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-2021	BBB+	A2	Stable	Maintain	-
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 country's 2nd largest agro-based industry, comprising 90 mills with an annual crushing capacity estimated ~65–70mln MT. The industry is trying to overcome the supply challenges. However, support price, set by considering the cost incurred by farmers, remains a constraint. During MY21, the overall sugar production increased by 15%, YoY, to 5.6mln MT (MY20: 4.9mln MT) due to better crop availability and an increase in area under cultivation. The recent surge in local sugar prices was registered by the demand-supply gap. Previously, the sales tax levied on sugar was increased to 17% (previously 8%,) charged on the PKR 60/KG price, which contributed to higher prices. In the FY21 budget, a sales tax of 17% was proposed to be levied on the market retail price instead of PKR 60/kg. However, Government has allowed not to charge sales tax on market retail price till Nov-21. Moreover, in MY21 crushing season, the Government increased the support price of sugarcane to PKR 200 per maund (previously, it was increased to PKR 190 from PKR 180 per maund). Actual realized sugarcane prices at the mill gate were even higher. To meet the local demand and curb the hike in sugar prices, the Government planned to import 0.8mln MT of sugar. Out of this, 0.3mln MT has already been imported, till Jun-21. Lately, TCP approved to import another 0.1mln MT of sugar. Going forward, despite higher input costs, higher sugar prices are expected to remain favorable for millers.
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 and higher procurement cost led to inflated sugar prices in local market resulting in better profits. Moreover, the Company's profitability is supported through the 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 the 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 Rating(Jun-21),Criteria | Correlation Between Long-term & Short-term Rating Scales(Jun-21),Criteria | Rating Modifiers(Jun-21)
Related Research	Sector Study | Sugar(Dec-20)
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 MY21's crushing season, the Company's sugar production increased significantly and stood at 58,298 MT (MY20: 44,624MT). Meanwhile, a slight dip in sucrose recovery rate was observed standing at 9.6% (MY20: 9.65%).

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 9MMY21, the Company had total assets of ~PKR 7.2bln, supported by an equity base of ~PKR 3.9bln.

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 Mr. Imamuddin Shouqeen, Chairman of the Board, has over 41 years of experience in business and is Chairman of PGI. He is an elected member of provincial assembly.

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 The auditors of the Company are Reanda Haroon Zakaria & Company, Chartered Accountants, issued an unqualified opinion for MY20. 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. Imamuddin Shouqeen also leads the management team as the CEO. He has been associated with the Group for the last 30 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 country's 2nd largest agro-based industry, comprising 90 mills with an annual crushing capacity estimated ~ 65 – 70mln MT. The industry is trying to overcome the supply challenges. However, support price, set by considering the cost incurred by farmers, remains a constraint. During MY21, the overall sugar production increased by 15%, YoY, to 5.6mln MT (MY20: 4.9mln MT) on the back of better crop availability and an increase in area under cultivation. The recent surge in local sugar prices was registered by the demand-supply gap. Previously, the sales tax levied on sugar was increased to 17% (previously 8%,) charged on the PKR 60/KG price, which contributed to higher prices. In the FY21 budget, a sales tax of 17% was proposed to be levied on the market retail price instead of PKR 60/kg. However, Government has allowed not to charge sales tax on market retail price till Nov-21. Moreover, in MY21 crushing season, the Government increased the support price of sugarcane to PKR 202 per maund (previously, it was increased to PKR 190 from PKR 180 per maund). Actual realized sugarcane prices at the mill gate were even higher. To meet the local demand and curb the hike in sugar prices, the Government planned to import 0.8mln MT of sugar. Out of this, 0.3mln MT has already been imported, till Jun-21.

Relative Position Owing to high number of players in the industry, companies relatively have low market share. The Company had a market share of ~1% during MY21, in terms of sugar production.

Revenues Popular Sugar generates most of its revenue (~80%) from the sale of sugar. However, sale of molasses (~17%) and bagasse (~3%) also contribute to the turnover. The Company posted revenue worth ~PKR 3.9bln in 9MMY21 (9MMY20: ~PKR 3.4bln), reflecting a significant growth of ~15% or ~PKR 475mln emanating from increased sugar prices and higher molasses sold.

Margins Popular Sugar has posted a gross profit of ~PKR 593mln in 9MMY21 (9MMY20: ~PKR 536mln), translating into a gross margin of ~15% (9MMY20: ~16%). The decline is primarily attributable to inflationary pressure. However, the operating margin (9MMY21: ~13%, 9MMY20: ~13%) remained at the same level owing to better control at operating cost. Finance cost witnessed a prominent decline to ~PKR 100mln in 9MMY21 (9MMY20: ~PKR 200mln). In accumulation, the net margin stood at ~7% in 9MMY21 (9MMY20: ~7%).

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 The Company faces an inherent stress in its working capital cycle due to seasonality in the sugar industry. The Company has maintained a weak position on working capital management over the years mainly owing to excessive short-term borrowings which have resulted in a persistent debt mismatch. In 9MMY21, the inventory days improved to 43 days (9MMY20: 77 days) on the back of efficient inventory management. Similarly, the receivable days witnessed an improvement to 5 days (9MMY20: 13 days). Payable days remained at the same level (9MMY21: 16 days, 9MMY20: 15 days). Resultantly, the net working capital days observed a prominent improvement (9MMY21: 32 days, 9MMY20: 73 days). The Company has a negative borrowing cushion at the trade and total asset level.

Coverages In 9MMY21, the free cashflows of the Company declined to ~PKR 526mln (9MMY20: ~PKR 683mln). However, the finance cost (9MMY21: ~PKR 100mln, 9MMY20: ~PKR 200mln) witnessed an improvement on the back of lower KIBOR. Consequently, the interest coverage increased significantly to 5.4x (9MMY20: 3.4x). Meanwhile, the core and total coverage deteriorated to 1.1x (9MMY20: 1.7x) and 1.1x (9MMY20: 1.7x), respectively, due to higher excess borrowings.

Capitalization Popular Sugar maintains a moderately leveraged capital structure. In 9MMY21, the leveraging stood at ~33% (9MMY20: ~46%). Total debt is inclined towards short-term borrowings, which represented ~67% of total borrowings in 9MMY21. Short-term lines are utilized to support operations during the crushing cycle.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Popular Sugar Mills Limited Sugar	Sep-20 12M	Sep-19 12M	Sep-18 12M
A BALANCE SHEET			
1 Non-Current Assets	4,645	3,336	3,274
2 Investments	69	2	2
3 Related Party Exposure	698	131	20
4 Current Assets	562	1,542	1,173
a Inventories	*13*	*812*	*481*
b Trade Receivables	*106*	*217*	*108*
5 Total Assets	5,975	5,011	4,469
6 Current Liabilities	674	621	714
a Trade Payables	*176*	*183*	*382*
7 Borrowings	935	1,738	1,035
8 Related Party Exposure	188	100	182
9 Non-Current Liabilities	494	295	343
10 Net Assets	3,684	2,256	2,196
11 Shareholders' Equity	3,684	2,256	2,196
B INCOME STATEMENT			
1 Sales	4,516	2,373	3,272
a Cost of Good Sold	*(3,827)*	*(2,004)*	*(3,017)*
2 Gross Profit	688	369	255
a Operating Expenses	(101)	(81)	(82)
3 Operating Profit	588	288	173
a Non Operating Income or (Expense)	*(108)*	*27*	*19*
4 Profit or (Loss) before Interest and Tax	479	314	193
a Total Finance Cost	*(256)*	*(271)*	*(129)*
b Taxation	*(42)*	*18*	*(33)*
6 Net Income Or (Loss)	181	62	31
C CASH FLOW STATEMENT			
a Free Cash Flows from Operations (FCFO)	*602*	*390*	*233*
b Net Cash from Operating Activities before Working Capital Changes	*288*	*194*	*130*
c Changes in Working Capital	*543*	*(661)*	*168*
1 Net Cash provided by Operating Activities	832	(467)	298
2 Net Cash (Used in) or Available From Investing Activities	(15)	(178)	(327)
3 Net Cash (Used in) or Available From Financing Activities	(803)	638	90
4 Net Cash generated or (Used) during the period	14	(7)	61
D RATIO ANALYSIS			
1 Performance			
a Sales Growth (for the period)	90.3%	-27.5%	7.5%
b Gross Profit Margin	15.2%	15.5%	7.8%
c Net Profit Margin	4.0%	2.6%	0.9%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	25.4%	-11.4%	12.3%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sha*	5.4%	2.9%	1.4%
2 Working Capital Management			
a Gross Working Capital (Average Days)	46	124	71
b Net Working Capital (Average Days)	32	81	45
c Current Ratio (Current Assets / Current Liabilities)	0.8	2.5	1.6
3 Coverages			
a EBITDA / Finance Cost	2.5	1.7	2.4
b FCFO / Finance Cost+CMLTB+Excess STB	0.7	0.5	0.5
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	3.3	6.9	6.8
4 Capital Structure			
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	23.4%	44.9%	35.6%
b Interest or Markup Payable (Days)	102.5	181.7	159.7
c Entity Average Borrowing Rate	12.6%	12.2%	7.3%

Credit Rating

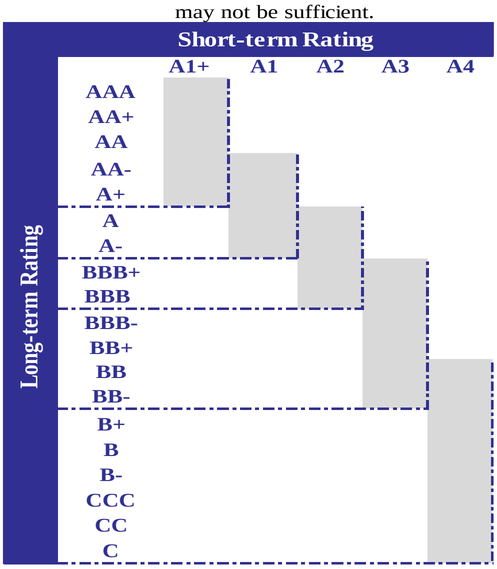
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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)
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(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)
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