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
08-May-2019	BBB	A2	Stable	Maintain	-
12-Nov-2018	BBB	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect Noon Sugar Mills Limited's 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 has displayed stability in margins through the support of distillery operations. The Company recently underwent capacity enhancement, expanding its distillery production capacity by 50,000 MT, with operations formally commencing in December, 2018. Going forward, the Company aims to focus on improving efficiency through BMR and utilization of recent capacity enhancement. Meanwhile, the Company's financial profile is adequate, characterized through weak working capital management, adequate coverages and a leveraged capital structure.

The ratings are dependent on the management's ability to reduce leveraging and improve working capital management, while maintaining profitability. Generating envisaged revenue and cashflows form distillery expansion is critical for ratings. Any deterioration in margins and/or coverages will have a negative impact.

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 | Criteria | Rating Modifier(Jun-18),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
Related Research	Sector Study | Sugar(Apr-19)
Rating Analysts	Adnan Dilawar | adnan@pacra.com | +92-42-35869504

Profile

Legal Structure 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 The Company has its head office located in Lahore, Cantonment, whereas, the mill is located in Bhalwal, Sargodha. The rated crushing capacity of the mill stands at 9,000 TCD and the distillery has an installed capacity of 130,000 liters. During the current season (MY19), the Company manufactured 63,097 MT of sugar, with a recovery rate of 10.1% and ~22mln Liters of Ethanol. The Company's recent expansion of distillery operations become fully operational in December, 2018.

Ownership

Ownership Structure Major shareholding of the Company lies with Noon Family (71%) 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 four 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 financial statements of the Company for the year ending in Sep-18.

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

Relative Position Owing to the high number of players in the industry, companies relatively have low market share. During MY18, the Company had a ~1.5% share in total sugar production of the Country.

Revenues The Company sources its revenue from the sale of sugar and ethanol. During MY18, total revenue registered an increase of ~30%, clocking in at ~PKR 6,273mln. Increased revenue can be traced to improved performance by both segments. Revenue from the sugar segment increased by ~25% during MY18, standing at ~PKR 5,252mln and representing 84% of total revenue. Despite lower production, higher sugar sales were achieved through off-load of previously accumulated inventory. Additionally, segment revenue was augmented by exports which fetched ~PKR 709mln (inclusive of subsidy worth ~PKR 159mln) during MY18. Similarly, distillery operations registered an income of ~PKR 1,310mln in MY18, 24% higher as compared to the corresponding period. Improved segmental performance was achieved through higher exports, supplemented by favorable international ethanol prices. During 1QMY19, revenue declined by ~37% and stood at ~PKR 1,322mln. Low sales can be explained by lower production and adverse market conditions.

Margins The Company was able to hold margins during the year owing to its distillery operations. During MY18, gross margin declined slightly to ~11% (MY17: ~12%) owing to poor performance in the sugar segment which saw segmental gross margin decline to 2% in MY18 (MY17: 7%). However, significant improvement in the distillery division, on the back of higher yields and favorable international prices helped the Company retain profitability. Similarly, operating margins were supported entirely by distillery operations as the sugar segment posted a nominal operating loss of ~PKR 15mln. During MY18, operating margin stood at 8%, improving by 1ppt. An increase in finance costs was observed during MY18, however, net profit margin was maintained at ~3% due to support from other income. during 1QMY19, profitability was maintained at the same level with the support of distillery operations. During the period gross margin improved to 12% with operating and net margin standing at 8% and 3%, respectively.

Sustainability The Company has no further plans for expansion and aims to focus on enhancing profitability through efficient operations. Additionally, no significant change in debt levels is expected.

Financial Risk

Working Capital The Company maintained high working capital days standing at 115 during MY18, owing to depressed market dynamics, forcing the Company to hold on to sugar stocks. Nonetheless, continued existence of mismatch observed in the debt mix indicates excess short-term borrowings utilized for capacity enhancement and reflects negatively on the Company. The Company was able to improve net working capital days to 96 during 1QMY19, however, an increase in excess borrowings further weakened the Company's working capital position.

Coverages The Company was able to maintain coverage ratios at adequate levels, despite an increase in finance costs, owing to stability in profitability. During MY18, interest coverage stood at 2.5x (MY17: 2.4x) with total coverage at 1.1x (MY17: 1.4X). During 1QMY19, coverage ratios were successfully maintained with interest and total coverage standing at 2.6x and 1.1x, respectively.

Capitalization A reduction in leveraging was observed during MY18, nonetheless, the Company has a highly leveraged capital structure, reflected by a leveraging ratio of ~78%. A reduction in leveraging can be traced to an increase in equity due to retained earnings as debt levels remained around the same levels. A further reduction in leveraging was observed in 1QFY19, coming down to ~75% on the back of a 15% reduction in short-term borrowings.

PKR mln

Noon Sugar Mills
Listed Public Limited

BALANCE SHEET	Dec-18 MY 3M	Sep-18 MY 12M	Sep-17 MY 12M	Sep-16 MY 12M
a Non-Current Assets	**1,411**	**1,363**	**1,129**	**1,012**
b Investments (Incl. Associates)	**8**	**8**	**8**	**8**
Investment Property	8	8	8	8
c Current Assets	**2,856**	**2,610**	**2,865**	**687**
Inventory	1,625	1,998	2,153	385
Trade Receivables	126	40	132	74
Others	1,104	572	580	228
d Total Assets	**4,275**	**3,980**	**4,002**	**1,708**
e Debt/Borrowings	**2,341**	**2,693**	**2,705**	**708**
Short-Term	2,026	2,386	2,334	583
Long-Term (Incl. Current Maturity of Long-Term Debt)	315	307	372	125
Other Short-Term Liabilities	1,110	501	666	497
Other Long-Term Liabilities	46	44	39	37
f Shareholder's Equity	**777**	**742**	**592**	**466**
g Total Liabilities & Equity	**4,275**	**3,980**	**4,002**	**1,708**

INCOME STATEMENT				
a Turnover	**1,322**	**6,273**	**4,836**	**2,589**
b Gross Profit	156	711	572	235
c Net Other Income	3	49	40	34
d Financial Charges	(57)	(252)	(205)	(87)
e Net Income	**35**	**211**	**144**	**40**

CASH FLOW STATEMENT				
a Free Cash Flow from Operations (FCFO)	139	580	458	214
b Total Cashflows (TCF)	139	580	458	214
c Net Cash changes in Working Capital	672	(206)	(1,775)	(150)
d Net Cash from Operating Activities	726	152	(1,472)	(12)
e Net Cash from InvestingActivities	(80)	(347)	(227)	(176)
f Net Cash from Financing Activities	(352)	(69)	1,981	143
g Net Cash generated during the period	294	(264)	283	(45)

RATIO ANALYSIS				
a Performance				
Turnover Growth	-16%	30%	87%	-14%
Gross Margin	12%	11%	12%	9%
Net Margin	3%	3%	3%	2%
ROE	18%	32%	27%	9%
b Coverages				
Debt Service Coverage (X) (FCFO/Gross Interest+CMLTD+Uncovered STB)	1.1	1.1	1.4	0.4
Interest Coverage (X) (FCFO/Gross Interest)	2.6	2.5	2.4	2.6
Debt Payback (Years) (Total Debt (excluding Covered Short Term Borrowings) / FCFO)	1.6	1.5	1.7	4.0
c Working Capital Management				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	96	115	91	75
d Capital Structure (Total Debt/Total Debt+Equity)	75%	78%	82%	60%

Rating Scale

Credit Rating Scale & Definitions

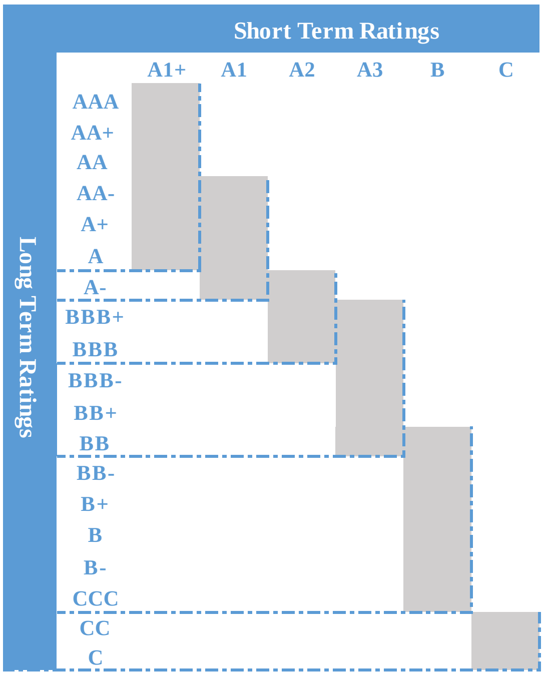
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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