The Pakistan Credit Rating Agency Limited

Rating Report

Mehran Sugar Mills Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
03-Dec-2018	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The Ratings reflect Meharan Sugar's strong business profile emanating from consistently high recovery rates (one of the highest in the country), diversified revenue stream and robust governance framework. To cushion against seasonality inherent in sugar industry, the bottom-line is supported through the Company's strategic joint venture investment in ‘Unicol Limited’, an ethanol production company, and sale of electricity generation. Of late, the Company has made investments in FMCG sector in similar joint venture ‘UniFoods Industries Limited’ and investments in the energy sector. Income from said projects are not expected anytime soon. Meanwhile, Mehran Sugar’s financial risk profile is characterized by moderately leveraged capital structure and relatively weak coverages. The Ratings draw comfort from Mehran Sugar’s ability to maintain healthy margins despite volatility in the sugar industry and a sizeable liquid investment portfolio.

The Ratings are dependent on the Company’s ability to improve its cashflows and coverages while maintaining strict financial discipline, especially in it’s working capital. Any significant deterioration in margins/ coverages would have negative impact on ratings.

Disclosure	
Name of Rated Entity	Mehran 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(Mar-18)
Rating Analysts	Adnan Dilawar | adnan@pacra.com | +92-42-35869504

Profile

Legal Structure Mehran Sugar Mills Limited (Mehran Sugar) is a public limited company listed on the Pakistan Stock Exchange.

Background Mehran Sugar was established in 1965 and was listed on the Karachi Stock Exchange in 1968. It began with production capacity of 1500 TCD. The Company increased capacity to 3500 TCD and installed a second unit, Tandem B, in 1994. Mehran Sugar entered in strategic partnership with other sugar companies in 2004 to establish a jointly operated distillery under the banner 'Unicol Limited'. Unicol has ethanol production capacity of 200,000 liters/day.

Operations The Company is primarily engaged in the production and sale of white sugar, brown sugar and ancillary products. It's mills are located in Deh Daro Sutha, District Tando Allahyar, over an area of 127 Acres having an installed capacity of 11,500 TCD. The Company has made sizeable strategic investments in companies that are involved in ethanol, CO2, bagasse based power plant and FMCG sectors in the form of joint venture companies and wholly owned investments. It also maintains an investment portfolio of PKR 1.2bln (end Jun '18). Merhan Sugar has the capacity to produce 14 MW of electricity. Excess power is sold to HESCO at NEPRA approved tariff . The Company's registered office is located in Clifton, Karachi.

Ownership

Ownership Structure Majority shareholding rests with individuals of Hasham Family (76%) ('Hasham Group'). Shareholding is divided among families of three brother Mr. M. Kasim Hasham (30%) Mr. M. Ebrahim Hasham (28%), and Mr. M. Hussain Hasham (18%). The remaining shareholding belongs to general public and other corporations.

Stability Ownership is seen as stable as the Company's controlling interest vests with one Group. Each family within the Group holds a defined share in the Company.

Business Acumen Mehran Group started its first business enterprise in 1930s with Mr. Haji Hasham trading in commodities. Mehran Sugar was incorporated in 1965 that continued as a single business enterprise. In 2004 Hasham Group entered the Ethanol segment through Unicol Limited. The Group has lately ventured into FMCG sector again through a joint venture 'UniFoods Limited'. Other prominent Group entities include Pakisatan Molasses Company (Pvt.) Ltd and Mogul Tobacco Company (Pvt.) Ltd.

Financial Strength Mehran Sugar alone has a consolidated asset base of PKR 5.7bln which is supported by an equity base of PKR 2.2bln. Consolidated debt stands at PKR 1.7bln. It acheived a consolidated turnover of PKR 5,500mln with a bottom-line of PKR 131mln. Mehran Sugar together with other entities of the Group give sufficient strength to the Company to support it times of stress.

Governance

Board Structure The BoD comprises eight individuals, which include two executive members, four non- executive members and two independent Directors.

Members' Profile The BoD members have significant experience in sugar industry which is balanced by an adequate mix of business, financial, legal and marketing experts. Mr. M. Kasim Hasham, Chairman of the BoD, has significant experience in the sugar and packaging industry. Mr. Amjad Waheed, CEO NBP Funds, and Mr. Mohammad Bashir, an industrialist by profession, serve as independent Directors on Board.

Board Effectiveness The BoD has constituted two committees namely HR Development Committee and Audit Committee. BoD met five times in FY17, whereas the Audit Committee and HR Development Committee met 4 (fifty percent attendance) and 2 times, respectively, during the year.

Financial Transparency The auditors of the Company are EY Ford Rhodes, Chartered Accountants. They issued an unqualified opinion on the financial statements for FY17 and conclusion for on Financial Statements for 1HFY18. The Auditors have included an Emphasis of Matter Paragraph with respect to various litigation pending decision. Majority of these litigations pretain to those in the Sugar Industry while others relate to taxation. The Auditors are categorized as 'A' panel maintained by State Bank of Pakistan and QCR rated by ICAP.

Management

Organizational Structure Organizational structure is divided in two, head office and site functions. All functions at site are headed by resident director. CFO, Resident Director & Director Cane/ Development report directly to the Managing Director. The Company is headed by the Managing Director under the oversight of the CEO.

Management Team Senior management has long association with Mehran Sugar adding the required experience in sugar industry and their respective fields.

Effectiveness The Company has instituted an Executive Committee comprising of the all head of departments headed by the CEO and MD. The Committee meets on a monthly basis for review performance and enable short-term decision making.

MIS Mehran Sugar has deployed an in-house system which has Sugar Cane Management module, Store Management module and HR module. These are all integrated with the accounting systems which is also developed in-house. In line with operations, the Company could upgrade its ERP software. Further, Mehran Sugar has installed Investment Portfolio Management System to ensure effective oversight of it's short-term investments.

Control Environment Mehran Sugar has an sufficiently staffed in-house internal audit department that reports directly to the Board's Audit Committee.

Business Risk

Industry Dynamics Sugar production decreased to 7mln tons during FY18 in comparison to 7.1mln tons in FY17. Sugar export quota announced helped clear excess 1.5mln ton carry over stock in FY18. This eased the sugar glut situation in market to a certain extent. Retail price averaged around PKR 55/kg. Minimum support price for sugarcane continued at same rates as in FY17 (180 per maund).

Relative Position Mehran is one of the bigger player in the sugar Industry owing to it's crushing capacity that stands at an official capacity of 11,500mln tons and consistently high recovery rates of over 11%. Income from Company's long-term investment portfolio and Sale of electricity augments the bottom-line.

Revenues Mehran Sugar's top-line consists of bulk sugar sale in local market and exports, packaged sugar in retail and sale of molasses and bagasse. Owing to depressed sugar prices and resultantly lower off-take, delay in announcement of export quotas and subsidy, turnover took a dip in FY17. Mehran Sugar continued with the downwards trend in its top-line during 9MFY18 owing to low sugar prices in both local and international market.

Margins Due to increase in Sugarcane Support price in Sindh and decline in sugar recovery rates to 11.05% in FY17, GP Margins experienced a decline in FY17 (5%). During 9MFY18, recovery improved to 11.52% and increased bagasse savings from BMR activities helped improve GP margins to 11%. Income from sale of electricity and income from Unicol Limited added the needed cushion to the bottom line. Net profit clocked in at PKR 132mln in FY17 and increased to PKR 236mln during 9MFY18. The positive impact of exchange gain mitigated higher borrowing cost to an extent.

Sustainability Mehran Sugar Mills is focusing on increasing its crushing capacity to 13,000 TCD and improve steam efficiency which would required an overall BMR expenditure of PKR 750mln. The Company has already invested more than PKR 500mln in this regard. The Company intends to increase its investment in UniFoods Industries Limited and Unicol Limited in the coming year.

Financial Risk

Working Capital Pile up of sugar stock was witnessed at end 9MFY18 taking average cash cycle days to 120 days on back of bumper sugar production. Delay in disbursement of subsidy from Federal Government created pressure on the cash flows increasing the need for short-term borrowing. Situation is expected to improve as the Company continues to off-load the piled up stocks.

Coverages Mehran sugar has been experienced dwindling interest coverages to .1x (FY17) in-line with its decreasing turnover and GP Margins while debt level increased. Improved bottom-line during 9MFY18 boded well for the interest coverages (2x) despite the surge in interest expense. Meanwhile, core coverage improved to .7x during 9MFY18 although coverage still remain under pressure. The situation is expected to improve as the Company reduces its short-term debt in line with lower inventory.

Capitalization Mehran Sugar's debt is a function of long-term and short term borrowings. The Company has witnessed a significant increase in its leveraging over the years (FY17: 45% ; 9MFY18: 57%). The increase is largely tilted towards short-term borrowings as these have been used to finance the delay in disbursement of subsidy and managing higher inventory. Increase in long-term borrowing was witnessed on back of the Company's investment and BMR activities. Long-term borrowing closed in at PKR 791mln at of 9MFY18. (FY17: PKR 480mln).

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Mehran Sugar Mills Limited

BALANCE SHEET	30-Jun-18	30-Sep-17	30-Sep-16	30-Sep-15
	9M	FY	FY	FY
	Un-Audited	*Audited*	*Audited*	*Audited*
Non-Current Assets	**2,123**	**2,189**	**1,954**	**1,650**
Investments (Incl. Associates)	**2,772**	**1,808**	**1,871**	**1,378**
Equity	1,110	978	766	652
Debt Securities	-	-	-	-
Other Investments	1,662	830	1,106	725
Current Assets	**3,269**	**1,725**	**692**	**1,859**
Inventory	2,077	1,205	412	1,463
Trade Receivables	736	175	11	42
Others	456	346	269	354
Total Assets	**8,164**	**5,723**	**4,517**	**4,887**
Debt	**4,308**	**1,778**	**509**	**648**
Short-Term (STB)	3,280	1,117	-	191
Long-term (Incl. Current Maturity of Long-Term Debt - CMLTD)	1,028	661	509	458
Other Short-Term Liabilities	957	1,248	1,168	1,933
Other Long-Term Liabilities	473	478	517	444
Shareholder's Equity	**2,426**	**2,219**	**2,323**	**1,862**
Total Liabilities & Equity	**8,164**	**5,723**	**4,517**	**4,887**

INCOME STATEMENT				
Turnover	**3,688**	**5,501**	**7,113**	**4,361**
Gross Profit	401	268	743	680
Other Income/(Expense)	319	453	258	227
Financial Charges	(138)	(197)	(98)	(147)
Net Income	236	132	542	430

Cashflow Statement				
EBITDA	350	201	750	665
Free Cashflow from Operations (FCFO)	274	23	675	646
Net Cash changes in Working Capital	(1,772)	(928)	419	373
Net Cash from Operating Activities	(1,439)	(1,078)	1,016	854
Net Cash from InvestingActivities	(1,016)	17	(658)	(396)
Net Cash from Financing Activities	2,514	1,055	(370)	(446)
Net Cash Generated during the period	87	28	34	46

Ratio Analysis				
Performance				
Turnover Growth (Annualised)	-11%	-23%	63%	0%
Gross Margin	10.9%	4.9%	10.4%	15.6%
Net Margin	6.4%	2.4%	7.6%	9.9%
ROE	9.9%	6.6%	22.4%	23.1%
Coverages				
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB)	0.7	0.1	2.4	2.1
Interest Coverage (x) (FCFO/Gross Interest)	2.0	0.1	6.9	4.4
Debt Payback (Years) (Total Lt.Debt (excluding Covered Short Term Borrowings) / FCFO)	7.6	-3.8	0.9	0.9
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	120	16	2	30
Capital Structure (Total Debt/Total Debt+Equity)	57%	45%	19%	27%

Rating Scale

Credit Rating Scale & Definitions

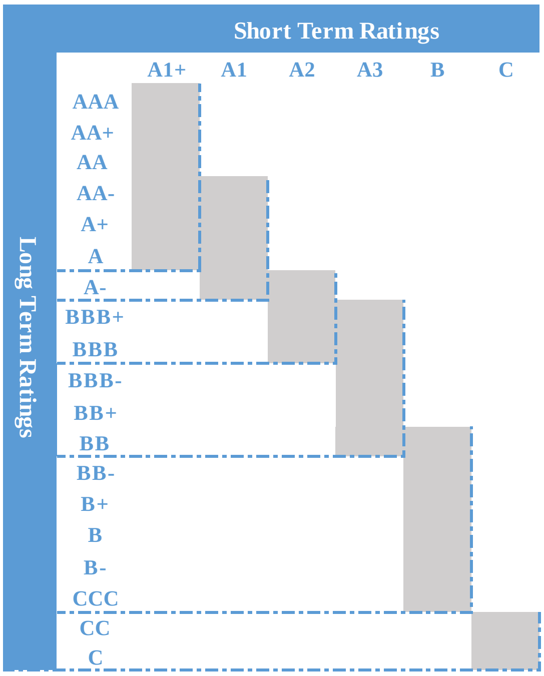
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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.



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.

Regulatory and Supplementary Disclosure
(Credit Rating Companies Regulations,2016)

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