RATING REPORT

Etihad Sugar Mills Limited (ESML)

REPORT DATE:
December 06, 2021

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 Outlook	Stable		Stable	
Rating Date	December 06, 2021		*November 19, 2020*	
Rating Action	Reaffirm		Reaffirm	

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):	
Al-Jawahar Technical Pakistanian Contracting Company LLC (UAE)– 40.66%	
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 Shakeel – 7.1%	
Mr. Sohail Munir – 6.6%	

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

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.

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. 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 at end-June'21 to finance working capital requirements, they remain within manageable levels. The company has made investment in 74MW bagasse-based power project, Etihad Power Generation Ltd., with a stake of 49% amounting Rs.605m. An additional Rs. 3.3b has been provided as an interest-bearing loan having repayment tenure of five years, to be paid in lump sum. Further investment in the project is contingent upon the decision of the management. 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 taxes/levies. Ratings will remain dependent upon 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.

ESML crushed 1.85m MT of sugarcane during crushing season of FY20-21 as compared to 1.79m MT; being higher than last year with operational days increasing from 102 days to 118 days. Given slightly lower recovery rate of 10.01% (FY20: 10.32%), sugar production largely remained at previous year levels at around 186,000 MT. as a result of lower sucrose recovery rate, the production of molasses and bagasse increased in the outgoing crushing season with the same reported higher at 90k MT (FY20: 81k MT) and 531k MT (FY20: 504k MT), respectively. 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.

Key Rating Drivers:

Business Risk

The business risk profile of sugar sector is considered high given inherent cyclicality in the crop levels and raw material prices. Moreover, distortion in pricing mechanism of raw material prices and refined sugar also creates challenge for sugar mills. Typically, sugarcane production has a 3-5 year cycle, driven largely by government support for farmers and crop yield. Sugar cane production has increased by 22% to 81 MT on account of increase in area under cultivation and improvement in crop yield during FY21. Based on around 68% crushing and an average recovery rate of 10.2%, the sector has produced 5.62m MT (FY20: 4.8m MT) of sugar in FY21. Moreover, sugar demand is projected at 5.9m MT for the period. While narrow demand and supply dynamics may lead to high sugar prices, government plans to import sugar to keep the prices in check. Also, margins may also be curtailed due to increasing trend in sugarcane prices. During FY21, 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 other segments.

Profitability profile of the company witnessed sizeable improvement in FY20 being a function of higher sales revenue, retail prices and other income. Going forward, VIS expects margins and profitability to remain a function of average retail prices of sugar in the coming years.

Sales revenue of the company increased substantially to Rs. 15.4b exhibiting a growth of 15% as compared to the preceding year attributable to higher retail price of sugar and higher sales of by-products (Bagasse and Molasses) since the recovery rate was on the lower side. A similar trend was noted in the ongoing year. Around 95% of the sales mix continues to be provided by sugar sales. Gross margins improved to 16.6% in FY20 and 17.9% in 9MFY21 owing to higher selling prices in the market. Overall profitability in FY20 was positively affected by higher other income to the tune of Rs. 626m (FY19: Rs. 291m) provided by higher mark-up income on loan to subsidiary- Technical Associates Pakistan Private Limited and Etihad Power Generation Limited. Despite accounting for higher WPPF expenses, net income after tax surged to Rs. 1.14b (FY19: Rs. 562m) in FY20. Given higher gross margins in 9MFY21, profit after tax was reported higher at Rs. 1.19b. Going forward, VIS expects margins and profitability to remain a function of average retail prices of sugar in the coming years.

Adequate liquidity and debt coverage profile with manageable inventory risk

In line with improved profitability, Funds from Operations (FFO) increased sizably during FY20 and the ongoing year. Given improved cash generation coupled with debt at similar levels, FFO to total debt improved to 32.6% (FY19: 16.9%) during FY20. Given elevated debt levels at end-June'21 to finance BMR expansion and working capital requirements, FFO to total debt decreased to 26% in 9MFY21; however remains adequate for the assigned ratings. Further, stock in trade declined sizably at end-Sep'20 on account of offloading of carryover stocks in line with favorable market retail price. However, stock levels at end-June'21 were reported higher at Rs. 3.9b, around 83% of which (in volume terms) has been sold at end-September'21. The debt service coverage improved to 2.6x (FY20: 2.2x, FY19: 1.4x) at end-June'21. Moreover, at end-June'21 ESML has loans amounting to Rs. 2.7b to associate companies; the loans are receivable within twelve months or on demand, meanwhile the markup is charged on quarterly basis ranging between 9.54% to 9.88%.

Capitalization indicators improved in FY20 due to higher equity base and similar debt levels as preceding year. However, gearing increased at end-June'21 due to higher short term debt to finance working capital needs; however they remain within manageable levels

Equity base augmented in line with internal capital generation along with higher sponsor loan. Sponsor loan aggregated to Rs. 667m at end-Sep'21. The debt profile of the company comprised a mix of both long-term and short-term borrowings. The company procured long-term debt during FY20 to finance investment in associated concern. The utilization of short-term borrowings increased to Rs. 5.2b (FY20: Rs. 2.1b) at end-June'21 to finance working capital needs. Gearing and debt leverage ratios improved to 1.54x (FY20: 1.28x; FY19: 2.03x) and 2.02x (FY20: 2.35x; FY19: 4.13x) at end-June'21 led by higher profit retention. In line with periodic contractual repayments and no plans of further debt drawdown, the leverage indicators are expected to decline going forward.

Etihad Sugar Mills Limited (ESML) Appendix I

FINANCIAL SUMMARY *(amounts in PKR millions)*				
BALANCE SHEET	**FY18**	**FY19**	**FY20**	**9MFY21**
Fixed Assets	9,288.5	8,905.1	8,481.3	7,955.4
Stock-in-Trade	5,883.9	2,842.4	696.1	3,918.3
Trade Debts	63.4	449.9	1.2	-
Cash & Bank Balances	141.0	63.1	92.9	421.4
Total Assets	19,275.9	17,202.6	16,707.2	19,920.0
Trade and Other Payables	4,426.6	4,486.4	2,536.7	1,940.9
Long Term Debt	1,780.4	1,298.0	3,061.5	2,877.9
Short Term Debt	6,568.6	4,186.5	2,062.8	5,159.2
Total Debt	8,349.1	5,484.5	5,124.4	8,037.1
Total Equity	1,945.7	2,696.8	4,011.1	5,203.2
Total Liabilities	13,856.3	11,151.1	9,432.8	11,453.5
Paid Up Capital	990.0	990.0	990.0	990.0
INCOME STATEMENT	**FY18**	**FY19**	**FY20**	**9MFY21**
Net Sales	5,953.7	13,414.6	15,444.4	11,250.5
Gross Profit	194.1	1,832.0	2,562.6	2,012.8
Operating Profit	(202.7)	1,336.3	2,105.3	1,755.2
Profit Before Tax	(686.5)	608.6	1,659.3	1,679.0
Profit After Tax	(553.9)	561.8	1,141.7	1,192.1
RATIO ANALYSIS	**FY18**	**FY19**	**FY20**	**9MFY21**
Gross Margin (%)	3.3%	13.7%	16.6%	17.9%
Net Margin (%)	-9.3%	4.2%	7.4%	10.6%
Net Working Capital	(2,020.1)	(1,804.4)	(551.8)	627.4
Trade debts/Sales	1.1%	3.4%	0.0%	0.0%
FFO	(488.3)	927.4	1,671.6	1,552.6
FFO to Total Debt (%)	-5.8%	16.9%	32.6%	25.8%
FFO to Long Term Debt (%)	-27.4%	71.4%	54.6%	71.9%
Debt Servicing Coverage Ratio (x)	0.1	1.40	2.2	2.59
Current Ratio (x)	0.8	0.8	0.9	1.1
Stock+Trade Debts/STD	90.5%	78.6%	33.8%	75.9%
Gearing (x)	4.29	2.03	1.28	1.54
Leverage (x)	7.12	4.13	2.35	2.20
ROAA (%)	-2.9%	3.1%	6.7%	8.7%
ROAE (%)	-28.5%	24.2%	34.0%	34.5%

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		
06/12/2021	A-	A-2	Stable	Reaffirmed
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	CFO	23-Sep-2021
2	Mr. Sajid Ali	AGM Accounts	23-Sep-2021