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-2021	BBB+	A2	Stable	Maintain	-
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 country's 2nd largest agro-based industry, comprising 90 mills with an annual crushing capacity estimated ~65–70mln MT. The industry is trying to overcome the supply challenges. However, support price, set by considering the cost incurred by farmers, remains a constraint. During MY21, the overall sugar production increased by 15%, YoY, to 5.6mln MT (MY20: 4.9mln MT) due to better crop availability and an increase in area under cultivation. The recent surge in local sugar prices was registered by the demand-supply gap. Previously, the sales tax levied on sugar was increased to 17% (previously 8%,) charged on the PKR 60/KG price, which contributed to higher prices. In the FY21 budget, a sales tax of 17% was proposed to be levied on the market retail price instead of PKR 60/kg. However, Government has allowed not to charge sales tax on market retail price till Nov-21. Currently, 17% sales tax is levied on PKR 72.22/kg. Moreover, in MY21 crushing season, the Government increased the support price of sugarcane to PKR 200 per maund (previously, it was increased to PKR 190 from PKR 180 per maund). Actual realized sugarcane prices at the mill gate were even higher. To meet the local demand and curb the hike in sugar prices, the Government planned to import 0.8mln MT of sugar. Out of this, 0.3mln MT has already been imported, till Jun-21. Lately, TCP approved to import another 0.1mln MT of sugar. Going forward, despite higher input costs, higher sugar prices are expected to remain favorable for millers.
The ratings reflect Noon Sugar Mills Limited ('Noon Sugar' or 'the Company') diverse revenue stream, comprising the sale of sugar and ethanol. This provides a competitive advantage to the Company and mitigates volatility and industry specific risks. Despite higher cane costs, the Company benefitted from inflated sugar prices in the local market. However, the margins deteriorated owing to lower profits from the distillery division. 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 provide comfort to ratings.

The ratings are dependent on sustaining business margins, while maintaining stable financial risk profile. Any deterioration to revenue, margins, and/or cashflows will impact the ratings negatively. Meanwhile, improvement in capital structure will benefit 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 Rating(Jun-21),Criteria | Correlation Between Long-term & Short-term Rating Scales(Jun-21),Criteria | Rating Modifiers(Jun-21)
Related Research	Sector Study | Sugar(Dec-20)
Rating Analysts	Faiqa Qamar | faiqa.qamar@pacra.com | +92-42-35869504

Profile

Legal Structure Noon Sugar Mills Limited ('Noon Sugar Mills' or '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 12,000 TCD and the distillery has an installed capacity of 130,000 liters. During MY21, the Company witnessed a significant increase of ~57% in sugar production, which stood at 82,710 MT. Growth in sugar production is attributable to higher cane availability. Meanwhile, a slight decline in recovery rates was observed, standing at 9.6% in MY21 (MY20: 9.71%). During MY21, the Company has produced 19,369 MT (MY20: 14,680) of Ethanol, depicting a growth in production of ~32%.

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 financial 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), one executive director (CEO), three 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

Financial Transparency Shinewing Hameed Chaudhri & Company, Chartered Accountants, are the external auditors of the Company. They gave an unqualified opinion on financial statements of the Company ending in September, 2020. 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 the Chief Executive Officer. Subsequently, the key man's risk lies with the Chief Executive Officer.

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 Management accounts and many other technical matters, such as cane procurement vicinity and related costs, are discussed among the management on a frequent basis.

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

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

Business Risk

Industry Dynamics Pakistan’s sugar industry is the country's 2nd largest agro-based industry, comprising 90 mills with an annual crushing capacity estimated ~ 65 – 70mln MT. The industry is trying to overcome the supply challenges. However, support price, set by considering the cost incurred by farmers, remains a constraint. During MY21, the overall sugar production increased by 15%, YoY, to 5.6mln MT (MY20: 4.9mln MT) on the back of better crop availability and an increase in area under cultivation. The recent surge in local sugar prices was registered by the demand-supply gap. Previously, the sales tax levied on sugar was increased to 17% (previously 8%,) charged on the PKR 60/KG price, which contributed to higher prices. In the FY21 budget, a sales tax of 17% was proposed to be levied on the market retail price. Currently, 17% sales tax is levied on PKR 72.22/kg. However, Government has allowed not to charge sales tax on market retail price till Nov-21. Moreover, in MY21 crushing season, the Government increased the support price of sugarcane to PKR 200 per maund (previously, it was increased to PKR 190 from PKR 180 per maund). Actual realized sugarcane prices at the mill gate were even higher. To meet the local demand and curb the hike in sugar prices, the Government planned to import 0.8mln MT of sugar. Out of this, 0.3mln MT has already been imported, till Jun-21.

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 ~1.5%.

Revenues The Company has two reportable segments, which are, Sugar (~63%) and Distillery (~37%). During 9MMY21, the Company posted net revenue worth ~PKR 6.7bln (9MMY20: ~PKR 4.2bln), reflecting an increase of ~60%. The decline in revenue emanated from higher sugar and ethanol sales compared to the corresponding period.

Margins During 9MMY21, overall gross profit stood at ~PKR 740mln, depicting a decline of ~9%, YoY, translating into a gross margin of ~11% (9MMY20: ~20%). Decline in gross margin is primarily attributable to significant dip in the profits from distillery division, despite a significant increase in ethanol sales. Similarly, the operating margin deteriorated to ~6% (9MMY20: ~13%) due to trickle-down effect. Finance cost observed a prominent improvement to ~PKR 209mln (9MMY20: ~PKR 276mln). As a result, the net margin stood at ~2% (9MMY20: ~5%).

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 Noon Sugar Mills faces an inherent stress in its working capital due to seasonality in crushing cycle. The company manages its working capital by taking advance payments from their customers, which it uses during the crushing season to purchase sugarcane stock. Any short fall is financed through short-term borrowings, which make up a major portion part of the company’s balance sheet. In 9MMY21, net working capital days witnessed a prominent improvement to 117 days (9MMY20: 148 days) on the back of improved inventory cycle (9MMY21: 97 days, 9MMY20: 124 days) and receivable cycle (9MMY21: 30 days, 9MMY20: 38 days). However, the short-term trade leverage (9MMY21: ~10%, 9MMY20: ~10%) remained at the same level.

Coverages In 9MMY21, the FCFO of the Company declined to ~PKR 484mln (9MMY20: ~PKR 600mln); courtesy of higher profitability. Meanwhile, finance cost observed a prominent improvement to ~PKR 209mln (9MMY20: ~PKR 276mln). As a result, the interest coverage ratio increased to 2.4x (9MMY20: 2.2x). Meanwhile, core and total coverage ratio deteriorated to 1.9x (9MMY20: 2.2x) and 1.9x (9MMY20: 2.2x) due to higher debt repayments.

Capitalization Noon Sugar Mills has a highly leveraged capital structure, represented by a leveraging ratio of ~78% at end Jun-21 (9MMY20: ~76%). Majority of debt is composed of short-term borrowings which are utilized for meeting working capital requirements, accounting for 86% of total debt. Total borrowings stood at PKR 4,498mln (9MMY20: ~PKR 3,465mln) in 9MMY21, an increase of ~30%, YoY.

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Financial Summary
PKR mln

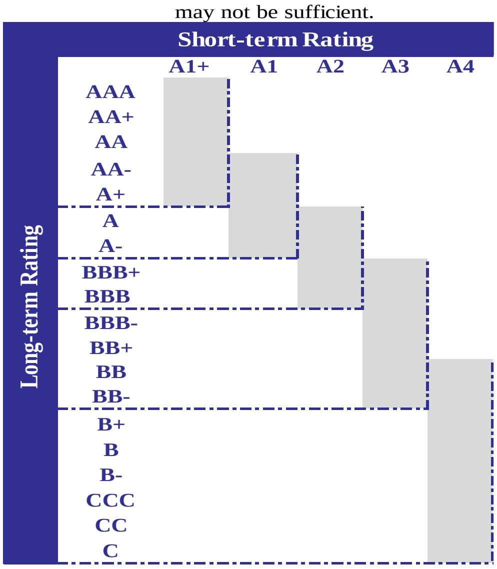
Noon Sugar Mills Limited	Jun-21	Sep-20	Jun-20	Sep-19	Sep-18
Sugar	9M	12M	9M	12M	12M
A BALANCE SHEET					
1 Non-Current Assets	1,528	1,527	1,491	1,485	1,363
2 Investments	16	8	8	8	8
3 Related Party Exposure	-	-	-	-	-
4 Current Assets	5,122	2,739	3,812	2,719	2,610
a Inventories	*3,330*	*1,006*	*2,657*	*1,147*	*1,998*
b Trade Receivables	*803*	*677*	*495*	*680*	*40*
5 Total Assets	6,666	4,273	5,311	4,211	3,980
6 Current Liabilities	873	610	712	556	501
a Trade Payables	*331*	*173*	*209*	*226*	*189*
7 Borrowings	4,064	2,041	3,015	2,680	2,693
8 Related Party Exposure	434	434	450	-	-
9 Non-Current Liabilities	60	56	53	46	44
10 Net Assets	1,236	1,133	1,081	929	742
11 Shareholders' Equity	1,236	1,133	1,081	929	742
B INCOME STATEMENT					
1 Sales	6,727	6,138	4,193	5,671	6,273
a Cost of Good Sold	*(5,987)*	*(5,178)*	*(3,377)*	*(4,806)*	*(5,562)*
2 Gross Profit	740	960	817	865	711
a Operating Expenses	(315)	(329)	(269)	(267)	(240)
3 Operating Profit	425	631	548	598	472
a Non Operating Income or (Expense)	*33*	*27*	*(14)*	*15*	*50*
4 Profit or (Loss) before Interest and Tax	458	658	534	613	522
a Total Finance Cost	*(209)*	*(335)*	*(276)*	*(341)*	*(252)*
b Taxation	*(88)*	*(66)*	*(56)*	*(47)*	*(59)*
6 Net Income Or (Loss)	161	256	202	225	211
C CASH FLOW STATEMENT					
a Free Cash Flows from Operations (FCFO)	*484*	*710*	*600*	*728*	*580*
b Net Cash from Operating Activities before Working Capital Changes	*317*	*362*	*352*	*400*	*358*
c Changes in Working Capital	*(2,102)*	*83*	*(925)*	*(52)*	*(206)*
1 Net Cash provided by Operating Activities	(1,785)	445	(573)	348	152
2 Net Cash (Used in) or Available From Investing Activities	(121)	(198)	(126)	(281)	(347)
3 Net Cash (Used in) or Available From Financing Activities	1,965	(254)	736	(55)	(69)
4 Net Cash generated or (Used) during the period	59	(7)	36	13	(264)
D RATIO ANALYSIS					
1 Performance					
a Sales Growth (for the period)	46.1%	8.2%	-1.4%	-9.6%	29.7%
b Gross Profit Margin	11.0%	15.6%	19.5%	15.3%	11.3%
c Net Profit Margin	2.4%	4.2%	4.8%	4.0%	3.4%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	-24.1%	12.9%	-7.8%	11.9%	6.0%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Shareholders' Equity)]*	21.1%	22.8%	27.8%	24.9%	28.3%
2 Working Capital Management					
a Gross Working Capital (Average Days)	127	107	163	124	126
b Net Working Capital (Average Days)	117	95	148	111	115
c Current Ratio (Current Assets / Current Liabilities)	5.9	4.5	5.4	4.9	5.2
3 Coverages					
a EBITDA / Finance Cost	2.9	2.5	2.5	2.3	2.7
b FCFO / Finance Cost+CMLTB+Excess STB	1.9	2.0	2.2	1.1	1.0
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	1.6	1.6	1.5	1.3	1.7
4 Capital Structure					
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	78.4%	68.6%	76.2%	74.3%	78.4%
b Interest or Markup Payable (Days)	120.1	53.4	101.2	80.6	107.2
c Entity Average Borrowing Rate	6.8%	10.2%	10.9%	11.2%	7.7%

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