RATING REPORT

Etihad Sugar Mills Limited

REPORT DATE:
October 25, 2022

RATING ANALYST:
Muhammad Tabish
muhammad.tabish@vis.com.pk

RATING DETAILS				
Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A-	A-2	A-	A-2
Rating Outlook	*Stable*		*Stable*	
Rating Date	*Oct 25, 2022*		*Dec 06, 2021*	
Rating Action	*Reaffirm*		*Reaffirm*	

COMPANY INFORMATION	
Incorporated in 2006	**External Auditors:** Crowe Hussain Chaudhury & Co., Chartered Accountants
Public Un-Listed Company	**CEO:** Mr. Sakandar Ali Choudhry
Key Shareholders (with stake 5% or more):	
Al-Jawahir Technical Overseas Contracting LLC-FZ, Dubai ~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: Industrial Corporates (August 2021) https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

Etihad Sugar Mills Limited

OVERVIEW OF THE INSTITUTION

Etihad Sugar Mills Limited (ESML) was incorporated in 2006 as an unquoted public limited under the Companies Ordinance, 1984. 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 5-6 years and currently serves as CEO of the Company. He has enough experience of Banking, Finance and Administration.

RATING RATIONALE

Etihad Sugar Mills Limited (ESML) has been engaged in manufacturing and sale of white crystalline sugar as well as its by-products for the last 15 years. ESML is headquartered in Lahore, with a manufacturing facility in Karamabad, District Rahim Yar Khan. Total staff strength stands at 874 employees as at end-Sept'21. Since last review, there has been no change in board of director or senior management team.

Regulatory Matter (Update on CCP Penalty)

Ratings have incorporated the developments concerning to penalties imposed by Competition Commission of Pakistan (CCP) on certain sugar mills and legal proceedings for interim relief initiated by the subject company. However, in the meanwhile, uncertainty of outcome would persist on the sector. CCP penalty imposed on ESML stands at Rs. 1.6b.

Long-term Investment Portfolio

ESML's long-term investment portfolio, representing nearly one-fifth of total asset base, comprises investment in two associates (Etihad Alloys Private Limited & Etihad Power Generation Limited (EPGL) - 74MW bagasse-based power project) and one subsidiary (Skyways Aviation Private Limited). In addition, the company has provided Rs. 3.1b to EPGL over the last two years, as an interest-bearing loan with repayment tenure of five years, to be paid in lump sum. Further investment in the project is contingent on management's decision. Once operational, the power project is expected to support the entity's operations and cost inputs.

Operational Performance:

Stated sugarcane crushing capacity on per day basis remains unchanged at 16K MT. As per management, there are no immediate plans to increase capacity; however, capital expenditure is carried out on an annual basis to improve production efficiencies; estimated capex for the season 2022-23 is Rs. 226m. Major additions to fixed assets would include MV switchgear, M.S. pipes, electric cables and roller shaft.

The mill was operational for 138 days during the outgoing crushing season (MY21: 118 days; MY20: 102 days), which is consistent with the industry trend. The mill crushed 2.3m MT of sugarcane, a 26% increase over the last year. This, combined with an improvement in sucrose recovery rate, resulted in ~30% increase in overall sugar production in MY22, which stood at 242K MT (MY21: 186K MT). As per management, the previous year's low sucrose recovery was caused by atmospheric changes, specifically dry weather.

Figure: Sugar Mill - Capacity & Production

	MY20	MY21	MY22
Sugarcane Crushing Capacity (TPD)	16,000	16,000	16,000
Total Cane Crushed (Tons)	1,794,904	1,855,426	2,336,469
Crushing Days	102	118	138
Crushing Per Day (Tons)	17,597	15,724	16,931
Capacity Utilization (%)	110%	98%	106%
Sugar Produced (Tons)	185,211	185,764	241,830
Sucrose Recovery (%)	10.32%	10.01%	10.35%

Molasses Produced (Tons)	81,109	89,885	111,785
Molasses Recovery (%)	4.52%	4.84%	4.78%

Molasses production increased significantly in tandem with cane crushing; however, molasses recovery rate reduced slightly due to imbibition (water use during milling), as there is an inverse relationship between sucrose and molasses recovery. Utilization levels have depicted considerable improvement during MY22 in comparison to the previous crushing seasons.

Key Rating Drivers:

Sugar production exceeded expectations in the current season, causing retail prices to remain low. However, given the impact of floods on sugarcane crop in Sindh and South Punjab, sugar retail prices are likely to trend upwards.
The sugar sector has high business risk profile given inherent cyclicality in crop levels and raw material prices. Moreover, distortion in pricing mechanism of raw material prices and refined sugar also create challenges for sugar mills. Typically, sugarcane production has a 3-5 year cycle, driven largely by government support for farmers and crop yield. During the past two years, government's assurances of paying a minimum support price to farmers has driven the increase in planted area.

As per annual PSMA report, sugarcane production grew by ~22% to 80.9m MT in MY21 on account of increase in area under cultivation and improvement in crop yield. In MY21, sector produced 5.6m MT (MY20: 4.8m MT) of sugar while annual domestic consumption stood at 5.8m MT, based on 72% utilization with average recovery rate of 9.61%. As per recent industry estimates, total sugar production in the current season stood significantly higher at 7.7m MT, resulting in lower retail prices while continued rising trend in sugarcane prices curtailed profitability margins of the mills.

Despite higher production levels, sales in the current season have remained sluggish due to lower quantity sold and decline in retail prices.
Following a year of double-digit annual growth, sales revenue increased by ~7% in MY21 to Rs. 16.5b (MY20: Rs. 15.4b), owing to considerable jump of ~29% in average sale prices as stocks remained scarce in the market. However, the current season saw bumper sugar production, thus sales remained sluggish despite higher production levels, with lower quantity sold and price decline. As per management, total sales for the full year MY22 are projected to reach Rs. 14b, with a closing sugar stock of ~60K MT.

Figure: Sales Data

	MY20	MY21	9M'MY22
Sugar Sold - Quantity (MT)	238,353	196,711	102,058
Sugar Price (Rs. per MT)	68,920	89,220	79,389
Molasses Sold - Quantity (MT)	81,128	89,904	104,362
Molasses Price (Rs. per MT)	13,655	11,186	20,984

Sugar sales account for more than 90% of total revenue, with by-products accounting for the remainder. At present, there are no institutional sales, and all sugar sales are routed through brokers to the market.

Profitability margins have remained under pressure in the current year as sugar prices have fallen.

Given efficient sugarcane procurement, gross margins have improved over time (MY21: 20.3%; MY20: 16.6%; MY19: 13.7%); average procurement cost also [1]compares favorably to similar rated peers. However, margins have remained under pressure in the current year due to decline in sugar prices. On the cost front, absence of aircraft running and maintenance expenses resulted in a significant decrease in administrative overheads. Financial charges have risen to historic levels after falling in the previous year. Other income, primarily markup on loans given to associate and subsidiary companies, continues to support the profitability profile.

Overall liquidity buffers are adequate.

In line with improved bottom-line, funds from operations (FFO) were reported higher at Rs. 1.9b (MY20: Rs. 1.7b; MY19: Rs. 0.9b). Thus, positively impacting the cash flow and debt coverage metrics as reflected by increase in DSCR to 2.44x (MY20: 2.18x) in MY21. However, cash flow generation has remained limited in the ongoing year due to low-profitability.

Current ratio has improved and is now above 1.0x, while coverage of short-term borrowings in relation to stock in trade and trade debts is considered sound. Ageing profile of trade debts is satisfactory, with ~62% of receivables outstanding for less than 90 days and the remainder for more than a year but backed by security deposit.

Leverage indicators have trended downwards over time on account of sustained growth in equity base.

Equity base (excluding revaluation surplus) has witnessed a three-fold increase over the last four marketing years (Sept'18 to present), amounting to Rs. 6.1b (MY21: Rs. 5.6b; MY20: Rs. 4.0b) as at end-June'22. Debt profile comprises a mix of short-term and long-term borrowings. At present, total interest bearing liabilities (inclusive of current portion and loan from sponsors) amounted to Rs. 9.6b (MY21: Rs. 4.3b; MY20: Rs. Rs. 5.1b) as at end-June'22. Leverage and gearing ratios have trended downwards on a timeline basis on account of healthy growth in equity base. Going forward, ratings remain dependent on managing leverage indicators within prudent levels.

MY – Marketing Year (October to September)

FINANCIAL SUMMARY *(amounts in PKR millions)*				Appendix I
BALANCE SHEET	**MY19**	**MY20**	**MY21**	**9M'MY22***
Property, Plant & Equipment	8,905	8,481	7,835	7,738
Long Term Investments	900	3,518	4,020	4,448
Stores & Spares	209	222	277	255
Stock in Trade	2,842	696	235	7,973
Trade Debts	450	1	15	-
Advances, Prepayments & Other Rec	3,404	3,138	3,023	3,051
Cash & Bank Balance	63	93	83	109
Total Assets	**17,203**	**16,459**	**15,609**	**23,589**
Trade & Other Payables	4,486	2,537	692	2,444
Short-term Borrowings	4,187	2,063	1,538	7,179
Long-Term Borrowings *(Including current maturity)*	1,298	3,062	2,808	2,395
Total Liabilities	**11,151**	**9,184**	**6,837**	**14,373**
Paid-up Capital	990	990	990	990
Loan from sponsors	589	667	669	669
Retained Earnings	1,118	2,354	3,973	4,416
Total Equity *(Excluding revaluation surplus)*	**2,697**	**4,011**	**5,632**	**6,075**
INCOME STATEMENT				
Net Sales	**13,415**	**15,444**	**16,466**	**9,224**
Gross Profit	1,832	2,563	3,338	1,472
Operating Profit	1,336	2,105	2,989	1,062
Profit Before Tax	**609**	**1,659**	**2,542**	**625**
Profit After Tax	**562**	**1,142**	**1,495**	**444**
RATIO ANALYSIS				
FFO	927	1,672	1,950	964
Gross Margin (%)	13.7%	16.6%	20.3%	16.0%
Net Margin (%)	4.2%	7.4%	9.1%	4.8%
Net Working Capital	(1,804.4)	(948.3)	73.4	468.0
FFO to Long-Term Debt (x)	0.71	0.55	0.69	0.54
FFO to Total Debt (x)	0.17	0.33	0.45	0.13
Debt Servicing Coverage Ratio (x)	1.40	2.18	2.44	1.06
ROAA (%)	3.1%	6.8%	9.3%	3.0%
ROAE (%)	9.8%	17.1%	18.6%	6.6%
Gearing (x)	2.03	1.28	0.77	1.58
Debt Leverage (x)	4.13	2.29	1.21	2.37
Current Ratio (x)	0.80	0.82	1.02	1.04
Inventory + Receivables to ST Borrowings (x)	79%	34%	16%	111%

**Management Accounts*

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				
	25/10/2022	A-	A-2	Stable	Reaffirmed
	06/12/2021	A-	A-2	Stable	Reaffirmed
	19/11/2020	A-	A-2	Stable	Reaffirmed
	10/1/2020	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. Copyright 2022 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.				
Due Diligence Meetings Conducted	**Name**	**Designation**	**Date**		
	Mr. Sajid Ali	Manager Finance	27/09/2022		