The Pakistan Credit Rating Agency Limited

Rating Report

Sindh Abadgars Sugar Mills Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
16-Sep-2019	BBB	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The Sugar industry of Pakistan is the 2nd largest agro based industry comprising ~90 sugar mills with annual crushing capacity estimated between 65 – 70 mln MT. During MY19, sugar production dropped by 20% to ~5.5mln MT amid low crop cultivation from two consecutively high crushing season. The decrease in piled up sugar stocks rallied up retail prices by ~20%, providing relief to sugar producers.

The ratings reflect the Company's association with an established group in the agri chain and demonstrated support of it's sponsors. Sindh Abadgars Sugar Mills (Sindh Abadgars) has a modest business profile and relatively lower margins in the Sugar industry. The Company generates its revenue from the sale of refined sugar and it's ensuing by-products, molasses and bagasse. The mill, located in Sindh, has a relatively small capacity of 8,000 TCD. Timely BMR activities to enhance efficiency yielded positive results in the form of increased recovery rates of ~10.8%. However, lower crop cultivation and high concentration of mills in adjoining areas led to lower production levels and remains a challenge for the Company. Sindh Abadgars held on to stock during 9MMY19 to gain from rising sugar prices. This is expected to bode well for the Comapany's profitability as sugar prices have increased significantly. Lack of diversification exposes the Company to volatility inherent in the sugar industry. The financial risk profile is characterized by a high working capital cycle, dominated by sugar stocks and moderate leveraging, to finance working capital requirements. Coverages, a function of the Comany's business activity and leveraging, remain adequate.

The ratings are dependent upon increasing utilization, while improving margins and strict working capital discipline. Any significant deterioration in margins and/or cashflows will negatively impact the ratings.

Disclosure

Name of Rated Entity	Sindh Abadgars Sugar Mills Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	PACRA_Methodology_Corporate_FY19(Jun-19),PACRA_Crtieria_LT ST Relationship_FY19(Jun-19),PACRA_Criteria_Rating Modifiers_FY19(Jun-19)
Related Research	Sector Study | Sugar(Apr-19)
Rating Analysts	Silwat Malik | silwat.malik@pacra.com | +92-42-35869504

Profile

Legal Structure Sindh Abadgars Sugar Mills Limited (Sindh Abadgars) is a Public Limited Company and is listed on the Pakistan Stock Exchange.

Background The Company was incorporated in Karachi, Pakistan, on January 28, 1984. The Company used to be under the ownership of the Effendi Group. However, the Essarani Family over took the business in 2005.

Operations The Company is involved in the manufacture and sale of white refined crystal sugar of all grades (including pharmaceutical grade), colors and by products bagasse and molasses. Sugar Mill is located at Tando Mohammed Khan (38 miles from Hyderabad, Sindh) with a current crushing capacity of 8,000 MT per day. During 9MY19 the Company produced ~47mln MT of sugar significantly lower than MY18 (67mln MT) owing to unavailability of sugarcane stock. However, a healthy recovery rate of ~10.8% was achieved (MY18: 10.1%)

Ownership

Ownership Structure Sindh Abadgars Limited is majorly owned by the Essarani Family with ~79% of the holding vesting with the sponsoring family members. Insurance Companies collectively hold ~2.5% while foreign investors (mainly Islamic Development Bank) also hold a sizeable chunk of 9%. Remaining ~9% of the Company's shares reside with the general public.

Stability Ownership is seen as stable as major stake rests with the Essarani Family. Although no documented succession planning exists, roles of family members are clearly defined.

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

Financial Strength The Company has adequate financial strength derived from its Group and support of sponsors. The Group has total assets worth ~PKR 19bln, supported through an equity base of ~PKR 8bln as at MY18. The Group posted a net profit worth ~PKR 881mln in MY18, however, the figure was subdued owing to losses incurred by SGM Sugar Mills. The Group has a debt-to-equity ratio of 45%. Total debt during MY18 receded to ~PKR ~7bln (MY17: ~PKR 9bln).

Governance

Board Structure Sindh Abadgars Board consists of eight members. There are five non-executive directors, two executive directors and one independent member. All of the members are male, with no female representation. The board is dominated by the sponsoring family (7) and less independent oversight indicates room for improvement in the governance framework.

Members' Profile Mr. Deoo Mal Esraani, Chairman of the Board, also chairs the Board of two other group companies, SGM Sugar Mills Limited and United Ethanol Industries Limited. He has more than 46 years of experience to his name and assumed chairmanship in May, 2017. Dr. Shafaqat Ali Shah, the sole independent member of the board is a medical doctor by profession and has served on the board for more than 7 years.

Board Effectiveness Sindh Abadgars board has constituted two committees for effective monitoring and oversight namely, Audit Committee and HR & Remuneration Committee.

Financial Transparency Auditors of the Company, M/s Rahman Sarfaraz Rahim Iqbal Rafiq, expressed an unqualified opinion on financial statements of the Company for MY18. The firm has been categorised in class 'A' category by SBP and has been QCR rated by ICAP.

Management

Organizational Structure The Organization Structure is divided into two segments, to oversee operations at the Mill and administration from the Head-Office. Mill operations are headed by resident director, whereas administration is headed by Group CFO with both heads reporting directly to the CEO. The Company has established departments for its core functions, namely: a) Administration & Sales, b) Finance & Tax (including internal audit), c) Purchase, and d) Corporate Affairs. All departments report to the CFO who then reports to the CEO.

Management Team 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 SGM Sugar Mills. He is ably supported by Mr. Abdul Rahim Mallah (Resident Director Mills) and Mr. Syed Abid Hussain (Group CFO). The senior management team comprises seasoned professional having significant experience in the Sugar Industry.

Effectiveness The Company has no management committees in place. However, performance is discussed among management on a fortnightly basis. Further, daily reporting to CEO of bank lines, inventory and sales positions enables effective control and management.

MIS Sindh Abadgars uses an in-house developed web based information system for MIS. Reports pertaining to production, bank positions, etc. are submitted to senior management on a daily and monthly basis.

Control Environment Internal audit department 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 The sugar industry in Pakistan is the 2nd largest agro based industry comprising ~90 sugar mills with annual crushing capacity estimated between 65 – 70 million tons. During MY19, sugar production is estimated around 5.5mln MT, coming down from 6.5mln MT in the preceding year.

Relative Position Owing to the high amount of players in the industry, players relatively have low market share. Sindh Abadgars is a relatively small player and contributed ~ 0.8% to the total production of sugar in Pakistan, whereas larger player supply ~ 6% of the total sugar produced.

Revenues Sindh Abadgars generates most of its revenue from the sale of refined sugar. However, sale of molasses and bagasse also contribute to its turnover. The Company gradually improved it's' top-line performance as it amounted to PKR 4,536mln in MY18 (MY17: PKR 2,314mln , MY16: PKR 3,377mln). During MY17, the Company's revenue witnessed a dip of ~31% as the Company held stock in anticipation of increase in sugar prices. In MY18, the Company fully utilized the subsidized export quota provided by the Government to off load stocks and seasons production leading to a surge in revenue of ~96%. Topline in 9MY19 remained low at ~PKR 1,045mln as the Company again held stocks for favorable prices.

Margins Sindh Abadgars has witnessed volatile margins over recent years. In MY18, the Company's GP margins massively improved from gross loss of ~-9% in MY17 to gross profit of ~9% in MY18 on the back of improved recovery rates and utilization of export subsidy. Lower sugarcane support price in Sindh, which was reduced in mid-crushing season of MY18 to PKR 160 per 40kg (PKR180 in previous periods) after intervention by the High Court, added to the margins. Company continues it's net loss position in 9MMY19 of PKR 22mln (MY17: PKR 231mln) owing to high finance costs.

Sustainability The Company's margins are expected to improve on the back of increase of sugar prices in the market. However, volumes are expected to remain low due to decreased production in line with unavailability of sugarcane crop in adjoining areas.

Financial Risk

Working Capital The Company has built up inventory levels again during the current crushing season resulting in high working capital requirements. The Company managed its working capital through sponsor's loans and short term finance from banks. Long cash cycle result from holding of inventory, adversely affecting the Company's net working capital 9MMFY19: 386 days (MY18: 74 days and MY17: 55 days).

Coverages Coverages, a function of the Comany's business activity, remained volatile. Interest coverage ratio improved during MY18 as it stood at 4.9x (MY17: -1x) as cashflows increased from off take of stocks. The Company's core debt service coverage also improved to 1.7x in MY18 (MY17: -0.6). Although Interest and core debt service coverage deteriorated to 2.1x and 1.1x in 9MMY19, remain adequate.

Capitalization Sindh Abadgars has a total debt of PKR 1,039mln at the end of MY18 with a leverage ratio of ~45%. Long-term loans amounted to PKR 504mln which were obtained to meet capital expenditure requirements. Short term debt amounted to PKR 1,920mln and were obtained for procurement of sugarcane and holding. In 9MY19, the Company's total debt increased to ~PKR 2.6bln as the Company held on to sugar stocks increasing the leverage ratio to 70%.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

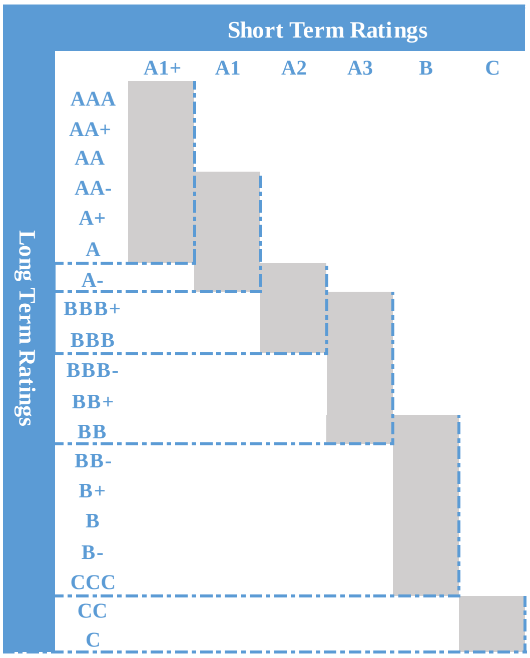
Sindh Abadgars Sugar Mills Limited	Jun-19	Sep-18	Sep-17	Sep-16
Sugar	9M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	2,622	2,805	1,934	2,013
2 Investments	-	-	-	-
3 Related Party Exposure	-	-	-	-
4 Current Assets	2,372	645	1,559	595
a Inventories	*1,349*	*9*	*1,013*	*33*
b Trade Receivables	*510*	*252*	*106*	*27*
5 Total Assets	4,994	3,450	3,493	2,608
6 Current Liabilities	376	309	527	263
a Trade Payables	*254*	*262*	*284*	*191*
7 Borrowings	2,303	779	1,728	629
8 Related Party Exposure	260	260	260	260
9 Non-Current Liabilities	809	818	489	566
10 Net Assets	1,246	1,284	489	890
11 Shareholders' Equity	1,246	1,284	489	890
B INCOME STATEMENT				
1 Sales	1,046	4,536	2,314	3,377
a Cost of Good Sold	*(907)*	*(4,129)*	*(2,527)*	*(3,197)*
2 Gross Profit	138	407	(213)	179
a Operating Expenses	(83)	(191)	(126)	(92)
3 Operating Profit	55	216	(339)	87
a Non Operating Income or (Expense)	*74*	*26*	*20*	*7*
4 Profit or (Loss) before Interest and Tax	129	242	(320)	94
a Total Finance Cost	*(144)*	*(116)*	*(135)*	*(93)*
b Taxation	*(7)*	*(57)*	*54*	*(26)*
6 Net Income Or (Loss)	(22)	68	(401)	(25)
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*299*	*510*	*(164)*	*234*
b Net Cash from Operating Activities before Working Capital Changes	*228*	*357*	*(269)*	*142*
c Changes in Working Capital	*(1,652)*	*741*	*(788)*	*(267)*
1 Net Cash provided by Operating Activities	(1,424)	1,098	(1,057)	(125)
2 Net Cash (Used in) or Available From Investing Activities	(8)	(144)	(105)	(43)
3 Net Cash (Used in) or Available From Financing Activities	1,509	(70)	1,099	170
4 Net Cash generated or (Used) during the period	77	884	(63)	2
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	-69.3%	96.0%	-31.5%	--
b Gross Profit Margin	13.2%	9.0%	-9.2%	5.3%
c Net Profit Margin	-2.1%	1.5%	-17.3%	-0.7%
d Cash Conversion Efficiency (EBITDA/Sales)	30.6%	12.3%	-5.8%	7.3%
e Return on Equity (ROE)	-2.3%	7.7%	-58.1%	-2.8%
2 Working Capital Management				
a Gross Working Capital (Average Days)	454	96	93	4
b Net Working Capital (Average Days)	386	74	55	-17
c Current Ratio (Total Current Assets/Total Current Liabilities)	6.3	2.1	3.0	2.3
3 Coverages				
a EBITDA / Finance Cost	2.2	4.9	-1.0	2.7
b FCFO / Finance Cost+CMLTB+Excess STB	1.1	1.7	-0.6	0.9
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	4.2	2.6	-3.7	6.3
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	67.3%	44.7%	80.3%	50.0%
b Interest or Markup Payable (Days)	173.4	0.0	0.0	0.0
c Average Borrowing Rate	10.6%	7.6%	9.3%	10.4%

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