The Pakistan Credit Rating Agency Limited

Rating Report

Noon Sugar Mills Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-Sep-2020	BBB+	A2	Stable	Upgrade	-
07-Nov-2019	BBB	A2	Stable	Maintain	-
08-May-2019	BBB	A2	Stable	Maintain	-
12-Nov-2018	BBB	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Pakistan's sugar industry is the 2nd largest agro based industry after textile, comprising ~ 90 mills with annual crushing capacity estimated around 65 – 75 mln MT. It contributes about 0.6% to GDP and 2.9% of total value addition in agriculture. In previous years, the industry was under pressure owing to over supply combined with challenges in the support price mechanism. Additionally, a slowdown in international sugar prices made exports viable only through subsidy support. Government approved an export quota upto 1 MMT, however, no subsidy was announced. Consequently, zero exports were reported in August 2020 (August 2019: ~USD 5mln). During MY20, sugar production declined by ~9% YoY and clocked in at ~4.8MT (MY19: ~5.27MT), owing to reduction in the area under cultivation and water scarcity. Sugar prices improved in local market as inventory levels reduced. Due to low crop availability in the crushing period ended Mar-20. The Government increased the support price of sugarcane to PKR 190 per maund (previously PKR180). Actual realized sugarcane price at mill gate were higher. Despite increase in costs, higher local sugar prices have improved miller's profitability.

The ratings reflects Noon Sugar Mills Limited ('Noon Sugar' or 'the Company') diverse revenue stream, comprising the sale of sugar and allied products, electricity and ethanol. This provides a competitive advantage to the Company and mitigates volatility and industry specific risks. Relatively lower sugarcane availability in MY20 and higher procurement cost has resulted in rising sugar prices in local market and led to better profits from sugar segment. The Company has displayed significant improvement in margins through support of distillery operations. It underwent capacity enhancement in MY19, expanding its distillery production capacity by 50,000 MT. Raw material supply remained constrained; however, strong demand for ethanol, during Covid-19, led to significant improvement in capacity utilization. Going forward, the Company aims to focus on improving efficiency through BMR. The financial profile of Noon Sugar remains adequate, characterized by improved working capital management, strong coverages and adequately leveraged capital structure. Sponsors support and strengthening the governance structure provides comfort to ratings.

The ratings are dependent on sustaining business margins, while maintaining strong financial risk profile. Any deterioration to topline, margins or cash flows will impact the ratings negatively. Meanwhile, improvement in capital structure will be favourable for the ratings.

Disclosure

Name of Rated Entity	Noon Sugar Mills Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-20),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria | Rating Modifier(Jun-20)
Related Research	Sector Study | Sugar(Dec-19)
Rating Analysts	Faiqa Qamar | faiqa.qamar@pacra.com | +92-42-35869504

Profile

Legal Structure Noon Sugar Mills Limited (the Company) is a public listed company.

Background The Company was incorporated in 1964 and started its production operations in 1966, initially having a crushing capacity of 1,500 TCD. Additionally, it operates a distillery, which commenced operations in 1986, with a production capacity of 50,000 litres/day.

Operations The Company has its head office located in Lahore, whereas, the mill is located in Bhalwal, Sargodha. The rated crushing capacity of the mill stands at 10,000 TCD and the distillery has an installed capacity of 130,000 liters. During MY20, the Company witnessed a decline of 16% in sugar production, which stood at 52,788 MT. Decline is attributable to reduction in area under cultivation and water scarcity. Moreover, a decline in recovery rates was observed, standing at 9.71% in MY20 (MY19: 10.01%). During MY20, the Company has produced 24,321 MT (MY19: 28,800MT) of Molasses, reflecting a decline in production of ~15%.

Ownership

Ownership Structure Majority of the shareholding lies with the Noon Family, who hold a 62% stake in the company. The family holds 57% directly through Ms. Tahia Noon and Mr. Salman Hayat Noon, whereas, 5% is held indirectly through Noon Industries limited, an associated company. Remaining shareholding is split between public institutions and the general public.

Stability Ownership structure of the Company is seen as stable as no major ownership changes are expected. Sponsors are inducting next generation in business.

Business Acumen The Company is a part of Noon Group which comprises a total of four companies. Other group companies are involved trading services, with no significant asset base. The group previously used to own and operate Noon Pakistan, most famous for its brand ‘nurpur’. However, major shareholding of the company was sold off to Fauji Foundation Limited (FFL). The main sponsors now only holds an 11% stake in FFL, whereas, Fauji Foods operates the brand ‘nurpur’.

Financial Strength With the exception of Noon Sugar Mills, majority of the companies are involved in trading which provide indenting services relating to the textile industry. Noon Sugar Mills is seen as the main company in the group since other companies do not generate sufficient revenues and have an insignificant asset base.

Governance

Board Structure The Company’s Board comprises of seven members. It includes the Chairman (Mr. K. Iqbal Talib), two executive directors (including CEO), two non-executive directors and two independent directors.

Members’ Profile The Company’s Board represents a good skill mix which comprises members who have extensive experience in the sugar industry. It is further aided by the independent directors who specialize and provide insight on legal and financial matters.

Board Effectiveness The Company has three Board committees in place, namely, Human Resources and Remuneration Committee, Technical Committee and Audit Committee. All committees must comprise at least three members of the board. Meetings are called when deemed fit, however, the Audit Committee must meet at least once each quarter. During MY20, six meetings of Board of Directors were held, with high attendance of members.

Financial Transparency Shinewing Hameed Chaudri Company, Chartered Accountants, are the external auditors of the Company. They gave an unqualified opinion on financial statements of the Company ending in September, 2019. The firm is QCR rated by ICAP and is classified in Category 'B' in the panel of auditors by SBP.

Management

Organizational Structure Noon Sugar Mills has a well-defined organizational structure that has various layers of management. All department heads are reportable to General Manager Operations, who along with the Chief Executive Officer, Manager Tax and Commercial Manager are Reportable to the Chief Operating Officer. Subsequently, highest level of authority lies with the Chief Executive.

Management Team Lt. Col. (R) Abdul Khaliq Khan (CEO) served in the military for 25 years. He has been associated with the Group from last 18 years. He holds Master’s Degree in International Relations. Other members of management are also well qualified with ample experience.

Effectiveness The Company has no management committees in place. However, management accounts are discussed among the management to review monthly activity.

MIS Recently, the management implemented ERP system, which integrates major disciplines like cane accounts, general accounts and HR for efficient management.

Control Environment The Company recently developed its internal audit department which has basic internal controls required to ensure compliance and efficiency. However, room for improvement exists, as the Company needs to further develop and strengthen its control mechanism.

Business Risk

Industry Dynamics Pakistan’s sugar industry is the 2nd largest agro based industry after textile, comprising ~ 90 mills with annual crushing capacity estimated around 65 – 75 mln MT. It contributes about 0.6% to GDP and 2.9% of total value addition in agriculture. In previous years, the industry was under pressure owing to over supply combined with challenges in the support price mechanism. Additionally, a slowdown in international sugar prices made exports viable only through subsidy support. Government approved an export quota upto 1 MMT, however, no subsidy was announced. Consequently, zero exports were reported in August 2020 (August 2019: ~USD 5mln). During MY20, sugar production declined by ~9% YoY and clocked in at ~4.8MT (MY19: ~5.27MT), owing to reduction in the area under cultivation and water scarcity. Sugar prices improved in local market as inventory levels reduced. Due to low crop availability in the crushing period ended Mar-20. The Government increased the support price of sugarcane to PKR 190 per maund (previously PKR180). Actual realized sugarcane price at mill gate were higher. Despite increase in costs, higher local sugar prices have improved miller's profitability.

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

Revenues The Company generates revenue from two segments: Sugar (61%) and Distillery (39%). The Company posted net revenue worth ~PKR 4,193mln (9MMY19: ~PKR 4,579mln), reflecting a decline of ~8%. This decline emanates from lower sugar sales which fell by 23%, YoY, and stood at ~PKR 2,845mln (9MMY19: ~PKR 3,722mln), owing to a reduction in the area under cultivation and water scarcity. Meanwhile, revenues from distillery segment improved significantly by ~56% in 9MMY20. The segment posted net revenue worth ~PKR 1,811mln (9MMY19: ~PKR 1,164mln) supported by increased consumption of ethanol-based products in the wake of the COVID-19 outbreak.

Margins During 9MMY20, the gross margin of the sugar segment increased to ~8% (9MMY19: ~5%) due to high sugar prices. Meanwhile gross margin of distillery segment decreased to ~32% (9MMY19: ~39%) due to high raw material costs owing to restricted supply; however, remains high. Resultantly, overall gross margin improved to ~20% (9MMY19: ~14%), supported by increased sugar prices and higher share of distillery segment in topline compared to preceding period. Similarly, operating margin increased to ~13% (9MMY19: ~9%) due to trickle-down effect. Although, other income of the Company deteriorated, net margin remained strong and stood at ~5% (9MMY19: ~4%). The Company posted a net income of ~PKR 202mln (9MMY19: PKR 163mln)

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 During 9MMY20, net working capital days deteriorated to 148 days (9MMY19: 130 days) on the back of both; elongated inventory cycle (9MMY20: 124 days, 9MMY19: 116 days) and receivable cycle (9MMY20: 38 days, 9MMY19: 28 days). However, the short term trade leverage (9MMY20: 10.4%, 9MMY19: -11.4%) improved on the back of higher trade assets, eliminating the asset-liability mismatch.

Coverages During 9MMY20, the FCFO of the Company remained strong and increased to ~PKR 600mln (9MMY19: ~PKR 533mln) due to better profitability. Meanwhile, finance cost witnessed an increase of ~7% and clocked in at ~PKR 276mln (9MMY19: ~PKR 258mln) due to higher borrowings. As a result, the interest coverage ratio remained stable at 2.2x (9MMY19: 2.1x). Meanwhile, the debt coverage ratio improved to 2.2x (9MMY19: 1.0x) as the Company has availed deferment facility of SBP on its long-term debt.

Capitalization Noon Sugar has a highly leveraged capital structure, represented by a leverage ratio of ~76% at the end Jun-20 (9MMY19: ~79%). Majority of debt (~81%) comprises short-term borrowings to meet the working capital requirements. Total borrowings stood at PKR 3,465mln (9MMY19: ~PKR 3,311) in 9MMY20, with an increase of ~5%, YoY. This includes PKR 450mln of loan given by Mr. Adnan Hayat Noon to fund the working capital requirement.

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Financial Summary
PKR mln

Noon Sugar Mills Ltd.	Jun-20	Sep-19	Jun-19	Sep-18	Sep-17
Sugar and Allied	9M	12M	9M	12M	12M
A BALANCE SHEET					
1 Non-Current Assets	1,491	1,485	1,470	1,363	1,129
2 Investments	8	8	8	8	8
3 Related Party Exposure	-	-	-	-	-
4 Current Assets	3,812	2,719	3,419	2,610	2,865
a Inventories	*2,657*	*1,147*	*1,894*	*1,998*	*2,153*
b Trade Receivables	*495*	*680*	*896*	*40*	*132*
5 Total Assets	5,311	4,211	4,897	3,980	4,002
6 Current Liabilities	712	556	674	501	666
a Trade Payables	*209*	*226*	*298*	*189*	*168*
7 Borrowings	3,015	2,680	3,311	2,693	2,705
8 Related Party Exposure	450	-	-	-	-
9 Non-Current Liabilities	53	46	50	44	39
10 Net Assets	1,081	929	862	742	592
11 Shareholders' Equity	1,081	929	862	742	592
B INCOME STATEMENT					
1 Sales	4,193	5,671	4,579	6,273	4,836
a Cost of Good Sold	*(3,377)*	*(4,806)*	*(3,943)*	*(5,562)*	*(4,264)*
2 Gross Profit	817	865	636	711	572
a Operating Expenses	(269)	(267)	(210)	(240)	(218)
3 Operating Profit	548	598	426	472	354
a Non Operating Income or (Expense)	*(14)*	*15*	*10*	*50*	*41*
4 Profit or (Loss) before Interest and Tax	534	613	436	522	395
a Total Finance Cost	*(276)*	*(341)*	*(258)*	*(252)*	*(205)*
b Taxation	*(56)*	*(47)*	*(15)*	*(59)*	*(46)*
6 Net Income Or (Loss)	202	225	163	211	144
C CASH FLOW STATEMENT					
a Free Cash Flows from Operations (FCFO)	*600*	*728*	*533*	*580*	*458*
b Net Cash from Operating Activities before Working Capital Changes	*352*	*400*	*330*	*358*	*304*
c Changes in Working Capital	*(925)*	*(52)*	*(627)*	*(206)*	*(1,775)*
1 Net Cash provided by Operating Activities	(573)	348	(298)	152	(1,472)
2 Net Cash (Used in) or Available From Investing Activities	(126)	(281)	(218)	(347)	(227)
3 Net Cash (Used in) or Available From Financing Activities	736	(55)	576	(69)	1,981
4 Net Cash generated or (Used) during the period	36	13	60	(264)	283
D RATIO ANALYSIS					
1 Performance					
a Sales Growth (for the period)	-1.4%	-9.6%	-2.7%	29.7%	86.8%
b Gross Profit Margin	19.5%	15.3%	13.9%	11.3%	11.8%
c Net Profit Margin	4.8%	4.0%	3.6%	3.4%	3.0%
d Cash Conversion Efficiency (EBITDA/Sales)	15.8%	13.5%	12.1%	9.9%	10.2%
e Return on Equity (ROE)	26.8%	27.0%	27.1%	31.6%	27.3%
2 Working Capital Management					
a Gross Working Capital (Average Days)	163	124	144	126	104
b Net Working Capital (Average Days)	148	111	130	115	91
c Current Ratio (Total Current Assets/Total Current Liabilities)	5.4	4.9	5.1	5.2	4.3
3 Coverages					
a EBITDA / Finance Cost	2.5	2.3	2.2	2.7	2.6
b FCFO / Finance Cost+CMLTB+Excess STB	2.2	1.1	1.0	1.0	1.2
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	1.5	1.3	1.5	1.7	1.9
4 Capital Structure (Total Debt/Total Debt+Equity)					
a Total Borrowings / Total Borrowings+Equity	76.2%	74.3%	79.3%	78.4%	82.0%
b Interest or Markup Payable (Days)	101.2	80.6	133.1	107.2	109.8
c Average Borrowing Rate	11.6%	12.3%	11.2%	8.6%	11.1%

Credit Rating

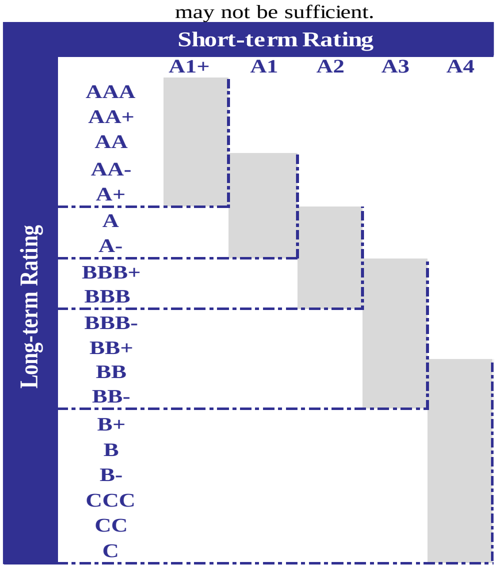
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short-term Rating

Scale	Definition
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

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

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

Entities
a) Broker Entity Rating
b) Corporate Rating
c) Financial Institution Rating
d) Holding Company Rating
e) Independent Power Producer Rating
f) Microfinance Institution Rating
g) Non-Banking Finance Companies (NBFCs) Rating

Instruments
a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk Rating

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**
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