RATING REPORT

Indus Sugar Mills Limited

REPORT DATE:

December 7, 2023

RATING ANALYSTS:

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

RATING DETAILS				
Rating Category	Latest Ratings		Previous Ratings	
	Long-term	Short-term	Long-term	Short-term
Entity	A-	A-1	A-	A-1
Rating Date	Dec 07, 2023		Nov 08, 2022	
Rating Action	Reaffirmed		Initial	
Rating Outlook	Stable		Stable	

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 – 6.41%	
Mr. Ali Raza Khan – 6.38%	
Sardar Zulfiqar Khan Dreshak – 6.37%	

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was incorporated as unlisted Public Limited Company on Dec 13, 1980 under the Companies Act 1913 and then under the repealed Companies Ordinance 1984 (now the Companies Act, 2017).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.

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 notable growth in topline and sizeable margins, in the outgoing year, supported by higher volumetric sale and sugar prices, better sucrose recovery rates and relatively lower cost of cane procurement owing to favorable geographic location. Liquidity profile is underpinned 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

Business Risk & Sector Update: Pakistan is the seventh-largest producer and the fifth-largest consumer of sugar. 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%). Its production contributes 0.8% to GDP and 3.7% to agriculture's value addition. 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 by raising yields by 40 to 50 percent. According to the data collected by Ministry of Food Security, through September 30, 2022, at least 5.3 million metric tons (MT) of sugar has been removed from inventories or has been consumed. The volume of sugar consumed each day is around 15,980 tons. More than 1.7m MT surplus sugar was available at the start of crushing season MY23. Additionally, exporting this surplus sugar would have generated USD 1.0b in foreign currency. During CY22, 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. On aggregate, direct losses from rice, cotton, and sugarcane were USD 1.30b (rice: USD 543m, cotton: USD 485m, and sugarcane: USD 273m).

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.

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 in MY22. 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.

Operations Update: During the outgoing season 2022-23, the mill remained operational for 112 days as compared to 134 days in the preceding year, on account of lower cane availability caused by floods. The cane crushing during the season was lower by ~18% while average sucrose recovery ratio improved to 10.39% (MY22: 10.16%) primarily due to better quality of crop. As a result, the Company managed to produce 127.6K tons of sugar (MY22: 151.6K tons) in the outgoing season. Similarly, due to lower crushing, molasses production decreased by ~15% with recovery rate of 4.33% (MY22: 4.18%). The production statistics for three years are tabulated below:

Crushing Season	2020-21	2021-22	2022-23
Sugarcane Crushed (tons)	1,116,920	1,492,104	1,229,053
Sucrose Recovery	10.06%	10.16%	10.39%
Sugar Production (tons)	112,315	151,635	127,639
Molasses Produced (tons)	47,120	62,390	53,240
Molasses Recovery	4.22%	4.18%	4.33%

Property, plant and equipment (PP&E) stood higher at Rs. 5.85b (FY22: Rs. 5.59b) primarily due to additions related to powerhouse upgradation and replacement of various other machinery parts for efficiency enhancements. Additionally, a significant portion of the capital work in progress is associated with the construction of a new warehouse. ISML has committed a substantial investment of Rs. 691.0 million (MY22: Rs. 432.0m) into a new venture, Oceans Ceramics (Pvt.) Ltd, in which it holds around 14% equity stake. Oceans Ceramics is anticipated to start commercial production at its tile manufacturing facility in December 2023.

Sales and Profitability: During 9M'MY23, net sales of ISML augmented to Rs. 12.6b as compared to Rs. 5.02b in SPLY (MY22: 7.94b). The substantial growth in revenue was primarily due to a significant 48% rise in the quantity of sugar sold, coupled with an 8% increase in the average selling prices. Additionally, sugar's share in the overall sales mix increased to 87% vis-à-vis 77% in the SPLY; gross revenue from sugar was reported higher at Rs. 12.6b (9M'MY22: Rs. 5.0b; MY22: Rs. 7.7b). The company has also exported 4,254 MT of sugar in lien with the export quota allocated by the Government. Molasses sales contributed 12% (MY22: 20%) to the revenue mix. The molasses sales were recorded higher at Rs. 1.7b (MY22: 1.3b) on the back of around 56% increase in average selling prices despite nearly 15% decrease in volumetric sales in 9M'MY23. The molasses sales were largely booked as indirect exports under DTRE. The selling rates of molasses are supported by favorable demand dynamics of ethanol exports amidst massive local currency devaluation.

During 9M'MY23, ISML recorded higher gross profits of Rs. 1.46b (9M'MY22: Rs. 913.2m; MY22: Rs. 1.1b) as a result of sizable growth in topline. However, despite the higher average prices for their products, the gross margins decreased to 11.6% (9M'MY22: 16.2%; MY22: 14.0%). This decline in margin was mainly due to the increased costs associated with cane procurement. Administrative expenses increased to Rs. 412.4m (9M'MY22: Rs. 181.0m; MY22: Rs. 261.2m) mainly due to higher fee and subscription charges related to requital fee for regularization of crushing capacity, while increase in salaries, wages and other expenses was mainly in line with inflationary pressure. Distribution cost increased to Rs. 40.9m (9M'MY22: Rs.17.2m; MY22: Rs. 20.2), mainly due to higher freight, octroi & clearing charges for export sales of sugar. Other expenses included workers profit participation fund and workers welfare fund contributions. Financial cost incurred during this period amounted to Rs. 304.1m (9M'MY22: Rs. 230.1m; MY22: Rs. 364.4m) largely in line with higher average markup rates. Accounting for taxation, the company reported higher net profitability amounting Rs. 451.8m (9M'MY22: Rs. 300.1m; MY22: Rs. 289.7m) during 9M'MY23, yielding net margin of 3.6% (9M'MY22: 5.5%; MY22: 3.6%).

The crushing season 2023-24 is expected to start by end-November. Retail sugar prices, while remaining relatively elevated, have recently exhibited a downward trend due to government initiatives aimed at reducing smuggling across the Afghan border. Meanwhile, given higher indicative prices (i.e., Rs. 425/maund) of sugarcane for the upcoming crushing season and lower available sugar stocks in the country, it is expected that sugar prices will increase, going forward.

Liquidity Profile: The company's liquidity position is underpinned by adequate cash flow coverages maintained on a timeline basis. Despite higher profitability during 9M'MY23, funds from operations (FFO) were reported lower at Rs. 282.0m (MY22: Rs. 661.9m) owing to substantial increase in taxes paid and positive differential in paid and incurred finance cost. However, FFO to total debt decreased marginally to 0.22x (MY22: 0.26x) due to reduction in outstanding short-term borrowings. FFO to total debt, on the other hand, remained sizable due to limited long-term loans constituting only lease liabilities. Similarly, debt service coverage, albeit decreased due to lower FFO and substantially higher financial charges paid, remained adequate at 1.54x (MY22: 4.15x) in 9M'MY23.

The company held stock in trade worth Rs. 3.2b (MY22: Rs. 3.7b) as of Jun'23, which largely included 51,643 MT of sugar stock. The company's trade debts remain consistently low because they sell sugar through brokers and conduct sales primarily on advance payment basis. On the other hand, trade and other payables have also increased to Rs. 3.2b (MY22: Rs. 1.6b) mainly due to considerable increase in advances from customers. Therefore, net operating cycle has remained at quite comfortable level on a timeline basis. Advances deposits, prepayments and other receivables stood higher at Rs. 1.6b (MY22: Rs. 861.4m) at end-Jun'23. The increase was largely due to advance income tax payment, security margin to bank for purchase of new turbine and higher advances to growers. Cash and bank balances were reported substantially higher at Rs. 670.4m (MY22: Rs. 94.6m) at end-9M'MY23. The company has consistently upheld a satisfactory current ratio and coverage of short-term borrowings via stock in trade and trade debts.

Capitalization Profile: The core equity has augmented over to Rs. 4.7b (MY22: Rs. 4.1b) on the back of internal capital generation during 9M'23. Total equity, including revaluation surplus on PP&E, stood at Rs. 6.7b (MY22: 6.3b) as of Jun 30, 2023. The debt profile of the company largely includes short-term borrowings to meet working capital requirements while long-term loans included only lease liabilities against right of use assets. At end-9M'23, short-term borrowings stood lower at Rs. 1.6b (MY22: Rs. 2.5b). Meanwhile, as of Sep 30, 2023, short-term borrowings have been significantly reduced due to around Rs. 500m in line with lifting of majority of the sugar stock. The outstanding short-term loans comprised only agricultural finance facility for extending advances to growers. Gearing has decreased to 0.36x (MY22: 0.62x) while debt leverage stood at 1.33x (MY22: 1.31x) at end-Jun'23. The company's strategy to maintain low debt levels has resulted in both gearing and debt leverage staying at very manageable levels over time. Furthermore, in view of challenging economic environment, the company does not intend to obtain long-term loan for any major capital expenditure.

Regulatory matter (Update on CCP penalty): Ratings have incorporated the developments with regards to penalties imposed by Competition Commission of Pakistan (CCP) on certain sugar mills and legal proceedings initiated by the subject company. The Company has filed Constitutional Petition before the Honorable Lahore High Court against the impugned order. The Honorable Lahore High Court vide its order dated October 18, 2021, has restrained the Competition Commission of Pakistan from recovering the impugned demand, and restrained the authorities from recovering any amounts from the Company. The case is pending adjudication.

Indus Sugar Mills Limited — Annexure I

BALANCE SHEET	Sep 30, 2020	Sep 30, 2021	Sep 30, 2022
Property and Equipment	3,212	5,052	5,592
Long-Term Investment	-	-	432
Long-Term Deposits	12	6	405
Right of Use assets	65	43	71
Stores, Spares and Loose Tools	180	398	281
Stock in Trade	414	472	3,690
Trade Debts	3	1	2.7
Biological Assets	163	150	271
Advances, deposit, prepayments	303	775	861
Cash & Bank Balances	2,408	2,153	95
Total Assets	**6,761**	**9,050**	**11,701**
Trade and Other Payables	1,251	1,382	1,516
Short Term Borrowings	364	243	2,496
Lease Liabilities	69	49	95
Total Interest-Bearing Debt	433	292	2,591
Deferred Liabilities	873	993	1,068
Provision for Taxation	272	415	267
Total Liabilities	**2,829**	**3,081**	**5,442**
Paid Up Capital	177	177	177
Tier-1 Equity	2,649	3,771	4,148
Total Equity	**3,932**	**5,969**	**6,259**

INCOME STATEMENT	Sep 30, 2020	Sep 30, 2021	Sep 30, 2022
Net Sales	9,076	9,301	7,940
Gross Profit	1,991	1,997	1,113
Operating Profit	1,744	1,755	831
Finance Cost	209	94	364
Profit Before Tax	1,447	1,590	471
Profit After Tax	1,040	1,123	290

RATIO ANALYSIS	Sep 30, 2020	Sep 30, 2021	Sep 30, 2022
Gross Margin (%)	21.9	21.5	14.0
Net Margins (%)	11.5	12.1	3.6
Current Ratio (x)	1.82	1.91	1.21
Net Working Capital	1,565	1,886	905
Funds from Operations (FFO)	1,613	1,369	662
FFO to Total Debt (x)	3.72	4.70	0.26
FFO to Long Term Debt (x)	23.4	28.1	6.9
Debt Leverage (x)	1.07	0.82	1.31
Gearing (x)	0.16	0.08	0.62
Debt Servicing Coverage Ratio (x)	8.22	12.8	4.15
ROAA (%)	17.7	14.2	2.8
ROAE (%)	48.4	35.0	7.3
(Stock in Trade+ Trade Debt) to Short-Term Borrowing (x)	1.14	1.95	1.48
Net Operating Cycle (days)	(21)	(44)	34

REGULATORY DISCLOSURES — Annexure II

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.
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Due Diligence Meetings Conducted	see table below

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
07-Dec-23	A-	A-1	Stable	Reaffirmed
08-Nov-22	A-	A-1	Stable	Initial

Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Abdul Sattar Qureshi	Financial Advisor	Nov 07, 2023
Mr. Muhammad Ali	General Manager Finance	
Mr. Bahzad Bashir	Dy. General Manager Accounts	
Mr. Usman Tariq	Manager Finance	