The Pakistan Credit Rating Agency Limited

Rating Report

Hunza Sugar Mills (Pvt.) Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
06-Sep-2018	BBB	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings draw comfort from the Company's diverse revenue streams (Sugar, Ethanol, Bagasse and CO2) and sponsors strong acumen in the sector. Financial risk is high owing to highly leveraged capital structure due to seasonality typical of entities in the sugar sector and significant BMR activities carried out during the year. Low recovery rate and depressed sugar prices resulted in subpar performance in the sugar segment having a significant impact on the Companys' bottomline. This coupled with high finance costs put the Companys' coverages in a distressed situations for the period. Meanwhile, Sponsors commitment to provide financial support cushions the risk profile of the Company.

The ratings are dependent upon the Company's ability to strengthen its margins, improve profitability and strengthening debt service coverages. Any further deterioration in margins and/or cashflows will impact the ratings.

Disclosure

Name of Rated Entity	Hunza Sugar Mills (Pvt.) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-18),Methodology | Criteria | Rating Modifier(Jun-18),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
Related Research	Sector Study | Sugar(Mar-18)
Rating Analysts	Shahzad Saleem | shahzad@pacra.com | +92-42-35869504

Profile

Legal Structure Private Limited Company.

Background Hunza Sugar Mills Limited ('Hunza Sugar') was incorporated in 2002 by acquiring an existing unit. In 2010, it expanded its capacity by acquiring its second unit i.e. Unit 2 from Shakarganj. In 2014, Hunza Sugar installed a distillery adjacent to its Sugar unit-1 and a CO2 processing plant.

Operations The Company operates two sugar units in District Jhang and District Faisalabad. The sugar units have a combined crushing capacity of 16,000 MT per day. Distillery adjacent to its Sugar unit-1 has a production capacity of 125,000 Liters/day and is engaged in processing of food grade ethanol. Additionally, the Company has CO2 plants with a storage capacity of 200MT.

Ownership

Ownership Structure Hunza Sugar is a Family owned entity of three brothers. Mr. Idrees Chaudhrys' family has 31% sharehholding, Mr. Saeed Chaudhrys' family has 32% and Mr. Waheed Chaudhrys' family 37% shareholding.

Stability There is clear distinction as the shareholding is divided in three families.

Business Acumen The family has been involved in business for a significant period of time and owns entities collectively called 'Hunza Group of Industries'. The Groups flagship company is Hunza Ghee Industries (Pvt.) Limited in the Edile Oil sector which dates back to 1988. The Company produces vegetable ghee and cooking oil that sells under the brand 'Swera Vanaspati' and 'Swera Cooking Oil'. It is involved in the import and sale of Edible Oil through its company Swera Traders (Pvt.) Limited. The Group diversified its operations and entered the sugar industry in 2002. Currently, the Group is in the process of setting up a bagasse based power plant under its' new Company 'Hunza Power'.

Financial Strength Hunza Group as a whole (Hunza Ghee, Hunza Sugar, Swera Traders & Power) have an asset base of PKR 12.9bln of which PKR 3.5bln are represented by equity in FY 17. Total debt exposure of the Group is PKR 1.9bln. The group had a turnover PKR 16bln and a profit after tax of PKR 504mln.

Governance

Board Structure BoD comprises three member all of whom are family members, including the CEO. Limited size of the board, dominance of sponsoring family and absence of independent oversight indicates room for improvement in the overall governance framework.

Members' Profile The BoD is chaired by Mr. Idrees Chaudhry, the eldest brother, who serves as Chairman of the board of all Group Companies (except Swera (Pvt) Ltd.). The directors have around fifteen years of experience in the Sugar Industry and over thirty years of experience in the Edile Oil Sector.

Board Effectiveness The BoD met four times during FY17 to approve the financial statement. However, minutes of the meetings are restricted to formal approvals required for regulatory purposes. The BoD has no sub-commitees.

Financial Transparency The auditors of the Company, Javed Chaudhry & Co, issued an unqualified opinion the financial statements for FY17. Auditors are not on the panel maintained by State Bank of Pakistan and are not QCR rated by ICAP. The auditors for FY18 have been changed to Amin Mudasser & Co. Chartered Accountants. The firm has satisfactory QCR rating and listed on SBP panel in catagory 'B'.

Management

Organizational Structure The Company is headed by the CEO who is supported by Senior General Manager and Manager Finance & Accounts at the Head office. On Site, the Company has GM projects with a team of production and technical staff including a head responsible for cane purchase and accounts personnel dealing with operational matters. IT function is provided to entities at Group level.

Management Team Mr. Saeed is CEO of all Group Companies (except Swera Traders (Pvt) Ltd.). He has fifteen years of experience in the Sugar Industry and over thirty years of experience in the Edile Oil Sector.

Effectiveness The CEO and directors monitor the Company's performance on a monthly basis through review of management accounts, accounts receivable and payable balance.

MIS Hunza Sugar has developed an in house software for managing its financial accounting needs. It has an Inventory module, Sales module, Payroll management and Cane Procurement System. Currently, the Company is negotiating installation/implementation of a new ERP system to meet the growing needs of Hunza Sugar.

Control Environment The Company relies on segregation of duties and established processes and procedures as a means of internal control. The Company should lay emphasis on improving its' control environment.

Business Risk

Industry Dynamics Sugar industry is characterized as competitive with a large number of players having relatively small shares in the market. Sugar production increased to 7.3mln Tons during FY17 in comparison to 6.1mln tons in FY16 on the back of increase in area cultivated under sugarcane. This has created excess sugar in the market and significant stocks piled up at the end of Sept '17.

Relative Position Hunza Sugar contributed approximately 3.1% making it one of the top 20 sugar producers in the Country and a leading sugar mill in Punjab region.

Revenues Hunza Sugar has experienced an increasing trend line in its turnover. The sales mix is dominated by local and export sales of refined sugar comprising 70% of the sales mix, followed by ethanol exports at 25%. Remaining portion of sales comprise CO2 sales and sale of molasses and bagasse.

Margins GP Margins have also shown a similar trend despite volatility in the sugar prices, increasing from 7% in FY16 to 12% in FY17. However, GP margins 1HFY18 clocked in at a gross loss of 15% owing to low recovery rates and depressed sugar prices.

Sustainability Going forward, Hunza Sugar is expected to increase its turnover due to scheduled BMR activities underway in unit-2 that will add another 6000MT to the crushing capacity per day. Performance of the company would mostly depend on the ethanol division which is expected to remain stable however, performance in the sugar division would largely depend on industry dynamics.

Financial Risk

Working Capital The Company experienced a surge in it's working capital days increasing from 41 days in FY16 to 120 days in FY17 owing to bumper sugar production in the outgoing season and untimely export quotas. Working capital days surged to 114 days at end of 9MFY18 with refined sugar stocks piled up at the end of the crushing season.

Coverages The Company's interest coverage stood at 2.6x during FY17 deteriorating from 3x in FY16 owing to highly leveraged balance sheet. With low cashflows interest coverage further deteriorated to .7x during 9MFY18. Total coverage stood at 1x in FY17 dropping from 1.2x in FY18 and continued to deteriorate in 9MFY18 to 0.5x.

Capitalization Total Debt: Debt plus equity ratio increased from 62% in FY16 to 76% in FY18. This debt majorly comprises of short-term debt and approaching current maturity of long-term debt (79%). A drastic increase in short-term borrowings is witnessed in FY17 due to major pile up of sugar stocks, a phenomenon in line with the industry dynamics. Further, borrowing for BMR activity to enhance capacity in Unit-2 and addition of CO2 plant contributed to the increase in long-term loans. Total borrowings stood at PKR 7.8bln end 9MFY18 resulting in a highly leveraged ratio of 80%.

PKR mln

Hunza Sugar Mills (Pvt.) Limited

BALANCE SHEET	30-Jun-18	30-Sep-17	30-Sep-16	30-Sep-15
	Unaudited	Audited	Audited	Audited
	9M	*FY*	*FY*	*FY*
Non Current Assets	**4,728**	**4,743**	**4,211**	**4,078**
Investments				
Long term	193	122	113	-
Short Trem				
Current Assets				
Inventory	3,593	4,270	867	611
Trade Recieveables	1,014	357	448	282
Others	1,495	1,435	543	712
Total Assets	**11,024**	**10,926**	**6,182**	**5,683**
Debt				
ShortTerm	5,595	5,730	1,784	1,864
LongTerm(Incl current maturity of long term)	2,288	1,916	1,713	1,970
Other Short term liabilities	914	802	505	299
Other Long term liabilities	-	-	-	-
Shahreholder's Equity	**2,228**	**2,478**	**2,180**	**1,549**
Total Liabilities & Equities	**11,024**	**10,926**	**6,182**	**5,682**
Income Statement				
Turnover	**9,239**	**8,866**	**8,751**	**6,336**
Gross Profit	(990)	1,047	603	422
Financial Charges	(319)	(378)	(366)	(334)
Net Inocme	**(251)**	**299**	**473**	**103**
Cashflow Statement				
Free cashflow from operations	234	979	1,087	847
Net cash changes in working capital	303	(3,978)	51	778
Net cash from operating activities	150	(3,263)	831	1,273
Net cash from investing activities	(376)	(905)	(360)	(382)
Net cash from financing activities	236	4,149	(450)	(927)
Net cash generated during period	10	(19)	21	(36)
Closing balance of Cash and Cash Equivalent	13	3	22	1
Ratio Analysis				
Profitability				
Turnover Growth	39%	1%	38%	7%
Gross Margin	-11%	12%	7%	7%
Net Profit Margin	-3%	3%	5%	2%
Return on Equity (ROE)	-11%	15%	23%	7%
Coverages				
FCFO/Gross Interest	0.7	2.6	3.0	2.5
Debt Service Coverage-times (FCFO*/Gross Interest+CMLTD+Uncovered Short Term Borrowings)	0.5	1.0	4.2	20.1
Interest Coverage-times (FCFO/Gross Interest)	0.7	2.6	3.0	2.5
Debt Payback (years) (Total Debt (excluding Covered Short Term Borrowings) / FCFO)	(27.0)	3.2	2.4	3.8
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	114	120	41	47
Capital Structure (Total debt/ total debt + total equity)	78%	76%	62%	71%

FCFO: Free Cashflow from operations

Rating Scale

Credit Rating Scale & Definitions

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

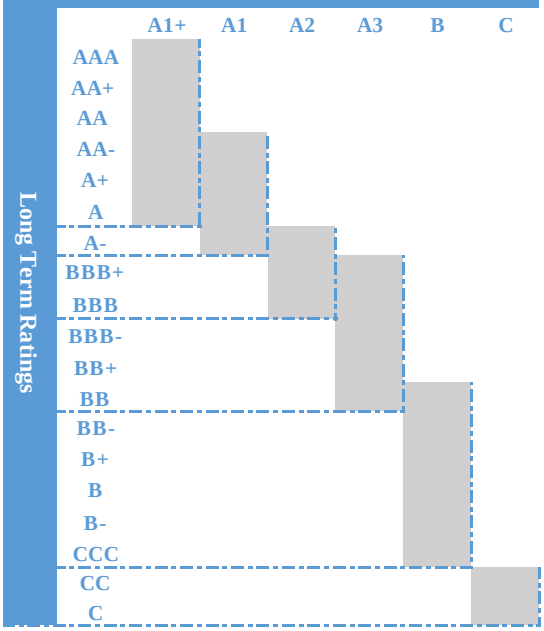
Long Term Ratings

AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short Term Ratings

A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
C	An inadequate capacity to ensure timely repayment.

Short Term Ratings



Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Rating Team Statements
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest
(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)
Probability of Default
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)
Proprietary Information