The Pakistan Credit Rating Agency Limited

Rating Report

United Ethanol Industries Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
22-Dec-2023	A-	A2	Stable	Maintain	-
22-Dec-2022	A-	A2	Stable	Maintain	-
24-Dec-2021	A-	A2	Stable	Maintain	-
24-Dec-2020	A-	A2	Stable	Maintain	-
27-Dec-2019	A-	A2	Stable	Maintain	-
29-Jun-2019	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ethanol industry in Pakistan is predominantly export-oriented, primarily due to limited domestic consumption. The country experienced a notable increase in ethanol exports during MY23 compared to MY22. This growth can be attributed to increased molasses production and improved recovery rate. Global ethanol prices have remained elevated, driven by a surge in demand, despite economic uncertainties on a global scale. Positive demand dynamics of ethanol underpinned by increasing trend towards its blending with gasoline fuels in international market and export competiveness due to PKR devaluation has boded well for local industry players. The impact of high international ethanol prices was further amplified by the depreciation of the Pakistani Rupee. During MY23, Pakistan observed an improvement of about 3% in sugarcane production, contributing to stable profits for domestic distilleries. Looking ahead, it is anticipated that the industry's profit margins will maintain stability. However, it is important to note that raw material prices have also risen due to the elevated cost of molasses.
The ratings assigned to United Ethanol underscore its robust business profile, driven by strong profit margins and the export-centric nature of the ethanol industry. The company has achieved formidable margins at both the gross and operating levels, primarily attributable to the appreciation in prices and improved volume metrics. Recent years have been advantageous for the company, benefiting from factors such as molasses availability, heightened international demand, and favorable ethanol prices. During 9MMY23 company achieved a net profit of ~1.1bln a rise of ~8%. A key contributing factor to the positive ratings is United Ethanol's affiliation with the well-established United Group, which holds a prominent presence in the country's sugar and related industries. The company leverages its comparative advantage, stemming from the support of sugar mills at the group level and its widespread geographical presence, resulting in a robust financial performance. United Ethanol maintains a strong financial risk profile, characterized by moderate leveraging which stood at 35% and borrowings predominantly consisting of the ERF- Part II. This financial resilience is further reinforced by robust coverages and effective management of working capital. The company has successfully improved operational efficiency through the implementation of effective BMR strategies, yielding positive outcomes.

The ratings hinge on the management's adeptness in consistently preserving profit margins. It is imperative that the management exercises prudent debt management and ensures robust liquidity, as these factors play a pivotal role in determining the ratings. A substantial rise in debt, decline in coverages, will adversely affect the ratings. Concurrently, enhancing the governance framework is of paramount importance for maintaining favorable ratings.

Disclosure

Name of Rated Entity	United Ethanol Industries Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating(Jul-23),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jul-23),Methodology | Rating Modifiers(Apr-23)
Related Research	Sector Study | Sugar(Aug-23)
Rating Analysts	Muhammad Zain Ayaz | zain.ayaz@pacra.com | +92-42-35869504

Profile

Legal Structure United Ethanol Industries Limited, referred to as "United Ethanol" or "the Company," operates as a publicly unlisted entity.

Background Established in 2003, United Ethanol Industries Limited was initially under the ownership of the Etihad Group. However, on the 16th of September, it underwent a change in ownership, being acquired by the Essarani Family and subsequently becoming an integral part of the United Group.

Operations The company's manufacturing facility is situated in Sadiqabad, Rahimyar Khan, strategically positioned to access 11 sugar mills within a 100-kilometer radius, including SGM Sugar Mills, a subsidiary. The company specializes in the production of ENA Grade ethanol (~96% v/v ethanol) and B Grade ethanol (~94% v/v ethanol), boasting an installed production capacity of 120,000 liters per day. In the 9MMY23, the company produced 39,170,829 liters of ethanol (MY22: 40,803,989 liters), experiencing a 4% decline primarily attributed to reduced molasses availability.

Ownership

Ownership Structure The ownership structure of the company is held by the Essarani Family, represented by Mr. Deoo Mal Essarani with a (24%) stake, and his four sons – Mr. Asha Ram (29%), Dr. Tara Chand (24%), Mahesh Kumar (22%), and Mr. Jugdesh Kumar (1%).

Stability The ownership framework of the enterprise demonstrates stability, and no alterations are anticipated in the foreseeable future.

Business Acumen The Essarani family possesses extensive experience in the agricultural sector, operating under the umbrella of the 'United Group.' The group's portfolio includes two sugar mills (Sindh Abadgar's Sugar Mills and SGM Sugar Mills), United Ethanol Industries Limited, Agro Trade Private Limited, and United Agro Chemicals.

Financial Strength The company maintains robust financial stability attributed to the support of its group and sponsors. As of the 9MMY23, the group's total assets amounted to ~PKR 6.4bln, backed by an equity base of around PKR 4.3bln. During this period, the group achieved a net profit of ~PKR 684mln. The group maintains a moderate level of leverage, as evident from a debt-to-equity ratio of approximately 9%. The total debt stood at around PKR 426mln, a notable decrease from MY22 when it was ~PKR 9.1bln.

Governance

Board Structure The Board of Directors is composed of four members, encompassing the Chairman, CEO, and two Non-Executive Directors. The board is predominantly influenced by the sponsoring family, lacking independent oversight, signifying an opportunity for enhancement. The sponsors have expressed their intention to augment the Board's composition by appointing an independent director in the future.

Members' Profile Mr. Deoo Mal Essarani serves as the Chairman of the Board and also holds the position of Chairman on the board of two other group companies, namely Sindh Abadgar's Sugar Mills Limited and SGM Sugar Mills Limited. With over 47 years of experience, he assumed the chairmanship role. Meanwhile, his son, Mr. Mahesh Kumar, serves as a Non-Executive Director, bringing more than 21 years of experience to the board. Additionally, Mr. Mahesh Kumar holds a position on the board of Sindh Abadgar's Sugar Mills Limited.

Board Effectiveness In MY23, the Board convened on four meetings with formal documentation of meeting minutes. Currently, United Ethanol does not have any established Board committees.

Financial Transparency The Company's external auditors are Reanda Haroon Zakaria & Co. Chartered Accountants The audit firm is rated in category 'B' of SBP's panel of auditors.

Management

Organizational Structure The Company's organizational framework is characterized by well-defined reporting structures, delineating responsibilities between the production site and the head office. Operational matters fall under the purview of the GM Mill, while support functions, excluding finance, are centrally managed at the group level and overseen by the Group CFO.

Management Team The Company's management comprises experienced individuals, though they haven't been associated with the Company for long. Dr. Tara Chand, the CEO, has more than 15 years of experience in the sugar and allied industry. Additionally, he acts as the CEO for Sindh Abadgar's Sugar Mills and SGM Sugar Mills. He is ably supported by Mr. Ishfaque Ahmed Nizamani (GM Factory) and Mr. Waseem Akhtar (Group CFO).

Effectiveness The company currently lacks established management committees. Nevertheless, regular performance discussions occur within the management team to assess ongoing activities.

MIS The Company has deployed ERP software from Cosmosoft.

Control Environment The internal audit function is situated at the group level. Moving forward, the group intends to strengthen its control environment by incorporating additional personnel.

Business Risk

Industry Dynamics Pakistan's ethanol industry is export-focused due to limited domestic consumption, with ~50%-70% of production being exported. In MY22, the country's ethanol exports reached 800 million liters (MY21: 435mln liters), marking an ~82% increase. Global market prices have been elevated due to heightened ethanol demand, despite global economic uncertainties. The impact of high international prices was amplified by the devaluation of the Pakistani Rupee. Improved sugarcane production in MY23, alongside stable profits for domestic distilleries, is expected to keep industry margins steady in the current fiscal year. However, the industry faces increased raw material costs from the elevated price of molasses.

Relative Position In MY23, the company represented 8% of Pakistan's overall ethanol exports.

Revenues The company's revenue stream is primarily export-driven, contributing to ~93% of the total revenue in the 9MMY23. Revenue during this period saw a notable increase, reaching around PKR 5.2bln (9MMY22: PKR 4.4bln), reflecting a substantial surge of approximately 18%, primarily attributed to price adjustments. Consequently, this upswing in revenue has directly influenced a significant positive impact on net income, resulting in an increase ~150%. Looking ahead, the company anticipates a continuous upward trajectory in revenue, propelled by elevated international prices following the devaluation of the rupee.

Margins During 9MMY23, the company effectively transferred the heightened costs of raw materials, specifically molasses, to the export market. This positively impacted the company's margins, resulting in a notable improvement. The gross margin experienced a rise, reaching approximately 38% (MY22: 29%). Similarly, the operating margin saw an increase (9MMY23: 30.7%, MY22: 23.9%). Consequently, the company achieved a net income of PKR 1,073mln (9MMY22: PKR 430mln), representing a more than two-fold increase. Despite a rise of ~125% in finance costs (9MMY23: PKR 291 million, 9MMY22: PKR 129 million), the company's net margin improved to 20.8% (MY22: 15.4%).

Sustainability The company currently has no significant expansion initiatives in the pipeline. Its primary emphasis lies in enhancing efficiency through BMR efforts. Additionally, the management has no intentions of acquiring additional long-term loans and is committed to retaining profits over the next couple of years.

Financial Risk

Working Capital Seasonal fluctuations increased the Company's net working capital cycle to 134 days in 9MMY23 (MY22: 108 days). This was driven by a rise in inventory days to 115 (MY22: 91 days). Receivable days remained constant at 22 (MY22: 22 days), and payable days at 3 (MY22: 3 days). Short-term trade leverage and total leverage were ~31% and ~47.8%, suggesting borrowing capacity against trade and total current assets.

Coverages Amidst higher profitability during 9MMY23, the Company's interest cover declined and stood at 3.9x during 9MMY23 (MY22: 7x). Similarly, the Company's debt coverage ratio witnessed same trend and stood at 2.3x (MY22: 3x). Going forward, the Company's coverages are expected to remain strong owing to stable profits and higher free cash flows.

Capitalization The Company's Debt-to-equity ratio improved to ~35% in 9MMY23 (MY22: ~41%). Total borrowings decreased to PKR 3,297mln in 9MMY23 (MY22: PKR 3,546mln). About 83% of the borrowings are from the ERF-Part II facility for working capital (9MMY23: PKR 2,764mln, MY22: PKR 2,879mln), with the remaining from a Long-Term Loan (9MMY23: PKR 533mln, MY22: PKR 667mln).

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

United Ethanol Industries Limited Sugar	Jun-23 9M	Sep-22 12M	Sep-21 12M	Sep-20 12M
A BALANCE SHEET				
1 Non-Current Assets	3,775	3,423	2,729	2,761
2 Investments	-	300	-	-
3 Related Party Exposure	-	-	300	588
4 Current Assets	5,929	5,182	3,369	3,414
a Inventories	*2,930*	*1,390*	*1,825*	*1,188*
b Trade Receivables	*149*	*687*	*11*	*270*
5 Total Assets	9,704	8,905	6,397	6,762
6 Current Liabilities	333	273	208	220
a Trade Payables	*44*	*57*	*52*	*54*
7 Borrowings	3,297	3,546	2,672	3,435
8 Related Party Exposure	-	-	200	-
9 Non-Current Liabilities	-	-	-	-
10 Net Assets	6,074	5,086	3,318	3,108
11 Shareholders' Equity	6,074	5,086	3,318	3,108
B INCOME STATEMENT				
1 Sales	5,158	6,456	3,787	3,305
a Cost of Good Sold	*(3,211)*	*(4,569)*	*(2,913)*	*(2,516)*
2 Gross Profit	1,947	1,886	875	789
a Operating Expenses	(363)	(344)	(250)	(217)
3 Operating Profit	1,584	1,542	624	571
a Non Operating Income or (Expense)	*(157)*	*(273)*	*(13)*	*43*
4 Profit or (Loss) before Interest and Tax	1,427	1,269	611	615
a Total Finance Cost	*(291)*	*(197)*	*(159)*	*(239)*
b Taxation	*(62)*	*(80)*	*(42)*	*(45)*
6 Net Income Or (Loss)	1,073	992	410	331
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*1,135*	*1,376*	*735*	*688*
b Net Cash from Operating Activities before Working Capital Changes	*1,135*	*1,201*	*565*	*438*
c Changes in Working Capital	-	*(1,708)*	*813*	*(1,352)*
1 Net Cash provided by Operating Activities	1,135	(507)	1,378	(914)
2 Net Cash (Used in) or Available From Investing Activities	-	(49)	(105)	(4)
3 Net Cash (Used in) or Available From Financing Activities	-	874	(762)	1,149
4 Net Cash generated or (Used) during the period	1,135	318	511	230
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	6.5%	70.5%	14.6%	N/A
b Gross Profit Margin	37.7%	29.2%	23.1%	23.9%
c Net Profit Margin	20.8%	15.4%	10.8%	10.0%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	22.0%	-5.1%	40.9%	-20.1%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/S*	25.6%	23.6%	12.7%	10.7%
2 Working Capital Management				
a Gross Working Capital (Average Days)	137	111	159	161
b Net Working Capital (Average Days)	134	108	154	155
c Current Ratio (Current Assets / Current Liabilities)	17.8	19.0	16.2	15.5
3 Coverages				
a EBITDA / Finance Cost	3.9	7.6	5.3	3.2
b FCFO / Finance Cost+CMLTB+Excess STB	2.3	3.0	1.8	1.9
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.5	0.6	1.9	2.4
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	35.2%	41.1%	46.4%	52.5%
b Interest or Markup Payable (Days)	65.7	106.0	84.2	62.2
c Entity Average Borrowing Rate	11.4%	6.1%	4.8%	6.9%

Credit Rating

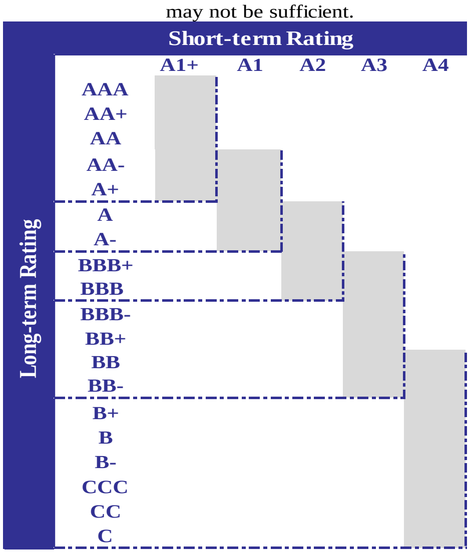
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
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 Rating

Scale	Definition
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
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

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 some material identifiable event with indeterminable rating implications. 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 rating 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) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) 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.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

a) Broker Entity Rating
b) Corporate Rating
c) Debt Instrument Rating
d) Financial Institution Rating
e) Holding Company Rating
f) Independent Power Producer Rating
g) Microfinance Institution Rating
h) Non-Banking Finance Companies Rating

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 | Clause 11-(A)(p).
(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 | 17-(a)
(19) PACRA reviews all the outstanding ratings periodically, on annual basis; Provided that public dissemination of annual review and, in an instance of change in rating will be made; | Chapter III | 17-(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 | 17-(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 | 17-(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 | 14-3(f)(vii)
Proprietary Information