



The Pakistan Credit Rating Agency Limited

Rating Report

Hunza Sugar Mills (Pvt.) Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
06-Sep-2019	BBB	A2	Stable	Maintain	-
08-Mar-2019	BBB	A2	Stable	Maintain	-
06-Sep-2018	BBB	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The Sugar industry of Pakistan is the 2nd largest agro based industry comprising ~90 sugar mills with annual crushing capacity estimated between 65 – 70 mln MT. During MY19, sugar production dropped by 20% to ~5.5mln MT amid low crop cultivation from two consecutively high crushing season. The decrease in piled up sugar stocks rallied up retail prices by ~20%, providing relief to sugar producers.

The ratings reflect the Company's diverse revenue streams (Sugar, Ethanol, Bagasse) and sponsors strong acumen in the sector. The Company remains exposed to volatility in Sugar sector. Higher recovery rate and rising sugar prices resulted in improving performance in 10MMY19, having a positive impact on the Company's bottom-line despite lower production. Financial risk is high owing to highly leveraged capital structure and stretched working capital. The Company utilizes short-term borrowings to finance its inventory. Short-term borrowings remain high despite significant reduction in trade assets. This, coupled with high finance cost, keeps the Company's coverages under pressure. Meanwhile, sponsors firm commitment to provide financial support in a timely manner provides comfort to the ratings.

The ratings are dependent upon the Company's ability to maintain its margins, improve coverage's and rationalize short-term borrowings to avoid asset liability mismatch. Any significant deterioration in margins and/or cash flows will impact the ratings. Improvement in governance framework and internal controls will be favorable for the ratings.

Disclosure

Name of Rated Entity	Hunza Sugar Mills (Pvt.) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	PACRA_Methodology_Corporate_FY19(Jun-19),PACRA_Criteria_LT ST Relationship_FY19(Jun-19)
Related Research	Sector Study Sugar(Apr-19)
Rating Analysts	Silwat Malik silwat.malik@pacra.com +92-42-35869504

Profile

Legal Structure Hunza Sugar Mills is a Private Limited Company.

Background Hunza Sugar Mills Limited ('Hunza Sugar' or 'the Company') was incorporated in 2002. Hunza Sugar installed a distillery adjacent to its Sugar unit-1 that commenced commercial production in MY '14 and has a CO2 processing plant that increased its capacity of 200MT during MY18.

Operations The Company operates two sugar units in District Jhang and District Faisalabad. The sugar units have a combined crushing capacity of 22,000 MT per day. Average capacity utilization for 10MMY19 stood at 86.5% (MY18: 87.8%). Distillery adjacent to its Sugar unit-1 (Faisalabad) has a production capacity of 150,000 Liters/day and is engaged in processing of food grade ethanol. Additionally, the company has CO2 plants with a processing capacity of 200MT. During 10MMY19 the Company produced ~123mln MT of sugar significantly lower than MY18 (~145mln MT) owing to unavailability of sugarcane stock. However, a better recovery rate of ~9.57% was achieved (MY18: 8.67%).

Ownership

Ownership Structure Hunza Sugar is a Family owned entity. Three brothers, along with their family members hold entire shareholding of the Company. There are no changes in the ownership structure during 10MMY19. Mr. Idrees Chaudhrys' family has 31% shareholding, 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 Entities owned by the family are collectively called 'Hunza Group'. The group's flagship company is Hunza Ghee Industries (Pvt.) Limited in the Edible Oil sector which dates back to 1988. The company produces vegetable ghee and cooking oil that sells under the brand 'Swera Ghee' and 'Swera Cooking Oil'. It is involved in the import and sale of Edible Oil through its group company called Swera Traders (Pvt.) Limited. The Group diversified its operations and entered the sugar industry in 2002. Hunza Sugar expanded through forward integration by venturing into distillery business in MY14. The group is in the process of setting up a bagasse based power plant under its' new group company 'Hunza Power'.

Financial Strength Hunza Group as a whole (Hunza Ghee, Hunza Sugar, Swera Traders & Power) has an asset base of PKR 13.8bln of which PKR 3.6bln are represented by equity in MY18. Long-term debt exposure of the Group from banks is PKR 2.3 bln. The Group has a turnover PKR 18bln and a profit after tax of PKR 38mln in MY18.

Governance

Board Structure The Company has a three member board. All three are family members and shareholders of the company. There are no independent members on the Board.

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.). He serves as an advisor to the management. The directors have around fifteen years of experience in the Sugar Industry and over thirty years of experience in the Edible Oil Sector. Mr. Waheed looks after external relations of the company and represents the company at different forums including LCCI.

Board Effectiveness The BoD meets four times during MY18 to approve the financial statement. However, minutes of the meetings are restricted to formal approvals required for regulatory purposes.

Financial Transparency The auditors of the company, Amin, Mudassar & Co, issued an unqualified opinion the financial statements for MY18. The firm has been auditors of the company since MY18. The firm has satisfactory QCR rating and is listed on SBP panel in category 'B'. From MY09 - MY17, the Company was audited by Javed Chaudhry & Co. who were not on the panel maintained by State Bank of Pakistan and are not QCR rated by ICAP.

Management

Organizational Structure The Company is headed by the CEO, Mr. Saeed Chaudhry, 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. There were no significant changes in organizational structure during 10MMY19.

Management Team Mr. Saeed Chaudhry is the youngest brother and is CEO of all Group companies (except Swera (Pvt) Ltd.). He has fifteen years of experience in the Sugar Industry and over thirty years of experience in the Edible 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 (Purchases and Inventory Management stores), Sales module (Sales Management and Stock Management), Payroll management and Cane Procurement System. Currently, the company is implementing a new MIS 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 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 MT in the preceding year.

Relative Position Hunza Sugar contributed approximately 2.2% making it one of the top 20 sugar producers in the country and a leading sugar mill in Punjab region.

Revenues The sales mix is dominated by local and export sales of refined sugar (~70% of revenue) and ethanol sugar sales (~28% of revenue). Remaining portion comprises CO2, molasses and bagasse sales. The Company generated majority of its revenues (~69%) through exports. Hunza Sugar's turnover stood at PKR 11,540mln in 10MMY19 (MY18: PKR 12,041mln) as the Company sold off its stocks at favorable prices. Previously, Hunza Sugar has experienced an increasing trend line in its turnover on account of heightened exports of refined sugar.

Margins Hunza Sugar has witnessed volatile margins over recent years. In 10MMY19, the Company's gross margins improved to ~16.4% (MY18: ~6%) on the back of better recovery rates and higher sugar prices. Recent Pak rupee devaluation also supported the top-line and margins.

Sustainability Going forward, the ethanol division of the Company is expected to remain stable. Meanwhile, higher sugar prices in local market is expected to bode well for the Company.

Financial Risk

Working Capital The Company experienced a decline in its working capital days in line with season cycle, as they decreased from 93 days in MY18 to 61 days in 10MMY19 owing to a significant decrease in average inventory days as the Company sold off majority of stocks. There is significant asset-liability mismatch at trade level.

Coverages The Company's interest coverage stood at 2.2x during 10MMY19 improving from 1.5x in MY18 owing to an increase in FCFO. Total coverage remains thin and stood at 1.3x in 10MMY19. Coverages are expected to improve, going forward, with better profitability and cash-flow prospects.

Capitalization The Company's leveraging remains very high. Total Debt: Debt plus equity ratio stood at ~70% in 10MMY19. This debt majorly comprises short-term debt (~71%), which is utilized to fund the Company's working capital requirements. Further, long term borrowings noted a slight decrease as phases of BMR activity enhancing capacity in Unit-2 and addition of CO2 plant was completed. Total Borrowings stood at PKR ~7,223mln in 10MMY19 decreasing from PKR ~7,679mln in MY18.



The Pakistan Credit Rating Agency Limited

Financial Summary

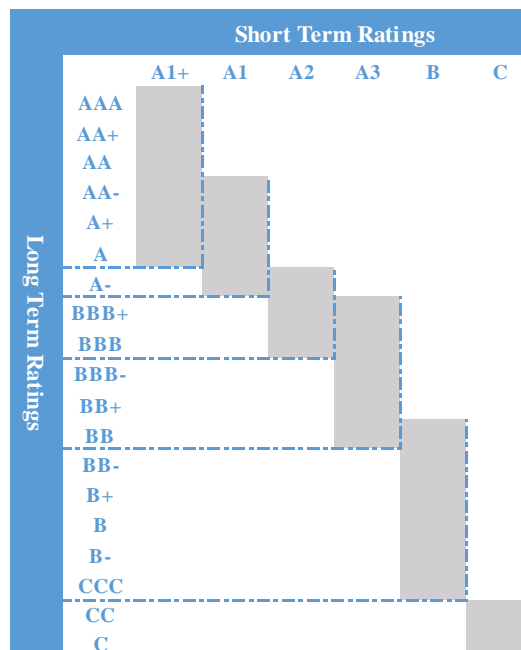
PKR mln

Hunza Sugar Mills Sugar	Jul-19 9M Management Accounts	Sep-18 12M Audited Accounts	Sep-17 12M Audited Accounts	Sep-16 12M Audited Accounts
A BALANCE SHEET				
1 Non-Current Assets	5,334	5,209	4,634	4,129
2 Investments	110	-	-	-
3 Related Party Exposure	278	201	122	113
4 Current Assets	5,408	5,789	6,170	1,941
<i>a Inventories</i>	1,536	2,531	4,270	867
<i>b Trade Receivables</i>	1,555	247	251	-
5 Total Assets	11,130	11,200	10,926	6,182
6 Current Liabilities	806	1,140	802	505
<i>a Trade Payables</i>	280	786	399	38
7 Borrowings	6,266	6,692	6,765	2,470
8 Related Party Exposure	957	987	881	1,027
9 Non-Current Liabilities	-	-	-	-
10 Net Assets	3,101	2,381	2,478	2,180
11 Shareholders' Equity	3,101	2,381	2,478	2,180
B INCOME STATEMENT				
1 Sales	11,541	12,041	8,866	8,751
<i>a Cost of Good Sold</i>	(9,653)	(11,325)	(7,819)	(8,148)
2 Gross Profit	1,888	717	1,047	603
<i>a Operating Expenses</i>	(530)	(653)	(456)	(371)
3 Operating Profit	1,358	64	591	233
<i>a Non Operating Income or (Expense)</i>	9	409	89	536
4 Profit or (Loss) before Interest and Tax	1,367	473	680	769
<i>a Total Finance Cost</i>	(709)	(481)	(378)	(366)
<i>b Taxation</i>	-	(27)	(3)	70
6 Net Income Or (Loss)	658	(35)	299	473
C CASH FLOW STATEMENT				
<i>a Free Cash Flows from Operations (FCFO)</i>	1,541	661	979	1,087
<i>b Net Cash from Operating Activities before Working Capital Changes</i>	809	362	715	780
<i>c Changes in Working Capital</i>	94	839	(3,978)	51
1 Net Cash provided by Operating Activities	903	1,202	(3,263)	831
2 Net Cash (Used in) or Available From Investing Activities	(436)	(950)	(905)	(360)
3 Net Cash (Used in) or Available From Financing Activities	(374)	28	4,149	(450)
4 Net Cash generated or (Used) during the period	94	280	(19)	21
D RATIO ANALYSIS				
1 Performance				
<i>a Sales Growth (for the period)</i>	27.8%	35.8%	1.3%	--
<i>b Gross Profit Margin</i>	16.4%	6.0%	11.8%	6.9%
<i>c Net Profit Margin</i>	5.7%	-0.3%	3.4%	5.4%
<i>d Cash Conversion Efficiency (EBITDA/Sales)</i>	14.4%	6.7%	12.0%	13.1%
<i>e Return on Equity (ROE)</i>	32.0%	-1.5%	12.8%	21.7%
2 Working Capital Management				
<i>a Gross Working Capital (Average Days)</i>	74	111	116	N/A
<i>b Net Working Capital (Average Days)</i>	61	93	107	N/A
<i>c Current Ratio (Total Current Assets/Total Current Liabilities)</i>	6.7	5.1	7.7	3.8
3 Coverages				
<i>a EBITDA / Finance Cost</i>	2.4	1.8	2.8	3.2
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	1.3	0.4	1.0	1.2
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>	2.2	14.1	3.8	2.8
4 Capital Structure (Total Debt/Total Debt+Equity)				
<i>a Total Borrowings / Total Borrowings+Equity</i>	70.0%	76.3%	75.5%	61.6%
<i>b Effective Borrowing Rate</i>	12.6%	5.8%	6.7%	10.3%

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		Short Term Ratings	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
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.	A1	A strong capacity for timely repayment.
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.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial 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.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
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.	C	An inadequate capacity to ensure timely repayment.
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.		



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 surveil the opinion due to lack of requisite information.

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

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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

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- (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.
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- (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)

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- (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)

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- (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)

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