



AL-ABBAS SUGAR MILLS LIMITED

Ratings (May 2006)

Al-Abbas Sugar Mills Limited

	New	Previous
Entity		
Long Term	A	A
Short Term	A1	A1

Financial Data

PKR (mln)	Sep-05	Sep-04
Total Assets	1,681.8	1,805.2
Equity	699.6	636.2
Profit after Tax	63.4	233.5
ROE (%)	9.08	42.41
Total Debt/Equity (%)	43.07	42.46
Net Debt/ EBITDA	1.64	0.90

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Rating Rationale

Assessment

AASML's ratings reflect the company's sound capital structure that provides comfort to creditors in periods of industry downturns, an inherent feature of the cyclical nature of sugar operations. In a departure from past trends, the contribution of distillery operations to net profitability is expected to be subdued. However, the company - on the back of its high-quality operations and management - is well-positioned to benefit from any improvement in sector prospects.

Overall performance- measured in terms of ROE and ROA- registered a significant decline in 2005. This was owing mainly to a short sugarcane crop, which affected price and availability of inputs for both the sugar and distillery divisions. The output prices did not register a commensurate increase. The declining margins in distillery operations was mainly the result of higher incidence of import duties on exports to the EU region following the loss of GSP status previously enjoyed by Pakistan. The management endeavoured to alleviate the adverse effect of these factors by maintaining a stricter control on costs. Consequently, despite growth in turnover, financial charges and selling and administration costs were maintained at prior year's level.

Going forward, distillery margins are unlikely to show any material improvement. However, higher YoY molasses availability in the current year is expected to enable the management to partially offset the negative impact through volume expansion. Additionally, efforts are being made to tap non-EU markets.

Thus, in the medium-term, sugar operations are expected to remain the main focus. Results from the recently ended crushing season are more encouraging on a YoY basis, with higher availability of sugarcane in Sind, as growers were paid higher premiums on the back of governmental efforts to increase the support price. Additionally, sugar prices are spiralling upwards due to the demand-supply gap in the country. While the GoP is importing sugar to fill this gap, the rising trend in international prices is unlikely to provide relief to local prices. Thus, a YoY improvement in gross margins is expected on the back of this division alone. This is, to some degree, evidenced in 2QFY06 results.

AASML's FY05 cash flows and coverages were adversely affected due to reduced profitability. This position is expected to be largely rectified in the current year on the back of improved performance prospects. A larger setback, however, is the reduced proportion of less volatile revenues from distillery operations that previously added stability to the company's cash flows. However, the company's low-leveraged capital structure with the correspondingly low debt burden, and strong coverages that remain comfortable even in times of industry downturn, are mitigating factors.

The company's privately placed TFC of PKR 350mln, issued in FY03 for a five year tenor, was fully redeemed in FY05 through the utilisation of the call option. The reason for this was the company's access to lower-cost funding relative to the cost of the TFC.

Background

Al-Abbas Sugar Mills Limited (AASML), listed on the Karachi Stock Exchange, was incorporated in May 1991. The company operates a sugar plant and Industrial Alcohol Distillery (IAD) located in Mirpurkhas, a district of Lower Sindh.

The company's sponsors have more than 50% shareholding. The management, with a good blend of youth and experience, have a track record of efficient operations and a strategic vision. The Al-Abbas Group, which includes four manufacturing concerns, benefits from its association with the Jahangir Siddiqui (JS) Group. The JS Group has a 22 % shareholding in AASML, and has emerged as a major conglomerate with an increasingly diverse asset base.