



The Pakistan Credit Rating Agency Limited

Rating Report

Chanar Sugar Mills Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
17-Oct-2019	BBB-	A3	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The sugar industry of Pakistan has remained under pressure in recent times. A persistent supply glut negatively impacted players across the industry. Additionally, slowdown in international sugar prices rendered domestically manufactured sugar uncompetitive, making exports viable only through subsidy support. However, prices during the current season (MY19) have improved owing to lower sugar production and depletion of carryover stock. This has impacted profitability for industry players positively. Moreover, retirement of subsidy amount due by the government has eased the liquidity pressure to an extent.

The ratings reflect modest business profile of Chanar Sugar Mills Limited with relatively small crushing capacity of 4,800 tons per day. The sponsors have sound understanding of the business and have been proactive in improving efficiencies. The Company has been able improve profitability, albeit moderate, over the years. However, it remains exposed to inherent cyclical nature of the sugar industry as it lacks diversification in revenues. The Company has developed a leveraged capital structure. Financials needs mainly emanates from prolonged working capital cycle. The Company has long term loans to finance BMR and group projects. The may put stress on existing cashfolws as coverages remain adequate.

The ratings are dependent upon the management's ability to improve revenues while sustaining the margins and, in turn profitability. Meanwhile, close monitoring of working capital requirements remain critical for the ratings. Timely completion of expansion plan is important. Any deterioration in the Company's cashflows and/or coverages would have a negative impact on the ratings.

Disclosure

Name of Rated Entity	Chanar Sugar Mills Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	PACRA_Methodology_Corporate_FY19(Jun-19),PACRA_Criteria_LT ST Relationship_FY19(Jun-19),PACRA_Criteria_Rating Modifiers_FY19(Jun-19)
Related Research	Sector Study Sugar(Oct-19)
Rating Analysts	Ayesha Malik ayesha.malik@pacra.com +92-42-35869504

Profile

Legal Structure Chanar Sugar Mills Limited (The Company or Chanar Sugar) was incorporated as a Public Limited Company in Nov'90.

Background Sponsors entered the business arena through textile sector. In early 80's, Mr. Javed Kayani setup textile mills named Rai and Aruj in the spinning segments. Later in 90's, he tapped in the sugar industry by setting up or acquiring Chanar Sugar Mills Limited. In FY14, the Company set-up into co-generation biomass power plant. The plant achieved COD in Feb-19.

Operations Chanar Sugar primarily manufactures and sell sugar and its by-products molasses, bagasse and mud. The Company has one sugarcane crushing unit, Line I, with an installed capacity of 4,800 tons per day. In FY18, capacity utilization was 69%. While, in 9MFY19, utilization improved to 82%, as the Company's crushing days were less in comparison to its competitors'. Chanar Sugar produced 0.43 mln tons of sugar at an average recovery rate of 10.4% in FY19. The Company's registered office and mill is located in Tehsil Tandianwala, District Faisalabad, while the head office is situated in Muslim Town, Lahore.

Ownership

Ownership Structure Chanar Sugar's ownership resides with the sponsors, Kayani Family, through individual family members. Mr. Javed Kayani, along with his spouse holds 99% shareholding in the Company. The remaining shareholding is evenly divided between two sons of Mr. Javed Kayani.

Stability Ownership structure of the Company seems stable. Although there is no formal succession plan but the second generation is gradually being inducted.

Business Acumen The sponsoring family has a long standing business history. Their first venture was in the spinning segment. Later, Mr. Javed Kayani tapped in the sugar industry by setting up Chanar Sugar Mills Limited. Recently, the Company has ventured into energy segment by setting up Chanar Energy Limited, a 22MW co-generation power plant, using bagasse as fuel.

Financial Strength The sponsors main cash producing assets remains Chanar Sugar.

Governance

Board Structure Chanar Sugar's Board, comprising four Executive Directors, is dominated by the sponsoring family. Lack of independent oversight and absence of non-executive director on Board indicate room for improvement in the Company's governance framework.

Members' Profile The Board's Chairman, Mr. Javed Ahmed Kayani, is the founder of the Company. Having an overall business experience of above two decades, Mr. Javed Kayani has served as the Chairman of Pakistan Sugar Mills Association as well and is a veteran of sugar industry .

Board Effectiveness Chanar Sugar Mills Board meets informally and minutes of these meetings are documented as per requirement. Moreover, there are no formal Board committees.

Financial Transparency In MY18, the Company's external auditors - Junaidy Shoaib Asad, Chartered Accountants - have expressed unqualified opinion on financial statements. The firm is in class 'C' category by SBP and has been QCR rated by ICAP. The Company has recently appointed Grant Thornton Anjum Asim as their external auditors.

Management

Organizational Structure Chanar Sugar's operations are segregated between Head Office and Mill. Purchase, Finance, Information Technology and Sales functions are monitored by their respective Heads from the Company's head office. However, mill is monitored by GM Mill. All functional Heads and GM Mill reports to the Company's Business Head, who reports to the Chief Executive Officer. Pertinent decisions made by the Company's CEO are implemented by the entire team.

Management Team Mr Javed Kayani, a veteran professional, is the CEO of the Company. Mr. Hassan Ali, Business Head, has an overall experience of more than a decade. He has been associated with the Company for four years. Mr. Ahmed Raza, GM Finance, holds the office of Company Secretary as well. Having an overall experience of above a decade, Mr. Ahmed has been a part of the Company for more than five years.

Effectiveness No formal management committees are not in place at Chanar Sugar. However, senior management monitors operational issues through informal meetings.

MIS Chanar Sugar relies on in-house developed modules for MIS, updated on real time basis. Six reports are generated from these modules to assist the top management in decision making process. Most of these reports are seasonal in nature and generated as per requirement.

Control Environment At present, internal audit function is not in place at Chanar Sugar Mills. Going forward, the management is planning to set up an in-house internal audit function to provide support and also to monitor the already placed policies and procedures within the Company and Mill.

Business Risk

Industry Dynamics Pakistan's sugar industry is the 2nd largest agro based industry, comprising ~90 mills with annual crushing capacity estimated around 65 – 70 mln MT. The sugar industry of Pakistan has remained under pressure in recent times. Prices during the current season (MY19) have improved owing to lower sugar production and depletion of carryover stock. Sugar production fell by ~20%, YoY, to 5.3mln MT. This has impacted the profitability for industry players positively. Moreover, provision of subsidy amount by the government has eased the liquidity pressure. An export quota of 1.1mln tons was approved, nonetheless, absence of subsidy led to low quantities availed. During the FY20 budget, sales tax levied on sugar was increased to 17% charged on the price of PKR 60/KG, effective from July 1, 2019. Additionally, provision of CNIC for all buyers has been made mandatory. This has been made effective from August 1, 2019.

Relative Position Chanar Sugar Mills contributes approximately 0.06% to total sugar production in Pakistan, relatively a small capacity.

Revenues Chanar Sugar generates gross revenue by selling refined sugar in the local (88%) and export (1%) markets, molasses (6%) and bagasse (5%). The Company makes direct sales to a diverse set of local corporate customers and exports white sugar to Afghanistan and Tajikistan. The Company have fluctuated in recent years, in line with sugar sector dynamics. In 9MFY19, total revenue posted a dip of 12% (YoY) and amounted to PKR 2.1bln (9MFY18 – PKR 2.4bln), mainly due to lower output by the Company and management's decision to hold stocks in anticipation of better prices. Lower utilization levels and less no. of crushing days also affected the revenues. In comparison to large industry players, Chanar Sugar's revenue is considerably low.

Margins Improved recovery rate and significant increase in sugar prices led margins in 9MFY19 ~11% (9MFY19 ~ 9%) at gross level. However, the Company was not able to maintain stability in its operating costs. Currently, Chanar Sugar's over-reliance on a single product limits its margins and leaves little cushion to mitigate volatility in sugar industry. A significant portion of its gross profit is absorbed by the finance cost, limiting the Company's bottom-line.

Sustainability In Feb-19, Chanar Energy - bagasse based co-generation power plant - became commercially operational. Going forward, sizeable revenue stream (emanating from Chanar Energy) would remain important for the Company's performance. The management also plans to set up a distillery. While, financing decision for the project is yet to be finalized.

Financial Risk

Working Capital Increased inventory levels kept the net working capital days on the higher side (9MFY19: 158 days, 9MFY18: 179 days). High short-term borrowings to support working capital requirement limits the cushion to borrow against trade assets. Discipline in working capital management is required to improve the short term borrowing buffer.

Coverages The Company's interest coverage depicts a stable trend (9MFY19: 2.4x, FY18: 2.4x, FY17: 3x) supported by moderate free cash flows (9MFY19: 206mln, FY18: 214mln, FY17: 209mln). Core and total interest cover shown a downward trend due to increased borrowings leading to high current maturing liabilities (9MFY19: 89mln, FY18: 40mln, FY17: 40mln).

Capitalization Chanar Sugar Mills is significantly leveraged (~ 60%). The Company's total debt stood at PKR 2.5bln during 9MFY19. Major portion of the debt comprises short term borrowings (PKR 1.5bln) to finance its working capital requirements. Long-term loan of PKR 570mln (including current maturity) as at June '19, was obtained for BMR and to set-up biomass power plant.

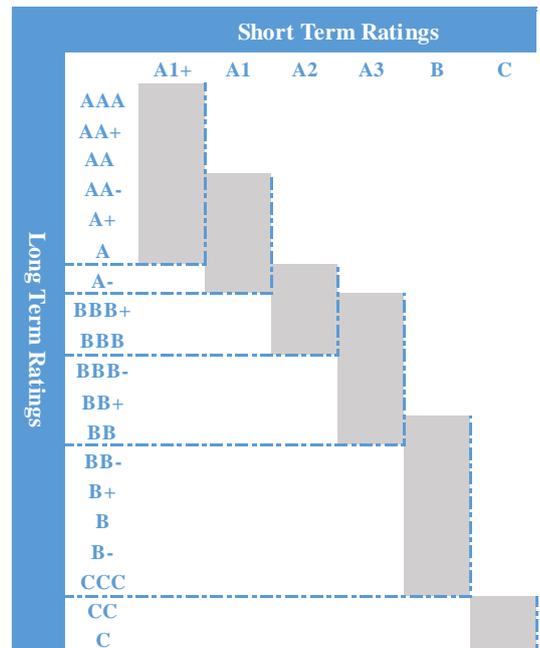


Chanar Sugar Mills Limited Sugar	Jun-19 9M	Sep-18 12M	Sep-17 12M	Sep-16 12M
A BALANCE SHEET				
1 Non-Current Assets	2,822	2,500	2,134	1,999
2 Investments	-	-	-	-
3 Related Party Exposure	48	48	48	0
4 Current Assets	2,111	1,624	2,009	503
<i>a Inventories</i>	1,282	993	1,567	64
<i>b Trade Receivables</i>	409	135	60	97
5 Total Assets	4,981	4,172	4,192	2,502
6 Current Liabilities	336	595	648	193
<i>a Trade Payables</i>	118	284	109	65
7 Borrowings	2,114	1,126	1,442	143
8 Related Party Exposure	354	364	57	139
9 Non-Current Liabilities	522	501	499	504
10 Net Assets	1,655	1,586	1,545	1,523
11 Shareholders' Equity	1,655	1,586	1,546	1,523
B INCOME STATEMENT				
1 Sales	2,097	3,181	2,032	4,361
<i>a Cost of Good Sold</i>	(1,870)	(2,895)	(1,815)	(4,032)
2 Gross Profit	226	286	216	329
<i>a Operating Expenses</i>	(95)	(138)	(128)	(123)
3 Operating Profit	131	149	89	207
<i>a Non Operating Income or (Expense)</i>	(2)	8	35	(0)
4 Profit or (Loss) before Interest and Tax	129	157	124	207
<i>a Total Finance Cost</i>	(95)	(102)	(85)	(119)
<i>b Taxation</i>	(5)	(14)	(14)	(37)
6 Net Income Or (Loss)	29	40	25	51
C CASH FLOW STATEMENT				
<i>a Free Cash Flows from Operations (FCFO)</i>	206	214	209	225
<i>b Net Cash from Operating Activities before Working Capital Changes</i>	90	103	152	100
<i>c Changes in Working Capital</i>	(799)	441	(1,091)	366
1 Net Cash provided by Operating Activities	(709)	545	(939)	465
2 Net Cash (Used in) or Available From Investing Activities	(300)	(536)	(283)	(51)
3 Net Cash (Used in) or Available From Financing Activities	987	(19)	1,212	(383)
4 Net Cash generated or (Used) during the period	(22)	(10)	(10)	31
D RATIO ANALYSIS				
1 Performance				
<i>a Sales Growth (for the period)</i>	-12.1%	56.6%	-53.4%	39.4%
<i>b Gross Profit Margin</i>	10.8%	9.0%	10.6%	7.6%
<i>c Net Profit Margin</i>	1.4%	1.3%	1.2%	1.2%
<i>d Cash Conversion Efficiency (EBITDA/Sales)</i>	10.7%	8.5%	11.3%	6.9%
<i>e Return on Equity (ROE)</i>	2.4%	2.5%	1.6%	3.3%
2 Working Capital Management				
<i>a Gross Working Capital (Average Days)</i>	184	158	161	49
<i>b Net Working Capital (Average Days)</i>	158	136	145	44
<i>c Current Ratio (Total Current Assets/Total Current Liabilities)</i>	6.3	2.7	3.1	2.6
3 Coverages				
<i>a EBITDA / Finance Cost</i>	2.6	3.0	3.3	3.2
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	1.3	1.6	1.9	2.4
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>	5.8	4.0	1.7	1.1
4 Capital Structure (Total Debt/Total Debt+Equity)				
<i>a Total Borrowings / Total Borrowings+Equity</i>	59.9%	48.3%	49.2%	15.6%
<i>b Interest or Markup Payable (Days)</i>	132.3	83.0	154.3	127.4
<i>c Average Borrowing Rate</i>	5.8%	6.1%	7.9%	61.8%

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		Short Term Ratings	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
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.	A1	A strong capacity for timely repayment.
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.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial 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.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
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.	C	An inadequate capacity to ensure timely repayment.
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.		



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 surveil the opinion due to lack of requisite information.

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

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- (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)
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Probability of Default

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