

Table 1: Area Under Cultivation and Sugarcane Production

	Area Under Cultivation (Hect)			Production (Tonnes)		
	2018-19	**2019-20**	**2020-21**	**2018-19**	**2019-20**	**2020-21**
Punjab	710,610	643,430	776,980	44,906,310	43,346,580	57,000,000
Sindh	279,472	286,090	279,694	16,691,323	17,233,832	18,335,533
KPK	110,991	109,359	107,438	5,532,012	5,753,957	5,627,545
Baluchistan	N/A	N/A	N/A	N/A	N/A	N/A
Total	1,101,073	1,038,879	1,164,112	67,129,645	66,334,369	80,963,078

Source - PSMA

- Pakistan is the 6th largest sugar producer and 8th largest sugar consumer in the world. Sugar production is the second largest agricultural industry in Pakistan after textile. Pakistan's sugarcane production stood at ~81m MTs in MY21, up 22% YoY given expansion in area under cultivation following assurances from Government of Pakistan (GoP) of affixing Minimum Support Price (MSP) for sugarcane and higher retail price for sugar.
- Punjab has the highest sugarcane production, comprising two-third of the aggregate sugarcane output in MY21, followed by Sindh (25%), KPK (8%) and Baluchistan (<1%).

Table 2: Domestic Production, Supply and Demand of Sugar

In MT '000s	MY20	MY21	MY22*
Beginning Stocks	1920	1,685	2,752
Total Sugar Production	5,400	6,505	7,160
Total Imports	40	312	-
Total Supply	7,360	8,502	9,912
Total Exports	75	-	-
Human Domestic Consumption	5,600	5,750	5,900
Total Use	5,600	5,750	5,900
Ending Stocks	1,685	2,752	3,512
***Provisional**			

Source- USDA

- Refined sugar production increased by 20% in MY21, given further expansion in area under cultivation. Given the sugar shortfall in MY20, the GoP banned export of sugar in February 2020 on recommendations of Sugar Advisory Board (SAB) to arrest the pricing uptick. As such, there is no restriction on the import of sugar, though prior permission is required from the Economic Coordination Committee (ECC) to control its inflow. Sugar imports was minimal during MY22, due to the high sugar production, which has consistently translated in an increase in carry-over stock.
- Sugar prices in Pakistan have depicted volatility historically, given demand/supply gap and market inefficiencies. The provincial government sets the MSP for the sugarcane, incorporating cost of production of farmers. During the last 3-year period (MY20-22), MSP has increased notably to encourage farmers for sugar production, as they were

moving towards alternate crop cultivation given lower profitability in sugarcane. Therefore, with increase in MSP, retail price of sugar has also escalated.

- Punjab and KPK sugarcane indicative price is Rs. 225/40kg, which is 12.5% higher than preceding year, while pricing in Sindh posted a YoY increase of 23.8%, to Rs. 250/40kg bag.

Table 3: Sugarcane Indicative Price and Retail Average Price

Year	Sugar Price (Rs.)			Season Avg. Retail/KG (Rs.)
	Punjab	Sindh	KPK	
2016-17	180	182	180	64.94
2017-18	180	182	180	53.7
2018-19	180	182	180	59.84
2019-20	190	192	190	76.6
2020-21	200	202	200	93.5
2021-22	225	250	225	-

Source - PSMA

- The recent flood has manifested devastating effects on the agricultural output including sugarcane. Sindh, which accounts for 31% of national aggregate sugarcane production, was the most affected area in terms of agricultural damage.
- Sugarcane is mainly grown in northeast region of Pakistan, where impact of flood was minimal. However, sugarcane area in Sindh has been affected, where loss is estimated at ~10.5m MTs i.e. 61% of the projected sugarcane production valued at USD 273m. The sugarcane losses in Punjab region are still under scrutiny, as officials are still estimating the numbers.
- Sugar consumption, which follows the population growth trajectory, is projected to increase by 5% in MY23 to 6.2m MTs.
- Given the higher carry-over stocks, there are ongoing discussions between the Sugar Advisory Board (SAB) and Pakistan Sugar Mills Association (PSMA) to allow export of sugar. In case the same materialized, it would have a positive impact of the profitability of sugar companies.

Business Update – TSIPL

Table 4: Installed Capacity and Production

Particulars	MY'20	MY'21	9M'MY21	9M'MY22
Capacity (per day)	16,000	16,000	16,000	16,000
Crushing Period	114	116	116	141
Total Crushing Capacity	1,824,000	1,856,000	1,856,000	2,256,000
Cane Crushed	1,091,394	1,437,749	1,437,749	1,923,195
Utilization	59.8%	77.5%	77.5%	89.5%
Sugar Production	102,492	128,060	128,060	183,737
Recovery Ratio	9.39	8.92	8.92	9.56
Molasses Produced	52,840	72,104	72,104	91,680
Molasses Recovery	4.84%	5.02%	5.02%	4.77%
Capacity Utilized (based on sugarcane crushing)	59.8%	77.5%	77.5%	85.2%

- The Company's installed sugarcane crushing capacity stands at 16,000 MTs per day. The mill operated for 141 days during 9M'MY22, up from 116 days during SPLY. Due to high sugarcane production, the mill crushed 1.9m MTs, up from 1.4m MTs during SPLY. Furthermore, the recovery rate also improved from 8.92% in MY21 to 9.56% in 9M'MY22. Resultantly, the Company produced 183,737 MTs of sugar during 9M'MY22 up from 128,060 MTs in MY21. Molasses production also increase by 27% in 9M'MY22 vis-à-vis SPLY. However, its recovery rate dropped from 5.02% in 9M'MY21 to 4.77% in 9M'MY22.
- Going forward, the management is confident of sugarcane supply in the northeast region, where TSIPL is situated. The forecasted quantity of cane crushing is ~2.0m MTs, translating in an increase of 2.7% YoY. The higher projection is attributable to lower flood losses in Central Punjab.

Sales & Operations

Table 5: P&L Extract

(In Million Rs.)	MY19	MY20	MY21	9M'MY21	9M'MY22
Sales	6,608	11,548	11,833	6,679	9,867
GP Margin	24.8%	11.0%	10.4%	18.4%	21.9%
EBIT	1,567	1,197	1,160	1,184	2,047
Net Margin	1.52%	0.04%	0.56%	5.43%	9.42%

- Net sales of the Company was posted an uptick of 48% in 9M'MY22 vis-à-vis SPLY, primarily driven by increase in sugarcane production. Volumetric offtake of the Company was reported at 105,771 MTs up from 67,608 MTs during SPLY. The average pricing of the sugar was 3.5% lower than SPLY.
- The Company also sold 93,380 MTs (9M'MY21: 69,127 MT) of molasses at an average rate of Rs. 19,895 (9M'MY21: 20,509) during 9M'MY22.
- Gross Margin soared in 9M'MY22 to 22% due to decrease in average procurement price of sugarcane from Rs. 272.6 per mound in 9M'MY21 to Rs. 251.7 per mound in 9M'MY22 as a result of narrowing supply-demand gap.
- The management envisaging aggregate revenue of Rs. 12.2b for MY22. While gross margin is likely to be maintained, net margin will come under pressure as finance cost burden would be higher.

Cash Flow Coverages & Capitalization

Table 6:Cash Flow Coverages & Other Ratios

(In Million Rs.)	MY19	MY20	MY21	9M'MY21	9M'MY22
FFO	435.7	(85.0)	212.1	600.8	1,266.1
FFO/Total Debt (%)	3.7%	-1.0%	2.5%	5.8%*	13.0%*
FFO/Long Term Debt (%)	6.5%	-1.3%	3.4%	12.6%*	29.6%*
DSCR (x)	1.4	0.7	0.9	1.0*	1.6*
Current ratio	0.84	0.72	0.72	1.00	0.99
(Stock in trade + debt)/STD	0.99	0.84	0.78	0.97	1.00

*Annualized**

- Given higher revenues and improvement in margins, cash flow coverage indicators have improved, despite the sizable uptick in short term borrowings. DSCR is likely to come under pressure going forward, falling in the range of 0.9-1x, given debt repayments on the anvil.

Table 7: Balance Sheet Extract

	Sep'19	Sep'20	Sep'21	Jun'22
Total Assets	15,237	12,164	12,301	17,829
Total Liabilities	13,138	10,063	9,532	14,025
Total Equity	2,099	2,100	2,769	3,803
Total Debt	11,882	8,607	8,654	13,014
- **Short Term Debt**	5,170	1,954	2,368	7,316
- **Long term Debt**	6,713	6,653	6,286	5,698
Gearing Ratio	5.66	4.10	3.13	3.42

- The Company's gearing ratio remains on the higher side, despite growth in topline and profitability margins. The management projects gearing ratio to fall to 2.0x during the rating horizon. Nevertheless, given increasing business volumes, reducing gearing will be a challenging task. VIS will continue

Key Rating Drivers - TSIPL

Rating incorporate track record of sponsors

The assigned ratings take into account satisfactory operating track record, and extensive experience of sponsors - Umer Group of Companies and RYK Group - in the sugar sector.

Rating take into account business risk profile of Sugar Sector

VIS classifies the business risk profile of Sugar sector as 'Medium', which incorporates high cyclicality medium competition, capital intensity and technology risk, low energy sensitivity and high regulatory risk.

Ratings incorporate elevated financial risk profile of the Company

TSIPL's financial risk profile is elevated, given high level of gearing. The management has projected the gearing to decline to moderately high level by end-MY23. Nevertheless, amidst growing business volumes and rising running finance requirements, this will likely be a challenging task. VIS will continue to monitor the changes in financial risk profile on an ongoing basis.

TWO STAR INDUSTRIES (PVT) LIMITED Appendix I

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**Sept'19**	**Sept'20**	**Sept'21**	**June'22**
Fixed Assets	9,059.7	9,045.9	9,053.0	9,129.6
Stock-in-Trade	5,067.9	1,603.5	1,607.8	7,305.8
Trade Debts	76.1	40.5	247.3	262.8
Cash & Bank Balances	17.7	38.1	31.0	84.3
Total Assets	15,236.9	12,163.8	12,301.1	17,828.6
Trade and Other Payables	809.1	1,209.4	600.5	510.5
Long Term Debt	6,712.5	6,652.5	6,285.5	5,697.7
Short Term Debt	5,169.9	1,954.0	2,368.4	7,316.3
Total Debt	11,882.5	8,606.6	8,653.9	13,014.0
Paid-up Capital	0.04	0.04	0.04	0.04
Total Equity	2,098.5	2,100.5	2,769.0	3,803.2

INCOME STATEMENT	**MY19**	**MY20**	**MY21**	**9M'MY21**	**9M'FY22**
Net Sales	6,608.2	11,548.0	11,832.7	6,679.1	9,866.7
Cost of sales	(4,968.7)	(10,281.9)	(10,598.5)	(5,447.5)	(7,704.8)
Gross Profit	1,639.5	1,266.1	1,234.1	1,231.7	2,161.9
Operating Profit	1,567.1	1,196.5	1,159.6	1,187.6	2,047.2
Finance Cost	(1,444.5)	(1,133.8)	(971.6)	(731.6)	(979.2)
Profit before Tax	122.6	62.7	188.0	456.0	1,068.0
Profit After Tax	100.3	4.99	65.7	362.6	929.2

RATIO ANALYSIS	**FY19**	**FY20**	**FY21**	**9M'MY21**	**9M'FY22**
Gross Margin (%)	24.8%	11.0%	10.4%	18.4%	21.9%
Net Margin (%)	1.52%	0.04%	0.56%	5.43%	9.42%
Net Working Capital	(1,133.9)	(1,033.3)	(1,084.8)	(1.4)	(80.5)
FFO	435.7	(85.0)	212.1	600.8	1,266.1
FFO to Total Debt (%)	3.7%	-1.0%	2.5%	5.8%*	13.0%*
FFO to Long Term Debt (%)	6.5%	-1.3%	3.4%	12.6%*	29.6%*
Debt Servicing Coverage Ratio (x)	1.4	0.7	0.9	1.0*	1.6*
Current Ratio (x)	0.84	0.72	0.72	1.00	0.99
Leverage (x)	6.3	4.8	3.4	4.8	3.7
Gearing (x)	5.7	4.1	3.1	4.5	3.4
ROAA (%)	0.70%	0.04%	0.54%	3.24%*	7.01%*
ROAE (%)	4.9%	0.2%	2.7%	16.7%*	36.2%*
(Stock in trade + trade debts)/STD	0.99	0.84	0.78	0.97	1.00

**Annualized*

ISSUE/ISSUER RATING SCALE & DEFINITION 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	Two Star Industries (Pvt) Limited
Sector	Sugar Industry
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				
18-10-2022	BBB+	A-2	Stable	Reaffirmed
11-08-2021	BBB+	A-2	Stable	Reaffirmed
16-05-2020	BBB+	A-2	Stable	Downgrade
22-04-2019	A-	A-2	Stable	Initial

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 Meeting Conducted	

Name	Designation	Date
Mr. Ahmed Subhani	Chief Finance Officer	**20th September, 2022**
Mr. Anwar Hussain	Group CFO	