The Pakistan Credit Rating Agency Limited

Rating Report

Popular Sugar Mills Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-Apr-2019	BBB+	A2	Stable	Maintain	-
31-Oct-2018	BBB+	A2	Stable	Maintain	-
02-May-2018	BBB+	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Pakistan is the 6th largest country in the world in terms of area under sugarcane cultivation. Sugar industry is Pakistan's 2nd largest agro-based industry comprising ~90 sugar mills with annual crushing capacity estimated between 65 – 70 million tons. During MY19, sugar production totaled to ~5.5mln MT, coming down from ~6.5mln MT in the preceding year. Industry players have been negatively affected by depressed prices owing to a persistent supply glut and substantial carry over stock in the preceding years. Corrective measures implemented by the government in the shape of export quotas in-conjunction with subsidies provided relief by reducing carry over stock. Going forward, industry players are likely to benefit from recovering domestic prices.

The ratings reflect Popular Sugar Mills Limited’s adequate business profile. The Company has depicted stability in margins whilst maintaining a positive trend in revenues during challenging market dynamics. The Company’s profitability is supported through sale of by-products. Although a mismatch in the debt mix persisted, management’s efforts are reflected with improving cushion. Meanwhile, inventory and leveraging increased in Mar '19 at the end of the crushing season maintaining modest coverages.

Ratings are dependent on the Company’s ability to maintain margins while implementing strict working capital discipline. Continued efforts to realign the debt mix are critical for ratings. Any material deterioration in coverages and/or margins will negatively impact ratings.

Disclosure

Name of Rated Entity	Popular Sugar Mills 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(Apr-19)
Rating Analysts	Adnan Dilawar | adnan@pacra.com | +92-42-35869504

Profile

Legal Structure Popular Sugar Mills Limited is a public limited company.

Background The Company was formerly known as National Sugar Industries Limited and was setup in 1989. In 2013, Popular Group of Industries acquired the sugar business from National Sugar Industries Limited. The Company was subsequently named to Popular Sugar Mills Limited.

Operations Popular Sugar Mills is primarily engaged in the manufacturing and sale of sugar and its by-products molasses and bagasse. The Company has the capacity to crush 8,000 tons of sugarcane per day (TCD) with 24 rollers installed in 5 mills. During MY18 the Company produced 44,508 MT of sugar with a sucrose recovery rate of 10%. The Company also generates power for mill operations and has plans in place to enhance capacity to generate 8MW through upgrading turbines and sourcing bagasse internally. The Company's mill is located in Jan Muhammad Wala, near Sargodha. While, the registered office is situated on 9th floor, Chappal Plaza, Hasrat Mohani Road, Karachi.

Ownership

Ownership Structure Popular Sugar Mills is a wholly owned venture of Popular Group of Industries ('Popular Group'). 87% of the Company's shares vests with other Group Companies. Remaining 13% stake resides with the individuals of the sponsoring families. Mr. Imran Ali Roshan, the Chairman's Nephew, owns 48% shares of the Company.

Stability Ownership reflects stability as no ownership changes are expected going forward.

Business Acumen Over the years Popular Group has expanded into diversified businesses through organic growth and acquisition. Today, Popular Group has an inclined interest in the manufacturing segment that includes fruit juices, sugar, match, packaging and textile. In the services sector, the Group is represented by a Modaraba Company (listed), security services and a trading company. Moreover, the Company is set to penetrate the cement industry.

Financial Strength The Company has adequate financial strength through the support of its group. During MY18, the Company had total assets of ~PKR 6bln, supported by an equity base of ~PKR 2,282mln.

Governance

Board Structure Popular Sugar Mills Board comprises two executive and two non-executive Directors. The Board is dominated by the sponsoring family and lacks independence, thus indicating a room for improvement in the Company's governance framework.

Members' Profile The Board's Chairman, Mr. Imamuddin Shouqeen, has a long association with the Company. He has business experience of over 40 years. Moreover, Mr. Imamuddin is a member of Pakistan's Senate.

Board Effectiveness Keeping in view the size of the Board, absence of sub-committees may not impact Board's effectiveness. During MY18, four Board meetings, with majority attendance, were held to discuss pertinent matters and future strategy.

Financial Transparency Popular Sugar Mills external auditors Reanda Haroon Zakaria & Company, Chartered Accountants, have expressed an unqualified opinion on the Financial Statements of the Company ending in September, 2018. The firm has been QCR rated by ICAP and are in Category 'B' of SBP panel.

Management

Organizational Structure Popular Sugar Mills is headed by the Managing Director (MD), supported by a team of General Managers for site, factory, finance and marketing. However, the support functions (HR, legal and administration) are shared at Group level and reports to the Group's Chairman.

Management Team Popular Sugar Mills management comprises experienced professionals. Mr. Shahbaz Ali Malik, the Company's MD, has worked with the Group for over 25 years.

Effectiveness The Company does not have management committees in place. However, to discuss management targets and aligned budgets, meetings are called on monthly and ad-hoc basis by the Borad's Chairman and/or the Company's MD.

MIS Popular Sugar Mills has implemented Cosmosoft system which is fully integrated with the financial systems, except for the inventory module. The system also provides various detailed reports to monitor and control the performance of the Company.

Control Environment The Company has engaged Baker Tilly Mehmood Idrees Qamar (MIQ), Chartered Accountants, for the internal audit. Popular Sugar Mills control environment gains support from budgetary control exercised at the BoD level, followed throughout the year.

Business Risk

Industry Dynamics Pakistan is the 6th largest country in the world in terms of area under sugarcane cultivation. The sugar industry in Pakistan is the 2nd largest agro based industry comprising ~90 sugar mills with annual crushing capacity estimated between 65 – 70 million tons. During MY19, sugar production is estimated around 5.5mln MT, coming down from 6.5mln MTin the preceding year.

Relative Position Owing to the high number of players in the industry, players relatively have low market share. The Company had a 0.85% market share in total sugar production in MY18.

Revenues Primary source of revenue generation is provided through the sale of sugar, supported by proceeds from the sale of by-products (molasses and bagasse) which account for 8% of total revenue. During MY18, sales revenue grew by ¬8%, standing at ¬PKR 3,272mln. Growth in revenue is attributable to increased export sales which grew to ¬PKR 477mln in MY18 (MY17: ¬PKR 105mln). However, bulk of the revenue emanates from local sales which account for 78% of total revenue and witnessed a mild slowdown of ¬3% amid depressed prices. During 1HMY19, revenue plunged by ¬48%, YoY, to ¬PKR 1,027mln (1HMY18: ¬PKR 1,986mln). Lower sales are a factor of absence of export sales and lower units sold due to adverse market dynamics.

Margins The Company witnessed a slight decline in margins during MY18 owing to a lower recovery rate and higher conversion cost. During MY18, gross margin declined by 1 bps coming down to 8% (MY17: 9%). Owing to a proportionate increase in operating expenses, operating margin also registered a decline of 1 bps. Moreover, a 26% increase in finance costs reduced net profit margin to 1% (MY17: 3%). The Company observed a significant improvement in profitability during 1HMY19 on the back higher prices and improved sucrose recovery rate. Gross margin stood at 20% (1HMY18: 10%), whereas, the Company posted an operating margin of 16% (1HMY18: 8%). During the quarter, the Company posted a net profit of ~PKR 85mln, translating into a margin of 8% (1HMY18: 5%).

Sustainability Going forward, the Company expects an improvement in profitability amid recovery in domestic sugar prices.

Financial Risk

Working Capital Inventory days during MY18 increased by 20 days to 61 days as the Company held on to stock. However, delayed payments to suppliers helped the Company maintain its net working capital days at 45 days (MY17: 42 days). Inherent seasonality in working capital cycle led to a surge in net working capital days in 1HMY19 as the Company concluded its crushing cycle and had high amounts of inventory. On the other hand, persistence of mismatch in the debt mix, owing to excess short-term borrowings, negatively impacted the Company.

Coverages Improved profitability has helped the Company register an improvement in coverages. During 1HMY19, the Company improved interest coverage to 2.5x (MY18: 1.9x). Similarly, total coverage stood at 1.7x, coming up from 0.5x in MY18. Going forward, prudent management of short-term debt will be vital for coverage ratios.

Capitalization Total borrowings during the period witnessed an increase ~PKR 1,743mln, totaling to ~PKR 2,960mln, resulting in a debt-to-equity ratio of 57% during 1HMY19. Higher borrowings were witnessed primarily due to a surge in short-term borrowing, which make up ~82% of the debt mix, in line with increased working capital requirements brought about by higher inventories.

Sugar
Financials (Summary) in PKR mln
The Pakistan Credit Rating Agency Limited

PKR mln

Popular Sugar Mills (Private) Limited
Listed Public Limited

BALANCE SHEET	Mar-19	Sep-18	Sep-17	Sep-16
	MY 6M	MY 12M	MY 12M	MY 12M
a Non-Current Assets	**3,275**	**3,274**	**3,070**	**2,202**
b Investments (Incl. Associates)	**2**	**2**	**3**	**-**
Investment Property	2	2	3	-
c Current Assets	**3,010**	**1,193**	**1,441**	**452**
Inventory	2,258	481	678	126
Trade Receivables	113	108	68	54
Others	639	604	695	272
d Total Assets	**6,287**	**4,469**	**4,514**	**2,654**
e Debt/Borrowings	**2,812**	**1,035**	**997**	**531**
Short-Term	2,412	797	847	121
Long-Term (Incl. Current Maturity of Long-Term Debt)	400	238	150	410
Other Short-Term Liabilities	703	714	871	271
Other Long-Term Liabilities	343	343	364	217
f Shareholder's Equity	**2,429**	**2,378**	**2,283**	**1,635**
g Total Liabilities & Equity	**6,287**	**4,469**	**4,514**	**2,654**
INCOME STATEMENT				
a Turnover	**1,027**	**3,272**	**3,043**	**2,969**
b Gross Profit	205	255	269	479
c Net Other Income	11	19	7	(8)
d Financial Charges	(78)	(129)	(102)	(82)
e Net Income	**85**	**31**	**93**	**231**
CASH FLOW STATEMENT				
a Free Cash Flow from Operations (FCFO)	153	233	235	451
b Total Cashflows (TCF)	153	233	235	451
c Net Cash changes in Working Capital	(1,900)	168	(326)	13
d Net Cash from Operating Activities	(1,821)	298	(178)	372
e Net Cash from InvestingActivities	-	(327)	(281)	(127)
f Net Cash from Financing Activities	1,759	90	458	(233)
g Net Cash generated during the period	(62)	61	(2)	12
RATIO ANALYSIS				
a Performance				
Turnover Growth	-37%	8%	2%	32%
Gross Margin	20%	8%	9%	16%
Net Margin	8%	1%	3%	8%
ROE	8%	1%	5%	15%
b Coverages				
Debt Service Coverage (X) (FCFO/Gross Interest+CMLTD+Uncovered STB)	1.4	0.5	0.4	2.0
Interest Coverage (X) (FCFO/Gross Interest)	2.1	1.9	2.3	5.6
Debt Payback (Years) (Total Debt (excluding Covered Short Term Borrowings) / FCFO)	3.9	6.4	4.2	1.1
c Capital Structure (Total Debt/Total Debt+Equity)				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	198	45	42	42
d Capital Structure (Total Debt/Total Debt+Equity)	56%	36%	35%	25%

Popular Sugar Mills (Private) Limited
Apr-19

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.

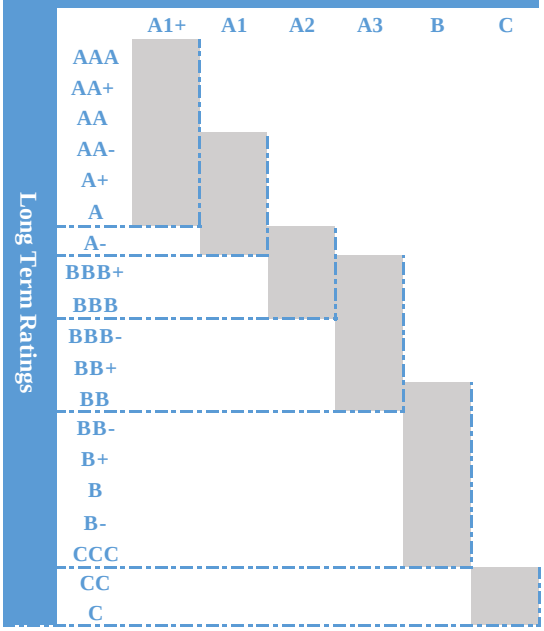
Long Term Ratings

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