



The Pakistan Credit Rating Agency Limited

Rating Report

Mehran Sugar Mills Limited

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Rating History

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

Rating Rationale and Key Rating Drivers

The Ratings reflect Mehran Sugar's strong business profile emanating from consistently high recovery rates (highest in the country in MY18), diversified revenue stream and robust governance framework. To mitigate risks associated with seasonality and volatility in the sugar industry, the Company's profitability is supported through a strategic joint venture investment in 'Unicol Limited', an ethanol production company, and sale of electricity generation. Of late, the Company has made investments in the FMCG sector in a similar joint venture, 'UniFoods Industries Limited', and investments in the energy sector through its wholly-owned subsidiary, 'Mehran Energy Limited'. However, income from these avenues are not expected anytime soon. The Ratings draw comfort from Mehran Sugar's ability to maintain healthy margins despite volatility in the sugar industry and a sizable liquid investment portfolio. The Company's financial risk profile is characterized by a leveraged capital structure and adequate coverages and working capital management.

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

Disclosure

Name of Rated Entity	Mehran Sugar Mills Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Corporate Ratings(Jun-18),Methodology Criteria Rating Modifier(Jun-18),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
Related Research	Sector Study Sugar(Apr-19)
Rating Analysts	Adnan Dilawar adnan@pacra.com +92-42-35869504

Profile

Legal Structure Mehran Sugar Mills Limited (the Company) is a public limited company listed on the Pakistan Stock Exchange.

Background The Company was established in 1965 and was listed on the Karachi Stock Exchange in 1968. It began with production capacity of 1,500 TCD. The Company increased capacity to 3,500 TCD and installed a second unit, Tandem B, in 1994. Mehran Sugar entered in strategic partnership with other sugar companies in 2004 to establish a jointly operated distillery under the banner 'Unicol Limited'. Unicol has ethanol production capacity of 200,000 liters/day.

Operations The Company is primarily engaged in the production and sale of white sugar, brown sugar and ancillary products. It's mill is located in Deh Daro Sutha, District Tando Allahyar, over an area of 127 Acres having an installed capacity of 12,500 TCD. The Company has made sizeable strategic investments in companies that are involved in ethanol, CO₂, bagasse based power plant and FMCG sectors in the form of joint venture companies and wholly owned investments. It also maintains an investment portfolio of ~PKR 1bln (1QMY19). Mehran Sugar has the capacity to produce 14 MW of electricity. Excess power is sold to HESCO at NEPRA approved tariff. The Company's registered office is located in Clifton, Karachi.

Ownership

Ownership Structure Majority shareholding rests with individuals of Hasham Family (76%) ('Hasham Group'). Shareholding is divided among families of three brothers, Mr. M. Kasim Hasham (30%), Mr. M. Ebrahim Hasham (28%) and Mr. M. Hussain Hasham (18%). The remaining shareholding belongs to general public and other corporations.

Stability Ownership is seen as stable as the Company's controlling interest vests with one Group. Each family within the Group holds a defined share in the Company.

Business Acumen Mehran Group started its first business enterprise in 1930s with Mr. Haji Hasham trading in commodities. Mehran Sugar was incorporated in 1965 that continued as a single business enterprise. In 2004, Hasham Group entered the Ethanol segment through Unicol Limited. The Group has lately ventured into FMCG sector, again through a joint venture 'UniFoods Limited'. Other prominent Group entities include Pakistan Molasses Company (Pvt.) Ltd and Mogul Tobacco Company (Pvt.) Ltd.

Financial Strength During MY18, Mehran Sugar alone had a consolidated asset base of PKR 6.8bln which is supported by an equity base of PKR 2.6bln. Consolidated debt stands at PKR 2.9bln. Moreover, It achieved consolidated turnover of PKR 4.8bln with a bottom-line of PKR 407mln. Mehran Sugar together with other entities of the Group give sufficient strength to the Company to support it times of stress.

Governance

Board Structure The BoD comprises eight individuals, which include two executive members, four non- executive members and two independent Directors.

Members' Profile Members have significant experience in the sugar industry which is balanced by an adequate mix of business, financial, legal and marketing experts. Mr. M. Kasim Hasham, Chairman of the BoD, has significant experience in the sugar and packaging industry. Mr. Amjad Waheed, CEO NBP Funds, and Mr. Mohammad Bashir, an industrialist by profession, serve as independent Directors on Board.

Board Effectiveness During the year four meetings were convened among Board members with high attendance of members. Additionally, the Board has formed two committees to monitor effectiveness, namely, the Human Resources and Remuneration Committee and the Audit Committee.

Financial Transparency EY Ford Rodhes Chartered Accountants, classified in category 'A' by the SBP, with a satisfactory QCR rating are the external auditors of the Company. They have expressed an unqualified opinion on the financial statements of the Company for the year ending in September, 2018.

Management

Organizational Structure Organizational structure is split between the head office and production site. All functions at site are headed by resident director. CFO, Resident Director & Director Cane/ Development report directly to the Managing Director. The Company is headed by the Managing Director under the oversight of the CEO.

Management Team Senior management has long association with Mehran Sugar adding the required experience in sugar industry and their respective fields.

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

MIS Mehran Sugar has deployed an in-house system which has a Sugar Cane Management module, Store Management module and HR module. These are all integrated with the accounting systems which is also developed in-house. In line with operations, the Company could upgrade its ERP software. Further, Mehran Sugar has installed Investment Portfolio Management System to ensure effective oversight of its short-term investments.

Control Environment Mehran Sugar has a sufficiently staffed in-house internal audit department that reports directly to the Board's Audit Committee.

Business Risk

Industry Dynamics Pakistan is the 6th largest country in the world in terms of area under sugarcane cultivation. The sugar industry in Pakistan is the 2nd largest agro based industry comprising ~90 sugar mills with annual crushing capacity estimated between 65 – 70 million tons. During MY19, sugar production is estimated around 5.5mln MT, coming down from 6.5mln MT in the preceding year.

Relative Position Owing to the high number of players in the industry, market players relatively have low share. During MY18, the Company had a ~1.8% share in total sugar production.

Revenues The Company generates its revenue from the sale of sugar and ensuing by-products. Bulk of sales revenue emanated from export sales in MY18, accounting for 56% of total revenue. Total revenue during MY18, contracted by ~13% and stood at PKR 4,791mln (MY17: PKR 5,501mln). Declining sales are a factor of lower domestic sales owing to depressed market prices and a persistent supply glut. On the other hand, export sales registered an increase of ~67% in light of attractive subsidies offered by the federal and provincial governments. Revenue during 1QMY19 remained stagnant as compared to 1QMY18. During the quarter the Company posted revenues worth ~PKR 1,151mln, depicting an increase of ~2%, YoY.

Margins The Company witnessed significant improvement in profitability during MY18 owing to government subsidies on export, improved sucrose recovery rate and a reduction in the minimum support price for sugarcane in Sindh. As a result, gross margin improved to ~12% (MY17: 5%), while operating margin stood at ~4% in MY18 (MY17: -1%). Higher proceeds from the Company's strategic investment in Unicol Limited, helped boost net profit to ~PKR 413mln in MY18 (MY17: PKR 132mln) with net profit margin at ~9% (MY17: 2%). The Company maintained strong business performance in 1QMY19 through improved margins supported by a slight recovery in domestic sugar prices, increased prices of by-products and higher proceeds from its strategic investment. Gross margin stood at ~14% during the quarter (1QMY18: -5%) with operating margin at ~8% (1QMY18: -12%). Subsequently, net profit margin stood at ~9% in 1QMY19, coming up from -7% in the preceding period.

Sustainability Going forward, the Company plans on enhancing business performance through efficiency in operations.

Financial Risk

Working Capital Working capital days remained elevated owing to a significant pile of sugar stock and outstanding subsidy receivable from the federal government. Net working capital days increased to 95 days during MY18 (MY17: 54 days). However, unloading of short-term borrowings during 1QMY19, improved short-term trade leverage. Additionally, net working capital days during 1QMY19 stood at 85 days.

Coverages Coverages during MY18 registered an improvement on the back of better profitability. A significant increase in FCFO with only a nominal change in finance costs helped interest and core coverage during MY18 improve to 2.2x and 1.0x, respectively from 0.1x, for both ratios, in MY17. The situation improved further during 1QMY19 with interest coverage and core coverage elevating to 3.0x and 1.4x, respectively.

Capitalization The Company has a significantly leveraged capital structure represented by a debt-to-equity ratio of ~42% during 1QMY19. Majority of debt taken up is short-term in nature, representing 63% of the debt mix. During the quarter, total borrowings declined by ~35% or ~PKR 1,047mln standing at ~PKR 1,908mln. Reduced leveraging was primarily brought about by a reduction in short-term borrowings which witnessed a decline of 51% during the quarter.



Mehran Suagr Mills Limited Listed Public Limited				
BALANCE SHEET	Dec-18 3M	Sep-18 12M	Sep-17 12M	Sep-16 12M
a Non-Current Assets	2,220	2,169	2,189	1,954
b Investments (Incl. Associates)	2,344	2,449	1,808	1,871
Equity Instruments	2,344	2,449	1,808	1,871
c Current Assets	2,088	2,216	1,725	692
Inventory	1,091	1,167	1,223	456
Trade Receivables	36	131	175	11
Others	961	920	328	229
d Total Assets	6,652	6,834	5,723	4,517
e Debt/Borrowings	1,908	2,955	1,778	509
Short-Term	960	1,967	1,117	-
Long-Term (Incl. Current Maturity of Long-Term Debt)	948	988	661	509
Other Short-Term Liabilities	1,680	858	1,248	1,168
Other Long-Term Liabilities	421	412	478	517
f Shareholder's Equity	2,644	2,609	2,218	2,323
g Total Liabilities & Equity	6,652	6,834	5,723	4,517
INCOME STATEMENT				
a Turnover	1,151	4,791	5,501	7,113
b Gross Profit	155	590	268	743
c Net Other Income	90	389	146	150
d Financial Charges	(56)	(212)	(197)	(98)
e Net Income	108	413	131	542
CASH FLOW STATEMENT				
a Free Cash Flow from Operations (FCFO)	154	425	23	675
b Total Cashflows (TCF)	154	650	23	698
c Net Cash changes in Working Capital	954	(877)	(928)	419
d Net Cash from Operating Activities	1,044	(422)	(1,078)	1,016
e Net Cash from Investing Activities	(6)	(741)	17	(658)
f Net Cash from Financing Activities	(1,047)	1,150	1,055	(370)
g Net Cash generated during the period	(9)	(13)	(6)	(11)
RATIO ANALYSIS				
a Performance				
Turnover Growth	-4%	-13%	-23%	63%
Gross Margin	13%	12%	5%	10%
Net Margin	9%	9%	2%	8%
ROE	16%	17%	6%	26%
b Coverages				
Debt Service Coverage (X) (FCFO/Gross Interest+CMLTD+Uncovered STB)	1.4	1.0	0.1	2.4
Interest Coverage (X) (FCFO/Gross Interest)	3.0	2.2	0.1	7.0
Debt Payback (Years) (Total Debt (excluding Covered Short Term Borrowings) / FCFO)	2.3	4.3	-4.0	0.9
c Working Capital Management				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	85	95	54	96
d Capital Structure (Total Debt/Total Debt+Equity)	42%	53%	44%	18%
Mehran Suagr Mills Limited				
May-19				

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		Short Term Ratings	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
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.	A1	A strong capacity for timely repayment.
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.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial 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.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
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.	C	An inadequate capacity to ensure timely repayment.
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.		



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 surveil the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

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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.
- (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)
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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)
- (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)

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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)

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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