RATING REPORT

Etihad Sugar Mills Limited (ESML)

REPORT DATE:

November 19, 2020

RATING ANALYSTS:
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RATING DETAILS				
	Latest Rating		Previous Rating	
Rating Category	Long-term	Short-term	Long-term	Short-term
Entity	A-	A-2	A-	A-2
Rating Date	*Nov 19, 2020*		*Jan 10, 2020*	
Rating Outlook	Stable		Stable	

COMPANY INFORMATION	
Incorporated in 2006	**External Auditors:** M/s Grant Thornton Anjum Rahman, Chartered Accountants
Public Limited – Unquoted	**Chief Executive Officer:** Sakandar Ali Choudhry
Key Shareholders (with stake 5% or more):	**Executive Coordinator:** Mr. Muhammad Shakil
Al-Jawahir Technical Pakistanian Contracting Company LLC. (UAE)– 40.7%	
Mr. Hashim Jawan Bakhat – 10.7%	
Chaudhary Muhamad Munir – 9.2%	
Technical Associates Pakistan (Pvt.) Limited – 9.1%	
Mr. Faisal Munir – 9.1%	
Mr. Muhammad Shakil – 7.1%	
Mr. Sohail Munir – 6.6%	

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 (now Companies Act' 2017). The principal business activity of the company is manufacturing and sale sugar and its byproducts.

Profile of CEO

Sakanadar Ali Choudhry has been serving as CEO of the company since 2018. He has ample experience in banking, finance and administration.

Profile of Executive Coordinator

Mr. Muhammad Shakil has over 30 years of experience in multiple sectors. The Executive Coordinator (EC) reports directly to the CEO acting as the CEO's primary coordinator and liaison for external relations. Mr. Shakil is also the CEO of Etihad Power Generation Limited (EPGL), an associated concern.

Financial Snapshot

Core Equity: end-9MFY20: Rs. 3.4b; end-FY19: Rs. 2.7b; end-FY18: Rs. 1.9b

Assets: end-9MFY20: Rs. 18.7b; end-FY19: Rs. 17.2b; end-FY18: Rs. 19.3b

Profit/(Loss) After Tax: 9MFY20: Rs. 630.7m; FY19: Rs. 561.8m; FY18: Rs. (553.9)m

RATING RATIONALE

The ratings assigned to ESML take into account ample experience of sponsors in the sugar sector and sizeable crushing operations. Sponsors have also supported the company in the form of interest free loans. The ratings incorporate improvement in profit margins mainly on back of increase in retail prices of sugar. Liquidity profile remained largely intact supported by notable increase in FFO leading to improvement in debt service coverage. While gearing and debt leverage remained on higher side, the latter decreased during the review period on account of lower trade and other payables. The company has made investment in 74MW bagasse-based power project, Etihad Power Generation (Pvt.) Ltd., with a stake of 49%. Once operational, the power project is expected to support the operations and cost inputs of the entity. Meanwhile, the ratings remained constrained on account of high business risk emanating from inherent cyclicality in crop levels, raw material prices and any adverse changes in regulatory duties. Ratings will remain dependent upon maintenance of leverage indicators at lower than current levels, going forward.

Key Rating Drivers:

Business risk is considered high due to inherent cyclicality in crop levels and raw material prices: According to Pakistan Economic Survey 2019-20, sugarcane crop contributes about 0.6% to GDP and 2.9% of the total value addition in agriculture. During 2019-20, sugarcane production decreased by 0.4% to 66.880 million tons vis-à-vis 67.174 million tons of preceding year. Lower output is mainly the result of decrease in area of cultivation i.e 1,040 thousand hectares in MY20 as compared to 1,102 thousand hectares in MY19, a decrease of 5.6%. Meanwhile, the yield has improved by 5.5% compared to MY19. Average sugar prices have increased by 19% in MY19 and 16% in MY20. In order to control sugar prices and to maintain a strategic reserves of sugar, the GoP has allowed import of 300,000 tons of refined sugar, starting from Sep'20. Further, Economic Coordination Committee (ECC) has recently allowed exemption of sales tax on supply of sugar, imported through Trading Cooperation of Pakistan. Contrarily no support or subsidy was awarded for sugar export. While business risk is considered high, diversification of major industry players into ethanol business provides some cushion to profitability of the companies.

Production and capacity utilization: Crushing capacity of ESML remained intact at 16,000 MT per day. The mill was operational for 102 days (2018-19: 102 days; 2017-18: 142 days) and crushed 1.79m MT of sugarcane during 2019-20 season vis-à-vis 1.62m MT in the preceding season. Sugar production was recorded higher at 185,211 MT (2018-19: 183,332 M.T; 2017-18: 172,900 M.T) during the outgoing season despite decrease in sucrose recovery rate to 10.32% (2018-19: 11.28%). Molasses production increased to 81,108 MT (2018-19: 72,647 MT) due to higher crushing and marginal improvement in molasses recovery rate to 4.52% (2018-19: 4.48%) in 2019-20 season.

	FY18	FY19	9MFY20
Crushing Capacity – TCD	16,000	16,000	16,000
Average Cane Crushed – TCD	11,230	15,875	17,597
Crushing Days	142	102	102
Capacity Utilization – %	70	99	110
Sucrose Recovery – %	10.84	11.28	10.32
Sugar Produced – MT	172,900	183,332	185,211
Molasses Produced – MT	77,385	72,647	81,108

Molasses Recovery Rate – %	4.85	4.48	4.52

Growth in non-current assets on account of investment in associate: Property, plant and equipment stood at Rs. 8.6b (FY19: Rs. 8.9b; FY18: Rs. 9.3b) at end-9MFY20. Long-term investment in associate *(with a stake of 49%)* comprising investment in Etihad Power Generation Limited (EPGL) increased to Rs. 3.5b (FY19: Rs. 604.8m; FY18: Rs. 604.8m) by end-9MFY20. The power project entailed electricity generation through bagasse-based high pressure boilers having capacity of 74 MW/day. EGPL will supply electricity and excess steam to ESML, which in turn would supply bagasse for power generation.

Improvement in profitability mainly on the back of higher retail prices of sugar: The company recorded net revenue of Rs. 11.9b (FY19: Rs. 13.4b; FY18: Rs. 6.0b) during 9MFY20. Sale of molasses and other by-products increased to Rs. 1.4b (FY19: Rs. 748.4; FY18: Rs. 561m). Increase in gross margins to 14.2% (FY19: 13.7%; FY18: 3.3%) was majorly a function of higher sugar prices during 9MFY20. ESML sold 188,396 MT (FY19: 252,882 MT; FY18: 120,317 MT) of sugar at a higher average rate of Rs. 65,911.8/MT (FY19: Rs. 55,205.2/MT; FY18: Rs. 49,380/MT). Cost of sales was recorded at Rs. 10.3b (FY19: Rs. 11.6b; FY18: Rs. 5.8b) during 9MFY20. The company procured 44.9m maunds of sugarcane (2018-19: 40.5m maunds) at an average procurement rate of Rs. 214.6/maund in 2019-20 vis-à-vis Rs. 182/maund in the preceding year.

ESML incurred Rs. 377.1m (FY19: Rs. 407.7m; FY18: Rs. 355.1m) in administrative expenses during 9MFY20. Distribution expenses were recorded lower at Rs. 37.8m (FY19: Rs. 77.1m; FY18: Rs. 41.7m) primarily due to lower exports. Other income amounting Rs. 217.8m (FY19: Rs. 290.5m; FY18: Rs. 169.3m) mainly comprised markup on loans to related parties have provided impetus to the bottom-line. Finance cost of Rs. 690.5m (FY19: Rs. 981.8m; FY18: Rs. 651.6m) was incurred during 9MFY20. Despite higher effective tax rate, net margin of the company improved to 5.3% (FY19: 4.2%) primarily on back of higher gross margin. The company reported net profit of Rs. 630.7m (FY19: Rs. 561.8m) during 9MFY20.

Liquidity position remained largely intact: Funds from Operations (FFO) increased to Rs. 1.1b (FY19: Rs. 927m) during 9MFY20 due to higher profitability and positive difference between incurred and paid finance cost. However, annualized FFO to total debt remained at 0.17x (FY19: 0.17x) due to sizeable increase in total borrowings. Further, annualized FFO to long-term debt decreased to 0.51x (FY19: 0.71x) in line with increase in long-term borrowings. Debt service coverage ratio improved to 2.27x (FY19: 1.25x; FY18: 0.09x) during 9MFY20.

Stock in trade was recorded at Rs. 3.1b (FY19: Rs. 2.8b; FY18: Rs. 5.9b) at end-9MFY20. Trade debts stood Nil (FY19: Rs. 450m; FY18: Rs. 63.4m) as trade debts amounting Rs. 450 were adjusted against advances from customers to determine net balance pertained to those customers. As per management, the amount would be fully recovered by end-FY21. Advances, deposits, prepayments and other receivables amounted to Rs. 3.2b (FY19: Rs. 4.1b; FY18: Rs. 3.1b). This mainly includes loan extended to related parties of Rs. 2b (FY19: 3.1b; FY18: Rs. 1.5b); the loan is receivable within 12 months or earlier on demand with markup charged on quarterly basis at an average borrowing rate of the company. Additionally, it includes loans given by the company to sugarcane growers amounting Rs. 251m (FY19: Rs. 237.1m; FY18: Rs. 392m) to assist in purchase of seeds, fertilizer and pesticides and the rest of the amount largely pertained to advance income tax and other receivables. Trade and other payables decreased notably to Rs. 2.1b (FY19: Rs. 4.7b; FY18: Rs. 4.4b) by end-9MFY19 on account of lower advances from customers of Rs. 890.4m (FY19: Rs. 4.1b; FY18: Rs. 4.0b) given higher offtake of sugar deliveries were made against advances. Current ratio continued to remain low at 0.82x (FY19: 0.84x; FY18: 0.82x). Coverage of short-term borrowings via trade debts and stock in trade was also lower at 0.60x (FY19: 0.79x; FY20: 0.91x) at end-9MFY20.

Leverage indicators have remained on a higher side: Total long-term borrowings from financial institutions (including current maturity) increased to Rs. 2.4b (FY19: Rs. 800m; FY18: Rs. 1.3b) by end-9MFY20. The company mobilized long-term loan of Rs. 1.9b in 9MFY20 to finance investment in EPGL. Additional investment during the review period amounted to Rs. 2.9b; the rest of the amount was funded through internal sources which also included recovery of part of loan from a related party *(Technical Associates Pakistan (Pvt.) Limited)*. Current portion of long-term borrowings was deferred by one year as the company availed SBP relief for Covid-19. Short-term borrowings increased to Rs. 6.0b (FY19: Rs. 4.2b; FY18: Rs. 6.6b) by end-9MFY20 in line with working capital requirements.

Tier-1 equity increased to Rs. 3.4b (FY19: Rs. 2.7b; FY18: Rs. 1.9b) mainly on back of profit retention. Moreover, sponsors' loan amounting to Rs. 645.7m (FY19: Rs. 589.2m; FY18: Rs. 518.8m) have supported the equity base of the company; the loan is interest free and payable at the discretion of the company. Surplus on revaluation of property, plant and equipment was recorded at Rs. 3.4b (FY19: Rs. 3.4b; FY18: Rs. 3.5b) at end-9MFY20. Sponsors have extended another loan amounting Rs. 498m (FY19: Rs. 498m; FY18: Rs. 442.2m) which is interest free and will be retired in full by FY23. It is measured at amortized cost in accordance with IFRS 9 and discounted using weighted average rate of 12.6% over a period of six years. Despite increase in equity base, gearing and leverage indicators continued to remain on a higher side. Gearing increased to 2.63x (FY19: 2.03x; FY18: 4.29x) meanwhile, leverage decreased slightly to 3.53x (FY19: 4.13x; FY18: 7.12x) mainly on account of lower trade payables by end-9MFY20.

Etihad Sugar Mills Limited (ESML) — Appendix I

BALANCE SHEET	FY18	FY19	9MFY20
Property, Plant & Equipment	9,287	8,904	8,572
Long Term Investments	605	605	3,533
Store, Spares & Loose Tools	212	209	195
Stock in Trade	5,884	2,842	3,098
Trade Debts	63	450	-
Loans, Advances, Prepayments & Other Receivables	3,056	4,105	3,200
Other Assets	28	24	10
Cash & Bank Balances	141	63	74
Total Assets	19,276	17,203	18,682
Trade and Other Payables	4,427	4,698	2,082
Short Term Borrowings	6,569	4187	5,958
Long Term Finances (including current maturity)	1,338	800	2,439
Long-Term Loan from Sponsors (At amortized cost)	442	498	498
Deferred Liabilities	1,081	967	966
Paid Up Capital	990	990	990
Tier-1 Equity	1,946	2,697	3,384
Total Equity	5,420	6,052	6,739
INCOME STATEMENT	FY18	FY19	9MFY20
Net Sales	5,954	13,414	11,949
Gross Profit	194	1,832	1,697
Operating Profit/(Loss)	(203)	1,336	1,283
Finance Cost	652	982	691
Profit/(Loss) Before Tax	(687)	609	810
Profit/(Loss) After Tax	(554)	562	631
FFO	(488)	927	1,132
RATIO ANALYSIS	FY18	FY19	9MFY20
Gross Margin (%)	3.3	13.7	14.2
Net Margin (%)	-	4.2	5.3
Net Working Capital	(2,020)	(1,509)	(1,474)
Current Ratio (x)	0.82	0.84	0.82
FFO to Total Debt (x)	-	0.17	0.17*
FFO to Long Term Debt (x)	-	0.71	0.51*
Debt Servicing Coverage Ratio (x)	0.09	1.25	2.27
ROAA (%)	-	3.1	4.7*
ROAE (%)	-	24.2	27.6*
Gearing (x)	4.29	2.03	2.63
Debt Leverage (x)	7.12	4.13	3.53
Inventory Plus Trade Debts to Short-Term Borrowings (x)	0.91	0.79	0.52

**Annualized*

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 Ratings				
Rating History	**Rating Date**	**Medium to Long Term**	**Short Term**	**Rating Outlook**	**Rating Action**
	RATING TYPE: ENTITY				
	19/11/2020	A-	A-2	Stable	Reaffirmed
	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	General Manager Finance	23-Oct-2020	