The Pakistan Credit Rating Agency Limited

Rating Report

Hunza Sugar Mills (Pvt.) Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
15-Mar-2024	BBB+	A2	Stable	Maintain	-
16-Mar-2023	BBB+	A2	Stable	Maintain	-
16-Mar-2022	BBB+	A2	Stable	Upgrade	-
03-Sep-2021	BBB	A2	Positive	Maintain	-
04-Sep-2020	BBB	A2	Stable	Maintain	-
06-Sep-2019	BBB	A2	Stable	Maintain	-
08-Mar-2019	BBB	A2	Stable	Maintain	-
06-Sep-2018	BBB	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The Pakistani sugar sector, recognized as the second most substantial agro-based industry within the nation, encompasses 91 mills with a collective processing capacity of roughly 80–90 million metric tons. The season ended with a sugar output of ~6.6 million tons, a ~16% decrease from the previous year’s ~7.9 million tons due to severe floods that damaged the crop and shortened the harvesting period. Despite the lower crop, the country had sufficient sugar stocks to meet the annual demand, owing to the large carryover from the previous year. Anticipated water scarcity is projected to precipitate a significant ~13.7% contraction in the forthcoming sugarcane supply for MY24, ascribed to a decrement in cultivated area and yield.
Hunza Sugar's rating is a testament to its stable fiscal stewardship and strategic growth initiatives. The company experienced a ~58% surge in revenue to PKR ~34.2 billion in MY23 (21.62 billion in MY22), aligned with industry’s upward trend with an average recovery rate of ~9.75% from both plants. Rising cane cost has resulted in increasing sugar prices in the domestic market during MY23. As a result, the Company attained substantial profits from the sugar segment. Likewise, the Company also gained from the escalating ethanol prices, globally. Hunza Sugar's revenue streams are propelled by sugar sales and ethanol exports. The firm's gross profit is recorded at PKR ~6.2 billion (3.7 billion in MY22), corresponding to an ~18% gross margin. Despite the escalation in finance costs associated with KIBOR, the net income ascended to PKR ~1.2 billion (656 million in MY22), reflecting a ~4% net margin (3% in MY22). Amidst the economic tribulations and volatility of the sugar market in Pakistan, the company's export paradigm remains resilient. From a financial perspective, Hunza Sugar has exhibited commendable enhancements in working capital management. The optimization of short-term borrowings and cash flows has streamlined operations, although the borrowing buffer has experienced a marked constriction due to navigation of short-term borrowing into capital expansions. The leverage ratio of the company stood at ~63.4% in MY23, with short-term borrowings constituting 81% of the total debt. The profitability of Hunza Sugar has been buoyed by elevated sugar and ethanol prices, ensuring the sustenance of stable margins amidst market oscillations.

The credit ratings encapsulate the Company's adeptness in maintaining formidable profit margins, fortifying coverage ratios, and refining the management of short-term liabilities to address any incongruities in asset-liability alignment. The ratings are susceptible to negative implications in case of material erosion in margins and/or cash flows, and reliance on short-term financial instruments for long-horizon growth initiatives.

Disclosure	
Name of Rated Entity	Hunza Sugar Mills (Pvt.) 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	Usama Ali | usama.ali@pacra.com | +92-42-35869504

Profile

Legal Structure Hunza Sugar Mills (Pvt.) Limited (Hunza Sugar or the Company) is a private limited company incorporated in 2002.

Background Hunza Sugar is part of the Hunza Group ('the Group'). The flagship company of the Group was Hunza Ghee Mills (Pvt.) Limited in the edible oil sector and it dates back to 1988. The Company has a diverse revenue stream. It manufactures refined sugar, molasses, ethanol, and other allied products. The Company installed its distillery and CO2 processing plant in MY14 and MY18, respectively.

Operations Hunza Sugar is a manufacturer and seller of sugarcane products, including sugar, ethanol, and other allied products. The company has two sugar units in Jhang and Faisalabad, with a total crushing capacity of 30,000 MT per day. In MY23, the company crushed 2,269,944 MT of sugarcane and produced 221,275 MT of refined sugar, which was a 4.67% increase from MY22. The company also has a distillery in Faisalabad, with a production capacity of 150,000 liters per day, that processes food grade ethanol. The company sells by-products such as molasses and bagasse, and has invested in CO2 plants that capture and store the gas from the fermentation process. In MY23, the company distilled 53,272,827 liters of ethanol and produced 14,714 MT of CO2.

Ownership

Ownership Structure The Company is a family-owned entity. Shares of the Company are divided among the families of three brothers Mr. Idrees Chaudhry, Mr. Saeed Chaudhry, and Mr. Waheed Chaudhry. All three sponsoring families own an equal stake of 33%.

Stability The distinction in the ownership is very clear adding to the stability of the structure.

Business Acumen The Group has witnessed multiple business cycles and the sponsor's strong acumen is evident from substantial presence in the country's sugar, ethanol, and edible oil segments. Hunza Group initially started with Hunza Ghee Industries (Pvt.) Limited in the Edible Oil sector in 1988. The Company produces vegetable ghee and cooking oil that sells under the brand 'Swera Ghee' and 'Swera Cooking Oil'. The Company carries out the import and sale of Edible Oil through its group company called Swera Traders (Pvt.) Limited. The Group diversified its operations and entered the sugar industry in 2002. Hunza Sugar expanded through forward integration by venturing into distillery business in MY14. The Group has setup Hunza Citrus, Hunza Steel and Suraj Traders.

Financial Strength Hunza Group as a whole (Hunza Ghee, Hunza Sugar, Swera Traders & Power) has a strong asset base. The Company posted stable turnover and adequate profit after tax during MY23.Futher, an assets and equity base of PKR 23.5 bln and 7.45 bln respectively.

Governance

Board Structure The BoD comprises three members from the sponsoring families. The BoD lacks independent oversight

Members' Profile Mr. Idrees Chaudhary, the eldest brother, is the Chairman of the Board of Directors. He serves as an adviser to the management. Mr. Waheed Chaudhary looks after the external relations of the Company. All the Board members have more than 35 years of overall experience and more than 15 years of experience in the sugar industry.

Board Effectiveness The Board met four times during MY23 to approve the financial statements. Minutes of the Board meetings are not formally documented

Financial Transparency The auditors of the Company are Amin, Mudassar & Co, opinion for MY23 has not been issued yet. The auditors have satisfactory QCR rating and also listed in SBP panel in category B.

Management

Organizational Structure The Company operates through five main departments: Finance, IT, Administration, Technical and Quality Control. All functional heads reports to the Company's CEO.

Management Team Mr. Saeed Chaudhry is the CEO of the Company. He has an overall experience of 35 years in the edible oil sector and 15 years of experience in the sugar industry. Other members of senior management are also well qualified with ample experience.

Effectiveness Mr. Saeed Chaudhry is the CEO of the Company. He has an overall experience of 35 years in the edible oil sector and 15 years of experience in the sugar industry. Other members of senior management are also well qualified with ample experience.

MIS Hunza Sugar, a diversified sugar and ethanol producer, upgraded its ERP system from an in-house solution to Microsoft Dynamics 365 ERP. This strategic move aimed to streamline and automate its business processes across various functions, such as supply chain, finance, accounts, tax, production, sales, and distribution. The company also invested in user training and HR development to ensure a smooth transition and adoption of the new system. This transformation has improved the company's operational efficiency and reduced the risk of errors and delays in its processes.

Control Environment The company has implemented internal controls based on established processes and procedures that ensure segregation of duties. Additionally, the organization's internal audit function is executed with complete independence by a QCR-rated firm, A.H.W & Co, which assigns dedicated teams to oversee both the head office and the site locations, thereby promoting a culture of transparency, accountability, and strict adherence to established protocols.

Business Risk

Industry Dynamics The Pakistani sugar sector, recognized as the second most substantial agro-based industry within the nation, encompasses 91 mills with a collective processing capacity of roughly 80–90 million metric tons. The season ended with a sugar output of ~6.6 million tons, a ~16% decrease from the previous year's ~7.9 million tons due to severe floods that damaged the crop and shortened the harvesting period. Despite the lower crop, the country had sufficient sugar stocks to meet the annual demand, owing to the large carryover from the previous year.

Relative Position Hunza Sugar contributed approximately 3.5% in term of production making it one of the leading sugar mills in Punjab region.

Revenues During MY23, the major portion of the Company's revenue emanates from Sugar (~73.03%), and Ethanol exports (~22.18%). Remaining portion of sales (~5%) comprises CO2, bagasse, mud, and other chemicals. Hunza Sugar posted net revenue worth ~PKR 34.2bln during MY23 (MY22: ~PKR 21.2bln), reflecting growth of ~58% supported by an increase sugar prices, and ethanol prices internationally

Margins During MY23, the gross profit of the Company appreciated and stood at PKR ~6.2bln (MY22: ~PKR 3.7bln), as administrative costs, exchange loss and selling and marketing expenses increased which resulted in gross margin of ~18% (MY22: ~17%). The operating margin stood at ~14% (MY22: ~13%). Finance cost of the Company witnessed prominent increase (MY23: ~PKR 2,7299mln, MY22: ~PKR 1,113mln) on account of increased KIBOR, as the Company posted net income of PKR 1.2mbln during MY2 (MY22: PKR 615mln) and increase in net margin was observed (MY23: ~4%, MY22: ~3%).

Sustainability Being an export sector with minimal imports tends to bode well for the Company as the economic situation has favored exports and constrained imports into Pakistan. However, the Company is exposed to volatility and ensuing challenges in the sugar sector.

Financial Risk

Working Capital Hunza Sugar faces an inherent stress in its working capital cycle due to seasonality in the sugar industry. Hunza Sugar manages its working capital requirement through short-term borrowings and internal cashflows. In MY23, net working capital days decreased to 49 days (MY22: 90 days) The fall in net working capital days was due to the lower inventory days (MY23: 45 days, MY22: 74 days). Other components of working capital i.e., receivable days also decreased (MY23: 11 days, MY22: 21 days) and payable days (MY23: 8 days, MY22: 5 days) increased. The Company has a negative borrowing cushion at the trade asset level which increased to -223% in MY23 from -39.2% in MY22.

Coverages In MY23, the free cash flows of the Company remained strong and stood at ~PKR 3.3bln (MY22: ~PKR 2.4bln). Moreover, the finance cost witnessed a significant increase (MY23: ~PKR 2,799mln, MY22: ~PKR 1,113mln). As a result, the interest coverage ratio observed a drop to 1.7x (MY22: 2.3x). Similarly, debt coverage ratio regressed and stood at 0.5x in MY23 (MY22: 0.8x). Moreover, Debt payback period stood at 4.0x in MY22 (MY22: 2.6x).

Capitalization Hunza Sugar has a substantially leveraged capital structure, represented by a leveraging ratio ~63.4% in MY23 (MY22: ~67.7%). Majority of debt (~81%) comprises short-term borrowings to meet the working capital requirements. Short-term lines are utilized to support operations during the crushing cycle.

The Pakistan Credit Rating Agency Limited

Hunza Sugar Mills	Sep-23	Sep-22	Sep-21
Sugar	12M	12M	12M
A BALANCE SHEET			
1 Non-Current Assets	9,992	7,533	6,177
2 Investments	64	66	175
3 Related Party Exposure	5,485	2,525	1,038
4 Current Assets	7,960	10,999	6,690
a Inventories	*2,501*	*5,974*	*2,772*
b Trade Receivables	*832*	*1,304*	*1,237*
5 Total Assets	23,501	21,123	14,081
6 Current Liabilities	2,983	1,560	1,683
a Trade Payables	*1,135*	*400*	*207*
7 Borrowings	12,074	12,342	4,927
8 Related Party Exposure	831	780	1,780
9 Non-Current Liabilities	159	194	57
10 Net Assets	7,455	6,248	5,634
11 Shareholders' Equity	7,455	6,248	5,634
B INCOME STATEMENT			
1 Sales	34,142	21,654	20,157
a Cost of Good Sold	*(27,953)*	*(17,936)*	*(17,096)*
2 Gross Profit	6,189	3,718	3,061
a Operating Expenses	(1,473)	(955)	(672)
3 Operating Profit	4,716	2,763	2,388
a Non Operating Income or (Expense)	*(301)*	*(780)*	*459*
4 Profit or (Loss) before Interest and Tax	4,415	1,982	2,848
a Total Finance Cost	*(2,799)*	*(1,113)*	*(789)*
b Taxation	*(408)*	*(254)*	*(203)*
6 Net Income Or (Loss)	1,208	615	1,856
C CASH FLOW STATEMENT			
a Free Cash Flows from Operations (FCFO)	*4,754*	*2,463*	*2,943*
b Net Cash from Operating Activities before Working Capital Changes	*2,234*	*1,691*	*2,254*
c Changes in Working Capital	*786*	*(5,617)*	*428*
1 Net Cash provided by Operating Activities	3,020	(3,926)	2,681
2 Net Cash (Used in) or Available From Investing Activities	(2,985)	(2,087)	(2,135)
3 Net Cash (Used in) or Available From Financing Activities	(413)	6,300	(385)
4 Net Cash generated or (Used) during the period	(378)	287	162
D RATIO ANALYSIS			
1 Performance			
a Sales Growth (for the period)	57.7%	7.4%	39.5%
b Gross Profit Margin	18.1%	17.2%	15.2%
c Net Profit Margin	3.5%	2.8%	9.2%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	16.2%	-14.6%	16.7%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Shareholders*	17.6%	10.4%	39.4%
2 Working Capital Management			
a Gross Working Capital (Average Days)	57	95	62
b Net Working Capital (Average Days)	49	90	56
c Current Ratio (Current Assets / Current Liabilities)	2.7	7.1	4.0
3 Coverages			
a EBITDA / Finance Cost	1.8	2.6	3.9
b FCFO / Finance Cost+CMLTB+Excess STB	0.5	0.8	2.3
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	3.9	2.6	1.5
4 Capital Structure			
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	63.4%	67.7%	54.3%
b Interest or Markup Payable (Days)	73.8	156.5	77.4
c Entity Average Borrowing Rate	17.5%	9.0%	6.8%

Credit Rating

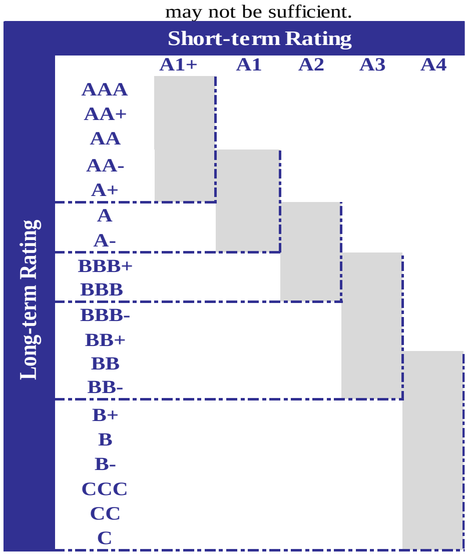
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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