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
27-Dec-2019	A-	A2	Stable	Maintain	-
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 MY19, growing steeply by ~39% due to increased volumes. Prices in the global market have been fluctuating recently, with a decline observed in MY18. However, impact of subdued international ethanol prices was offset to a certain extent by devaluation of the Pakistani Rupee. Bumper sugarcane production in Pakistan during MY17 and MY18 of years 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 high prices of molasses.

The ratings reflect United Ethanol's strong business profile emanating from robust margins and export oriented nature of ethanol industry and grew, mainly due to rupee devaluation. Strong margins at gross and operating level resulted in augmented profitability. 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. Since being acquired by United Group in 2016, the Company has been able to enhance efficiency through effective BMR implementation, yielding positive results. The company has a leveraged capital structure supplemented by strong coverages and effective working capital management. This keeps financial risk manageable.

Ratings are dependent on the management's ability to effectively maintain margins during foreseen challenges expected to be faced by the ethanol industry. Prudent debt and liquidity management is critical for ratings. Any significant increase in debt, deterioration in coverages 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-19),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria | Rating Modifier(Jun-19)
Related Research	Sector Study | Sugar(Dec-19)
Rating Analysts	Bakhtawar Abid | bakhtawar.abid@pacra.com | +92-42-35869504

Profile

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

Background The Company was incorporated in Oct'03 and was formerly owned by Etihad Group. The Company was acquired by Essarani Family in Sept'16 forming it a part of 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 9MMY19, a dip of 8% was witnessed in total production as compared to MY18.

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 Sept'19, 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 Sept'19.

Governance

Board Structure Board of Directors comprises three members including the Chairman, Chief Executive Officer and a Non-Executive Director. The Board is dominated by the sponsoring family and lacks independent oversight. Thus, indicating a 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 and assumed chairmanship. His son, Mr. Mahesh Kumar, acts as a Non-Executive Director. He has more than 20 years of experience and serves on the Board of Sindh Abadgar's Sugar Mills Limited as well.

Board Effectiveness During MY19, three Board meeting was convened among members with meeting minutes being captured formally. There are no board committees in place at United Ethanol.

Financial Transparency The Company's external auditors, Muhammad Ali Hussain & Co. Chartered Accountants, has given a qualified opinion on the financial statements for MY18. The qualification pertains to legal suit of the previous management and related provisioning. The potential impact on the company is adequately covered. The auditor firm hold a satisfactory QCR rating by ICAP, however are not SBP's panel of auditors.

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 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 Internal audit function is placed at 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. 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 MY19, 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 ~98% of total revenue in MY19. Sales revenue during MY19 stood at ~PKR 2.9bln (MY18: 2.6bln) posting a increase of 15%. This increase was mainly supported by high prices and sales volume.

Margins During MY19, the Company was fairly able to pass on the increased raw material, i.e. molasses, in the export market. This led the gross margins to remain high (MY19: 40%, MY18: 35%). Similarly, operating margin posted an increase (MY19: 33%, MY18: 27%) on the back of proportionately lower administrative expenses. The Company posted PAT of PKR 756mln (MY18: ~PKR 527mln), translating into an increase in net margin (MY19: 25%, MY18: 20%).

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 Seasonality posts an inherent stress on the Company working capital cycle. During MY19, the Company witnessed a decrease in net working capital days to 94 days owing to reduction of inventory held days. On the other hand, prudent management of short-term debt was reflected in an enhanced room to borrow, as well as efficient control on trade borrowing and paying off trade debts in timely manner improved net working cycle of the company (MY19: 77days, MY18: 101days).

Coverages The Company's interest cover posted a slight dip (MY19: 4.6x, MY18: 5x) due to increased finance cost (MY19: PKR 224mln, MY18: PKR 157mln). Improved free cash flow from operation (MY19: PKR 1,034mln, MY18: PKR 791mln) led to improved core and total interest cover (Core - MY19: 2.1x, MY18: 1.9x and Total - MY19: 2.1x, MY18: 1.9x). Debt payback period reduced to 1.5 years (MY18: 2.3 years) on the back of long term loan repayment.

Capitalization Despite an improvement, the Company's capital structure remain highly leveraged. Debt-to-equity ratio stands at 54% in MY19 (MY18: 67%). Total borrowings witnessed a dip of 9% in MY19 owing to repayment of long term borrowings (MY19: PKR 1.2bln, MY18: PKR 1.5bln - includes current maturity). These comprise a finance facility worth PKR 1.6bln payable in semiannual installments and will mature in Mar'24. Short term borrowings posted a slight increase to support the working capital (MY19: PKR 1.1bln, MY19: PKR 1bln) . Mr. Asha Ram, one of the sponsors, has 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.

PACRA

The Pakistan Credit Rating Agency Limited

Financial Summary

PKR mln

United Ethanol Industries Limited	Sep-19	Sep-18	Sep-17	Sep-16
Agriculture and Allied	12M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	2,058	2,111	1,967	1,651
2 Investments	-	-	7	6
3 Related Party Exposure	745	475	-	-
4 Current Assets	1,675	1,374	1,440	246
a Inventories	*454*	*535*	*643*	*25*
b Trade Receivables	*177*	*187*	*214*	*12*
5 Total Assets	4,478	3,960	3,415	1,903
6 Current Liabilities	210	222	126	23
a Trade Payables	*26*	*74*	*66*	*22*
7 Borrowings	2,286	2,507	2,585	1,265
8 Related Party Exposure	-	-	200	350
9 Non-Current Liabilities	-	-	-	-
10 Net Assets	1,983	1,231	503	265
11 Shareholders' Equity	1,983	1,231	503	265
B INCOME STATEMENT				
1 Sales	2,989	2,596	1,256	3
a Cost of Good Sold	*(1,797)*	*(1,684)*	*(1,069)*	*(165)*
2 Gross Profit	1,192	913	187	(162)
a Operating Expenses	(209)	(203)	(124)	(62)
3 Operating Profit	983	709	63	(224)
a Non Operating Income or (Expense)	*28*	*15*	*(0)*	*(1)*
4 Profit or (Loss) before Interest and Tax	1,010	724	63	(224)
a Total Finance Cost	*(225)*	*(159)*	*(165)*	*(112)*
b Taxation	*(30)*	*(38)*	*(13)*	*(0)*
6 Net Income Or (Loss)	756	527	(115)	(337)
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*1,034*	*791*	*142*	*(133)*
b Net Cash from Operating Activities before Working Capital Changes	*810*	*635*	*25*	*(269)*
c Changes in Working Capital	*(598)*	*(313)*	*(1,157)*	*(105)*
1 Net Cash provided by Operating Activities	212	323	(1,133)	(375)
2 Net Cash (Used in) or Available From Investing Activities	(53)	(230)	(56)	9
3 Net Cash (Used in) or Available From Financing Activities	(173)	(78)	1,170	373
4 Net Cash generated or (Used) during the period	(14)	14	(18)	8
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	15.1%	106.7%	43112.2%	--
b Gross Profit Margin	39.9%	35.2%	14.9%	-5580.0%
c Net Profit Margin	25.3%	20.3%	-9.1%	-11581.1%
d Cash Conversion Efficiency (EBITDA/Sales)	35.6%	31.5%	12.3%	-4586.8%
e Return on Equity (ROE)	47.1%	60.8%	-29.9%	-127.1%
2 Working Capital Management				
a Gross Working Capital (Average Days)	83	111	166	1563
b Net Working Capital (Average Days)	77	101	153	-1156
c Current Ratio (Total Current Assets/Total Current Liabilities)	8.0	6.2	11.4	10.7
3 Coverages				
a EBITDA / Finance Cost	4.7	5.2	1.0	-1.2
b FCFO / Finance Cost+CMLTB+Excess STB	2.1	1.9	0.5	-1.2
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	1.5	2.3	-91.9	-6.6
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	53.6%	67.1%	84.7%	85.9%
b Interest or Markup Payable (Days)	87.6	120.2	108.3	1.6
c Average Borrowing Rate	9.3%	5.9%	7.4%	6.9%

Rating Scale | Corporate

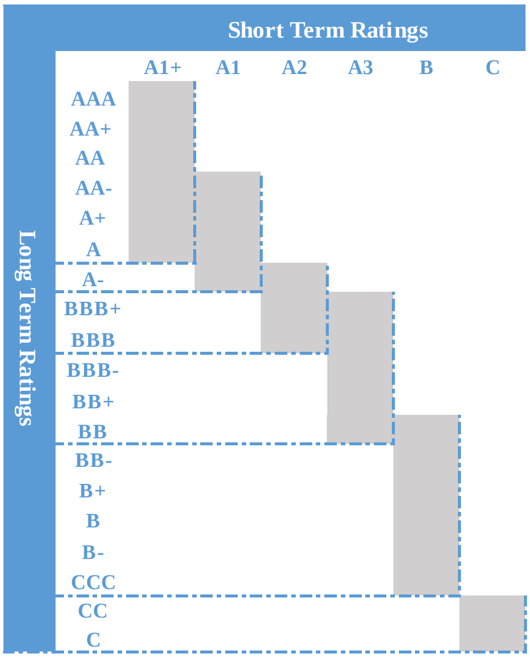
2019

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