The Pakistan Credit Rating Agency Limited

Rating Report

Jauharabad Sugar Mills Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
07-Apr-2020	BBB	A2	Positive	Maintain	-
17-Oct-2019	BBB	A2	Stable	Maintain	-
30-Apr-2019	BBB	A2	Stable	Maintain	-
28-Dec-2018	BBB	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Pakistan's sugar industry is the 2nd largest agro based industry, comprising 90 mills with annual crushing capacity estimated around 65 – 75 mln MT. In previous years, the industry was under pressure owing to a supply glut combined with a distortion in the support price mechanism. Additionally, a slowdown in international sugar prices made exports viable only through subsidy support. During MY19, prices improved in local market as inventory levels reduced. The overall sugar production also fell by 16%, YoY, to 5.5 mln MT on the back of lower crop availability. The government approved an export quota upto 1 MMT, however, no subsidy was announced, leading to low quantities availed. In the FY20 budget, sales tax levied on sugar was increased to 17% from 8%, charged on the price of PKR 60/KG. Moreover, sales to unregistered buyers have been disallowed and CNIC of all buyers must be maintained. Due to low crop availability in the crushing period ended Mar-20, sugar production is expected to be around 5-5.2 mln MT. The Government increased the support price of sugarcane to PKR 190 per maund (previously PKR180). Despite higher sugarcane costs, higher local sugar prices are expected to improve miller's profitability.

The ratings reflect an improving business profile of Jauharabad Sugar Mills Limited in line with the current dynamics of sugar industry. During MY19, rise in sugar prices in domestic market led to growth in the Company's revenue. Profit margins improved significantly on gross and net levels on the back of relatively low conversion costs. Over the years, the sponsors business acumen and support (in the form of loan) have remained beneficial for the Company. The management's consistent attention to improve efficiencies supplements margins. Going forward, the management plans to diversify the Company's revenue base by setting up a power plant and a distillery. Jauharabad Sugar Mills financial profile remains stretched and is characterized by modestly leveraged capital structure, largely emanating from working capital needs. The coverage ratios have improved due to strong cash flows despite the rising finance costs.

The ratings are dependent upon the management's ability to sustain margins while capitalizing on higher sugar prices. Meanwhile, close monitoring of working capital requirements remains critical. Any significant deterioration in the Company's margins and/or coverages would have a negative impact. Improving financial transparency and related controls will be positive for the ratings.

Disclosure

Name of Rated Entity	Jauharabad Sugar Mills Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-19),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria | Rating Modifier(Jun-19)
Related Research	Sector Study | Sugar(Dec-19)
Rating Analysts	Faiqa Qamar | faiqa.qamar@pacra.com | +92-42-35869504

Profile

Legal Structure Jauharabad Sugar Mills Limited ('JSML' or 'the Company') was incorporated as a public limited company and is listed on the Pakistan Stock Exchange since 1973.

Background The Company was initially established on build, operate and transfer (BOT) contract by Pakistan Industrial Development Corporation (PIDC) in collaboration with Thal Development Authority (TDA). In 1955, Saigol Group acquired the contract and named the Company Kohinoor Sugar Mills Limited. In Oct 2013, Cane Processing (Pvt.) Limited (CPL) acquired major stake (64%) of Kohinoor Sugar Mills and changed its name to Jauharabad Sugar Mills Limited.

Operations JSML has two sugarcane crushing units, named Line-I and Line-II. Line-I can crush 5,500 MT of sugarcane per day, however, it's currently not operational. While, Line-II can crush 7,000 MT of sugarcane per day. The Company manufactured 44,776 MT of sugar at an average recovery rate of 10.4%, with the capacity utilization of 71% during MY19. The Company's mill is located in Jauhrabad, district Khushab, while the registered office is in Lahore.

Ownership

Ownership Structure JSML is majorly owned by a Holding Company - Cane Processing (Pvt.) Limited (64%) - and individual's of Latif family (12%). NIT and ICP hold 3% shares each in the Company. The Company has a free float of ~ 20%. The Holding Company is primarily owned by Mrs. Ghazala Amjad (99%).

Stability The presence of a Holding Company bodes well for stability of ownership. Meanwhile, transferring entire family stake to Holding Company would further strengthen the structure.

Business Acumen The sponsoring family has interests in other ventures and enjoys strong business acumen. Apart from owning two LPG businesses, named Synergy and Awami, the sponsors have acquired Pasrur Sugar Mills Limited, having an operational capacity of 3,500 TCD (installed capacity 8,000 TCD) recently.

Financial Strength JSML is primarily owned by Cane Processing (Pvt.) Limited. In FY19, Cane Processing's total assets stood at PKR 643mln, which are entirely financed by equity.

Governance

Board Structure JSML's board comprises three Executive Directors, two Independent Directors and two Non-executive Directors nominated by Cane Processing (Pvt.) Limited. Board's chairman is a Non-executive Director. The Company's board structure draws strength from its size and independent oversight.

Members' Profile All BoD members have relevant expertise. The board's chairman, Mr. Muhammad Aamir Beg, is associated with JSML since 4 years and has an over all work experience of 5 decades. Mr. Amjad Bashir Hussain, an Independent Director, is the chairman of Audit Committee and has work experience of above 3 decades.

Board Effectiveness Jauharabad Sugar Mills' board met four times during MY19, with majority attendance to discuss pertinent matters and maintains well documented minutes. The board has two sub-committees: Audit Committee and Human Resource & Remuneration Committee. The Audit Committee met four times, while HR and Remuneration Committee met once during MY19.

Financial Transparency The Company's external auditors, UHY Hassan Naeem & Company, Chartered Accountants, have expressed an unqualified opinion on the financial report of MY19. The firm has been QCR rated by ICAP and is in Category 'B' of SBP panel.

Management

Organizational Structure JSML operates through eight divisions: Mill, Operations, Power, Cane, Marketing, Human Resource, Internal Audit and Finance. All functional heads report to the Chief Operating Officer (COO), who reports to the Company's CEO. However, head of Internal Audit and Human Resource department report administratively to the CEO and functionally to the board's Audit and Human Resource & Remuneration Committees, respectively.

Management Team The Company's management comprise veteran professionals. Mr Jamal Ahmad, the newly appointed CEO, has an overall work experience of above 40 years and has been associated with the Company for 3 years. Mr. Ahsan Latif, the COO, has an overall work experience of 21 years and has been associated with the Company since October 2013.

Effectiveness The Company's management ensures effectiveness through a Management Committee. This committee comprises heads of all divisions. A co-ordination meeting is held on daily basis to review the progress of every department. Minutes of these meetings are documented and circulated for follow ups.

MIS The Company initially used COSMOSOFT system to control cane procurement. Now, an ERP system is in place at the Company, which is updated on real time basis. It generates 15 reports to assist the top management in monitoring and evaluating the performance of different departments.

Control Environment To ensure operational efficiency, the Company has setup an Internal Audit Function and it is co-sourced internal audit to KPMG. They provide support, guidance and monitoring of the internally placed SOPs. KPMG conduct Gap Analysis for evaluating the already placed policies and procedures.

Business Risk

Industry Dynamics Pakistan's sugar industry is the 2nd largest agro based industry, comprising 90 mills with annual crushing capacity estimated around 65 – 75 mln MT. In previous years, the industry was under pressure owing to a supply glut combined with a distortion in the support price mechanism. During MY19, prices improved in local market as inventory levels reduced. The overall sugar production also fell by 16%, YoY, to 5.5 mln MT on the back of lower crop availability. The government approved an export quota upto 1 MMT, however, no subsidy was announced, leading to low quantities availed. In the FY20 budget, sales tax levied on sugar was increased to 17% from 8%, charged on the price of PKR 60/KG. Moreover, sales to unregistered buyers have been disallowed and CNIC of all buyers must be maintained. Due to low crop availability in the crushing period ended Mar-20, sugar production is expected to be around 5-5.2 mln MT. Despite higher sugarcane prices, recovery in local sugar prices are expected to improve miller's profitability.

Relative Position The Company contributed approximately 0.8% to the total sugar production in Pakistan and can be categorized as a relatively small player.

Revenues JSML generates revenue by selling refined sugar, in the local and export markets, molasses and bagasse. During MY19, the Company's revenue posted an increase of 57% (MY19: PKR 3,441mln, MY18: PKR 2,195mln). The rise was attributable to increase in average selling price and better volumes of both local sales (MY19: 44,772MT, MY18: 33,970MT) and export sales (MY19: 9,000MT, MY18: 5,012MT). During 1QMY20, the Company posted 42% increase in revenue (1QMY20: PKR 357mln, 1QMY19: PKR 251mln), as it sold sugar due to better prices in the country, despite no export quota provided by the Government.

Margins During MY19, the Company's gross margins improved to 19% (MY18: 2.2%), supported by rise in sugar, molasses and bagasse prices, along with high recovery rate. Better capacity utilization (MY19: 71%, MY18: 59%) led to higher net margins (MY19: 5.3%, 1QMY20: 6.6%, MY18: 0.2%). The Company's net income improved significantly to PKR 183 mln during (MY18: PKR 5mln). Similarly, improvement in the margins was witnessed during 1QMY20 (Gross: 20%, Net: 6.6%).

Sustainability Going forward, the Company is planning to install a distillery. Initial feasibility has been carried out in this regard. The Company has also installed 15MW biomass co-generation power plant, with an exportable capacity of 10MW to FESCO, expected to be commercially operational by end of 2020.

Financial Risk

Working Capital By selling previous inventory, the Company improved the inventory held days (MY19: 61days, MY18: 109days). Receivable days remain inline with the normal cycle of 40-45 days (MY19: 32days, MY18: 27days). Due to timely payments made to the sugar cane suppliers, payable days remain low (MY19: 6days, MY18: 17days). This led to improved net working capital cycle (MY19: 86days, MY18: 119days). During 1QMY20, net working increased (184 days) owing to increased stocks held by the Company as the crushing started. Strict discipline in the working capital management is required to improve the borrowing buffer.

Coverages JSML's interest cover (MY19: 2.8x, FY18: 0.0x) is a function of improved free cash flows, despite a 49% rise in finance cost (MY19: PKR 206mln, MY18: PKR 138mln). Significant improvement in the Company's cash flows led to strong core coverage ratio (MY19: 1.8x, MY18: 0.0x). Similarly, during 1QMY20, interest cover posted an increase (6.4x) due to improved cash flows.

Capitalization During MY19, the Company improved its leverage ratio (MY19: 35%, MY18: 49%) owing to reduced short term debt (MY19: PKR 409mln, MY18: PKR 1,114mln). Total debt stood at PKR 637mln in MY19 (MY18: PKR 1,442mln). Around 33% of the debt comprises short term borrowings obtained to finance working capital requirement (MY18: 54%). Long-term loan was obtained to set-up the biomass power plant. Leveraging remained moderate during 1QMY20 (42%).

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Jauharabad Sugar Mills Limited Sugar	Dec-19 3M	Sep-19 12M	Sep-18 12M	Sep-17 12M	Sep-16 12M
A BALANCE SHEET					
1 Non-Current Assets	3,282	3,276	3,241	3,084	2,787
2 Investments	-	-	-	-	-
3 Related Party Exposure	-	-	-	-	-
4 Current Assets	1,475	1,085	1,449	838	441
a Inventories	*864*	*390*	*753*	*556*	*30*
b Trade Receivables	*12*	*270*	*327*	*1*	*-*
5 Total Assets	4,757	4,361	4,689	3,922	3,227
6 Current Liabilities	529	563	261	413	209
a Trade Payables	*47*	*50*	*67*	*137*	*67*
7 Borrowings	1,047	637	1,442	577	38
8 Related Party Exposure	611	611	610	445	1,124
9 Non-Current Liabilities	258	261	242	338	332
10 Net Assets	2,312	2,289	2,135	2,149	1,524
11 Shareholders' Equity	2,313	2,289	2,135	2,149	1,524
B INCOME STATEMENT					
1 Sales	357	3,441	2,195	2,582	2,095
a Cost of Good Sold	*(284)*	*(2,788)*	*(2,149)*	*(2,282)*	*(1,888)*
2 Gross Profit	73	654	46	300	206
a Operating Expenses	(39)	(186)	(138)	(116)	(90)
3 Operating Profit	34	468	(93)	184	117
a Non Operating Income or (Expense)	*1*	*(5)*	*267*	*5*	*19*
4 Profit or (Loss) before Interest and Tax	35	463	174	189	136
a Total Finance Cost	*(9)*	*(206)*	*(138)*	*(124)*	*(54)*
b Taxation	*(2)*	*(75)*	*(31)*	*(33)*	*24*
6 Net Income Or (Loss)	23	183	5	32	106
C CASH FLOW STATEMENT					
a Free Cash Flows from Operations (FCFO)	*59*	*565*	*(2)*	*233*	*191*
b Net Cash from Operating Activities before Working Capital Changes	*29*	*291*	*(129)*	*112*	*125*
c Changes in Working Capital	*(433)*	*667*	*(652)*	*(226)*	*(83)*
1 Net Cash provided by Operating Activities	(404)	958	(781)	(114)	42
2 Net Cash (Used in) or Available From Investing Activities	(24)	(112)	(245)	(396)	(106)
3 Net Cash (Used in) or Available From Financing Activities	410	(834)	1,045	518	50
4 Net Cash generated or (Used) during the period	(18)	11	19	8	(15)
D RATIO ANALYSIS					
1 Performance					
a Sales Growth (for the period)	-58.5%	56.8%	-15.0%	23.3%	--
b Gross Profit Margin	20.5%	19.0%	2.1%	11.6%	9.9%
c Net Profit Margin	6.6%	5.3%	0.2%	1.2%	5.1%
d Cash Conversion Efficiency (EBITDA/Sales)	17.8%	16.9%	2.1%	11.1%	9.9%
e Return on Equity (ROE)	4.1%	8.3%	0.2%	1.7%	8.2%
2 Working Capital Management					
a Gross Working Capital (Average Days)	196	92	136	42	36
b Net Working Capital (Average Days)	184	86	119	27	16
c Current Ratio (Total Current Assets/Total Current Liabilities)	2.8	1.9	5.6	2.0	2.1
3 Coverages					
a EBITDA / Finance Cost	6.9	2.9	0.3	2.4	4.4
b FCFO / Finance Cost+CMLTB+Excess STB	1.7	1.8	0.0	1.8	3.7
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	4.0	2.3	-7.0	5.3	8.1
4 Capital Structure (Total Debt/Total Debt+Equity)					
a Total Borrowings / Total Borrowings+Equity	41.7%	35.3%	49.0%	32.2%	43.3%
b Interest or Markup Payable (Days)	71.0	34.9	144.7	51.0	0.0
c Average Borrowing Rate	2.5%	12.2%	8.6%	10.8%	4.1%

Rating Scale | Corporate

2019

Credit Rating Scale & Definitions

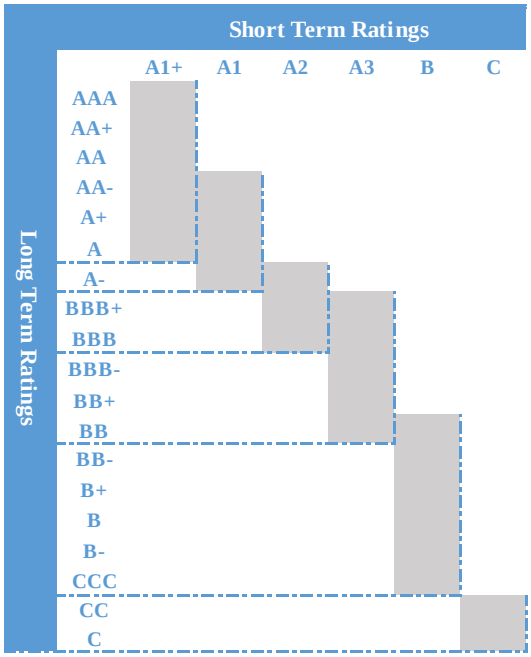
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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.



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