RATING REPORT

Etihad Sugar Mills Limited

REPORT DATE:
February 21, 2024

RATING ANALYST:
Hannan Athar
hannan.athar@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	*Feb 21, 2024*		*Oct 25,2022*	
Rating Action	*Upgrade*		*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 Shakil ~7.1%	
Mr. Sohail Munir ~6.6%	

APPLICABLE METHODOLOGY

VIS Entity Rating Criteria: Corporates
https://docs.vis.com.pk/docs/CorporateMethodology.pdf

VIS Rating scale
https://docs.vis.com.pk/docs/VISRatingScales.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 of sugar and its byproducts.

Profile of CEO

Sakanadar Ali Choudhry has been actively involved in the company's operations and currently serves as CEO of ESML. He has experience of Banking, Finance and Administration.

Financial Snapshot

Tier-1 Equity: end-MY23: Rs. 8.9b; end-MY22: Rs. 6.9b; end-MY21: Rs. 5.6b

Total Assets: end-MY23: Rs. 26.4b; end-MY22: Rs. 24.6b; end-MY21: Rs. 15.6b

Profit After Tax: MY23: Rs. 1.97b; MY22: Rs. 497.8m; MY21: Rs. 1.5b

RATING RATIONALE

Etihad Sugar Mills Limited (ESML) is engaged in manufacturing and sale of white crystalline sugar along with by-products. ESML headquartered is in Lahore, with a manufacturing facility in Mauza Karamabad, District Rahim Yar Khan.

Business Risk & Sector Update: Pakistan is the seventh-largest producer and the fifth-largest consumer of sugar. The sector has strategic importance due to linkages with national food security, rural economy, and agricultural growth. Sugar production contributes 0.8% to GDP and 3.7% to agriculture's value addition. 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%). 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 but raising yields by 40 to 50 percent. According to the data collected by Federal Bureau of Revenue (FBR), as of August 15, 2023 the country has 2.27million metric tons (MT) of sugar stock available. More than 1.7m MT surplus sugar was available at the start of crushing season MY23.

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 PSMA, which represents the sugar mill owners, and Government of Pakistan, to allow export of 2 million tons of sugar, to cover up for the higher costs associated with producing sugar and pulling the industry out of crisis. In addition, 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 in the outgoing year. On aggregate, direct losses from rice, cotton, and sugarcane were USD 1.30b (rice: USD 543m, cotton: USD 485m, and sugarcane: USD 273m).

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 quota in MY23. 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.

Update on regulatory matter involving penalty imposed by Competition Commission of Pakistan (CCP): The ratings incorporate the developments in relation to penalties imposed by Competition Commission of Pakistan (CCP) on selected sugar mills and the subsequent legal proceedings initiated by the subject company. ESML has filed a petition before Lahore High Court, Lahore against the impugned order dated 13 August 2021 by the Competition Commission of Pakistan (CCP) in which a penalty of Rs. 1.6b was imposed on the Company for distorting competition in the market by sharing sensitive commercial stock information. The Lahore High Court, Lahore vide order dated 07 October 2021 suspended the impugned order and restrained the authorities from recovering any amounts from the Company till the next date of hearing. The case is pending adjudication. Nevertheless, the material impact of penalty imposed will still be significant and hence VIS will continue to monitor further development in this matter.

Production Update:

Sugar Division:

Crushing season for 2022-23 started on Nov 25, 2022, while it ended on Mar 15th 2023, lasting a total of 111 days (2021-22: 138 days; 2020-21: 118 days). Due to the shorter duration, sugarcane crushed was reported lower at 1.97m MT (2021-22: 2.34m MT; 2020-21: 1.86m MT); however, sucrose recovery rate improved to 10.99% (2021-22: 10.35%), as the company procured better quality cane locally. As per the management, cane procured from mill gate area was approximately 60-70% of the total procurement. The company facilitates cane growers by providing them with loan facility for crop inputs, while the Research & Development (R&D) department ensures that high quality cane is transferred to the mill for crushing. Sugar production was recorded lower at 217,034 MT (2021-22: 241,830 MT; 2020-21: 185,764 MT). Similarly, molasses production was recorded at 90,424 MT (2021-22: 111,785 MT; 2020-21: 89,885 MT) with decrease in recovery rate to 4.58% (2021-22: 4.78%; 2020-21: 4.84%). A snapshot of production related information of sugar segment is tabulated below:

Sugar Plant	MY21	MY22	MY23
Sugarcane Crushing Capacity-tpd	16,000	16,000	25,000
Total Cane Crushed (Tons)	1,855,426	2,336,469	1,975,739
Crushing Days	118	138	111
Crushing Per Day (Tons)	15,724	16,931	17,799
Capacity Utilization (%)	98%	106%	111%
Sugar Produced (Tons)	185,764	241,830	217,034
Sucrose Recovery (%)	10.01%	10.35%	10.99%
Molasses Produced (Tons)	89,885	111,785	90,424
Molasses Recovery (%)	4.84%	4.78%	4.58%

The sugarcane crushing capacity on per day basis increased to 25K MT during FY23, as the company obtained the regularization certificate from Directorate General of Industries, Price, Weights & Measures (DGIPWM). As per management, currently the mill can reach an optimum crushing capacity of 20,000 tons crushed per day (TCD); however, for higher capacity utilization ESML would need to carryout Balancing Modernization and Replacement (BMR). Property, plant, and equipment was recorded at Rs. 11.8b (MY22: 12.4b). Additions during the outgoing year amounted to Rs. 193.5m (MY22: Rs. 229.2m), which mainly included additions to vehicles (including those on leases) amounting to Rs. 91.7m, building amounting to Rs. 80.7m and plant & machinery amounting to Rs. 37.6m.

Long-term investments stood muted at Rs. 4.6b (MY22: Rs. 4.6b) by end-MY23, amounting to nearly one-fifth of the total asset base, details of which are given below:

1. **Etihad Power Generation Limited (EPGL):** This is a 74MW bagasse-based power plant. During MY22, the long-term loan of Rs. 3.142b and short-term loan amounting to Rs. 293.9m together with accrued markup 8thereon amounting to Rs. 306.4m were converted into non-redeemable, non-participatory preference shares of EPGL. The company has also invested Rs. 604.8m at cost in EPGL. On 9th May, 2023 the company requested National Electric Power Regulatory Authority (NEPRA) to grant it power supply license; however, it has not yet been granted. EPGL is currently in process of importing machinery from China, which is expected to delay Commencement of Operations (COD) till Dec'24. The company held 49% shares in EPGL at end-MY23.

2. **Etihad Alloys (Private) Limited (EAPL):** Etihad Group is also setting up a steel industrial unit in Rahim Yar Khan adjacent to its existing Sugar Mill – Etihad Alloys (Pvt.) Limited (EAPL). The unit will have steel melting capacity of 250,000 MT per annum. Primarily, EAPL will be engaged in the manufacturing of steel billets and bars. The investment amounting to Rs. 271.9m is made in the ordinary shares of EAPL. At end-MY23, ESML held 49% shares in EAPL. EAPL is expected to be operational till end-Dec'24 and will buy energy directly from EPGL.

3. **Skyways Aviation (Private) Limited (SAPL):** This represents minimal investment made in Skyways Aviation (Private) Limited (SAPL). The Company held 99.8% shares in SAPL at end-MY23. Two shares are held in the name of Directors of SAPL. SAPL was established with the purpose of providing the services of a hanger; however, the company is currently not operational.

<u>Revenues and Profitability:</u> During the outgoing year (i.e., MY23), net sales were recorded higher at Rs. 22.8b (MY22: Rs. 14.5b) due to higher volumetric sales coupled with higher selling prices of the sugar vis-à-vis MY22. Around 84% of the net sales constituted sugar sales, while molasses sales amounted to ~11.2%. Bagasse and mud sales have remained modest on a timeline basis. ESML only sells to open market brokers; hence client concentration risk of the company remains negligible. During the outgoing year, net average selling price of sugar produced by ESML remained on the lower side as compared to those of other industry players, as the company sold majority of sugar, not awaiting favorable prices in the future.

Rs. Million (Gross Sales)	MY21	MY22	MY23
Sugar Sold (Bags)	3,934,211	3,571,428	4,669,469
Sugar Price/Bag	4,461	3,947	4,806
Molasses Sold (MT)	89,904	111,785	90,425
Molasses Price/MT	11,186	21,166	28,175

Cost of sales were recorded higher at Rs. 18.1b (MY22: Rs. 12.2b) during the same period. During the crushing season 2022-23, the company procured cane at an average cost of Rs. 314/maund (2021-22: Rs. 246.7/ maund) vis-à-vis a support price of Rs. 300/maund during the same period. Gross margins during MY23 were recorded higher at 20.6% (MY22: 16.2%), mainly due to better average selling prices of carryover sugar stock coupled with the impact of higher sucrose recovery. Administration expenses witnessed a surge amounting to Rs. 938.1m (MY22: Rs. 413.9m), mainly due to increase in salaries and wages payables amidst inflationary pressures, directors numeration and other miscellaneous expenses. Distribution and selling expenses increased to Rs. 97.2m (MY22: Rs. 56.4m), which mainly included commissions on sales and godown expenses. Financial charges were recorded at Rs. 1.2b (MY22: Rs. 1.1b), with tilt mainly towards long-term borrowings (at end-MY23) coupled with higher markup rates. Other income during the same period, increased sizably to Rs. 781.2m (MY22: Rs. 447.8m), mainly due to higher markup charged to EPGL. Accounting for taxation, net profit was recorded higher at Rs. 1.97b (MY22: Rs. 497.8m), with better net margins at 8.6% (MY22: 3.4%), primarily due to higher topline, better gross margins and higher other income.

The crushing season 2023-24 officially started on 25th November, 2023, with approval given by the Punjab government. Retail sugar prices, while remaining relatively elevated, have recently exhibited a downward trend on account of government intervention aimed at reducing smuggling across the Afghan border and hoarding of sugar stock. Meanwhile, given higher support prices of sugarcane at Rs. 400/maund for Punjab for the crushing season 2023-24 and lower available sugar stocks in the country, it is expected that sugar prices may increase, in the ongoing year. However, MY24 is anticipated to be yet another challenging year for various industries due to the escalating socio-political instability and macroeconomic hurdles. Going forward, the ratings upgradation will remain dependent on the share of profit received from the associates (once they commence operations) which is expected to bolster profitability.

Liquidity Profile:

The liquidity position of the company has depicted improvement on a timeline basis. On the back of internal capital generation, funds from operations (FFO) were recorded higher at Rs. 2.05b (MY22: Rs. 871.9m) in MY23. As a result of higher FFO, coupled with lower seasonal short-term borrowings at reporting date, FFO-to-total debt and FFO-to-long-term debt strengthened to 0.85x (MY22: 0.17x) and 0.97x (MY22: 0.56x) respectively during MY23. Debt service coverage ratio (DSCR) also improved to 1.87x (MY22: 1.19x).

Stores, spares and loose tools were recorded higher at Rs. 357.6m (MY22: Rs. 319.3m) by end-MY23. Stock in trade stood at Rs. 3.1b (MY22: Rs. 3.8b), out of which Rs. 3.05b pertains to finished sugar stock. By end-MY23, the company held 49,051 MT of sugar stock. Trade debts have remained negligible on a timeline basis amounting to Rs. nil (MY22: Rs. 17.5m) at end-MY23. By end-MY23, loans, advances and prepayments were recorded sizably higher at Rs. 6.5b (MY22: Rs. 3.1b). These mainly included advances to associates such as Technical Associates Pakistan (Pvt.) Ltd (TAPL) and EAPL amounting to Rs. 2.25b and Rs.1.74b respectively, coupled with advances made to cane growers and suppliers. Cash and bank balances were recorded at Rs. 96.3m (MY22: Rs. 111.6m).

Trade and other payables (including accrued markup) were recorded higher at Rs. 5.6b (MY22: Rs. 2.6b) by end-MY23. These mainly includes advances from customers amounting to Rs. 4.2b (MY22: Rs. 1.66b) against which sugar inventory was not yet dispatched as of the reporting date. Despite higher contract liabilities, current ratio improved to 1.60x (MY22: 1.07x) mainly due to increase in advances made to TAPL and EPGL. Coverage of short-term borrowings via stock in trade and trade debts improved to 9.81x (MY22: 1.06x) mainly due to lower short-term borrowings at end-MY23.

Capitalization Profile: Tier-1 equity stood higher at Rs. 8.9b (MY22: Rs. 6.9b) by end-MY23, on account of profit retention. The company did not declare any cash dividend in MY23. Gearing and debt leverage improved to 0.27x (MY22: 0.75x) and 1.30x (MY22: 1.69x) respectively on the back of equity expansion and lower short-term borrowings at end-MY23.

Short-term borrowings were recorded at Rs. 314.3m (MY22: Rs. 3.6b) at end-MY23. The company has obtained various funded and unfunded financial facilities from different banks/financial institutions for a total sanctioned limit of Rs. 8.3b towards working capital requirements, for retirement of foreign LCs and issuance of letters of guarantee. Mark-up on these facilities is at 1–6 month KIBOR + 1% - 5%. These arrangements are secured by way of pari passu and ranking charge over the Company's present and future current and fixed assets and personal guarantees of directors.

Long-term loans (including current maturity & leases) stood higher at Rs. 2.1b (MY22: Rs. 1.55b) at end-MY23. During MY23, the company obtained Rs. 1.0b from Habib Bank Limited (HBL) to provide funds to its subsidiary EAPL. The loan has a grace period of 1.5 years and is priced at 6 month KIBOR + 2.5% payable semi-annually. ESML charges fixed interest rate of 20% to EAPL. Going forward, the management plans not to mobilize further long-term borrowings in the foreseeable future; leverage indicators are expected to remain within manageable levels. The assigned ratings remain underpinned on achievement of projected capitalization indicators.

FINANCIAL SUMMARY *(amounts in PKR millions)*

BALANCE SHEET	MY21	MY22	MY23*
Property, plant and Equipment	7,809.9	12,355.2	11,811.6
Long-term Investments	4,019.6	4,619.9	4,619.9
Stores, spares and loose tools	277.0	319.3	357.6
Stock-in-Trade	235.0	3,849.9	3,083.4
Trade Debts	15.5	17.5	-
Advances, Prepayments and other receivables	3,023.2	3,065.5	6,452.6
Accrued Interest	105.6	216.2	-
Cash & Bank Balances	83.4	111.6	96.3
Other Assets	39.9	42.3	18.2
Total Assets	15,609.0	24,597.4	26,439.6
Accrued Markup	187.9	353.4	-
Trade and Other Payables	692.4	2,578.9	5,581.4
Long Term Debt	2,808.1	1,553.7	2,100.8
Short Term Debt	1,538.1	3,637.0	314.3
Total Debt	4,346.2	5,190.7	2,415.1
Deferred Liabilities	1,575.8	3,579.5	3,578.1
Other Liabilities	35.2	-	-
Total Liabilities	6,837.5	11,702.4	11,574.7
Paid Up Capital	990.0	990.0	990.0
Tier-1 Equity	5,631.9	6,920.9	8,890.8
Total Equity	8,771.6	12,895.0	14,864.9

INCOME STATEMENT	MY21	MY22	MY23
Net Sales	16,465.8	14,538.3	22,840.2
Gross Profit	3,337.9	2,349.3	4,702.9
Other Expenses	232.2	87.5	-
Other Income	535.2	447.8	781.2
Finance Cost	749.9	1,140.8	1,219.5
Profit Before Tax	2,542.3	1,098.5	3,229.3
Profit After Tax	1,495.3	497.8	1,969.9

RATIO ANALYSIS	MY21	MY22	MY23
Gross Margin (%)	20.3%	16.2%	20.6%
Net Margin (%)	9.1%	3.4%	8.6%
Current Ratio (x)	1.02	1.07	1.60
Net Working Capital	73.4	508.9	3,736.6
FFO	1,950.3	871.9	2,047.7
FFO to Total Debt (%)	0.45	0.17	0.85
FFO to Long Term Debt (%)	0.69	0.56	0.97
Debt Servicing Coverage Ratio (x)	2.57	1.19	1.87
Stock+Trade Debts/STD	0.16	1.06	9.81
Gearing (x)	0.77	0.75	0.27
Leverage (x)	1.21	1.69	1.30
ROAA (%)	9.3%	3.3%	10.3%
ROAE (%)	18.6%	6.1%	18.9%

*Unaudited

REGULATORY DISCLOSURES — Appendix II

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				
21/02/2024	A	A-2	Stable	Upgrade
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 2024 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. Sohail Dil	CFO	08/11/2023
Mr. Sajid Ali	AGM Accounts & Finance	08/11/2023