RATING REPORT

TWO STAR INDUSTRIES (PVT) LIMITED

REPORT DATE:
November 17, 2023

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	*November 17, 2023*		*October 18, 2022*	
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 (May, 2023) ***https://docs.vis.com.pk/docs/CorporateMethodology.pdf***
VIS Rating Scale: https://docs.vis.com.pk/docs/VISRatingScales.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.

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 by raising yields by 40 to 50 percent. According to the data collected by 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 sugarcane cost being regulated by the government. 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 Pakistan Sugar Mills Association (PSMA), which represents the sugar mill owners, and Government of Pakistan, to allow export of sugar, to cover up for the higher costs associated with producing sugar and pulling the industry out of crisis.

According to the most recent USDA sugar report published on April 12, 2023, sugarcane production is expected at 83.5m MT during 2023-24, three percent above 2022-23 production, on account of expected recovery in yield in areas which were previously impacted by the floods. For the season 2023-24, the estimated harvesting area is also expected to increase to 1.25 million hectares (2022-23: 1.23 million hectares). Sugar output for the forthcoming season is expected to clock at 7.05 million MT, a marginal increase from that in 2022-23. Moreover, due to population growth and demand from the developing food processing industry, sugar consumption is projected to rise by around 3% to 6.3 million MT. In view of accumulating sugar stocks, the Govt. allowed 250,000 tons of sugar export in MY22. Sugar prices remained relatively low throughout the 2022-23 crushing season. However, following the season's conclusion, sugar prices experienced a noticeable increase in line with inflationary pressures. While this uptick may have positively impacted the gross profitability of companies, those with a heavily leveraged capital structure are likely to face challenges due to elevated interest rates, potentially affecting their bottom line.

Capacity Utilization & Production Update

Maximum Installed crushing capacity of the Company was revised to 30,000 tpd in February 2023, as a result of regularization by Directorate General of Industries, Price, Weights & Measures (DGIPWM) under section 11 of the Punjab Industries (Control on Establishment and Enlargement) Amendment Act, 2022 against which the Company has already paid a requital fee. This will be incorporated in the audited annual report for MY23. In MY23, TSIPL reported higher crushing capacity of 30,000 tons per day (tpd) (MY22 & MY21: 16,000 tpd) as a result of regularization in February 2023 under section 11 of the Punjab Industries (Control on Establishment and Enlargement) (Amendment) Act, 2022. The mill remained operational for 105 days, down from 141 days in MY22. This reduction was primarily attributed to decrease in sugarcane supply due to the devastating floods in the region. Despite these challenges, TSIPL managed to process 1,563,384 metric tons (MT) of sugarcane in the MY23 season, around 19% lower than the quantity in MY22. However, the average sucrose recovery rate for the MY23 season stood higher at 9.915%, vis-à-vis 9.556% in the preceding season, primarily on account of some delay in start of crushing season. Consequently, the Company's sugar production for the year MY23 reached 154,959 MT, representing a decrease of ~16% compared to MY22. On the other hand, molasses production in MY23 amounted to 71,831.13 MT, ~22% down from preceding season, as a result of decrease in molasses recovery rate to 4.60%, (MY22: 4.77%).

Overall, TSIPL's performance in the MY23 crushing season reflected the challenges faced by the industry due to adverse weather conditions leading to supply constraints, resulting in a decrease in sugarcane processing and associated sugar and molasses production. The production statistics are presented in the table below:

	2020-21	2021-22	2022-23
Capacity per day	16,000	16,000	30,000*
Crushing Period	116	141	105
Total Crushing Capacity	1,856,000	2,256,000	3,150,000
Cane Crushed	1,437,749	1,923,195	1,563,384
Utilization	77.46%	85.25%	49.63%
Sugar Production	128,059.50	183,737.00	154,959.00
Recovery Ratio	8.916	9.556	9.915
Molasses Produced	72,104.02	91,679.90	71,831.13
Molasses Recovery	5.02	4.77	4.60
***Revised in lieu of Regularization**			

Revenues & Profitability:

In MY22, the Company experienced a modest increase in the topline, with net sales at Rs. 12.3b, compared to Rs. 11.8b in MY21. The contribution of sugar in the sales mix decrease to 82%, down slightly from the 87.2% share it held in MY21. Net revenue generated from sugar remained fairly stable at Rs. 10.0b (MY21: Rs. 10.3b), even though ~8% increase in volumetric sales, totaling 139,742 MT (MY21: 128,935MT). This was primarily due to subdued average sugar prices. During MY22, per ton average selling rates were recorded lower at Rs. 71,666, compared to Rs. 79,982 (Net of sales tax) in the preceding year. This drop in sugar prices can be attributed to a variety of factors. First and foremost, excess sugar stocks were prevalent in the country due to a bumper crop in the preceding year. Additionally, government interventions aimed at controlling retail sugar prices further exacerbated the pricing pressures in the sugar market.

Sugar is primarily sold in the open market, accounting for around 85% - 90% of total sugar sales, while the remaining were directed towards institutional clients. The by-products contribution in overall revenue increased in MY22, with molasses generating Rs. 1.9b (MY21: 1.4b), bagasse contributing Rs. 352m (MY21: Rs. 67m), and mud sales amounting to Rs. 27m (MY21: 16m).

In the 2021-22 crushing season, sugarcane support prices in Punjab were raised to Rs. 225 per 40 Kg, compared to Rs. 200 per 40 Kg in the previous year (2020-21). However, the premium paid by majority of the mills, over and above this support prices, was relatively lower owing to abundant availability of crop. Therefore, per maund average cane procurement cost was also reported lower at Rs. 251.9 vis-à-vis Rs. 272.6 in the preceding year. The cost of sales remained largely stable at Rs. 10.4b (MY21: Rs. 10.6b), primarily on account of adjustment of finished goods inventory from preceding year. The inventory gains and some increase in sucrose recovery rates, led to improvement in gross margins to 15.0% (MY21: 10.4%) despite lower average selling prices in MY22. Distribution and administrative expenses were increased largely due to inflationary pressures. During MY22, other income amounted to Rs. 4.7m (MY21: Rs. 6.1m) which largely included profit on bank deposits and sale of scrap. Finance cost increased notably to Rs. 1.4b (MY21: Rs. 971m), due to the impact of higher average markup rates and increase in borrowings. Despite higher operating and finance cost, the Company managed to achieve a higher net profit of Rs. 142.9m (MY21: Rs. 65.7m) with net margins of 1.2% (MY21: 0.6%) primarily driven by higher gross profitability and rationalized operating expenses in MY22.

As per the management account, during MY23, net sales amounted to Rs. 18.7b, marking a significant increase of 52.5% compared to MY22. This was driven by volumetric growth of 31% totaling 182,410MT and nearly 26% increase in average selling price to Rs. 89,995/MT. The average sugarcane procurement cost was also reported higher at Rs. 315.7 per maund, largely due to increase in indicative price (i.e., Rs. 300 per maund) in the outgoing season. Therefore, despite 44.5% YoY increase in cost of sales, higher average sugar prices and sucrose recovery rates led to improvement in gross profit margins to 19.5%. The distribution and administrative expenses were also rationalized with inflationary pressure. Additionally, other operating expenses were reported higher at Rs. 107.4m due to substantial increase in worker welfare fund and profit participation fund and allowance for expected credit losses. Although, finance costs significantly increased to Rs. 2.4b in MY23, profit after taxation was reported higher at Rs. 754m MY23, yielding a net profit margin of 4.0%.

Sugar prices were consistently under pressure throughout the outgoing crushing season. However, prices experienced a significant surge after the season's conclusion, primarily in line with inflationary trends. Meanwhile, in August 2023, the government's efforts to curb smuggling across the Afghan border resulted in some decline in retail sugar prices. The crushing season 2023-24 is expected to start in mid-November while cabinet approval is awaited on the same. Meanwhile, for the upcoming crushing season, the sugarcane support prices are expected to be set at Rs. 425/maund in both Punjab and Sindh, due to higher cost of production. Therefore, retail prices of sugar are expected to increase, going forward. Meanwhile, MY24 is anticipated to be yet another challenging for various industries due to the escalating socio-political instability and macroeconomic hurdles.

Liquidity Profile:
In MY23, Funds from Operations (FFO) increased to Rs. 997m (MY22: Rs. 478m; MY21: Rs. 212m), primarily driven by improved profitability. This, along with decrease in overall debt levels led to improved cash flow coverages; FFO to total debt and long-term debt ratios increased to 0.18x (Sept'22: 0.04x; Sept'21: 0.02x) and 0.21x (Sept'22: 0.09x; Sept'21: 0.03x), respectively as of Sept'23. Additionally, the debt service coverage ratio (DSCR) also improved marginally to 1.10x (Sept'22: 1.06x; Sept'21: 0.85x) as of Sept'23, mainly due to the higher FFO.

Moreover, the stock in trade amounted to Rs. 3.2b (Sept'22: Rs. 4.4b; Sept'21: Rs. 1.6b) as of Sept'23, primarily due to lifting of sugar stock. Stock held for sale at the end of Sept'23 stood at 34.3k MT. Trade debts remained largely stable at Rs. 391m (MY22: Rs. 384m; MY21: Rs. 247m). The percentage of trade debts in relation to net sales has consistently remained minimal. Notably, due to sugar primarily being sold on a cash/advance basis, the aging profile of trade debts has remained very comfortable, largely falling in two weeks period. Loans and advances primarily consisted of unsecured advances against purchases and services and advances made to growers.

Trade and other payables decreased to Rs. 310m (Sept'21: Rs. 600m) as of Sept'22, primarily due to lower sales tax payable, trade creditors, and advances from customers. However, trade and other payables significantly increased to Rs. 3.8b by the end of Sept'23, due to advance received from customers amounting to Rs. 3.4m. The current ratio has remained consistently less than one. On the other hand, due to significantly lower short-term borrowings, the coverage of short-term borrowings through trade debts and stock in trade increased to 4.47x in Sept'23, compared to 0.84x in Sept'22. Improvements in cash flow coverages and liquidity indicators will remain crucial rating sensitivities moving forward.

Capitalization:
The equity base increased to Rs. 4.2b (Sept'22: Rs 3.2b) owing to higher internal capital generation and loans from directors and associated parties, which have increased to Rs. 3.6b (MY22: Rs. 3.4b; MY21: Rs. 3.1b) as of Sept'23. These loans are interest free and payable at the Company's discretion. Consequently, they are categorized as equity. The management intends to keep these loans on the books until all long-term bank borrowings are settled. Furthermore, the sponsors intends to inject further equity amounting Rs. 900m in coming years to support operations.

The debt profile included a combination of long-term and short-term financing. Long-term financing (inclusive of current portion) amounted to Rs. 4.8b (Sep'22: Rs. 5.5b; Sept'21: Rs. 6.3b) at the end of Sept'23. This encompassed demand finance and term finance facilities, charged at 3M and 6M KIBOR plus 1%, with quarterly and biannual repayments. During the review period, no further long-term loans have been raised. Short-term borrowings decreased significantly to Rs. 802m (Sept'22: Rs. 5.8b; Sept'21: Rs. 2.4b) as of Sept'23. This reduction is attributed to the increased advances received from customers, which will be used to meet the Company's working capital requirements. The short-term borrowings included running finance and cash finance facilities, charged at 1M KIBOR + 0.10% to 3M KIBOR + 1%.

As a result of substantial decrease in short-term borrowings, debt leverage and gearing improved to 2.4x (Sept'22: 3.7x; Sept'21: 3.4x) and 1.3x (Sept'22: 3.5x; Sept'21: 3.1x), respectively, as of Sept'23. The leverage indicators are expected to improve steadily in line with growth in equity and scheduled repayment of long-term loans. Going forward, as per management, there are no plans for raising any major long-term borrowings for capital expenditures due to elevated markup rates.

Environment, Sustainability and Governance (ESG)
TSIPL upholds ESG standards and maintains an Environmental Manual, the document certifying the alignment of environmental management system with the requisite standards. This manual outlines environmental system and offers comprehensive policy guidance for its implementation and ongoing maintenance. It also communicates commitment to clients, ensuring they are aware of the stringent controls in place to promote eco-friendly operations, prevent nonconformities, and consistently support environmental protection.

TWO STAR INDUSTRIES (PVT) LIMITED Appendix I

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**Sept'20**	**Sept'21**	**Sept'22**	**Sept'23***
Tangible Fixed Assets	9,045.9	9,053.0	9,102.9	8,994.0
Stock-in-Trade	1,603.5	1,607.8	4,453.8	3,192.6
Trade Debts	40.5	247.3	384.3	390.6
Cash & Bank Balances	38.1	31.0	20.9	109.4
Total Assets	12,163.8	12,301.1	15,280.2	14,023.6
Trade and Other Payables	1,209.4	600.5	310.0	3,817.4
Long Term Debt (incl. current portion)	6,652.5	6,285.5	5,475.6	4,766.6
Short Term Debt	1,954.0	2,368.4	5,763.2	802.2
Total Debt	8,606.6	8,653.9	11,238.8	5,568.8
Paid-up Capital	0.04	0.04	0.04	0.04
Total Equity	2,100.5	2,769.0	3,217.9	4,152.6
INCOME STATEMENT	**MY20**	**MY21**	**MY22**	**MY23***
Net Sales	11,548.0	11,832.7	12,251.5	18,683.0
Cost of sales	(10,281.9)	(10,598.5)	(10,409.8)	(15,040.2)
Gross Profit	1,266.1	1,234.1	1,841.7	3,642.8
Operating Profit	1,196.5	1,159.6	1,723.9	3,416.9
Finance Cost	(1,133.8)	(971.6)	(1,432.5)	(2,379.0)
Profit before Tax	62.7	188.0	291.4	1,037.5
Profit After Tax	4.99	65.7	142.9	754.6
RATIO ANALYSIS	**MY20**	**MY21**	**MY22**	**MY23***
Gross Margin (%)	11.0%	10.4%	15.0%	19.5%
Net Margin (%)	0.04%	0.56%	1.17%	4.04%
Net Working Capital	(1,033.3)	(1,084.8)	(1,346.1)	(1,243.1)
FFO	(85.0)	212.1	478.0	997.0
FFO to Total Debt (x)	(0.01)	0.02	0.04	0.18
FFO to Long Term Debt (x)	(0.01)	0.03	0.09	0.21
Debt Servicing Coverage Ratio (x)	0.69	0.85	1.06	1.10
Current Ratio (x)	0.72	0.72	0.81	0.78
Leverage (x)	4.79	3.44	3.75	2.38
Gearing (x)	4.10	3.13	3.49	1.34
ROAA (%)	0.04%	0.54%	1.04%	5.15%
ROAE (%)	0.24%	2.70%	4.77%	20.48%
(Stock in trade + trade debts)/STD	0.84	0.78	0.84	4.47

**Unaudited*

REGULATORY DISCLOSURES — Appendix II

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				
17-11-2023	BBB+	A-2	Stable	Reaffirmed
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.
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 creditor profile.

Due Diligence Meeting Conducted

Name	Designation	Date
Mr. Ahmad Subhani	**Chief Financial Officer**	**6-October-2023**