RATING REPORT

Etihad Sugar Mills Limited (ESML)

REPORT DATE:
28th Jan '20

RATING ANALYSTS:
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RATING DETAILS		
	Initial Rating	
Rating Category	Long-term	Short-term
Entity	A-	A-2
Rating Outlook	Stable	
Rating Date	*10th Jan'20*	

COMPANY INFORMATION	
Incorporated in 2006	**External auditors:** Grant Thorton Anjum Rahim, Chartered Accountants
Public Limited – Unquoted	**Chief Executive Officer:** Sakandar Ali Choudhry
Key Shareholders (with stake 5% or more):	**Executive Co-ordinator:** Mr. Muhammad Shakil
Mr. Hashim Jawan Bakhat – 10.7%	
Al-Jawahar Technical Pakistanian Contracting Company (UAE)– 9.4%	
Chaudhary Muhamad Munir – 9.2%	
Technical Associates Pakistan Limited – 9.1%	
Mr. Faisal Munir – 9.1%	
Mr. Zahid Jamil – 8.1%	
Mr. Muhammad Mujahid – 8.1%	
Mr. Maqsood Ahmed – 8.1%	
Mr. Muhammad Shakil – 7.1%	
Ms. Rabia Munir – 8.1%	
Mr. Sohail Munir – 6.1%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: *Corporates (May 2019)*
https://www.vis.com.pk/kc-meth.aspx

Etihad Sugar Mills Limited (ESML)

OVERVIEW OF THE INSTITUTION

Etihad Sugar Mills Limited (ESML) was incorporated in 2006 as an unquoted public limited under the Companies Ordinance, 1984. The principal business activity of the company is manufacturing and sale sugar and its byproducts.

Profile of CEO

Sakanadar Ali Choudhry is actively participating with the affairs of the ESML since 4-5 years and currently serves as the CEO of the Company. He has enough experience of Banking, Finance and Administration.

Profile of Executive Coordinator

Mr. Muhammad Shakil is the Executive Coordinator of ESML. He has over 30 years of experience in multiple sectors.

Financial Snapshot

Total Equity: end-FY19: Rs. 5.7b; end-FY18: Rs. 5.4b; end-FY17: Rs. 2.4b

Assets: end-FY19: Rs. 16.3b; end-FY18: Rs. 19.3b end-FY17: Rs 12.2b

Profit/ (Loss) After Tax: FY19: Rs. 281m;

RATING RATIONALE

The ratings assigned to ESML take into account moderate business risk profile of the company, largely underpinned by ample experience of sponsors led management in the sugar sector and sizeable crushing operations. The ratings derive comfort from considerable improvement in net sales, profit margins and cash flows during the outgoing year, mainly on account of notable increase in sucrose recovery rate and higher sugar prices in the domestic and international markets. The ratings incorporate notable growth in FFO generation, mainly on the back of higher profits during the period under review, which resulted in slight improvement in coverages. In addition, the ratings reflect improvement in leverage indicators during the period on the back of augmentation of equity base. The aforementioned indicators are still on the higher side, though management has plans for further improvement, going forward. The ratings are constrained on account of cyclicality inherent in the sugar sector impacting the overall business risk profile of the company from time to time. Further, ratings will remain dependent upon sustenance of margins and profitability indicators coupled with maintenance of leverage indicators at lower than current levels, going forward.

ESML is involved in the manufacturing and sale of white crystalline sugar since 2007; the company has, over the years, established sound business relationships with the sugarcane growers and customers. ESML's crushing capacity is recorded at 16,000 M.T. per day.

Key Rating Drivers:

Susceptibility of business performance to oversupply

Sugar prices are largely driven by market forces, and are dependent on production during the sugar season and prevailing inventory levels. The average retail price of sugar declined to Rs.53.0 per kg during FY18, as compared to Rs. 61.4 per kg during FY17, driven largely by oversupply in the market which emanated from the bumper crop, hence higher production in the last crushing season. The aforementioned factors and unchanged sugarcane price have negatively impacted the overall profitability and inventory levels of the company. The company reported after tax losses of Rs. 553.9m (FY17: Rs. 125.6m) during FY18 primarily on account sharp decline in margins to 3.3% (FY17: 10.8%) coupled with higher finance cost incurred as a result piled up inventory stock; the decline in margins was an outcome of drop in average retail prices of sugar.

ESML crushed 1.6m M.T. of sugarcane during crushing season of FY18-19; the same was almost equivalent to last year despite the mill being operational for lesser number of days, 102 days, as compared to 142 days in FY17-18. However, the sugar production for the crushing season FY18-19 was recorded higher at 183,332 MT as compared to 172,900 MT of last year's crushing season in line with improved sucrose recovery levels to 11.28% (FY18: 10.84%) during this year's crushing season. The profitability indicators of the company exhibited improvement during the ongoing year with the company reporting a profit of Rs. 280.8m during FY19. The improvement in the operational performance of the company was a combined outcome of increase in volumetric sales, higher margins and increase in sucrose recovery levels. ESML was able to sell 254,098 MT (FY18: 120,317 MT) sugar during the ongoing year; hence alleviating the pressure on upheld inventory levels. Moreover, the

FY18: (Rs. 554); FY17: Rs. 126M

margins were recorded higher at 12.4% (FY18: 3.3%; FY17: 10.8%) as the company fetched better retail prices of end product coupled with improvement in sucrose recovery during the ongoing year. The slight increase in administrative expense was mainly a function of higher employee related expense as a result of annual salary adjustments. Moreover, ESML incurred higher finance cost amounting to Rs. 989.8m during FY19 as compared to Rs. 651.6m in FY18 primarily as a result of increase in the benchmark interest rates. Going forward, VIS expects margins and profitability to remain a function of average retail prices of sugar in the coming years. Given the sugar sector is highly cyclical in nature, the next two crushing seasons are expected to bear normal yields followed by a season of bumper crop.

Adequate liquidity and debt coverage profile with manageable inventory risk

In line with improved profitability, Funds from Operations (FFO) increased sizably during FY19. Therefore, in line with improved cash generation coupled with decline in debt levels, FFO to total debt improved to 0.17x (FY18: negative) during FY19. Further, stock in trade declined sizably on a timeline basis on account of offloading of carryover stocks in line with favorable market retail price. The remaining unsold inventory, which the company intends to carry over to the next year, is being financed by short-term borrowings. Moreover, trade payables demonstrated downward trajectory by end-FY19 owing to decreased advances received from customers against sale of sugar. The situation self-correct moderately during the outgoing year given the sugar stock held was sold to customers against payable outstanding. The debt service coverage improved to 1.25x (FY18: negative) at end-FY19. In addition, the company has given loans to sugarcane growers amounting to Rs. 246.1m (FY18: Rs. 392.0m) at end-FY19 to assist them in purchase of seeds, fertilizer and pesticides. Moreover, ESML has extended loans amounting to Rs. 2.0b (FY18: Rs. 1.5b) to associate companies; the loans are receivable within twelve months or on demand , meanwhile the markup is charged on quarterly basis ranging between 10.72% to 14.85%.

Gearing indicators remain on a higher side; however remaining within manageable levels

Equity base augmented in line with internal capital generation. Moreover, the capitalization levels are supported by loans from sponsors to the tune of almost Rs. 1.1b in aggregate during FY19. One of loans amounting to Rs. 518.8m is interest free and payable at the convenience of the company. The other loan extended by sponsors amounting to Rs. 561.1m is interest free; however, it is discounted using weighted average rate of 12.6% over a period of six years. The debt profile of the company comprised a mix of both long-term and short-term borrowings. However, the company has not procured any new long-term debt since the past three years. The utilization of short-term borrowings decreased to Rs. 4.6b (FY18: Rs. 5.9b) at end-FY19 on account of sale of inventory. Subsequently in line with contractual repayments of long-term debt, rationalization of short-term funding and simultaneous augmentation of equity base, gearing and debt leverage ratios decreased to 1.93x (FY18: 3.04x) and 3.81x (FY18: 5.80x), respectively by end-FY19. However, gearing and leverage indicators are on a higher side; however still considered to be within manageable levels. Therefore, in line with periodic contractual repayments the leverage indicators are expected to decline going forward.

Etihad Sugar Mills Limited (ESML) Appendix I

Financial Statement			
			Amount in Million (Rs.)
BALANCE SHEET	**FY17**	**FY18**	**FY19**
Non-Current Assets	4,301	9,287	8,853
Long Term Investments	1,121	0.4	621
Store, spares & stock	188	212	204
Stock in Trade	3,646	5,884	2,793
Trade Debts	12	63	478
Loans & Advances	1,807	2,241	2,336
Other Assets	1,080	1,448	1,627
Cash & Bank Balances	75	141	58
Total Assets	12,231	19,276	16,330
Trade and Other Payables	2,516	4,871	3,160
Short Term Borrowings	4,787	5,919	4,569
Long Term Finances (*incl current maturity)	1,764	1,338	800
Deferred Liabilities	202	1,081	1,093.5
Paid Up Capital	990	990	990
Core Equity	2,833	2,388	2,788
INCOME STATEMENT	**FY17**	**FY18**	**FY19**
Net Sales	6,872	5,954	13,319
Gross Profit	743	194	1,657
Operating Profit	682	(35)	1,214
Profit/ (Loss) Before Tax	70	(686)	433
Profit/ (Loss) After Tax	126	(554)	281
FFO	657	(488)	904
RATIO ANALYSIS	**FY17**	**FY18**	**FY19**
Gross Margin (%)	10.8	3.3	12.4
Net Margin (%)	1.8	-	2.1
Net Working Capital	(1,402)	(2,020)	(1,741)
Current Ratio (x)	0.83	0.82	0.80
FFO to Total Debt (x)	0.10	-	0.17
FFO to Long Term Debt (x)	0.37	-	1.13
Debt Servicing Coverage Ratio (x)	1.16	0.09	1.25
ROAA (%)	1.2	-	
ROAE (%)	4.6	-	10.6
Gearing (x)	2.31	3.04	1.93
Debt Leverage (x)	3.81	5.80	3.81

ISSUE/ISSUER RATING SCALE & DEFINITIONS 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	Etihad Sugar Mills Limited					
Sector	Sugar					
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					
	10/01/2020	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 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 Meetings Conducted		**Name**	**Designation**	**Date**		
	1	Mr. Sohail Dil	G.M Finance	03-Jan-2020		