The Pakistan Credit Rating Agency Limited

Rating Report

Mirpurkhas Sugar Mills Limited

Report Contents

Rating History					
Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
10-Apr-2020	A-	A2	Stable	Maintain	-
22-Oct-2019	A-	A2	Stable	Maintain	-
28-Jun-2019	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Pakistan’s sugar industry is the 2nd largest agro based industry, comprising 90 mills with annual crushing capacity estimated around 65 – 75 mln MT. In previous years, the industry was under pressure owing to a supply glut combined with a distortion in the support price mechanism. Additionally, a slowdown in international sugar prices made exports viable only through subsidy support. During MY19, the overall sugar production fell by 16%, YoY, to 5.5 mln MT on the back of lower crop availability. Sugar prices improved in local market as inventory levels reduced. The Government approved an export quota upto 1 MMT, however, no subsidy was announced, leading to low quantities availed. In the FY20 budget, sales tax levied on sugar was increased to 17% from 8%, charged on the price of PKR 60/KG, contributing to higher prices. Due to low crop availability in the crushing period ended Mar-20, sugar production is expected to be around 5-5.2 mln MT. The Government increased the support price of sugarcane to PKR 190 per maund (previously PKR180). Actual realized sugarcane price at mill gate were even higher. Despite increase in costs, higher local sugar prices are expected to improve miller's profitability. Local prices are expected to be capped due to lower international prices (making imports viable) and potential intervention by the Government.

The ratings reflect the Company’s established position in Pakistan’s sugar industry and its association with a leading industrial group – Ghulam Faruque Group. The ratings incorporate diversified revenue sources of the Company emanating from sale of sugar and related products and strategic investments in associates, including diversification in Unicol, a leading ethanol producer. This mitigates the impact of volatile nature of the sugar industry to an extent and supplements the Company's profitability. Business fundamentals are challenged as high concentration of mills in close vicinity ensues competition for sugarcane procurement leading to relatively higher input costs. High domestic sugar prices have significantly improved Company's profitability. Meanwhile, the Company’s financial profile remains stretched and is characterized by moderately leveraged capital structure and adequate working capital management. Coverages remain stretched. Likely group support, in case need arises, remains key rating factor.

The ratings are dependent on the Company’s ability to sustain profitability while further strengthening coverage ratios. Prudent management of debt structure and efficient working capital management to eliminate any mismatch is critical. Any significant deterioration in business performance and/or financial health will negatively impact ratings.

Disclosure	
Name of Rated Entity	Mirpurkhas 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(Dec-19)
Rating Analysts	Faiqa Qamar | faiqa.qamar@pacra.com | +92-42-35869504

Profile

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

Background The Company was incorporated in 1964 and commenced operations two years later in 1966 with a crushing capacity of 1,500 TCD. Over the years, through frequent BMR activities and capacity enhancements, crushing capacity has been enhanced to 12,500 TCD.

Operations Primary business activity of the Company involves manufacturing and selling of sugar. The Company's mill is located at Umerkot Road in Mirpurkhas, Sindh. Meanwhile the head office is based in Karachi. During MY19, the Company operated its mill for 88 days (MY18: 143 days), crushing a total of 577, 396 MT of sugarcane (MY18: 774,171MT) while producing 64,935 MT of sugar (MY18: 88,183 MT) at a recovery rate of 11.25% (MY18: 11.39%). . Additionally, the Company has made sizable strategic investments, including stake in Unicol (an ethonal producer), which yield healthy returns.

Ownership

Ownership Structure Major shareholding of the Company is attributable to Faruque Family that collectively owns ~57%, through associated companies (~52%) and individuals (~5%). Remaining shareholding is with the General Public (~22%), NIT (~9%), Public Sector Companies & Corporations (~10%) and Banks & DFIs (~1%).

Stability The Group is being operated by the third generation of sponsors, with the fourth generation gradually being inducted in the business. The existence of a holding company structure with defined interests of each family and understanding among sponsoring family members reflects stability in ownership

Business Acumen The Company is a part of the Ghulam Faruque Group, which was incorporated in 1964 by Mr. Ghulam Faruque. In addition to sugar, the Group has established a strong presence in the country's cement and packaging industry. Moreover, the Group is involved in air conditioning, power and software solutions, though development of operations is still required.

Financial Strength The Company derives financial strength through the support of its Group, which houses well-known companies under its umbrella, such as, Cherat Cement Company Limited and Cherat Packaging Limited.

Governance

Board Structure The Company's Board of Directors comprises seven members, including the Chairman. There are three non-executive directors, two executive directors and two independent directors, one of whom is a representative of NIT.

Members' Profile Members have diversified backgrounds with noteworthy experience and specialization in sugar, cement, packaging industries and finance.

Board Effectiveness Board of Directors maintain effective oversight through the board Audit Committee and Human Resources and Remuneration Committee. High frequency and participation from board members bodes well for the Company.

Financial Transparency Kreston Hyder Bhimji & Co. Chartered Accountants, have expressed an unqualified opinion on the financial reports for the Company for the year ending in September, 2019. The firm is classified under category 'A' by the State Bank of Pakistan and possesses a satisfactory QCR rating.

Management

Organizational Structure The Company's organizational structure is based on ten departments, including finance, sales and marketing, procurement and internal audit, among others. All department heads report to the Chief Operating Officer, who holds dual positions of Chief Financial Officer as well. Subsequently, the highest level of authority lies with the Chief Executive Officer.

Management Team Management comprises of experienced individuals, representing a good skill mix. Mr. Aslam Faruque, Chief Executive Officer, holds over 24 years of overall experience. He also serves as the Chief Executive Officer of Unicol Limited, a joint venture distillery project of the Company. He is ably supported by Mr. Wasif Khalid, who holds dual positions of Chief Financial Officer and Chief Operating Officer. Mr. Wasif has 21 years of overall experience and has been associated with the Group for the past 14 years.

Effectiveness The Company monitors operational efficiency and effectiveness of management systems through two management committees, namely, technical committee and IT steering committee. Meetings are conducted at regular intervals with high frequency during the crushing period.

MIS Implemented in 2010, the Company deploys SAP as its Enterprise Resource Planning system. Moreover, various production and sales reports are submitted to the senior management periodically.

Control Environment In order to ensure operational efficiency, the Company has setup an internal audit function. The department conducts regular reviews to monitor effectiveness of operations while identifying potential areas of improvement.

Business Risk

Industry Dynamics Pakistan's sugar industry comprises 90 mills with annual crushing capacity estimated around 65 – 75 mln MT. In previous years, the industry was under pressure owing to a supply glut combined with a distortion in the support price mechanism. Additionally, a slowdown in international sugar prices made exports viable only through subsidy support. During MY19, The overall sugar production fell by 16%, YoY, to 5.5 mln MT on the back of lower crop availability. Sugar prices improved in local market as inventory levels reduced. Due to low crop availability in the crushing period ended Mar-20, sugar production is expected to be around 5-5.2 mln MT. The Government increased the support price of sugarcane to PKR 190 per maund (previously PKR180). Actual realized sugarcane price at mill gate were even higher. Despite increase in costs, higher local sugar prices are expected to improve miller's profitability. Local prices are expected to be capped due to lower international prices (making imports viable) and potential intervention by the Government.

Relative Position Owing to high number of players in the industry, companies relatively have low market share. During MY19, the Company had ~1.4% share in total sugar production of the Country.

Revenues The Company generates revenues from the sale of sugar (90%), molasses (9%) and bagasse (1%). During MY19, revenue stood at ~PKR 3,728 mln, declining by ~11%. Drop in revenue is primarily a factor of a shorter crushing period and lower exports. Exports declined to 4,000 MT in MY19 (MY18: 74,092 mln) due to depressed international prices. However, the Company managed to sell off its stock at favorable price in the local market. In 3MMY20, the Company increased its local sales die to attractive prices and reported significant growth (~ 62%) in the top line.

Margins Amid higher sugar prices during MY19, the Company witnessed a significant improvement in profitability. Gross margin improved to ~16% (MY18: 9%) as the Company focused on domestic sales. Similarly, a sharp decline in distribution costs led to better operating margin (MY19: ~11%; MY18: 0%). The Company continues to receive healthy supplementary income from its strategic investments (mainly Uincol), which stood at PKR 406 million in MY19. The Company posted a net profit of PKR 307mln, translating into net profit margin of ~8% (MY18: 2%).

Sustainability Going forward, the Company plans to further diversify by setting up a paper mill with a production capacity of 36,000 – 42,000 Mt. The project is expected to have a cost of ~PKR 1.5-2bln and is currently in feasibility phase.

Financial Risk

Working Capital The Company's working capital requirements are a function of its inventories. The Company faces inherent volatility owing to seasonality in crushing cycle. Working capital requirements are met through a mix of internal cash generation and short-term borrowings. Net working capital (MY19: 96 days, MY18: 134 days) decreased significantly due to decline in inventory days (MY19: 104 days, MY18: 136 days). The inventory days further reduced in 3MMY19 to 61 days.

Coverages Coverages have improved in MY19 as the interest coverage ratio increased to 1.4x (MY18: 0.9x). Total coverage also improved to to 0.7x in MY19 (MY18:0.6x) though remains thin. Improvement in Coverages was on the back of higher free cash flows (MY 19: PKR 551 mln, MY18 PKR 188mln) on the back of improved profitability in MY19.

Capitalization The Company has a moderately leveraged capital structure represented by a debt-to-equity ratio of 57% during MY19. Majority of debt taken up is short-term in nature, representing 70% of the total debt.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

MirpurKhas Sugar Mills Sugar Mill	Dec-19 3M	Sep-19 12M	Sep-18 12M	Sep-17 12M
A BALANCE SHEET				
1 Non-Current Assets	2,502	2,489	2,424	2,376
2 Investments	-	-	2	2
3 Related Party Exposure	1,846	1,484	1,803	1,863
4 Current Assets	1,851	1,827	2,277	3,140
a Inventories	*771*	*1,011*	*1,074*	*2,030*
b Trade Receivables	*109*	*28*	*38*	*104*
5 Total Assets	6,200	5,801	6,505	7,381
6 Current Liabilities	748	553	520	590
a Trade Payables	-	*99*	*131*	*56*
7 Borrowings	2,425	2,575	3,132	3,868
8 Related Party Exposure	-	-	39	11
9 Non-Current Liabilities	689	688	564	404
10 Net Assets	2,339	1,984	2,250	2,508
11 Shareholders' Equity	2,339	1,984	2,250	2,508
B INCOME STATEMENT				
1 Sales	1,327	3,729	4,170	2,802
a Cost of Good Sold	*(1,206)*	*(3,121)*	*(3,789)*	*(2,849)*
2 Gross Profit	121	608	382	(47)
a Operating Expenses	(40)	(184)	(383)	(168)
3 Operating Profit	81	424	(1)	(215)
a Non Operating Income or (Expense)	*74*	*398*	*323*	*152*
4 Profit or (Loss) before Interest and Tax	155	822	322	(64)
a Total Finance Cost	*(82)*	*(404)*	*(210)*	*(229)*
b Taxation	*(22)*	*(110)*	*(38)*	*23*
6 Net Income Or (Loss)	51	307	73	(270)
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*88*	*551*	*188*	*(33)*
b Net Cash from Operating Activities before Working Capital Changes	*(15)*	*423*	*241*	*(195)*
c Changes in Working Capital	*196*	*331*	*653*	*(2,082)*
1 Net Cash provided by Operating Activities	181	754	893	(2,277)
2 Net Cash (Used in) or Available From Investing Activities	(28)	(155)	(162)	(166)
3 Net Cash (Used in) or Available From Financing Activities	(151)	(574)	(735)	2,445
4 Net Cash generated or (Used) during the period	2	24	(4)	2
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	42.3%	-10.6%	48.8%	-25.5%
b Gross Profit Margin	9.1%	16.3%	9.2%	-1.7%
c Net Profit Margin	3.9%	8.2%	1.8%	-9.6%
d Cash Conversion Efficiency (EBITDA/Sales)	7.9%	13.6%	0.3%	-4.2%
e Return on Equity (ROE)	9.5%	14.5%	3.1%	-9.9%
2 Working Capital Management				
a Gross Working Capital (Average Days)	66	107	142	303
b Net Working Capital (Average Days)	59	96	134	285
c Current Ratio (Total Current Assets/Total Current Liabilities)	2.5	3.3	4.4	5.3
3 Coverages				
a EBITDA / Finance Cost	1.3	1.3	0.1	-0.5
b FCFO / Finance Cost+CMLTB+Excess STB	0.3	0.5	0.2	-0.1
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	51.3	8.7	-67.5	-5.1
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	50.9%	56.5%	58.2%	60.7%
b Interest or Markup Payable (Days)	55.1	63.9	97.2	91.4
c Average Borrowing Rate	13.0%	14.1%	5.9%	8.6%

Rating Scale | Corporate

2019

Credit Rating Scale & Definitions

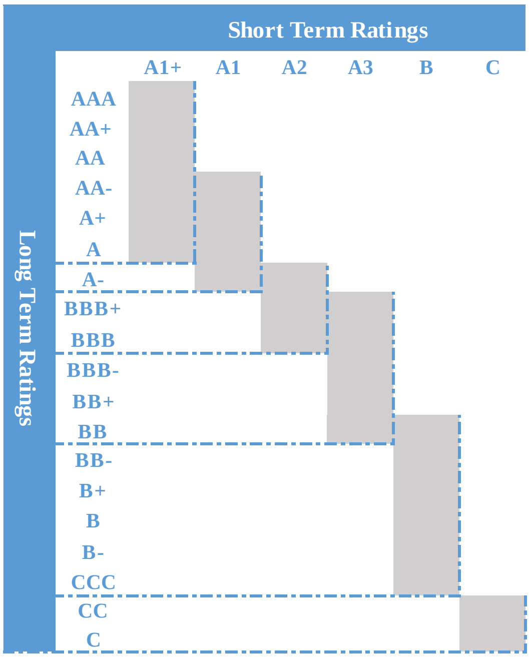
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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