The Pakistan Credit Rating Agency Limited

Rating Report

Jauharabad Sugar Mills Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
17-Oct-2019	BBB	A2	Stable	Maintain	-
30-Apr-2019	BBB	A2	Stable	Maintain	-
28-Dec-2018	BBB	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The sugar industry of Pakistan has remained under pressure in recent times. A persistent supply glut negatively impacted players across the industry. Additionally, slowdown in international sugar prices rendered domestically manufactured sugar uncompetitive, making exports viable only through subsidy support. However, prices during the current season (MY19) have improved owing to lower sugar production and depletion of carryover stock. This has impacted profitability for industry players positively. Moreover, retirement of subsidy amount due by the government has eased the liquidity pressure to an extent.

The ratings reflects improving business profile of Jauharabad Sugar Mills Limited in line with the current dynamics of sugar industry. During 9MFY19, rise in sugar prices in domestic market led to growth in the Company's revenue. Profit Margins improved significantly on gross and net levels on the back of relatively low conversion costs. Over the years, the sponsors business acumen and support (in the form of loan) have remained beneficial for the Company. The management's consistent attention to improve efficiency is expected bring efficiencies to supplement growth. Going forward, the management plans to diversify the Company’s revenue base by setting up a power plant and a distillery. Jauharabad Sugar Mills financial profile remains stretched and is characterized by modestly leveraged capital structure, largely emanating from working capital needs. The coverage ratios have improved due to strong cash flows despite the rising finance costs.

The ratings are dependent upon the management’s ability to improve its revenue while sustaining strong margins. Meanwhile, close monitoring of working capital requirements remains critical for the ratings. Any deterioration in the Company’s cash flows and coverage would have a negative impact.

Disclosure

Name of Rated Entity	Jauharabad Sugar Mills Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	PACRA_Methodology_Corporate_FY19(Jun-19),PACRA_Crtieria_LT ST Relationship_FY19(Jun-19),PACRA_Criteria_Rating Modifiers_FY19(Jun-19)
Related Research	Sector Study | Sugar(Oct-19)
Rating Analysts	Ayesha Malik | ayesha.malik@pacra.com | +92-42-35869504

Profile

Legal Structure Jauharabad Sugar Mills Limited is a public limited company listed on Pakistan Stock Exchange (PSX) since 1973.

Background The Company was initially established on Build, Operate and Transfer (BOT) contract by Pakistan Industrial Development Corporation (PIDC) in collaboration with Thal Development Authority (TDA). In 1955, Saigol Group acquired the contract and named the Company as Kohinoor Sugar Mills Limited. In Oct13, Cane Processing (Pvt.) Limited acquired major stake (64%) in Kohinoor Sugar Mills and changed its name to Jauharabad Sugar Mills Limited.

Operations The Company's registered office is in Kot Lakhpat, Lahore. It has two sugarcane crushing units installed in same facility, located in Jauharabad, Khushab. These named Line-I and Line-II with sugarcane crushing capacity of 5,500 MT and 7,000 MT per day, respectively. However, currently only Line-II is operational. Capacity utilization of the Company has improved in 9MFY19 to 71% (FY18: 59%), despite lesser crushing days of the Company than competitors. It has manufactured 0.45 MT sugar at an average recovery rate of 10.4% in 9MFY19 .

Ownership

Ownership Structure Cane Processing Limited – the holding company – owns major shareholding in Jauharabad Sugar Mills (64%) while 23% of shares are owned by individual members of Latif Family; 3% by NIT and ICP; and remaining 10% by general public. Cane Processing Limited is owned by Mrs. Ghazla Amjad, mother of Mr. Ahsan Latif, who is major driving force behind Jauharabad Sugar Mills.

Stability Holding Company – Cane Processing Limited – holds major ownership of Jauharabad Sugar Mill indicating stable structure.

Business Acumen The sponsoring family has interests in other ventures and enjoys strong business acumen. Apart from owning two LPG businesses, named Synergy and Awami, the Sponsoring family has recently acquired another sugar mill, having an operational capacity of 3,500 TCD (installed capacity 12,000 TCD).

Financial Strength Cane Processing Limited has total assets of PKR 643mln in FY19 with an equity base of PKR 643mln. The Sponsors have stake in Kohat Cement, Century Foods and Ravi Glass.

Governance

Board Structure The Company's Board comprises of two executive director, two independent directors and three non-executive directors nominated by Cane Processing Limited. Chairman of the board is a non-executive director nominated by the holding company, Cane Processing Limited. The Board draws strength from its size and independent oversight.

Members' Profile All of the BoD members are experienced professionals with industry knowledge. The Chairman, Mr. Muhammad Aamir Beg, is certificated from the Director Training Program and has an overall work experience of three decades. One of the independent directors, Mr. Amjad Bashir, has work experience of above 2 decades and Mr. Ghias ul Hassan also became director after resigning from the post of CEO during FY19.

Board Effectiveness The Board met thrice during 9MFY19, with majority attendance, to discuss pertinent matters and minutes were well documented. The Board has two sub-committees; Audit Committee and Human Resource and Remuneration Committee, both of the committees comprise of three directors and met thrice in 9MFY19.

Financial Transparency UHY Hassan Naeem & Company, Chartered Accountants, are the external auditors of the Company since 2009. The firm has been QCR rated by ICAP and is in Category 'B' of SBP Panel. They have expressed an unqualified opinion on the financial reports for FY18.

Management

Organizational Structure Jauharabad Sugar Mill operates through eight divisions: Mill, Operations, Power, Cane, Marketing, Human Resource, Internal Audit and Finance. All functional Heads report to the Chief Operating Officer (COO), who reports to the CEO. However, Heads of Internal Audit and Human Resource reports administratively to the CEO and functionally to the Audit and Human Resource and Remuneration Committee, respectively.

Management Team The Company's management comprise veteran professionals. Mr Jamal Ahmad, the newly appointed CEO, has an overall work experience of above 40 years. He has been associated with the Company for 3 years. Mr. Ahsan Latif, COO, has an overall work experience of 21 years and has been associated with the Company since its inception.

Effectiveness The Company's management ensures effectiveness through a Management Committee. This Committee comprises Heads of all divisions. A co-ordination meeting is held on daily basis to review the progress of every department. Minutes of these meetings are documented and circulated for follow ups.

MIS Initially, the Company used COSMOSOFT in order to get its procurement function in line. However, later the Company shifted on ERP, which is now in place and updated on real time basis. It generates several reports to assist the top management in monitoring and evaluating the performance of different departments.

Control Environment To ensure operational efficiency, Jauharabad Sugar has setup an Internal Audit Function. To monitor this function, the Company has co-sourced internal audit to KPMG. They provide support, guidance and monitoring of the internally placed SOPs. KPMG conduct Gap Analysis for evaluating the already placed policies and procedures .

Business Risk

Industry Dynamics Pakistan's sugar industry is the 2nd largest agri-based industry, comprising ~90 mills with annual crushing capacity estimated around 65 – 70 mln MT. The sugar industry of Pakistan has remained under pressure in recent times. Prices during the current season (MY19) have improved owing to lower sugar production and depletion of carryover stock. Sugar production fell by ~20%, YoY, to 5.3mln MT. This has impacted the profitability for industry players positively. Moreover, provision of subsidy amount by the government has eased the liquidity pressure. An export quota of 1.1mln tons was approved, nonetheless, absence of subsidy led to low quantities availed. During the FY20 budget, sales tax levied on sugar was increased to 17% charged on the price of PKR 60/KG, effective from July 1, 2019. Additionally, provision of CNIC for all buyers has been made mandatory. This has been made effective from August 1, 2019.

Relative Position Jauharabad Sugar contributes approximately 0.6% to total sugar production in Pakistan, relatively a small quantity.

Revenues The Company mainly generates its revenue selling refined sugar (~90%). It also sells by-products of sugar (Molasses, Bagasse and Mud) but their contribution in overall revenue is minor (~10%). In 9MFY19, revenue of Jauharabad Sugar Mill hiked by 23% to PKR 1.7bln as compared to the 9MFY18 (PKR 1.4bln). This increase was supported by hike in both sale volume and price but the main tilt remains towards the price surge. Moreover, improvement in utilization levels (71%) and sugar recovery rate (10.4%) also contributed positively. However, reliance of the Company on a single product leaves little cushion against industry fluctuations.

Margins In 9MFY19, Jauharabad Sugar gross margins improved significantly (9MFY19: 24.0%, FY18: 2.2%) supported by better prices of refined sugar and molasses coupled with the high recovery rates as compared to previous years. Further, the Company was able to curtail its finance cost in 9MFY19 leading to an improved bottom-line.

Sustainability The Company is planning to install 14MW biomass co-generation power plant, under captive regime with an upfront tariff (PKR 7.82) determined to sell 8-10 MW of electricity to FESCO. It also intends to set up a distillery of capacity 60,000 liters ethanol per day, going forward.

Financial Risk

Working Capital Increased inventory levels of the Company kept the net working capital days on the higher side (9MFY19: 226 days, FY18: 119 days). The Company ensured discipline in its working capital management by significantly reducing the short-term borrowings leading to an improved borrowing buffer.

Coverages Interest coverage ratio of Jauharabad Sugar improved (9MFY19: 2.4x, FY18: 0) backed by higher free cash flows (9MFY19: PKR 310mln FY18: PKR -2mln) The increase in cash flows is supported by enhanced production and profitability. Core and total debt service coverage ratios also improved with reduced debt exposure.

Capitalization The Company has a leverage ratio of ~54% for 9MFY19, which was lower as compared to the corresponding period in previous year (9MFY18: ~59%). This has decreased due to slight decline in total debt from PKR 2.5bln in 9MFY18 to PKR 2.2bln in 9MFY19. Major portion of the debt comprises of short term borrowings obtained to finance the working capital requirement. Long-term loan was obtained to set-up biomass power plant.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Jauharabad Sugar Mills Limited Sugar	Jun-19 9M	Sep-18 12M	Jun-18 9M	Sep-17 12M	Jun-17 9M	Sep-16 12M
A BALANCE SHEET						
1 Non-Current Assets	3,265	3,241	3,102	3,084	2,961	2,787
2 Investments	-	-	-	-	-	-
3 Related Party Exposure	-	-	-	-	-	-
4 Current Assets	2,463	1,449	2,474	838	2,199	441
a Inventories	*1,833*	*753*	*1,495*	*556*	*1,630*	*30*
b Trade Receivables	*9*	*327*	*387*	*1*	*-*	*-*
5 Total Assets	5,729	4,689	5,576	3,922	5,160	3,227
6 Current Liabilities	397	261	286	413	445	209
a Trade Payables	*99*	*67*	*71*	*137*	*129*	*67*
7 Borrowings	2,168	1,442	2,470	577	1,815	38
8 Related Party Exposure	495	610	489	445	446	1,124
9 Non-Current Liabilities	425	242	249	338	332	332
10 Net Assets	2,244	2,135	2,082	2,149	2,122	1,524
11 Shareholders' Equity	2,244	2,135	2,078	2,149	2,123	1,524
B INCOME STATEMENT						
1 Sales	1,673	2,195	1,355	2,582	1,346	2,095
a Cost of Good Sold	*(1,272)*	*(2,149)*	*(1,331)*	*(2,282)*	*(1,162)*	*(1,888)*
2 Gross Profit	401	46	24	300	185	206
a Operating Expenses	(122)	(138)	(83)	(116)	(72)	(89)
3 Operating Profit	279	(93)	(59)	184	112	117
a Non Operating Income or (Expense)	*(16)*	*267*	*144*	*5*	*4*	*19*
4 Profit or (Loss) before Interest and Tax	263	174	85	189	116	136
a Total Finance Cost	*(129)*	*(138)*	*(100)*	*(124)*	*(83)*	*(54)*
b Taxation	*(4)*	*(31)*	*(3)*	*(33)*	*(2)*	*24*
6 Net Income Or (Loss)	130	5	(17)	32	31	106
C CASH FLOW STATEMENT						
a Free Cash Flows from Operations (FCFO)	*310*	*(2)*	*8*	*233*	*197*	*192*
b Net Cash from Operating Activities before Working Capital Changes	*155*	*(129)*	*(46)*	*112*	*154*	*126*
c Changes in Working Capital	*(701)*	*(652)*	*(1,728)*	*(226)*	*(1,668)*	*(83)*
1 Net Cash provided by Operating Activities	(546)	(781)	(1,775)	(114)	(1,514)	42
2 Net Cash (Used in) or Available From Investing Activities	(80)	(245)	(84)	(396)	(241)	(106)
3 Net Cash (Used in) or Available From Financing Activities	610	1,045	1,938	518	1,736	50
4 Net Cash generated or (Used) during the period	(16)	19	80	8	(19)	(14)
D RATIO ANALYSIS						
1 Performance						
a Sales Growth (for the period)	1.6%	-15.0%	-30.0%	23.3%	-14.3%	--
b Gross Profit Margin	24.0%	2.1%	1.8%	11.6%	13.7%	9.9%
c Net Profit Margin	7.8%	0.2%	-1.3%	1.2%	2.3%	5.1%
d Cash Conversion Efficiency (EBITDA/Sales)	20.9%	2.1%	3.6%	11.1%	17.2%	9.9%
e Return on Equity (ROE)	7.9%	0.2%	-1.1%	1.7%	2.3%	8.2%
2 Working Capital Management						
a Gross Working Capital (Average Days)	239	136	246	42	N/A	36
b Net Working Capital (Average Days)	226	119	225	27	N/A	16
c Current Ratio (Total Current Assets/Total Current Liabilities)	6.2	5.6	8.6	2.0	4.9	2.1
3 Coverages						
a EBITDA / Finance Cost	2.7	0.3	0.5	2.4	2.8	4.4
b FCFO / Finance Cost+CMLTB+Excess STB	1.4	0.0	0.1	1.8	1.6	3.7
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	3.1	-7.0	-7.0	5.3	4.2	8.0
4 Capital Structure (Total Debt/Total Debt+Equity)						
a Total Borrowings / Total Borrowings+Equity	54.3%	49.0%	58.7%	32.2%	51.6%	43.3%
b Interest or Markup Payable (Days)	164.0	144.7	226.0	51.0	0.0	0.0
c Average Borrowing Rate	7.3%	8.6%	6.3%	10.8%	6.4%	4.1%

Credit Rating Scale & Definitions

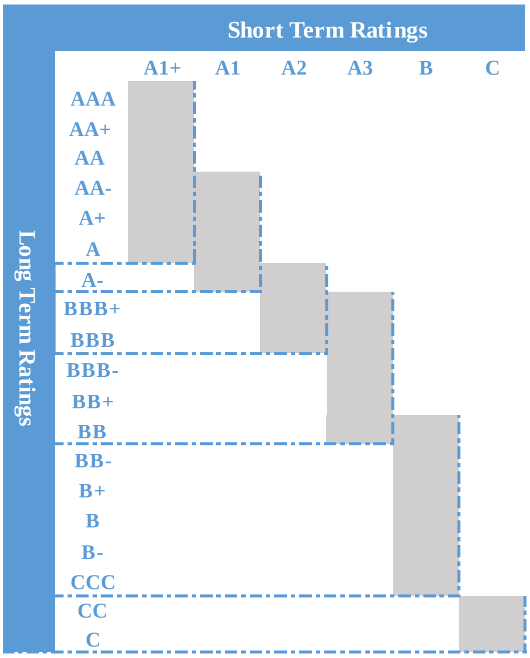
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings

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 Ratings

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 conditions.
B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
C	An inadequate capacity to ensure timely repayment.



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, a) some material identifiable event and/or b) deviation from expected trend. 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 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) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) 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.

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
(23) All information contained herein is considered proprietary by PACRA. Hence, none of the information in this document can be copied or, otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without PACRA’s prior written consent