The Pakistan Credit Rating Agency Limited

Rating Report

Hunza Sugar Mills (Pvt.) Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
04-Sep-2020	BBB	A2	Stable	Maintain	-
06-Sep-2019	BBB	A2	Stable	Maintain	-
08-Mar-2019	BBB	A2	Stable	Maintain	-
06-Sep-2018	BBB	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Pakistan’s sugar industry is the 2nd largest agro based industry, comprising 90 mills with annual crushing capacity estimated around 65 – 75 mln MT. 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. During MY19, the overall sugar production fell by 16%, YoY, to 5.5 mln MT on the back of lower crop availability. Sugar prices improved in local market as inventory levels reduced. The Government approved an export quota upto 1 MMT, however, no subsidy was announced, leading to low quantities availed. In the FY20 budget, sales tax levied on sugar was increased to 17% from 8%, charged on the price of PKR 60/KG, contributing to higher prices. Due to low crop availability in the crushing period ended Mar-20, sugar production is around 5-5.2 mln MT. 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 are expected to improve miller's profitability. Local prices are expected to be capped due to lower international prices (making imports viable) and potential intervention by the Government.

The ratings reflect the Hunza Sugar Mills (Pvt.) Ltd ('Hunza Sugar' or 'the Company') diverse revenue stream (Sugar, Ethanol and Bagasse) and sponsors strong acumen. The Company remains exposed to volatility and ensuing challenges in sugar sector. Relatively lower sugarcane availability in MY20 and higher procurement cost has resulted in rising sugar prices in local market resulting in better profits from sugar segment. The Company has stable business profile and healthy margins owing to diversification despite volatile market conditions. Hunza Sugar's financial risk remains high owing to a significantly leveraged capital structure and stretched working capital management. The Company utilises short-term borrowings to finance its inventory. This, coupled with high finance cost, keeps the Company's coverages under pressure. Meanwhile, sponsors firm commitment to provide financial support in a timely manner provides comfort to the ratings.

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. Improvement in governance framework and internal controls will be favorable for the ratings.

Disclosure	
Name of Rated Entity	Hunza Sugar Mills (Pvt.) 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 Hunza Sugar Mills (Pvt.) Limited (Hunza Sugar or the company) is a private limited Company. It was incorporated in 2002.

Background Hunza Sugar is part of the Hunza group. The flagship company of the group was Hunza Ghee Mills (Pvt.) Limited in the edible oil sector and it dates back to 1988. The Company has a diverse revenue stream. It manufactures refined sugar, molasses, ethanol, and other allied products. The Company installed its distillery and CO_2 processing plant in MY14 and MY18, respectively.

Operations Hunza Sugar have two sugar crushing units in District Faisalabad (Unit 1) and District Jhang (Unit 2). The sugar mills have a combined crushing capacity of 22,000 MT per day. Unit 1 and Unit 2 have a crushing capacity of 10,000 TCD and 12,000 TCD, respectively. Distillery is located adjacent to Unit 1, operates with a production capacity of 150,000 litres per day. Moreover, CO_2 plant has a processing capacity of 200 MT.

Ownership

Ownership Structure The Company is a family owned entity. Shares of the Company are divided among the families of three brother Mr. Idrees Chaudhry, Mr. Saeed Chaudhry, and Mr. Waheed Chaudhry. Mr. Idrees Chaudhary family owns 31% shares, Mr. Saeed Chaudhary family owns 32% shares, and Mr. Waheed Chaudhary owns 37% shares.

Stability The distinction in the ownership is very clear.

Business Acumen Hunza Group initially started with Hunza Ghee Industries (Pvt.) Limited in the Edible Oil sector in 1988. The Company produces vegetable ghee and cooking oil that sells under the brand ‘Swera Ghee' and ‘Swera Cooking Oil'. The Company carries out the import and sale of Edible Oil through its group company called Swera Traders (Pvt.) Limited. The Group diversified its operations and entered the sugar industry in 2002. Hunza Sugar expanded through forward integration by venturing into distillery business in MY14. The group is in the process of setting up a bagasse based power plant under its new group company 'Hunza Power'.

Financial Strength Hunza Group as a whole (Hunza Ghee, Hunza Sugar, Swera Traders & Power) has a strong asset base. The Group posted stable turnover and adequate profit after tax during MY19.

Governance

Board Structure There are three Board members. All of them are from the sponsoring families. There are no independent board members.

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

Board Effectiveness The Board has met four times in MY19 to approve the financial statements. Minutes of the Board meetings are not available.

Financial Transparency The auditors of the Company are Amin, Mudassar & Co, issued an unqualified opinion for MY19. The auditors have satisfactory QCR rating and also listed in SBP panel in category B. The Company was earlier audited by Javed Chaudhary & Co which were not listed in SBP panel and QCR ratings.

Management

Organizational Structure Mr. Saeed Chaudhry (CEO) sits with Senior General Manager and Manager Finance & Accounts at the Head office. Moreover, the Company has GM projects on each site who is supported with a team of production and technical staff including a head responsible for cane purchase and personnel dealing with operational matters. IT function is provided to entities at group level. There were no significant changes in organizational structure of the Company.

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

Effectiveness Management conducts a monthly review of management accounts, accounts receivable and payable, and other financial matters.

MIS The Company operates an in-house software to manage its financial accounts. Moreover, it also uses Inventory module (Purchases and Inventory Management stores), Sales module (Sales Management and Stock Management), Payroll management and Cane Procurement System. Currently, the Company is implementing a new ERP system to meet the growing needs of Hunza Sugar.

Control Environment The Company relies on set of segregation of duties established processes and procedure that incorporate internal controls. The Company has one member in the internal audit section. The Company should lay emphasis on improving its' control environment.

Business Risk

Industry Dynamics Pakistan's sugar industry is the 2nd largest agro based industry, comprising 90 mills with annual crushing capacity estimated around 65 – 75 mln MT. 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. During MY19, the overall sugar production fell by 16%, YoY, to 5.5 mln MT on the back of lower crop availability. Sugar prices improved in local market as inventory levels reduced. The Government approved an export quota upto 1 MMT, however, no subsidy was announced, leading to low quantities availed. In the FY20 budget, sales tax levied on sugar was increased to 17% from 8%, charged on the price of PKR 60/KG, contributing to higher prices. Due to low crop availability in the crushing period ended Mar-20, sugar production is around 5-5.2 mln MT. 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 are expected to improve miller's profitability. Local prices are expected to be capped due to lower international prices (making imports viable) and potential intervention by the Government.

Relative Position Hunza Sugar contributed approximately 2% making it one of the leading sugar mills in Punjab region.

Revenues The sales mix is dominated ethanol comprising 53% of the sale mix followed by local and export sales of refined sugar comprising 44.2%. Remaining portion of sales (2.8%) comprise CO_2 sales and occasional sale of bagasse, mud, and other chemicals. Hunza Sugar reported a revenue of PKR 4,110mln in 6MMY20 (MY19: PKR 12,594mln).The decline in revenues was due to nil sugar exports. The Company exported sugar worth of PKR 1,683mln in 6MMY19. The revenues from ethanol segment reached to PKR 2,206mln in 6MMY20 (MY19: PKR 3,952mln) due to high demand in the export market during Covid-19.

Margins The Company has experienced the rise in its gross margins despite the decline in the Company's topline. Gross margins (6MMY20:18.5%, MY19:15.9%) have improved due to higher prices of sugar and ethanol despite the increase in raw material cost. Consequently, operating margin (6MMY20:11.8%, MY19:11.2%) has also improved during the 6MMY20. Net margin has experienced a significant decline and reach to 0.7% (MY19: 5%). This decline is mainly due to the higher finance cost (6MMY20: PKR 490mln, MY19: PKR 887mln). Hunza Sugar reported a net income of PKR 31mln during 6MMY20 (MY19: PKR 630mln)

Sustainability High sugar price in the local market and robust demand of ethanol in the export market during Covid-19 tends to bode well for the Company. However, the Company is exposed to volatility and ensuing challenges in the sugar sector.

Financial Risk

Working Capital In 6MMY20, net working capital days increased to 430 days (MY19: 15 days) due to the high inventory held days (6MMY20:427days, MY19:9 days). Currently, the Company is holding significant inventory in its stock pile that is yet to be off loaded. However, strict working capital discipline is required to improve the borrowing cushion at trade and total asset level.

Coverages The Company's interest coverages posted a dip (6MMY20:1.4x , MY19: 2.7x) due to the significant increase in short term borrowing (6MMY20: PKR 11.3bln, MY19: PKR 5.1bln) and decline in free cash flows (6MMY20: PKR 678mln, MY19: PKR 2,199mln) of the Company. Similarly, core and total interest cover deteriorated due to increased utilization of short term borrowing limit.

Capitalization The Company's capital structure is highly leveraged with debt to equity of 81% in 6MMY20 (MY19: 70%). This increase was mainly due to increase in total borrowing (6MMY20: PKR 12.5bln, MY19: PKR 6.2bln). Short term borrowing (90%) is the major component of total borrowings of the Company and are obtained to fund the working capital requirement during the crushing period..

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Hunza Sugar Mills (Pvt.) Limited	Mar-20	Sep-19	Sep-18	Sep-17	Sep-16
Sugar	6M	12M	12M	12M	3M
A BALANCE SHEET					
1 Non-Current Assets	5,428	5,400	5,198	4,634	4,129
2 Investments	444	464	-	-	-
3 Related Party Exposure	921	394	201	122	113
4 Current Assets	12,647	4,817	5,782	6,170	1,941
a Inventories	*9,645*	*866*	*2,524*	*4,270*	*867*
b Trade Receivables	*600*	*561*	*247*	*251*	*-*
5 Total Assets	19,440	11,075	11,181	10,926	6,182
6 Current Liabilities	2,879	839	1,140	802	505
a Trade Payables	*1,792*	*420*	*786*	*399*	*38*
7 Borrowings	12,552	6,248	6,692	6,765	2,470
8 Related Party Exposure	906	913	906	881	1,027
9 Non-Current Liabilities	-	3	-	-	-
10 Net Assets	3,103	3,072	2,443	2,478	2,180
11 Shareholders' Equity	3,103	3,072	2,443	2,478	2,180
B INCOME STATEMENT					
1 Sales	4,110	12,594	12,041	8,866	8,751
a Cost of Good Sold	*(3,350)*	*(10,594)*	*(11,325)*	*(7,819)*	*(8,148)*
2 Gross Profit	761	2,000	717	1,047	603
a Operating Expenses	(277)	(589)	(653)	(457)	(371)
3 Operating Profit	484	1,410	64	591	233
a Non Operating Income or (Expense)	*37*	*241*	*409*	*89*	*536*
4 Profit or (Loss) before Interest and Tax	521	1,651	473	680	769
a Total Finance Cost	*(490)*	*(887)*	*(481)*	*(378)*	*(366)*
b Taxation	*-*	*(134)*	*(27)*	*(3)*	*70*
6 Net Income Or (Loss)	31	630	(35)	298	473
C CASH FLOW STATEMENT					
a Free Cash Flows from Operations (FCFO)	*673*	*2,199*	*661*	*979*	*1,087*
b Net Cash from Operating Activities before Working Capital Changes	*339*	*1,397*	*177*	*715*	*780*
c Changes in Working Capital	*(6,413)*	*120*	*847*	*(3,978)*	*51*
1 Net Cash provided by Operating Activities	(6,074)	1,517	1,024	(3,263)	831
2 Net Cash (Used in) or Available From Investing Activities	(170)	(1,043)	(950)	(905)	(360)
3 Net Cash (Used in) or Available From Financing Activities	6,297	(488)	(54)	4,149	(450)
4 Net Cash generated or (Used) during the period	53	(13)	21	(19)	21
D RATIO ANALYSIS					
1 Performance					
a Sales Growth (for the period)	-52.5%	336.5%	--	--	--
b Gross Profit Margin	18.5%	15.9%	6.0%	11.8%	6.9%
c Net Profit Margin	0.7%	5.0%	-0.3%	3.4%	5.4%
d Cash Conversion Efficiency (EBITDA/Sales)	16.6%	18.6%	6.7%	12.0%	13.1%
e Return on Equity (ROE)	1.3%	81.6%	-5.8%	48.2%	86.8%
2 Working Capital Management					
a Gross Working Capital (Average Days)	499	17	21	47	N/A
b Net Working Capital (Average Days)	430	15	15	42	N/A
c Current Ratio (Total Current Assets/Total Current Liabilities)	4.4	5.7	5.1	7.7	3.8
3 Coverages					
a EBITDA / Finance Cost	1.4	2.8	1.8	2.8	3.2
b FCFO / Finance Cost+CMLTB+Excess STB	0.4	2.0	0.9	1.8	2.2
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	12.9	0.5	3.4	0.9	0.7
4 Capital Structure (Total Debt/Total Debt+Equity)					
a Total Borrowings / Total Borrowings+Equity	81.3%	70.0%	75.7%	75.5%	61.6%
b Interest or Markup Payable (Days)	254.8	32.5	44.2	53.0	26.2
c Average Borrowing Rate	6.3%	46.1%	23.5%	19.6%	41.3%

Credit Rating

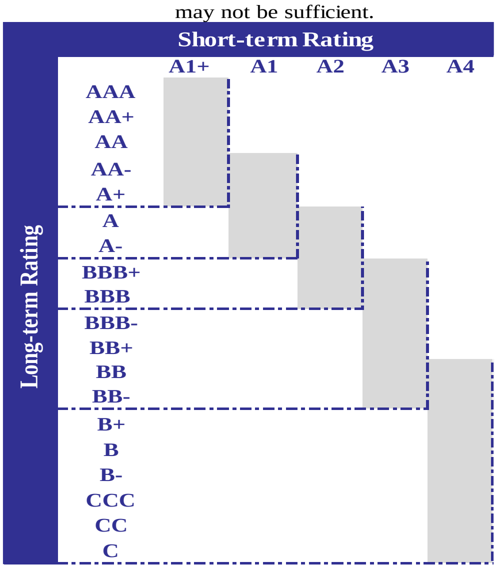
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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

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**
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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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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)
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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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(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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