RATING REPORT

Indus Sugar Mills Limited

REPORT DATE:
November 08, 2022

RATING ANALYSTS:

Tayyaba Ijaz, CFA
tayyaba.ijaz@vis.com.pk

RATING DETAILS		
Rating Category	Initial Rating	
	Long-term	Short-term
Entity	A-	A-1
Rating Outlook	*Stable*	
Rating Action	Initial	
Rating Date	*Nov 08, 2022*	

COMPANY INFORMATION	
Incorporated in 1980	**External auditors:** Malik & Co Chartered Accountants.
Public Limited Company (Unquoted)	**CEO/Chairman:** Mr. Ayub Sabir Izhar
Key Shareholders (with stake 5% or more):	
Mr. Hamza Dastgir – 27.3%	
Mr. Ayub Sabir Izhar – 26.6%	
Begum Syeda Iqbal – 9.3%	
Sardar Hasnan Bahadur Khan Dreshak – 5.3%	
Mr. Ali Raza Khan – 5.1%	
Sardar Zulfiqar Khan Dreshak – 5.0%	

APPLICABLE METHODOLOGY(IES)

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

Indus Sugar Mills Limited

OVERVIEW OF THE INSTITUTION

Indus Sugar Mills Limited was incorporated as unlisted Public Limited Company on Dec 13, 1980 under the Companies Act 1913 and then under the repealed Companies Ordinance 1984 (now the Companies Act, 2017). Registered office of the company is located at 17-Tipu Block, new Garden Town, Lahore.

Financial Snapshot

Tier-1 Equityend-MY21: Rs. 3.8; end-MY20: Rs. 2.6b; end-MY19: Rs. 1.6

Assets: end-MY21: Rs. 9.1b; end-MY20: Rs. 6.8b; end-MY19: Rs. 4.7b.

Profit After Tax: MY21: Rs. 1.1b; MY20: Rs. 1.0b; MY19: Rs. 258.6m.

RATING RATIONALE

Indus Sugar Mills Limited (ISML) is principally involved in production and sale of sugar and allied products. The shareholding of the company is vested with three families in equal proportion. The ratings incorporate sustained topline and sizeable margins supported by higher sugar prices, better sucrose recovery rates and relatively lower cost of cane procurement. Liquidity profile is under pinned by adequate cash flow coverages in relation to outstanding obligations. Cash conversion cycle of the company has also remained favorable relative to industry. The company has low leveraged capital structure, supported by equity growth due to profit retention and lower debt levels.

Key Rating Drivers

Sugar industry of Pakistan and the impact of recent floods: Sugarcane crop is a high value cash crop which is the second largest agro-industry sector after textile. Sugarcane production accounts for 3.4% in agriculture's value addition and 0.7% in the country's GDP. As per Pakistan Bureau of Statistics (PBS), during 2021-22, sugarcane was cropped on 1,260K hectares, recording an increase of 8.2% compared to the last year's sown area of 1,165K hectares. A bumper sugarcane crop production has been recorded at 88.6m during 2021-22 season, up by 9.4% over last year (FY2020-21: 81m). The higher domestic sugar price, better sugarcane procurement price and favorable weather conditions incentivized growers to dedicate more area to sugarcane. With largely intact recovery rates, sugar production during the outgoing season has been projected at 6.7m tons while sugar consumption is expected to increase slightly to 5.9m tons (MY21: 5.8m tons). However, despite sufficient supply, sugar prices witnessed an increasing trend over the last three years with prices in September 2021 were 92% higher than the prevailing prices in October 2018. To control prices, Government of Pakistan (GoP) imported more than 350,000 tons of sugar in 2020-21. The imports were meant to build stocks and not to be sold in the market, however, given higher production the imports were discontinued in the outgoing year. The average sugar prices in MY22 also remained lower than the previous year.

The government's assurances of paying a minimum support price, and the increase in the procurement price, has driven the 11% increase in the planted area during the past two years. In late 2021 and early 2022, farmers received good procurement prices, providing more incentive to expand area and apply sufficient inputs. In addition, the government directed sugar mill owners to pay sugarcane producers overdue payments for the outstanding deliveries to mills over the past few years. Typically, sugarcane production has a 3-to-5-year cycle, driven largely by government support for farmers and crop yield. For the outgoing crushing season, notified prices of sugarcane were revised to Rs. 225 per 40 Kg from Rs. 200 per 40 Kg in Punjab and Rs. 250 per 40 Kg from Rs. 202 per 40 Kg in Sindh. Even after substantial increase in support prices by the Provincial Governments, the industry procured sugarcane at higher rates, however, due to higher supply of cane, the premium paid above support prices was relatively lower in MY22 than the previous season.

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 cane prices and refined sugar also creates challenge for sugar mills. In efforts to regulate the sector, bring transparency and enhance tax collection, Federal Board of Revenue (FBR) has implemented Track & Trace System during Sep-Nov'21 across the country to ensure electronic monitoring of the production and sale of important sectors, including tobacco, fertilizer, sugar and cement sectors. Under the Track & Trace System, no bag of sugar can be taken out from the factory and manufacturing plant without stamp and individual identity mark. To ensure its implementation, Regional Enforcement hubs across Pakistan were tasked to conduct raids on the unstamped /non-tax paid sugar.

According to a report by United States department of Agriculture (USDA), for MY2022-23 sugarcane production was forecasted at 89.5m, a marginal increase over the previous year, with a slight increase in planted area. As a result, harvested cane area is forecast to grow to just under 1.3m hectares. Meanwhile, the recent floods in Pakistan have brought devastation for the major crops of Pakistan. Sindh, which accounts for around 31% of sugarcane production where it is predominantly grown in the northeastern districts. As per sources, floods caused loss of around 10.5m tons of sugarcane crop or equivalently 61% loss of the expected production in the province. In value terms, this amounts to USD 273m. The destruction in the agriculture sector means that Pakistan will not only encounter a supply shortage for industries but there could also be a seed crisis in the country.

Company's Introduction: ISML's manufacturing facilities are located at Kot Bahadur, Rajanpur, in Southwestern Punjab. The company has also agricultural farms over an area of 4000 acres near the mill. The shareholding is held by three families in equal proportion. The Board of Directors (BoD) constitutes six members from the sponsoring families, with Mr. Ayub Sabir Izhar being the CEO and Chairman of the board. Mrs. Masoom Zehra, another board member, also holds the position of Deputy CEO and is actively involved in day-to-day operations of the company. Board meetings are held on ad-hoc basis. The Board constitutes experienced resources from diversified interests including real estate, agriculture, law and business management.

ISML's Operations: ISML has an installed crushing capacity of 9,500 MT per day. The mill remained operational for 134 days (2020-21: 112 days; 2019-20: 111 days) as the 2021-22 crushing season lasted till March 28th, 2022 due to higher cane availability. The company has maintained relatively good sucrose recovery ratio on a timeline basis emanating from better crop availability and balancing, modernization and replacement (BMR) on a continuous basis. During the outgoing season, the mill crushed 1.49m MT (2020-21: 1.12m MT; 2019-20: 1.15m MT) of sugarcane. Capacity utilization has remained optimal on a timeline basis. Sugar production during the season was reported at 151.6K MT (2020-21: 112.3K MT; 2019-20: 117.4K MT). Accordingly, molasses production was recorded at 62.4K MT (2020-21: 47.1K MT; 2019-20: 48.2K MT).

Property, plant and equipment (PP&E) stood higher at Rs. 4.5b (MY20: Rs. 3.2b; MY19: Rs. 3.4b) primarily on account revaluation surplus of Rs. 1.33b related to plant and machinery and building. Capital work in progress amounting Rs. 558.1m (MY20 & 19: Nil). These largely pertained to efficiency enhancement for BMR. The company has 7.5 to 8 MW of power requirement which is entirely met through bagasse fueled captive power facility of 11 MW capacity. In addition, the company also has a sanctioned load from national grid. However, due to considerable cost difference, the power requirement is entirely met through in-house generation.

Sales and Profitability: ISML sells crystalline sugar and other by-products in the open market. The sugar sale is executed through brokers. Net revenue of the company grew marginally to Rs. 9.3b (MY20: Rs. 9.1b; MY19: Rs. 6.6b) as the impact of higher selling prices of key products was largely offset by decrease in volumetric sales during MY21. Sugar contributes around 90% to the revenue mix of the company. Gross revenue from sugar was reported slightly higher at Rs. 9.6b (MY20: Rs. 9.4b; MY19: Rs. 6.7b) with some decrease in quantity sold to 112,032 MT of sugar (MY21: 118,566 MT; MY20: 79,988 MT). The average sugar prices exhibited ~30% increase in MY21 vis-à-vis preceding year. Molasses sale, with a contribution of 9% in the sales mix, was reported slightly higher at Rs. 987.9m (MY20: Rs. 890.0m; MY19: Rs. 445.9m) on account of increase in average prices. Other products included bagasse and mud sale. During 9MFY22, ISML sold 60,733 MT of sugar while average rates were slightly lower at Rs. 82,650 MT owing to demand supply dynamics.

During MY21, the company generated Rs. 2.0b (MY20: 2.0b; MY19: Rs. 733.6m) in gross profits with gross margins of 21.5% (MY20: 21.9%; MY19: 11.0%). Sizeable margins have primarily been a function of higher sugar prices, better recovery rates and cane procurement at relatively competitive rates. The company procured sugarcane at a higher average rate of Rs. 5,853.3 per MT (MY20: Rs. 5,101.7 per MT; MY19: Rs. 4,702.4 per MT) due to increase in sugarcane support price. Sugarcane consumed accounted for nearly 88% of the cost of goods manufactured while other cost components were largely rationalized. Administrative and distribution expenses amounted to Rs. 231.3m (MY20: 234.2m; MY19: Rs. 194.8m) and Rs. 11.6m (MY20: Rs. 13.2m; MY19: 27.1m), respectively. Other expenses of Rs. 117.8m (MY20: Rs. 109.0m; MY19: Rs. 25.9m) pertains to employees related funds contributions. Other operating income increased to Rs. 47.1m (MY20: Rs. 21.4m; MY19: Rs. 0.6m) due to net fair value gain of Rs. 42.3m on initial measurement of biological assets. Finance cost was recorded notably lower at Rs. 94.2m (MY20: Rs. 208.8m; MY19: Rs. 137.3m) primarily on account of lower average markup rates during MY21. Accounting for taxation, net profits were reported slightly higher at Rs.1.1b (MY20: 1.0b; MY19: Rs. 258.6m) with some increase in net margins to 12.1% (MY20: 11.5%; MY19: 3.9%) owing to rationalized operating expenses and decrease in finance cost.

Adequate liquidity profile in terms of cash flow coverages and working capital management: The liquidity position of the company has remained adequate over the years. The company generated Rs. 1.4b (MY20: Rs. 1.6b; MY19: Rs. 410.1m) in funds from operations (FFO). FFO to total debt and FFO to long-term debt were reported at 4.70x (MY20: 3.72x; MY19: 1.69x) and 28.14x (MY20: 23.38x; MY19: n/a), respectively. Debt service coverage remained sizeable at 12.79x (MY20: 12.79x; MY19: 8.22x) due to minimal long-term repayments and healthy cash flows.

Stock in trade stood at Rs. 471.9m (MY20: 413.7m; MY19: Rs. 875.2m) at end-MY21. Biological assets worth Rs. 150.1m (MY20: Rs. 163.4m; MY19: Rs. 183.2m) comprised standing crops. The company started its cane farming in 2018 with cost model according to the requirements of IAS-41. The company has now adopted the fair value model in accordance with the requirements of IAS-41 and IFRS-13 (Fair value measurements). The company has maintained sizeable cash and bank balances of Rs. 2.2b (MY20: 2.4b; MY19: Rs. 176.3m) at end-MY21. Trade debts have remained minimal owing to majority sales on cash basis while trade and other payables were relatively higher mainly owing to advances from customers. Net operating cycle remained negative for the past two years amidst higher receivables and inventory turnover along with slower payables turnover. In comparison to peers, the current ratio and short-term borrowings coverage ratio remained sound at 1.91x (MY20: 1.82x; MY19: 1.48x) and 1.95x (MY20: 1.14x; MY19: 3.61x), respectively, on a trimline basis.

Low leveraged capital structure supported by minimal borrowings and profit retention: The core equity has augmented over the years to Rs. 3.8b (MY20: Rs. 2.6b; MY19: Rs. 1.7b) on the back of internal capital generation. Total equity, including revaluation surplus on PP&E, stood at 6.0b (MY20: 3.9b; MY19: Rs. 3.0b). The debt profile of the company largely includes short-term borrowings to meet working capital requirements while long-term liability only represents lease liabilities against right of use assets. Additionally, short-term borrowings at year-end have also remained low and comprised only agricultural finance facility for giving advances to growers. Hence, gearing remained at very comfortable level (MY21: 0.08x; MY20: 0.16x; MY19: 0.15x). Provision for taxation amounted to Rs. 414.7m (MY20: Rs. 271.9m; MY19: Nil). Deferred liabilities amounting Rs. 992.5m (MY20: Rs. 873.1m: MY19: Rs. 914.2m) included deferred taxation arising from temporary differences relating to accelerated depreciation and revaluation surplus. Debt leverage has remained at manageable level over the years (MY21: 0.82x; MY20: 1.07x; MY19: 1.21x). The company does not intend to execute any capacity enhancement in the medium term due to the country's economic and political constraints, therefore, there would be no need to mobilize any long-term financing in the foreseeable future amidst sufficient availability of cash flows. Hence, capitalization profile is expected to remain strong, going forward.

Regulatory matter related to imposed penalty: The ratings have incorporated 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. The impact of the imposed penalty would be significant. However, according to the management, the case is weak and any final decision by the court of law in this regard may take several years. Given uncertainty and material effect of the outcome, VIS will continue to monitor further developments in this matter.

Indus Sugar Mills Limited Annexure I

BALANCE SHEET (in PKR millions)	Sep 30, 2019	Sep 30, 2020	Sep 30, 2021
Property and Equipment	3,357	3,212	5,052
Stores, Spares and Loose Tools	161	180	398
Stock in Trade	875	414	472
Trade Debts	3	3	1
Biological Assets	183	163	150
Advances, deposit, prepayments	210	303	775
Cash & Bank Balances	176	2,408	2,153
Other Assets	2	77	49
Total Assets	**4,967**	**6,761**	**9,050**
Trade and Other Payables	842	1,251	1,382
Short Term Borrowings	243	364	243
Lease Liabilities against Right of Use Assets	-	69	49
Deferred Liabilities	914	873	993
Provision for Taxation	-	272	415
Total Liabilities	**1,999**	**2,829**	**3,081**
Paid Up Capital	177	177	177
Core Equity	**1,651**	**2,649**	**3,771**
Total Equity Including Revaluation Surplus	**2,968**	**3,932**	**5,969**
INCOME STATEMENT	**Sep 30, 2019**	**Sep 30, 2020**	**Sep 30, 2021**
Net Sales	6,647	9,076	9,301
Gross Profit	734	1,991	1,997
Operating Profit	512	1,744	1,755
Finance Cost	137	209	94
Profit Before Tax	349	1,447	1,590
Profit After Tax	259	1,040	1,123
RATIO ANALYSIS	**Sep 30, 2019**	**Sep 30, 2020**	**Sep 30, 2021**
Gross Margin (%)	11.0	21.9	21.5
Net Margins (%)	3.9	11.5	12.1
Current Ratio (x)	1.48	1.82	1.91
Net Working Capital	523	1,565	1,886
Funds from Operations (FFO)	410	1,613	1,369
FFO to Total Debt (x)	1.69	3.72	4.70
Debt Leverage (x)	1.21	1.07	0.82
Gearing (x)	0.15	0.16	0.08
Debt Servicing Coverage Ratio (x)	2.38	8.22	12.8
ROAA (%)	5.2	17.7	14.2
ROAE (%)	15.7	48.4	35.0
(Stock in Trade+ Trade Debt) to Short-Term Borrowing (x)	3.61	1.14	1.95
Net Operating Cycle (days)	2	(21)	(44)

ISSUE/ISSUER RATING SCALE & DEFINITION Annexure 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 — Annexure III

Name of Rated Entity	Indus Sugar Mills Limited
Sector	Sugar
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings
Rating History	see table below
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.
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. VIS is not an NRSRO and its ratings are not NRSRO credit ratings. Copyright 2022 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
08-Nov-22	A-	A-1	Stable	Initial

Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Abdul Sattar Qureshi	Financial Advisor	Sep 29, 2022
Mr. Muhammad Ali	General Manager Finance	
Mr. Behzad Bashir	Dy. General Manager Accounts	
Mr. Usman Tariq	Manager Finance	