The Pakistan Credit Rating Agency Limited

Rating Report

Mehran Sugar Mills Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-Sep-2020	A-	A2	Stable	Maintain	-
22-Oct-2019	A-	A2	Stable	Maintain	-
03-May-2019	A-	A2	Stable	Maintain	-
03-Dec-2018	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Pakistan’s sugar industry is the 2nd largest agro based industry after textile, comprising ~ 90 mills with annual crushing capacity estimated around 65 – 75 mln MT. It contributes about 0.6% to GDP and 2.9% of total value addition in agriculture. In previous years, the industry was under pressure owing to over supply combined with challenges in the support price mechanism. Additionally, a slowdown in international sugar prices made exports viable only through subsidy support. Government approved an export quota upto 1 MMT, however, no subsidy was announced. Consequently, zero exports were reported in August 2020 (August 2019: ~USD 5mln). During MY20, sugar production declined by ~9% YoY and clocked in at ~4.8MT (MY19: ~5.27MT), owing to reduction in the area under cultivation and water scarcity. Sugar prices improved in local market as inventory levels reduced. Due to low crop availability in the crushing period ended Mar-20. The Government increased the support price of sugarcane to PKR 192 per maund (previously PKR182). Actual realized sugarcane price at mill gate were higher. Despite increase in costs, higher local sugar prices have improved miller's profitability.

The ratings reflect Mehran Sugar Mills Limited's ('Mehran Sugar' or 'the Company') strong business profile emanating from a diversified revenue stream, robust governance and ability to post high recovery rates consistently, averaging in excess of 11% over the past five years. To mitigate risks associated with seasonality and volatility in the sugar industry, the Company’s profitability is supported through a strategic joint venture investment in ‘Unicol Limited’, an ethanol production company, and sale of electricity generation. The Company has made strategic investments in the FMCG sector through a joint-venture ‘UniFoods Industries Limited’ and in the energy sector through its wholly-owned subsidiary, ‘Mehran Energy Limted’. However, income from these avenues is not expected anytime soon. The ratings draw comfort from Mehran Sugar’s ability to maintain healthy topline despite volatility in the sugar industry and a sizable liquid investment portfolio. The investment portfolio remains exposed to market vicissitude, especially in current dynamics. The Company’s financial risk profile is characterized by a leveraged capital structure, strong coverage ratios and adequate working capital management.

The ratings are dependent on the Company’s ability to maintain strong cashflows and coverages while adhering to strict financial discipline, with an increased emphasis on working capital management. Any significant deterioration in margins and/or coverages will have a negative impact on ratings.

Disclosure	
Name of Rated Entity	Mehran Sugar Mills Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-20),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria | Rating Modifier(Jun-20)
Related Research	Sector Study | Sugar(Dec-19)
Rating Analysts	Faiqa Qamar | faiqa.qamar@pacra.com | +92-42-35869504

Profile

Legal Structure Mehran Sugar Mills Limited (the Company) is a public limited company incorporated in December, 1965.

Background The Company commenced operations three years after incorporation in 1968 with a production capacity of 1,500 TCD (Tons of Cane per Day). Over the years, the Company manage to increase its crushing capacity to 12,500 TCD through capacity enhancement initiatives. Mehran Sugar entered in strategic partnership with other sugar companies in 2004 to establish a jointly operated distillery under the banner 'Unicol Limited'. Unicol has ethanol production capacity of 200,000 liters/day.

Operations The Company primarily maunufactures sugar and its allied products. The mill is located in District Tando Allahyar, having an installed capacity of 12,500 TCD. During MY20, the Company crushed 654,339 MT of sugarcane to produce 702,259 MT of sugar while yielding a sucrose recovery rate of 11.13% (MY19: 11.44%).

Ownership

Ownership Structure Majority shareholding rests with individuals of Hasham Family (75%) ('Hasham Group'). Shareholding is divided among families of three brothers, Mr. M. Kasim Hasham (28%), Mr. M. Ebrahim Hasham (28%) and Mr. M. Hussain Hasham (18%). The remaining shareholding belongs to general public and other corporations.

Stability Company's controlling interests vests with one group and each family with in the group holds a defined share. The ownership of the company is stable.

Business Acumen Mehran Group started its first business enterprise in 1930s with Mr. Haji Hasham trading in commodities. Mehran Sugar was incorporated in 1965 that continued as a single business enterprise. Hasham Group has undergone forward integration and entered the Ethanol segment through Unicol Limited. The Group has lately ventured into FMCG sector through a joint venture 'UniFoods Limited'. The group has also vested and Energy Sector (Mehran Energy Limited and UniEnergy Limited).

Financial Strength Majority of the Groups' stakes are consolidated through its Flagship Company Mehran Sugar. In MY19, the Company has a consolidated asset base of PKR 6,955mln which is financed through PKR 2,406mln in Equity and PKR 2,810 mln in total debt.

Governance

Board Structure Board of Directors comprises of ten individuals, which include two executive directors, five non-executive directors and three independent Directors.

Members' Profile Sponsoring family has a strong presence on the Board. However, members have significant experience in the sugar industry which is balanced by an adequate mix of business, finance, and legal experts. Mr. Kasim Hasham, Chairman of the BoD, has significant experience in sugar and packaging industry. Mr. Amjad Waheed, CEO NBP Funds, and Mr. Mohammad Bashir, an industrialist by profession and Mr. Amin Mukaty serve as independent directors.

Board Effectiveness In order to maintain effective oversight, Board of Directors have formed two committees, namely, the Audit Committee and the Human Resource and Remuneration Committee. During the MY20, four meetings of the Audit Committee and two meetings of the Human Resources and Remuneration Committee were conducted.

Financial Transparency M/s EY Ford Rodhes, classified in category 'A' by SBP, with a satisfactory QCR ratings. They have issued an unqualified opinion on Sep 19 financial statements.

Management

Organizational Structure The Company is headed by the Managing Director under the oversight of the Chief Executive Officer. The Company's Chief Financial Officer, Resident Director and Director Cane report directly to the Managing Director. HR & IT are headed by the separate managers and they report to CEO and CFO.

Management Team Management has long association with Mehran Sugar adding the required experience in sugar industry and their respective fields. Mr. Ahmed Ebrahim Hasham, son of the Chairman, Mr. Ebrahim Hasham, acts as the Managing Director of the Company.

Effectiveness The Company has instituted an Executive Committee comprising of the all head of departments headed by the CEO and MD. The Committee meets on a monthly basis for review performance and enable short-term decision making.

MIS Mehran Sugar has deployed an in-house system which has a sugar cane management module, store management module and human resources module. These are all integrated with the accounting system which is also developed in-house.

Control Environment The Board has outsourced the internal audit function to Grant Thornton Anjum Rahman.

Business Risk

Industry Dynamics Pakistan's sugar industry is the 2nd largest agro based industry after textile, comprising ~ 90 mills with annual crushing capacity estimated around 65 – 75 mln MT. It contributes about 0.6% to GDP and 2.9% of total value addition in agriculture. In previous years, the industry was under pressure owing to over supply combined with challenges in the support price mechanism. Additionally, a slowdown in international sugar prices made exports viable only through subsidy support. Government approved an export quota upto 1 MMT, however, no subsidy was announced. Consequently, zero exports were reported in August 2020 (August 2019: ~USD 5mln). During MY20, sugar production declined by ~9% YoY and clocked in at ~4.8MT (MY19: ~5.27MT), owing to reduction in the area under cultivation and water scarcity. Sugar prices improved in local market as inventory levels reduced. Due to low crop availability in the crushing period ended Mar-20. The Government increased the support price of sugarcane to PKR 192 per maund (previously PKR182). Actual realized sugarcane price at mill gate were higher. Despite increase in costs, higher local sugar prices have improved miller's profitability.

Relative Position Market players have low market share because of high number of players in the market. During MY19, the Company had a ~2% share in total sugar production.

Revenues The Company's top line comprises of sugar sales along with the sale of by products. During 9MMY20, the Company posted 29% increase in revenues and amounted to ~PKR 5,164mln (9MMY19: PKR 3,995mln). Increase in revenue is a factor of higher price of sugar and other by-products. However, lower production during the current season and absence of exports impacted the revenues. Going forward, owing to lower domestic sugar production, prices are expected to remain elevated. The Company also receives dividend income from its trading portfolio, which posted a dip of PKR 57mln due to volatile and uncertain economic conditions.

Margins During 9MMY20, the Company posted a gross margin of ~11%, as compared to ~20% in the corresponding period. This declined is registered by substantial increase in sugarcane cost due to competition amongst mills in the vicinity. Consequently, operating margin also declined to ~7% during 9MMY20 (9MMY19:15%). Finance costs during 9MMY20 stood at ~PKR 262mln (9MMY19: PKR 290mln). All factors considered, the Company posted a net profit of ~PKR 78mln during 9MMY20 (9MMY19: ~PKR 369mln), translating into a margin of ~1.5% (9MMY19: ~9%).

Sustainability Going forward, the Company plans on enhancing business performance through efficiency in operations. Profitability can be supported by stable stock market as the Company has a sizable investment portfolio.

Financial Risk

Working Capital During 9MMY20, the Company was able to improve net working capital days on the back of lower inventory days as it offload carry over stock. Inventory days during 9MMY20 dropped to 62 days (9MMY19: 114 days). Resultantly, net working capital days stood at 52 days during 9MMY20 (9MMY19: 117 days). Persistence of short-term debt mismatch continued through 9MMY20. However, a sizeable portfolio of liquid short-term investments provide comfort.

Coverages During 9MMY20, the Company's coverage ratios witnessed a decline due to reduced free cash flows (9MMY20: PKR 436mln, 9MMY19: PKR 703mln). During 9MMY20, interest coverage declined to 1.7x (9MMY19: 2.6x). Meanwhile, core and total coverages decreased to 1.6x (9MMY19: 1.7x).

Capitalization The Company has a leveraged capital structure, represented by a debt-to-equity ratio of ~51% as at 9MMY20 (9MMY19: 59%). Total debt remains tilted towards short-term borrowings (61% of total debt). During 9MMY20, total borrowings stood at ~PKR 2,623mln (9MMY19: PKR 3,619mln). This is primarily attributable to relatively lower utilization of borrowings lines during the crushing season. Long term loan of ~PKR 1,007mln (9MMY19: 821mln) is obtained to finance BMR.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Mehran Sugar Mills Sugar	Jun-20 9M	Sep-19 12M	Jun-19 9M	Sep-18 12M	Jul-18 9M	Sep-17 12M
A BALANCE SHEET						
1 Non-Current Assets	2,289	2,192	2,159	2,169	2,123	2,189
2 Investments	865	995	1,065	1,259	1,662	830
3 Related Party Exposure	1,325	1,363	1,248	1,192	1,110	982
4 Current Assets	1,958	2,413	3,247	2,215	3,270	1,721
a Inventories	*1,278*	*1,061*	*2,164*	*1,167*	*2,084*	*1,223*
b Trade Receivables	*103*	*79*	*354*	*131*	*320*	*175*
5 Total Assets	6,437	6,963	7,719	6,834	8,164	5,723
6 Current Liabilities	922	1,334	1,112	858	957	1,248
a Trade Payables	*244*	*311*	*295*	*98*	*147*	*132*
7 Borrowings	2,623	2,833	3,619	2,955	4,308	1,778
8 Related Party Exposure	-	-	-	-	-	-
9 Non-Current Liabilities	384	382	451	412	473	478
10 Net Assets	2,509	2,415	2,538	2,609	2,426	2,219
11 Shareholders' Equity	2,509	2,415	2,538	2,609	2,426	2,218
B INCOME STATEMENT						
1 Sales	5,164	5,312	3,995	4,791	3,688	5,501
a Cost of Good Sold	*(4,613)*	*(4,491)*	*(3,192)*	*(4,201)*	*(3,287)*	*(5,233)*
2 Gross Profit	551	820	803	590	401	268
a Operating Expenses	(207)	(315)	(221)	(388)	(294)	(326)
3 Operating Profit	343	506	582	202	107	(59)
a Non Operating Income or (Expense)	*121*	*391*	*190*	*440*	*319*	*453*
4 Profit or (Loss) before Interest and Tax	464	897	772	642	425	395
a Total Finance Cost	*(262)*	*(385)*	*(290)*	*(212)*	*(138)*	*(197)*
b Taxation	*(124)*	*(108)*	*(112)*	*(17)*	*(51)*	*(67)*
6 Net Income Or (Loss)	78	404	369	413	236	131
C CASH FLOW STATEMENT						
a Free Cash Flows from Operations (FCFO)	*436*	*647*	*703*	*425*	*274*	*23*
b Net Cash from Operating Activities before Working Capital Changes	*100*	*338*	*646*	*454*	*333*	*(150)*
c Changes in Working Capital	*(539)*	*811*	*(783)*	*(877)*	*(1,772)*	*(928)*
1 Net Cash provided by Operating Activities	(439)	1,149	(138)	(422)	(1,439)	(1,078)
2 Net Cash (Used in) or Available From Investing Activities	131	(168)	(318)	(741)	(1,016)	17
3 Net Cash (Used in) or Available From Financing Activities	(306)	(324)	527	1,150	2,514	1,055
4 Net Cash generated or (Used) during the period	(614)	657	71	(13)	58	(6)
D RATIO ANALYSIS						
1 Performance						
a Sales Growth (for the period)	29.6%	10.9%	11.2%	-12.9%	-10.6%	-22.7%
b Gross Profit Margin	10.7%	15.4%	20.1%	12.3%	10.9%	4.9%
c Net Profit Margin	1.5%	7.6%	9.2%	8.6%	6.4%	2.4%
d Cash Conversion Efficiency (EBITDA/Sales)	10.3%	13.9%	19.3%	11.0%	9.5%	3.7%
e Return on Equity (ROE)	4.2%	16.1%	19.1%	17.1%	13.6%	5.8%
2 Working Capital Management						
a Gross Working Capital (Average Days)	67	84	131	103	141	62
b Net Working Capital (Average Days)	52	70	117	95	131	54
c Current Ratio (Total Current Assets/Total Current Liabilities)	2.1	1.8	2.9	2.6	3.4	1.4
3 Coverages						
a EBITDA / Finance Cost	2.1	1.9	2.9	2.7	2.7	1.1
b FCFO / Finance Cost+CMLTB+Excess STB	1.6	0.9	1.4	1.0	0.9	0.1
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	4.3	4.1	2.0	4.3	5.4	-4.0
4 Capital Structure (Total Debt/Total Debt+Equity)						
a Total Borrowings / Total Borrowings+Equity	51.1%	54.0%	58.8%	53.1%	64.0%	44.5%
b Interest or Markup Payable (Days)	54.4	120.6	109.4	92.0	0.0	0.0
c Average Borrowing Rate	12.6%	13.1%	10.8%	8.3%	5.8%	16.4%

Credit Rating

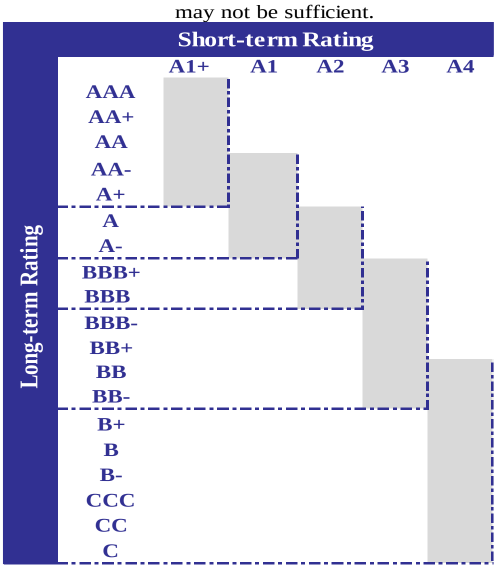
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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):

Entities

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

Instruments

a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk 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.
(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