The Pakistan Credit Rating Agency Limited

Rating Report

United Ethanol Industries Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
29-Jun-2019	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Pakistan's ethanol industry is largely export based owing to meager domestic consumption. The Country's ethanol exports stood at USD 392mln in FY18, growing steeply by ~39% owing to increased volumes. Prices fetched in the global market have been fluctuating in the recent past, with a decline observed in FY18. However, impact of subdued international ethanol prices was offset to a certain extent by devaluation of the Pakistani Rupee. Bumper sugarcane production in Pakistan in the past couple of years has benefited domestic distilleries through cheaper raw material costs, enhancing profitability. Going forward, margins for the industry is expected to come under pressure in light of increased raw material prices on the back of lower sugarcane production and resulting molasses availability.

The ratings reflect United Ethanol's strong business profile and margins in the ethanol industry. Additionally, the ratings draw strength from the Company's association with United Group, which has an established presence in the Country's sugar and allied industry. The Company's revenue comprises primarily of exports which are made to its developed clientele comprising of a few key entities. Since being acquired by United Group in 2016, the Company has been able to enhance efficiency through effective BMR implementation, yielding positive results while augmenting profitability and maintaining an upward trend. Meanwhile, the Company's financial profile is characterized by high leveraging. However, strong coverages and effective working capital management bodes well for the Company.

Ratings are dependent on the management's ability to effectively maintain margins during foreseen challenges expected to be faced by the ethanol industry. Prudent management of borrowings will be critical for ratings. Any significant increase in debt and/or drag of high advances extended to group concerns, if any, will impact the ratings negatively. Meanwhile, strengthening governance framework remains critical for ratings.

Disclosure	
Name of Rated Entity	United Ethanol Industries 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	Silwat Malik | silwat.malik@pacra.com | +92-42-35869504

Profile

Legal Structure United Ethanol Industries (the Company) is a public unlisted company.

Background The Company was incorporated in October, 2003 and was formerly owned by Etihad Group. The Company was acquired by the Essarani Family in September, 2016 and now forms a part of its group (United Group). The Company was non-operational before acquisition.

Operations The Company has its plant located in Sadiqabad, Rahimyar Khan and is strategically positioned with access to 11 sugar mills within a 100KM radius, including SGM Sugar Mills, a group company. The Company produces Extra Neutral Grade ethanol (~96% v/v ethanol) and B Grade ethanol (~94% v/v ethanol), with installed production standing at 120,000 liters per day. Production mainly comprises of ENA ethanol, accounting for 94% of total output. During sugar marketing year (MY) 2018, the Company produced 45mln liters, an increase of 47% over the preceding year. Subsequently, production for 1HMY19 stood at 20mln liters.

Ownership

Ownership Structure Major shareholding of the Company rests with Essarani Family, through Mr. Deoo Mal Essarani (24%) and his four sons – Mr. Asha Ram (29%), Dr. Tara Chand (24%), Mahesh Kumar (22%) and Mr. Jugdesh Kumar (1%).

Stability Ownership structure of the business reflects stability and no changes are expected in the near future.

Business Acumen Essarani family has been involved in agriculture sector for a significant period of time and operates under 'United Group'. The Group's entities include two sugar mills (Sindh Abadgar's Sugar Mills and SGM Sugar Mills), United Ethanol Industries Limited, Agro Trade Private Limited and United Agro Chemicals.

Financial Strength The Company has adequate financial strength derived from its Group and support of sponsors. At end Sep-18, the Group had total assets worth ~PKR 19bln, supported through an equity base of ~PKR 8bln. The Group posted a net profit worth ~PKR 881mln in Sep-18.

Governance

Board Structure Board of Directors comprises three members including the Chairman, Chief Executive Officer and a Non-Executive Director. The board only consists of the sponsoring family and lacks independence oversight, indicating room for improvement. The sponsors intend to increase the size of the board by inducting an independent director, going forward.

Members' Profile Mr. Deoo Mal Essarani, acts as the Chairman of the Board. He also chairs the Board of two other group companies, Sindh Abadgar's Sugar Mills Limited and SGM Sugar Mills Limited. He has more than 46 years of experience to his name and assumed chairmanship in October, 2016. His son, Mr. Mahesh Kumar, acts as a Non-Executive Director. Mr. Kumar has more than 20 years of experience to his name and serves on the Board of Sindh Abadgar's Sugar Mills Limited as well.

Board Effectiveness During MY18, only one Board meeting was convened among members with meeting minutes being captured formally. However, the Company lacks presence of Board committees.

Financial Transparency Muhammad Ali Hussain & Co. Chartered Accountants, who are not listed on State Bank of Pakistan's panel of auditors but hold a satisfactory QCR rating are the external auditors of the Company. They have expressed a qualified opinion on the financial statements for the year ending in September, 2018. The qualification pertains to legal suit of the previous management and related provisioning. The potential impact on the company is adequately covered.

Management

Organizational Structure The Company's organizational structure reflects clear reporting lines and is split between the production site and head office. Aspects pertaining to operations are headed by GM Factory, whereas, support functions, except for finance, are shared on a group level and are headed by the Group CFO.

Management Team The Company's management comprises experienced and qualified individuals, though haven't been associated with the Company for long. Dr. Tara Chand, the Chief Executive Officer, has more than 15 years of experience in the sugar and allied industry. Additionally, he acts as the Chief Executive for Sindh Abadgar's Sugar Mills and SGM Sugar Mills. He is ably supported by Mr. Ishfaque Ahmed Nizamani (GM Factory) and Mr. Syed Abid Hussain (Group CFO).

Effectiveness The Company has no management committees in place. However, performance is discussed among management on a frequent basis to review activity.

MIS The Company uses an in-house developed module for MIS. Reports pertaining to production and bank positions are generated on Microsoft excel and submitted to senior management on a daily and monthly basis.

Control Environment Oversight and effective management is maintained through the internal audit department which is shared on a group level. Going forward, the group plans to enhance its control environment through induction of additional individuals.

Business Risk

Industry Dynamics Ethanol in Pakistan is manufactured from molasses, which is a by-product of the sugar manufacturing process from sugar cane. Currently, Pakistan's ethanol industry comprises of 19 distilleries, most of which (74%) are set-up in conjunction with a sugar mill. Distilleries in Pakistan are mainly involved in the manufacture of food grade ethanol (>96.4% v/v ethanol). As domestic consumption of ethanol is meager, dominant portion of production is exported. During FY18, total exports grew by ~39% standing at ~PKR 392mln. Increased exports are a factor of high volumes sold due high sugar production and molasses carry over stock.

Relative Position During MY18, the Company exported a total of 41,677,399 liters, accounting for 6% of Pakistan's total ethanol export.

Revenues The Company's revenue stream is export based, accounting for ~97% of total revenue in MY18. Sales revenue during MY18 stood at ~PKR 2,596mln, surging by ~106% over the preceding year. Growth is a factor of higher units sold owing to increased production. During MY18, the Company sold ~45mln liters of ethanol as compared to ~23mln liters in the corresponding year. Moreover, owing to appreciation of the US Dollar, rate fetched in the international market was ~7% higher in MY18. Sales during 1HMY19 remained sluggish, declining by ~2% and totaling to ~PKR 1,480mln. A decline in sales can be traced to lower export sales caused by a reduction in production, amid constrained supply of raw materials.

Margins The Company has maintained a positive trend in margins since change in ownership in MY17. The Company, through efficient operations, has posted higher production yields (4% higher in MY18) while lowering conversion cost (25% lower in MY18). In conjunction with a lower procurement cost of raw materials and improved selling price (7% higher in MY18), gross margin improved to 35% as compared to 25% in the preceding year. Similarly, lower operating expenses, on the back of proportionately lower administrative expenses, during MY18 helped improve operating margin to 28% from 5% in the preceding year. During MY18, the Company posted PAT of ~PKR 527mln (MY17: ~PKR (115)mln), translating into a margin of ~20%. A positive trend was maintained through 1HMY19, despite a 38% increase in the cost of raw materials. Gross margin during the half improved to ~41% (1HMY18: 25%). Similarly, operating profit and net profit remained elevated at ~34% (1HMY18: ~18%) and ~24% (1HMY18: ~12%), respectively.

Sustainability The Company has no major expansion activities planned, with its main focus is to improve efficiency through BMR. Moreover, the management has no plans of obtaining further long-term loans and will aim to retain profits for the next couple of years.

Financial Risk

Working Capital The Company faces an inherent stress in its working capital cycle owing to seasonality in the industry. Additionally, it sources 30 - 35% of its raw materials form SGM Sugar Mills, an associated company. During 1HMY19, the Company witnessed an increase in net working capital days owing to high stocks accumulated during the purchasing season. On the other hand, prudent management of short-term debt was reflected in an enhanced room to borrow. Healthy cushion available during high working capital requirements reflects positively on the Company.

Coverages The Company has maintained a positive trend in coverage ratios. Strong coverage ratios were posted in MY18 with the Company posting an interest coverage of 5.0x (MY17: 0.9x) and a total coverage of 1.9x (MY17: 0.5x). A positive trend through 1HMY19 with interest coverage standing at 4.6x and total coverage at 2.1x. Moreover, debt payback period was reduced to 1.7 years in 1HMY19 from 2.3 years in MY18.

Capitalization The Company has a highly leveraged capital structure represented through a debt-to-equity ratio of ~63% in 1HMY19. Total borrowings witnessed an increase of ~9% in 1HMY19 owing to increased short-term borrowings. Long-term borrowings comprise of a finance facility worth PKR 1.6bln, which is payable in semi-annual installments and will mature in March, 2024. Mr. Asha Ram, one of the sponsors, had extended a short-term loan of PKR 200mln in MY16. However during MY18, this amount has been re-classified into equity, under Share Deposit Money for further issuance of shares.

Sugar & Allied
Financials (Summary) in PKR mln
The Pakistan Credit Rating Agency Limited

PKR mln

United Ethanol Industries Limited
Unlisted Public Limited

BALANCE SHEET	Mar-19	Sep-18	Sep-17	Sep-16
	6M	12M	12M	12M
a Non-Current Assets	**2,102**	**2,111**	**1,967**	**1,651**
b Investments (Incl. Associates)	**-**	**-**	**7**	**6**
Equity Instruments	-	-	7	6
Debt Instruments	-	-	-	-
c Current Assets	**2,515**	**1,849**	**1,440**	**246**
Inventory	1,041	535	643	25
Trade Receivables	329	187	214	12
Others	1,145	1,127	583	209
d Total Assets	**4,616**	**3,960**	**3,415**	**1,903**
e Debt/Borrowings	**2,724**	**2,507**	**2,585**	**1,265**
Short-Term	1,391	1,041	985	-
Long-Term (Incl. Current Maturity of Long-Term Debt)	1,333	1,467	1,600	1,265
Other Short-Term Liabilities	309	222	126	23
Other Long-Term Liabilities	-	-	-	-
f Shareholder's Equity	**1,583**	**1,231**	**703**	**615**
g Total Liabilities & Equity	**4,616**	**3,960**	**3,415**	**1,903**

INCOME STATEMENT				
a Turnover	**1,480**	**2,596**	**1,256**	**3**
b Gross Profit	602	913	187	(162)
c Net Other Income	(26)	15	(0)	(1)
d Financial Charges	(111)	(159)	(165)	(112)
e Net Income	**352**	**527**	**(115)**	**(337)**

CASH FLOW STATEMENT				
a Free Cash Flow from Operations (FCFO)	512	791	142	(133)
b Total Cashflows (TCF)	512	791	142	(133)
c Net Cash changes in Working Capital	(599)	(313)	(1,157)	(105)
d Net Cash from Operating Activities	(193)	323	(1,133)	(375)
e Net Cash from InvestingActivities	(38)	(230)	(56)	9
f Net Cash from Financing Activities	217	(78)	1,170	373
g Net Cash generated during the period	(14)	14	(18)	8

RATIO ANALYSIS				
a Performance				
Turnover Growth	-2%	107%	43112%	N/A
Gross Margin	41%	35%	15%	-5580%
Net Margin	24%	20%	-9%	-11581%
ROE	50%	61%	-30%	-127%
b Coverages				
Debt Service Coverage (X) (FCFO/Gross Interest+CMLTD+Uncovered STB)	2.1	1.9	0.5	-1.2
Interest Coverage (X) (FCFO/Gross Interest)	4.6	5.0	0.9	-1.2
Debt Payback (Years) (Total Debt (excluding Covered Short Term Borrowings) / FCFO)	1.7	2.3	-91.9	-6.6
c Working Capital Management				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	116	101	214	-1156
d Capital Structure (Total Debt/Total Debt+Equity)	63%	67%	85%	86%

Rating Scale | Corporate

2019

Credit Rating Scale & Definitions

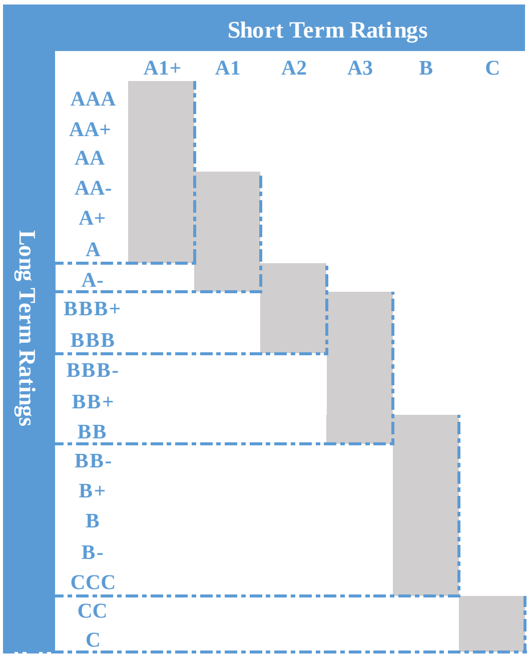
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings

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

Short Term Ratings

A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
C	An inadequate capacity to ensure timely repayment.



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

Rating Watch Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

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

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

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

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