The Pakistan Credit Rating Agency Limited

Rating Report

Noon Sugar Mills Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
12-Nov-2018	BBB	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect Noon Sugar Mills Limited's (Noon Sugar) diverse revenue stream, which in addition to the sale of sugar and ensuing by-products, is augmented by ethanol sales. The margins in the sugar industry have been depressed lately. However, the Company is able to maintain adequate margins owing to improved sucrose recovery and better ethanol margins. The Company turned around its operations under new management in the last two years and is undertaking several steps to improve its efficiency through BMR and expansion in ethanol capacity. Meanwhile, Noon Sugar's financial profile is stretched, characterized by a highly leveraged capital structure and modest coverages.

The ratings are dependent on the management's ability to reduce leveraging and improve working capital management, while maintaining profitability. Timely commencement of ethanol expansion leading to better margins and cashflows is critical. Any deterioration in margins and/or coverages will negatively impact ratings.

Disclosure	
Name of Rated Entity	Noon Sugar Mills Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(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 Noon Sugar Mills Limited (the Company) is a public listed company.

Background The Company was incorporated in 1964 and started its production operations in 1966, initially having a crushing capacity of 1,500 MT. Additionally, it operates a distillery, which commenced operations in 1986, with a production capacity of 50,000 litres/day. Noon Sugar faced several challenges resulting in low production in the recent past.

Operations Head office of the Company is located in Lahore, Cantonment, whereas, the mills and distillery are located in Bhalwal, Sargoda. The rated crushing capacity for the mill stands at 9,000 TCD and the distillery has an installed capacity of 80,000 litres of ethanol per day. At end Jun-18, the Company produced 98,655 MT of sugar, with a sucrose recovery rate of 9.77% and 17,168,029 litres of Ethanol.

Ownership

Ownership Structure Major shareholding of the Company lies with Noon Family (63%) through Mr. Adnan Hayat Noon (38%), Salman Hayat Noon (20%), and associates (13%). Remaining shareholding is split between the general public and financial institutions.

Stability Ownership structure of the Company is seen as stable as no ownership changes are expected.

Business Acumen The group previously owned and operated entities in cement and food sectors in addition to sugar. The sponsors divested their stake in cement and sold off Noon Pakistan, most famous for its brand ‘Nurpur’. However, the brand is now operated under Fauji Foods Limited (FFL), with the sponsors holding a 11% share in FFL.

Financial Strength With the exception of Noon Sugar Mills, other group companies are involved in indenting services relating to the textile industry. Noon Sugar Mills is seen as the main company in the Group. However, in addition to having an ownership stake in Fauji Foods Limited (11%), the sponsors have strength in personal assets.

Governance

Board Structure The Company’s Board of Directors consists of seven members including the Chairman, two executive directors, two non-executive directors and two independent directors.

Members’ Profile The board members have strong profiles and specialize in banking and legal matters, in addition to sugar.

Board Effectiveness The Company has in place three Board committees, namely, Human Resources and Remuneration Committee, Technical Committee and Audit Committee. During the year the Board met six times, with high attendance by members.

Financial Transparency M/s Shinewing Hameed Chaudhri & Co., Chartered Accountants, classified in category ‘B’ by SBP and having a satisfactory QCR rating, are the external auditors of the Company. They have expressed an un-qualified opinion on the Company.

Management

Organizational Structure Noon Sugar Mills has a well-defined organizational structure. All department heads, who are consolidated at site, are reportable to General Manager Operations, who along with the Chief Financial Officer, Manager Tax and Commercial Manager Report to the Chief Operating Officer. Subsequently, the highest level of authority lies with the Chief Executive Officer.

Management Team Lt. Col. (R) Abdul Khaliq Khan, the Chief Executive Officer, served in the military for 25 years during which he gained experience relating to operations, administration, human resource management and assessment. He is aided by Mr. Muhammad Sohail Khokar, the Chief Operating Officer and Mr. Rizwan Sohail, the Chief Financial Officer. Both individuals are Fellow Chartered Accountants and have significant experience in the sugar industry. The company revamped its top management in recent years to turn around its operations.

Effectiveness The Company has no management committees in place. However, management accounts are discussed among the management to review monthly activity.

MIS The Company relies on an in-house developed system. In line with growth in operations the Company is expected to invest in an effective software to facilitate efficient management.

Control Environment The Company recently developed its internal audit department which has basic internal controls required to ensure compliance and efficiency. However, room for improvement exists, as the Company needs to further develop and strengthen its control mechanism.

Business Risk

Industry Dynamics Pakistan is the 6th largest sugarcane producer, 9th largest sugar producer and 8th largest sugar consuming country in the world. Sugarcane is grown on approximately 1.2 million hectares and provides the raw material for ~90 sugar mills. The industry witnessed surplus sugar production during FY17, which resulted in depressed prices and a significant pile up of sugar stocks at end Sept-17. Sugar production decreased to 6.5mln Tons during FY18 in comparison to 7mln tons in FY17. The over supply situation persisted in FY18 and prices remained under pressure.

Relative Position Due to the high number of players in the industry, companies relatively have low market share. At end Jun-18, Noon Sugar had a market share of 1.40%.

Revenues Revenue comprises Sugar and Ethanol sales. Majority of sales revenue in FY17 (PKR 4,207mln) emanated from sugar sales, which represent 87% of total revenue. During FY17, the Company witnessed a surge in total revenue, which increased by 86% as compared to the preceding year, because of increased production and sales volume. Similarly, distillery sales also grew during the period and stood at ~PKR 1bln in FY17, 107% higher than the previous year. Growth can be seen as an effect of increased export sales which grew due to increased production and a higher price fetched in the international market. During 9MFY18 total sales stood at PKR 4,628mln, significantly higher as compared to the same period last year (9MFY17: PKR 3,442mln).

Margins The Company saw its gross profit margin improve to 12% during FY17 on the back of increased sucrose recovery, which improved to 10.16% in FY17 from 9.75% in the previous year. The Company was able to control its administration costs, posting an operating profit of PKR 354mln, 186% higher than last year and improving the operating margin to 7% in FY17 (FY16: 4%). Moreover, bottom line is supported by supplementary income in the form of proceeds from power generation and closed in at PKR 102mln in 9MFY18 (NP Margin 9MFY18: 2%).

Sustainability Going forward, the Company plans to install new boilers for its power plant which will bring its rated capacity to ~8 MW. Additionally, the Company also plans to upgrade its crushing capacity to 12,000 TCD by the year 2020. Moreover, expansions made in the distillery plant are expected to come into effect in December 2018.

Financial Risk

Working Capital Noon Sugar Mills has had difficulty managing its working capital over the years mainly because of low capacity utilization and production. The Company maintained a high number of net working capital days, which stood at 176 days. This can partly be explained by unfavorable market conditions during the season which forced the Company to hold on to sugar stock. Additionally, due to BMR implementation and expansion activities, a mismatch in the debt mix was observed which impacted the Company negatively.

Coverages Despite surge in debt levels and related finance costs in FY17, the Company was able to maintain adequate coverage ratios. However, due to increased short term borrowings in 9MFY18, the Company witnessed low coverage ratios with interest coverage and debt coverage standing at 2.1x and 0.7x, respectively, in 9MFY18. (FY17: Interest Coverage: 2.2; Debt Coverage: 1.2).

Capitalization Noon Sugar Mills has a highly leveraged capital structure, (86% at end Jun-18) signifying risk. Coverages would come under further pressure with raising interest rates. Ensuring cashflows from increased Ethanol production is critical and expected to improve coverages. Majority of the debt is short-term in nature and is used to finance working capital requirements which grew in line with increased production. The Company utilized long-term borrowings to finance BMR implementation during the period. Moreover, financing was utilized for capacity enhancement in the Company’s distillery plant.

Noon Sugar Mills Limited

BALANCE SHEET	Jun-18	Sep-17	Sep-16	Sep-15
	9M	FY	FY	FY
Non-Current Assets	**1,283**	**1,129**	**1,012**	**938**
Investments	**8**	**8**	**8**	**8**
Current Assets	**4,028**	**2,865**	**687**	**608**
Inventory	3,031	2,220	453	426
Trade Receivables	404	132	74	12
Others	593	513	160	170
Total Assets	**5,319**	**4,002**	**1,708**	**1,553**
Debt	**3,801**	**2,705**	**708**	**565**
Short-term	3,478	2,334	583	468
Long-term (incl. Current Maturity of Long-Term debt)	322	372	125	98
Other Short-term Liabilities	839	609	497	527
Other Long-term Liabilities	42	39	37	34
Shareholder's Equity	**636**	**592**	**466**	**427**
Total Liabilities & Equity	**5,319**	**3,945**	**1,708**	**1,553**
INCOME STATEMENT				
Turnover	**4,628**	**4,836**	**2,589**	**3,027**
Gross Profit	462	572	235	125
Other Income	64	50	24	(9)
Financial Charges	(185)	(205)	(87)	(122)
Net Income	**102**	**144**	**40**	**(116)**
Cashflow Statement				
Free Cashflow from Operations (FCFO)	389	458	214	54
Net Cash changes in Working Capital	(1,250)	(1,775)	(150)	443
Net Cash from Operating Activities	(1,015)	(1,472)	(12)	353
Net Cash from InvestingActivities	(235)	(227)	(176)	43
Net Cash from Financing Activities	1,039	1,981	143	(348)
Net Cash generated during the period	(210)	283	(45)	48
Ratio Analysis				
Performance				
Turnover Growth	-	87%	-14%	-
Gross Margin	10%	12%	9%	4%
Net Margin	2%	3%	2%	-4%
ROE	15%	34%	9%	-27%
Coverages				
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB)	0.7	1.4	0.4	0.1
Interest Coverage (x) (FCFO/Gross Interest)	2.1	2.2	2.5	0.4
Debt Payback (Total LT Debt Including UnCovered Total STBs) / (FCFO- Gross Interest)	0.6	0.6	0.4	0.6
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	163	83	2	-1
Capital Structure				
Leveraging (Total Debt/Total Debt+Equity)	86%	82%	60%	57%

Rating Scale

Credit Rating Scale & Definitions

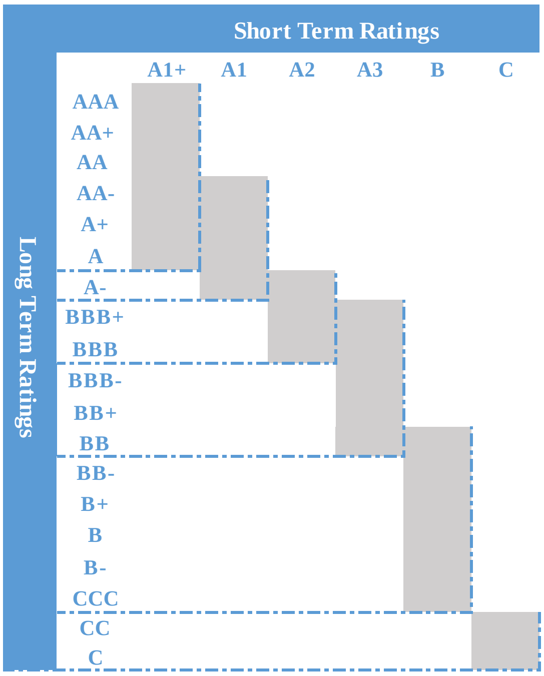
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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.

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
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(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)
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