The Pakistan Credit Rating Agency Limited

Rating Report

Noon Sugar Mills Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
07-Nov-2019	BBB	A2	Stable	Maintain	-
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 comprises the sale of sugar and ensuing by-products, electricity and ethanol. The margins in the sugar industry have been depressed lately. However, a reduced sugarcane crop during MY19, resulting in inflated sugar prices, benefited industry players. The Company has displayed stability in margins through the support of distillery operations. It recently underwent capacity enhancement, expanding its distillery production capacity by 50,000 MT, with operations formally commencing in January, 2019. Though, constrained raw material supply led to low capacity utilization, margins improved. Going forward, the Company aims to focus on improving efficiency through BMR. Meanwhile, the Company’s financial profile remains adequate, characterized by long working capital cycle, moderate coverages and a leveraged capital structure. The Company has a mismatch at trade asset level that strains coverages.

The ratings are dependent on the management’s ability to reduce leveraging and improve working capital management, while maintaining profitability. Increased utilization and generating envisaged cashflows for distillery expansion remains critical for ratings. Any deterioration in margins and /or coverage ratios will have a negative impact on 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-19),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria | Rating Modifier(Jun-19)
Related Research	Sector Study | Sugar(Oct-19)
Rating Analysts	Ayesha Malik | ayesha.malik@pacra.com | +92-42-35869504

Profile

Legal Structure Noon Sugar Mills Limited (Noon Sugar or the Company) is a public listed company.

Background The Company was incorporated in 1964 and started commercial operations in 1966, initially having a crushing capacity of 1,500 MT. It also operates a distillery, which commenced operations in 1986, with a production capacity of 50,000 liters/day. Noon Sugar faced several challenges resulting in low production in the recent past. However, the Company witnessed a turnaround in operations since incumbent management took over.

Operations The Company has its head office located in Lahore, Cantt., whereas, the mill is located in Bhalwal, Sargodha. Mill's rated crushing capacity stands at 9,000 TCD and the distillery has an installed capacity of 130,000 liters. During MY19, the Company manufactured ~36% less sugar standing at 63,097 MT (MY18: 98,655MT), with a recovery rate of 10% (MY18: 9.8%). Similarly, ethanol production declined by 12%, standing at ~15mln liters of ethanol (Jun-19) (Jun-18: ~17mln liters). The Company's recent expansion of distillery operations become fully operational in Dec-18.

Ownership

Ownership Structure Major shareholding of the Company lies with Noon Family (71%) through Mr. Adnan Hayat Noon and family (38%), Mr. Salman Hayat Noon (20%), and associates (13%). Remaining shareholding is split between the general public and financial institutions. During 9MMY19, 36% shareholding of the Company was transferred to Ms. Tahia Noon (wife of Mr. Adnan Hayat Noon), leaving Mr. Adnan Hayat Noon with 2% stake.

Stability Ownership structure is expected to undergo changes as sponsors induct second generation into the business.

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 Noon Pakistan, most famous for its brand 'Nurpur'. The brand is now operated under Fauji Foods Limited (FFL), with the sponsors holding ~ 11% share in FFL.

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

Governance

Board Structure 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. During 9MMY19, Mr. Adnan Hayat Noon resigned from the directorship of the Company. He was subsequently replaced by Mr. Saifullah Khan Noon.

Board Effectiveness The Company has in place three Board committees, namely, HR and Remuneration Committee, Technical Committee and Audit Committee. During MY18, 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 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 CEO, served in the military for 25 years during which he gained experience relating to operations, administration, HR management and assessment. He is aided by Mr. Muhammad Sohail Khokar, the COO and Mr. Rizwan Sohail, the CFO. Both individuals are Fellow Chartered Accountants and have significant experience in the sugar industry.

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, Noon Sugar is in the process of implementing an ERP.

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 intends to further develop and strengthen its control mechanism.

Business Risk

Industry Dynamics Pakistan's sugar industry is the 2nd largest agro based industry, comprising ~90 mills with annual crushing capacity estimated around 65 – 70 mln MT. The sugar industry of Pakistan has remained under pressure in recent times. Prices during the current season (MY19) have improved owing to lower sugar production and depletion of carryover stock. Sugar production fell by ~20%, YoY, to 5.3mln MT. This has impacted the profitability for industry players positively. Moreover, provision of subsidy amount by the government has eased the liquidity pressure. An export quota of 1.1mln tons was approved, nonetheless, absence of subsidy led to low quantities availed. During the FY20 budget, sales tax levied on sugar was increased to 17% charged on the price of PKR 60/KG, effective from July 1, 2019. Additionally, provision of CNIC for all buyers has been made mandatory. This has been made effective from August 1, 2019.

Relative Position Owing to the high number of players in the industry, companies relatively have low market share. The Company had a ~1% share during 9MMY19.

Revenues The Company has two reportable segments, (i) Sugar and (ii) Distillery. During 9MMY19, the Company posted net revenue worth ~PKR 4,579mln, ~1% lower as compared to 9MMY18. This was due to lower sugar sales, mainly on the export front as the government withdraw subsidy support. Sales for the sugar segment during 9MMY19 fell by 6%, YoY and stood at ~PKR 3,415mln. Meanwhile, revenue from the distillery segment grew by 15%, standing at ~PKR 1,164mln (9MMY18: ~PKR 1,010mln) on the back of favorable prices.

Margins During 9MMY19, gross margin improved to 14% (9MMY18; ~10%) owing to favorable sugar prices. During the period, the sugar division posted a gross margin ~ 5% (9MMY18: 0%). On the other hand, gross margin from distillery witnessed slow down but remained at 39% in 9MMY19 (9MMY18: 46%). Lower gross margin from the distillery are a factor of high raw material costs owing to restricted molasses supply. Similarly, operating margin improved to ~9% in 9MMY19 (9MMY18: 6%). The Company's overall profitability is supported by sale of power and bagasse. During 9MMY19, other income registered a sharp decline of 67% on the back of lower power sales. Additionally, 40% increase in finance costs constrained profitability. However, lower taxation during the period helped offset impact to an extent. The Company posted net profit of ~PKR 163mln during 9MMY19 (9MMY18: ~PKR 102mln), translating into net margin of ~4% (9MMY18: ~2%).

Sustainability The Company has no further plans for expansion and aims to focus on enhancing profitability through efficient operations.

Financial Risk

Working Capital During 9MMY19, net working capital days came down to 130 days (9MMY18: 155 days). This was primarily a factor of lower inventory days that came down to 116 days during the period (9MMY18: 151 days). On the other hand, high balance of trade receivables led to an increase in average receivable days which stood at 28 days (9MMY18: 16 days). Despite a reduction, working capital days still remain at an elevated level. Additionally, persistence of short-term debt mismatch stretches the Company's working capital management.

Coverages During 9MMY19, the Company was able to increase FCFO by 30%, YoY, standing at ~PKR 552mln. However, this was offset owing to increased finance costs, leading the Company resulting in adequate coverage ratios. Interest coverage during 9MMY19 stood at 2.2x (9MMY18: 2.3x). Similarly, core coverage during 9MMY19 stood at 1.0x (9MMY18: 0.9x). Moreover, a lower balance of long-term debt led to reduced debt payback period of 1.4x during 9MMY19 (9MMY18: 1.7x).

Capitalization Noon Sugar has a highly leveraged capital structure. Leveraging ratio stood at 79% at end Jun-19. Majority of debt is composed of short-term borrowings, accounting for 92% of total debt. Total borrowings stood at PKR 3,311mln, a decline of ~13%, YoY, during 9MMY19. Reduction in overall debt level is due to lower short-term borrowings, which are utilized for working capital requirements. Additionally, higher internal generation of cash flows during the period reduced the Company's utilization of short-term lines.

PKR mln

Noon Sugar Mills Limited Sugar	Jun-19 9M	Sep-18 12M	Sep-17 12M	Sep-16 12M
A BALANCE SHEET				
1 Non-Current Assets	1,470	1,363	1,129	1,012
2 Investments	8	8	8	8
3 Related Party Exposure	-	-	-	-
4 Current Assets	3,419	2,610	2,865	687
a Inventories	*1,894*	*1,998*	*2,153*	*385*
b Trade Receivables	*896*	*40*	*132*	*74*
5 Total Assets	4,897	3,980	4,002	1,708
6 Current Liabilities	674	501	666	497
a Trade Payables	*298*	*189*	*168*	*165*
7 Borrowings	3,311	2,693	2,705	708
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	50	44	39	37
10 Net Assets	862	742	592	466
11 Shareholders' Equity	862	742	592	466
B INCOME STATEMENT				
1 Sales	4,579	6,273	4,836	2,589
a Cost of Good Sold	*(3,943)*	*(5,562)*	*(4,264)*	*(2,353)*
2 Gross Profit	636	711	572	235
a Operating Expenses	(210)	(240)	(218)	(131)
3 Operating Profit	426	472	354	104
a Non Operating Income or (Expense)	*10*	*50*	*41*	*35*
4 Profit or (Loss) before Interest and Tax	436	522	395	138
a Total Finance Cost	*(258)*	*(252)*	*(205)*	*(87)*
b Taxation	*(15)*	*(59)*	*(46)*	*(12)*
6 Net Income Or (Loss)	163	211	144	40
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*533*	*580*	*458*	*214*
b Net Cash from Operating Activities before Working Capital Changes	*330*	*358*	*304*	*138*
c Changes in Working Capital	*(627)*	*(206)*	*(1,775)*	*(150)*
1 Net Cash provided by Operating Activities	(298)	152	(1,472)	(12)
2 Net Cash (Used in) or Available From Investing Activities	(218)	(347)	(227)	(176)
3 Net Cash (Used in) or Available From Financing Activities	576	(69)	1,981	143
4 Net Cash generated or (Used) during the period	60	(264)	283	(45)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	-2.7%	29.7%	86.8%	--
b Gross Profit Margin	13.9%	11.3%	11.8%	9.1%
c Net Profit Margin	3.6%	3.4%	3.0%	1.6%
d Cash Conversion Efficiency (EBITDA/Sales)	12.1%	9.9%	10.2%	9.0%
e Return on Equity (ROE)	27.1%	31.6%	27.3%	9.0%
2 Working Capital Management				
a Gross Working Capital (Average Days)	144	126	104	108
b Net Working Capital (Average Days)	130	115	91	75
c Current Ratio (Total Current Assets/Total Current Liabilities)	5.1	5.2	4.3	1.4
3 Coverages				
a EBITDA / Finance Cost	2.3	2.7	2.6	2.8
b FCFO / Finance Cost+CMLTB+Excess STB	1.0	1.0	1.2	0.4
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	1.4	1.7	1.9	4.0
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	79.3%	78.4%	82.0%	60.3%
b Interest or Markup Payable (Days)	140.8	107.2	109.8	0.0
c Average Borrowing Rate	10.6%	8.6%	11.1%	13.2%

Rating Scale | Corporate

2019

Credit Rating Scale & Definitions

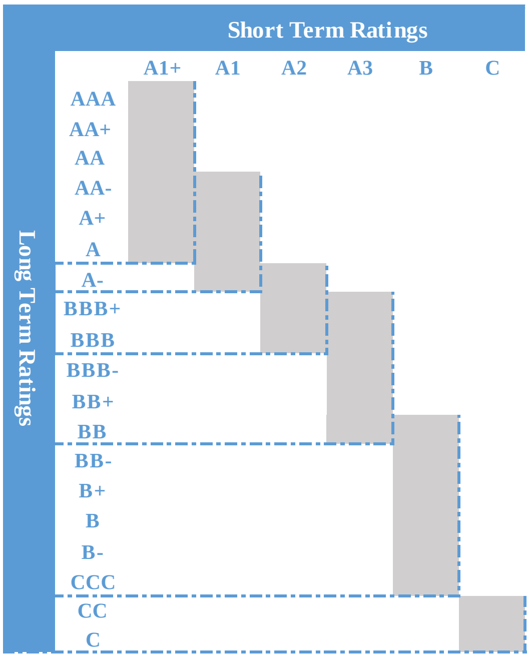
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings

AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk “CCC” Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. “CC” Rating indicates that default of some kind appears probable. “C” Ratings signal imminent default.
D	Obligations are currently in default.

Short Term Ratings

A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
C	An inadequate capacity to ensure timely repayment.



Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. ‘Stable’ outlook means a rating is not likely to change. ‘Positive’ means it may be raised. ‘Negative’ means it may be lowered. Where the trends have conflicting elements, the outlook may be described as ‘Developing’.

Rating Watch Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

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

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