The Pakistan Credit Rating Agency Limited

Rating Report

Popular Sugar Mills Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-Sep-2020	BBB+	A2	Stable	Maintain	-
29-Oct-2019	BBB+	A2	Stable	Maintain	-
30-Apr-2019	BBB+	A2	Stable	Maintain	-
31-Oct-2018	BBB+	A2	Stable	Maintain	-
02-May-2018	BBB+	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 190 per maund (previously PKR180). 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 Popular Sugar Mills Limited's ('Popular Sugar' or 'the Company') adequate business profile. The Company posted a positive trend in revenues along with improved margins. Relatively lower sugarcane availability in MY20 and higher procurement cost has resulted in rising sugar prices in local market resulting in better profits. Moreover, the Company's profitability is supported through sale of by-products. Financial profile of the Company remains adequate with modestly leveraged capital structure and improved coverages. However, mismatch in the debt mix persisted as the Company increased its reliance on short term borrowings to fund its working capital needs. The rating incorporates group support for the entity, if the need arises.

The ratings are dependent upon the Company's ability to maintain its margins, improve coverage's and rationalize short-term borrowings to avoid asset liability mismatch. Any significant deterioration in margins and/or cashflows will impact the ratings negatively. Meanwhile, strengthening of governance framework and internal controls will be favorable for the ratings.

Disclosure

Name of Rated Entity	Popular 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 Popular Sugar Mills Limited ('Popular Sugar' or 'the Company) is an unlisted public limited company.

Background The Company, formerly known as National Sugar Industries Limited, was setup in 1989. In 2013, Popular Group of Industries acquired the sugar business from National Sugar Industries Limited. The Company was subsequently named to Popular Sugar Mills Limited.

Operations Popular Sugar Mills is primarily engaged in the manufacturing and sale of sugar and its by-products (molasses and bagasse). The Company has the capacity to crush 8,000 tons of sugarcane per day (TCD) with 24 rollers installed in 5 mills. The Company also generates power for mill operations and has plans in place to enhance capacity to generate 8 MW through upgrading turbines and sourcing bagasse internally. The Company's mill is located in Jan Muhammad Wala, near Sargodha. While, the registered office is situated on 9th floor, Chappal Plaza, Hasrat Mohani Road, Karachi. During MY20's crushing season, the Company's sugar production witnessed a meagre increase of ~0.3% and stood at 44,624 MT (MY19: 44,508). Meanwhile, a decline in sucrose recovery rate was observed standing at 9.65% (MY19: 10.04%).

Ownership

Ownership Structure Popular Sugar Mills is a wholly owned company of the Popular Group of Industries (‘Popular Group’). Around 87% of the shares reside with other Group companies. While, remaining 13% of the stake vests with the individuals of Roshan and Malik family.

Stability Ownership reflects stability as no ownership changes are expected in near future.

Business Acumen Over the years, Popular Group has expanded into diversified businesses through organic growth and acquisition. Today, Popular Group has an inclined interest in the manufacturing segment that includes fruit juices, sugar, match, packaging and textile. In the services sector, the Group is represented by a Modaraba Company (listed), security services and a trading company. Moreover, the Company is set to penetrate the cement industry.

Financial Strength The Company has adequate financial strength through the support of its group. During 9MMY20, the Company had total assets of ~PKR 6bln, supported by an equity base of ~PKR 2.5bln.

Governance

Board Structure The Company’s Board comprises two executive and two non-executive Directors. The Board is dominated by the sponsoring family and lacks independence, thus indicating room for improvement.

Members’ Profile The Board's Chairman, Mr. Imamuddin Shouqeen, has a long association with the Company. He has business experience of over 42 years. Moreover,Mr. Imamuddin is a member of Pakistan's Senate.

Board Effectiveness Keeping in view the size of the board, absence of sub-committees may not impact it's effectiveness. During MY20, four Board meetings, with majority attendance, were held to discuss pertinent matters and future strategy.

Financial Transparency Popular Sugar Mills external auditors, Reanda Haroon Zakaria & Company, Chartered Accountants, have expressed an unqualified opinion on the Financial Statements of the Company ending in September, 2019. The firm has been QCR rated by ICAP and are in Category 'B' of SBP panel.

Management

Organizational Structure Popular Sugar Mills is headed by the Managing Director (MD) and supported by a team of General Managers for site, factory, finance and marketing. However, the support functions (HR, legal and administration) are shared at Group level and report to the Group's Chairman.

Management Team Mr. Shahbaz Ali Malik (CEO) leads the management team. He has been associated with the Group for last 29 years and has played a key role in the success of the Company. The CEO is supported by an able and professional team.

Effectiveness The Company does not have management committees in place. However, to discuss management targets and aligned budgets, meetings are called on monthly and ad-hoc basis by the board's Chairman and/or the Company's MD

MIS Popular Sugar Mills has implemented Cosmosoft system, which is fully integrated with the financial systems, except for the inventory module. The system also provides various detailed reports to monitor and control the performance of the Company.

Control Environment The Company has established internal audit department, which is an integral part of the management control system. Popular Sugar Mills control environment gains support from budgetary control exercised at the board level, followed throughout the year.

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 190 per maund (previously PKR180). Actual realized sugarcane price at mill gate were higher. Despite increase in costs, higher local sugar prices have improved miller's profitability.

Relative Position Owing to high number of players in the industry, companies relatively have low market share. The Company had a market share of 0.9% during MY20.

Revenues The Company generates most of its revenue (85%) from the sale of sugar. However, sale of molasses (11%) and bagasses (4%) also contribute to the turnover. During 9MMY20, the Company posted revenue worth ~PKR 3,413mln (9MMY19: ~PKR 1,860mln), depicting a significant growth of ~83%. The growth in topline emanated from rise in sugar prices and higher volumetric sales.

Margins During 9MMY20, the Company posted a gross profit of ~PKR 536mln (9MMY19: ~PKR 205mln), reflecting a growth of ~161% YoY, translating into gross margin of ~16% (9MMY19: ~11%), supported by increased sugar prices. The operating profit increased to ~PKR 446mln (9MMY19: ~PKR 154mln) due to trickle-down effect. Consequently, operating margin surged to ~13% (9MMY19: ~8%). Although the finance cost of the Company increased to ~PKR 200mln in 9MMY20 (9MMY19: ~PKR 79mln), net margin saw an improvement and stood at ~7% (9MMY19: ~3%).

Sustainability Going forward, the Company expects to sustain its profit margins on the back of increased sugar prices. However, lack of diversification exposes the Company to inherent volatility in the sugar sector.

Financial Risk

Working Capital During 9MMY20, the inventory days (9MMY20: 77 days, 9MMY19: 148 days) improved as the Company has offloaded its sugar inventory aggressively. Moreover, receivable days (9MMY20: 13 days, 9MMY19: 14 days) remained stable as most of the customers paid their dues within the credit period offered. However, due to early payments made to the sugar cane suppliers, payable days decreased to 17 days (9MMY19: 48 days). This led to a substantial improvement in net working capital days (9MMY20: 73 days, 9MMY19: 114 days). Meanwhile, the short term trade leverage witnessed a significant decline and stood at -10% (9MMY19: 11.8%) owing to higher short term borrowings and elevated trade liabilities.

Coverages During 9MMY20, the Company's free cashflows clocked in at ~PKR 683mln (9MMY19: ~PKR 241mln) on the back of higher profitability. On the other hand, the finance cost of the Company surged to ~PKR 200mln (9MMY19: ~PKR 79mln) owing to higher benchmark rates. Consequently, the interest coverage ratio witnessed a slight improvement and stood at 3.4x in 9MMY20 (9MMY19: 3.0x). Meanwhile, the debt coverage ratio increased to 1.7x in 9MMY20 (9MMY19: 0.6x) as the Company has paid its current maturity of long term debt.

Capitalization Popular Sugar Mills maintains a moderately leveraged capital structure. During 9MMY20, the leveraging stood at ~46% (9MMY19: ~51%). Total debt is inclined towards short-term borrowings, which represented 82% of total borrowings in 9MMY20. Short-term lines are utilized to support operations during the crushing cycle.

PKR mln

Popular Sugar Mills Limited	Jun-20	Sep-19	Jun-19	Sep-18	Sep-17
Sugar	9M	12M	9M	12M	12M
A BALANCE SHEET					
1 Non-Current Assets	3,185	3,336	3,178	3,274	3,070
2 Investments	2	2	2	2	3
3 Related Party Exposure	438	131	-	20	-
4 Current Assets	2,260	1,542	2,313	1,173	1,441
a Inventories	*1,109*	*812*	*1,532*	*481*	*608*
b Trade Receivables	*110*	*217*	*83*	*108*	*68*
5 Total Assets	5,885	5,011	5,493	4,469	4,514
6 Current Liabilities	784	621	588	714	871
a Trade Payables	*238*	*183*	*276*	*382*	*82*
7 Borrowings	2,115	1,738	2,242	1,035	997
8 Related Party Exposure	-	100	148	182	138
9 Non-Current Liabilities	495	295	257	343	364
10 Net Assets	2,491	2,256	2,258	2,196	2,145
11 Shareholders' Equity	2,491	2,256	2,258	2,196	2,145
B INCOME STATEMENT					
1 Sales	3,413	2,373	1,860	3,272	3,043
a Cost of Good Sold	*(2,877)*	*(2,004)*	*(1,655)*	*(3,017)*	*(2,774)*
2 Gross Profit	536	369	205	255	269
a Operating Expenses	*(90)*	*(81)*	*(51)*	*(82)*	*(75)*
3 Operating Profit	446	288	154	173	194
a Non Operating Income or (Expense)	*3*	*27*	*15*	*19*	*7*
4 Profit or (Loss) before Interest and Tax	448	314	169	193	202
a Total Finance Cost	*(200)*	*(271)*	*(83)*	*(129)*	*(102)*
b Taxation	*(13)*	*18*	*(25)*	*(33)*	*(7)*
6 Net Income Or (Loss)	235	62	61	31	93
C CASH FLOW STATEMENT					
a Free Cash Flows from Operations (FCFO)	*683*	*390*	*241*	*233*	*235*
b Net Cash from Operating Activities before Working Capital Changes	*500*	*194*	*186*	*130*	*148*
c Changes in Working Capital	*(752)*	*(661)*	*(1,272)*	*168*	*(326)*
1 Net Cash provided by Operating Activities	(252)	(467)	(1,086)	298	(178)
2 Net Cash (Used in) or Available From Investing Activities	-	(178)	(0)	(327)	(281)
3 Net Cash (Used in) or Available From Financing Activities	276	638	1,103	90	458
4 Net Cash generated or (Used) during the period	25	(7)	17	61	(2)
D RATIO ANALYSIS					
1 Performance					
a Sales Growth (for the period)	91.8%	-27.5%	-24.2%	7.5%	2.5%
b Gross Profit Margin	15.7%	15.5%	11.0%	7.8%	8.8%
c Net Profit Margin	6.9%	2.6%	3.3%	0.9%	3.0%
d Cash Conversion Efficiency (EBITDA/Sales)	17.7%	17.9%	13.0%	9.0%	10.4%
e Return on Equity (ROE)	13.2%	2.8%	3.7%	1.4%	4.9%
2 Working Capital Management					
a Gross Working Capital (Average Days)	90	124	162	71	48
b Net Working Capital (Average Days)	73	81	114	45	42
c Current Ratio (Total Current Assets/Total Current Liabilities)	2.9	2.5	3.9	1.6	1.7
3 Coverages					
a EBITDA / Finance Cost	3.0	1.7	3.0	2.4	3.2
b FCFO / Finance Cost+CMLTB+Excess STB	1.7	0.5	0.6	0.5	0.4
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	1.0	6.9	4.4	6.8	4.2
4 Capital Structure (Total Debt/Total Debt+Equity)					
a Total Borrowings / Total Borrowings+Equity	45.9%	44.9%	51.4%	35.6%	34.6%
b Interest or Markup Payable (Days)	198.3	181.7	282.4	159.7	99.7
c Average Borrowing Rate	13.5%	16.8%	5.9%	10.4%	12.1%

Credit Rating

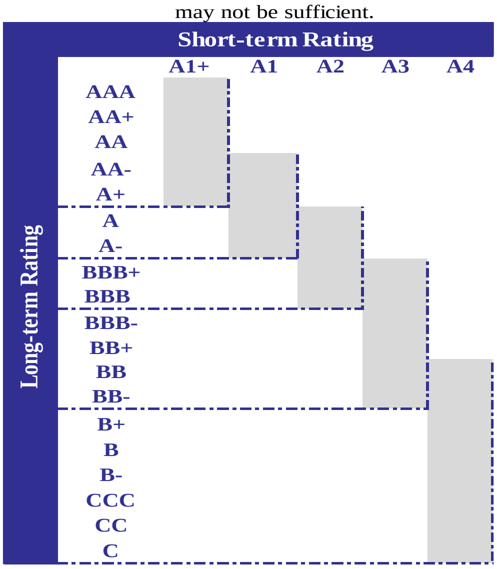
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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

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

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(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.
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(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)

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(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)
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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)
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