RATING REPORT

Chashma Sugar Mills Limited

REPORT DATE:
October 21, 2019

RATING ANALYSTS:
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RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A-	A-2	BBB+	A-2
Rating Outlook	*Stable*		*Stable*	
Rating Date	*18th Oct '19*		*15th Nov '18*	

COMPANY INFORMATION

Incorporated in 1988	**External auditors:** M/s. A.F. Ferguson & Co. Chartered Accountants.
Public Limited Company	**Chairman of the Board:** Mr. Abbas Sarfaraz Khan **Chief Executive Officer:** Mr. Aziz Sarfaraz Khan
Key Shareholders (with stake 5% or more): • The Premier Sugar Mills & Distillery Limited – 47.9% • Other Group Companies – 18.7% • Directors & Relatives – 14.0%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Corporates (May 2019)
https://www.vis.com.pk/kc-meth.aspx

Chashma Sugar Mills Limited

OVERVIEW OF THE INSTITUTION

CSML was incorporated in May 1988 as a public company, under the repealed Companies Ordinance 1984 (now the Companies Act, 2017). The company is engaged in production and sale of white crystalline sugar and other allied products. The head office of the company is situated in Islamabad, while manufacturing facilities are located at Dera Ismail Khan, KP.

Profile of CEO

Mr. Aziz S. Khan is Chairman BoD of Premier Sugar Mills & Distillery Co. Ltd. He is also a board member of The Frontier Sugar Mills & Distillery Ltd. and Arpak International Investments Ltd.

Financial Snapshot

Tier-1 Equity: 9MFY19: Rs. 2.4b; FY18: Rs. 1.8b; FY17: Rs. 1.5b

Net Profit: 9MFY19: Rs. 393m; FY18: Rs. 194m; FY17: Rs. 92m

RATING RATIONALE

The assigned ratings take into account Chasma Sugar Mills Limited's (CSML) sizeable scale of sugarcane crushing operations and diversified revenue stream through forward integration into ethanol manufacturing, which provides adequate cushion against the inherent cyclicality of sugar sector. Higher revenue contribution from ethanol business has supported the company's profitability during the past two years. The ratings also draw comfort from considerable improvement in net sales, profit margins and cash flows during 9MFY19, mainly on account of notable improvement in sucrose recovery rate, and higher sugar and ethanol prices in the domestic and international markets, respectively. Resultantly, the company has exhibited improvement in gearing and debt leverage during the period, though the said indicators are still on the higher side. However, the company's capacity to meet its financial obligations is considered adequate, as depicted by improvement in debt service coverage ratios. While the commodity risk is embedded in sugar business, the recent increase in domestic sugar prices may positively impact the profitability and cash flows of the company, going forward.

Corporate Profile

CSML is a part of the Premier Group, which has business interests in sugar, ethanol, high-grade polypropylene, as well as distribution of consumer goods and bulk storage, wheat soils and housing projects. The company has two sugarcane crushing and one ethanol distillery units located in Dera Ismail Khan, KP. The production capacity of the said units has remained unchanged at 18,000 tons of sugar per day (tpd) and 125,000 liters of ethanol per day (lpd) over the review period. As per the management, there is no plan to enhance either of the capacities in the foreseeable future. However, the company plans a capex of Rs. 500m in each year of FY20 and FY21 to conduct Balancing, Modernization and Replacement (BMR) and install falling film evaporator, leading to 8% improvement in heat consumption with notable cost efficiencies. CSML sells sugar in the open market on a cash basis, while ethanol is exported to foreign clients like Vitol and Mitsubishi on a 3 – 4 month supply contract.

During crushing season 2018-19, sugar units were operational for 98 days (2017-18: 129 days; 2016-17: 130 days) due to industry-wide delayed commencement of crushing activity. The company crushed 15,943 tpd of sugarcane during 2018-19 (2017-18: 15,820 tpd; 2016-17: 17,111 tpd), resulting in overall capacity utilization of 89% (2017-18: 88%; 2016-17: 95%). Despite higher sucrose recovery, total sugar production was recorded lower at 166.3k tons (2017-18: 193.3k tons; 2016-17: 203.7k tons) on account lower number of crushing days. The improvement in sucrose recovery rate to 10.61% (2017-18: 9.47%; 2016-17: 9.16%) was led by continued provision of support to farmers, including better usage of seed.

The distillery unit was operational for 273 days during 9MFY19 (FY18: 357 days; FY17: 261 days) with a capacity utilization of 99% (FY18: 100%; FY17: 91%). Resultantly, total ethanol production during the period was recorded at 33.6m liters (FY18: 44.6m liters; FY17: 29.6m liters).

Asset Mix

CSML had Rs. 14.9b in assets at end-9MFY19 (FY18: Rs. 13.8b; FY17: Rs. 10.6b), of which Rs. 9.4b (FY18: Rs. 9.5b; FY17: Rs. 7.8b) were vested in property, plant and equipment. The company made capex of Rs. 436m in fixed assets during 9MFY19 (FY18: Rs. 313m; FY17: Rs. 357m), mainly to enhance production efficiencies. During FY18, CSML invested Rs. 100m in unquoted shares of Whole Foods (Pvt.) Limited (WFL) – a wholly owned subsidiary of CSML. WFL was incorporated in October 2017 with the aim to setup, manage, supervise and control the storage facilities for agricultural produce. WFL is establishing wheat silos in Layyah and Bhakkar, having storage capacity of 20,000 tons, and intends earn rental income from the government contracts.

Total stock in trade amounted to Rs. 3.8b at end-9MFY19 (FY18: Rs. 2.2b; FY17: Rs. 1.4b). Despite decrease in production levels, sugar inventory was recorded higher at Rs. 3.0b (FY18: Rs. 1.7b; FY17: Rs. 692m) owing to stock carryover from the previous year. Molasses stock increased to Rs. 615m (FY18: Rs. 391m; FY17: Rs. 385m) due to higher procurement for the distillation process, while ethanol stock stood lower at Rs. 129m (FY18: Rs. 190m; FY17: Rs. 269m) on account of higher sales.

CSML makes sales on cash basis, thereby trade debts amounted to Rs. 143m at end-9MFY19 (FY18: Rs. 219m; FY17: Rs. 185m), representing less than 2% of total sales. Loans and advances were recorded higher at Rs. 420m (FY18: Rs. 332m; FY17: Rs. 271m) with the increase in advances to sugarcane farmers against seeds and fertilizers and higher receivables from related parties amounting to Rs. 117m (FY18: Rs. 108m; FY17: Rs. 50m). Receivables from related parties include short-term loan of Rs. 103m to WFL for the establishment of wheat storage facilities. Trade deposits, prepayments, and other receivables decreased to Rs. 533m (FY18: Rs. 812m; FY17: Rs. 532m) on account of reduction in sales tax refundable to Rs. 194m (FY18: Rs. 431m; FY17: Rs. 249m) and export subsidy receivable of Rs. 306m (FY18: Rs. 340m; FY17: Rs. 255m). Cash and bank balance amounted to Rs. 133m at end-9MFY19 (FY18: Rs. 189m; FY17: Rs. 84m).

Sales & Profitability

CSML reported net sales of Rs. 9.2b during 9MFY19 (FY18: Rs. 10.3b; FY17: Rs. 11.3b), of which 76% (FY18: 76%; FY17: 88%) sales pertained to sugar and remaining 24% (FY18: 24%; FY17: 12%) emanated from ethanol segment. The company managed to sell 135,500 MT sugar during the period (FY18: 168,654 MT; FY17: 192,111 MT) at a higher average selling price of Rs. 49,748 per ton (FY18: Rs. 46,493 per ton; FY17: Rs. 51,891 per ton). The recent uptrend in sugar prices due to reduced production levels is expected to bode well for the company, going forward. The industry witnessed decrease in total sugar production to 5.26m tons during crushing season 2018-19 (2017-18: 6.57m tons; 2016-17: 7.05m tons).

Ethanol volumetric sales were recorded at 35.6m liters during 9MFY19 (FY18: 44.6m liters; FY17: 27.0m liters) with an average selling price of Rs. 68 per liter (FY18: Rs. 57 per liter; FY17: 53 per liter).

Cost of sales were recorded at Rs. 7.7b during 9MFY19 (FY18: Rs. 9.0b; FY17: Rs. 10.2b) as the company incurred sugarcane procurement cost of Rs. 176 per mound (FY18: Rs. 151 per mound). Gross margin of the company improved to 16.5% during 9MFY19 (FY18: 12.4%; FY17: 9.8%) on account of considerable improvement in sucrose recovery, coupled with higher sugarcane and ethanol prices. CSML incurred Rs. 161m in administrative expenses during 9MFY19 (FY18: Rs. 215m; FY17: Rs. 133m) and Rs. 375m in distribution expenses (FY18: Rs. 397m; FY17: Rs. 350m). Other income amounted to Rs. 70m (FY18: Rs. 125m; FY17: Rs. 17m), which mainly pertained to exports subsidy and exchange gain. Given higher utilization of short-term borrowings amid higher average interest rates, finance cost increased to Rs. 570m (FY18: Rs. 512m; FY17: Rs. 493m). The company reported net profit of Rs. 393m during 9MFY19 (FY18: Rs. 194m; FY17: Rs. 92m) on the back of higher gross margin and maintained operating expenses, resulting in improved net margin of 4.3% (FY18: 1.9%; FY17: 0.8%).

Liquidity & Cash Flows

The company has exhibited gradual improvement in liquidity position over the review period. Current ratio, though still low, improved to 0.87x by end-9MFY19 (FY18: 0.80x; FY17: 0.75x) as the impact of increase in short-term borrowings was offset by higher stock in trade. Inventory plus trade debt to short-term borrowings ratio stood at 0.83x at end-9MFY19 (FY18: 0.65x; FY17: 0.61x) and has room for improvement. On the back of higher profits, funds from operations (FFO) increased to Rs. 1.1b during 9MFY19 (FY18: Rs. 836m; FY17: Rs. 899m). Resultantly, the annualized FFO-to-long-term debt and FFO-to-total debt ratios improved to 0.64x (FY18: 0.36x; FY17: 0.32x) and 0.20x (FY18: 0.14x; FY17: 0.17x) respectively. Similarly, the debt service coverage ratio (DSCR) stood higher at 2.29x (FY18: 1.31x; FY17: 1.34x). The DSCR is projected at 2.01x for FY19 (FY20: 1.79x; FY21: 1.80x) owing to higher scheduled repayments of long-term debt.

Capitalization & Funding

Paid-up capital remained unchanged at Rs. 287m. Tier-1 equity augmented to Rs. 2.4b by end-9MFY19 (FY18: Rs. 1.8b; FY17: Rs. 1.5b) with the retention of profits. Total liabilities increased to Rs. 8.7b (FY18: Rs. 8.0b; FY17: Rs. 6.5b) as the impact of some reduction in trade and other payables was offset by higher utilization of short-term borrowings. Trade and other payables decreased to Rs. 668m by end-9MFY19 (FY18: Rs. 712m; FY17: Rs. 470m) on account of lower creditors of Rs. 170m (FY18: Rs. 206m; FY17: 182m) and advance from customers of Rs. 267m (FY18: Rs. 298m; FY17: Rs. 135m). The increase in trade and other payables during FY18 was mainly due to higher advance payments from the customers against sugar deliveries. Deferred tax liability amounted to Rs. 1.1b (FY18: Rs. 1.2b; FY17: Rs. 723m).

The debt profile of the company comprises a mix of short-term and long-term borrowings. Long-term debt financing, inclusive of current portion and related-parties loan, stood at Rs. 2.2b at end-9MFY19 (FY18: Rs. 2.3b; FY17: Rs. 2.8b). The company has mobilized new long-term debt of Rs. 512m during FY19 and further long-term of Rs. 500m is expected during FY20, which would be utilized for the BMR-2. Long-term financing carry markup in a range of KIBOR plus 1% - 2% per annum and are payable in 3 – 5 years period. Loan from related parties decreased to Rs. 351m at end-9MFY19 (FY18: Rs. 459m; FY17: Rs. 389m) with the repayment of principal, carrying a markup of KIBOR plus 1.25% per annum.

The utilization of short-term borrowings has increased on a timeline basis owing to higher stock carryover. The outstanding amount of short-term borrowing stood at Rs. 4.7b at end-9MFY19 (FY18: Rs. 3.8b; FY17: Rs. 2.5b) owing to higher working capital requirements. The short-term borrowings represent cash finance and export re-finance, carrying markup in a range of KIBOR plus 1%-1.25% per annum. Due to notable growth in equity, gearing and debt leverage indicators have improved to 2.95x by end-9MFY19 (FY18: 3.43x; FY17: 3.62x) and 3.71x (FY18: 4.48x; FY17: 4.46x), respectively.

Chashma Sugar Mills Limited **Annexure I**

FINANCIAL SUMMARY *(amounts in PKR millions)*			
BALANCE SHEET	**FY17**	**FY18**	**9MFY19**
Property, Plant & Equipment	7,790	9,532	9,393
Long-term Investment	-	100	100
Stores, Spare & Loose Tools	345	343	353
Stock in Trade	1,354	2,243	3,791
Trade Debts	185	219	143
Loans, Advances & Tax Refund	271	365	420
Deposits, Prepayment & Others	546	826	548
Cash & Bank Balance	84	189	133
Total Assets	**10,574**	**13,816**	**14,881**
Trade & Other Payables	470	712	668
Deferred Taxation	723	1,155	1,087
Other Liabilities	33	8	35
Short-term Borrowings	2,504	3,796	4,739
Long-Term Borrowings *(Inc. current matur)*	2,778	2,339	2,197
Total Liabilities	**6,509**	**8,010**	**8,726**
Tier-1 Equity	1,461	1,786	2,351
Total Equity	4,065	5,805	6,155
INCOME STATEMENT	**FY17**	**FY18**	**9MFY19**
Net Sales	11,332	10,275	9,201
Gross Profit	1,108	1,270	1,522
Operating Profit	625	765	1,025
Profit After Tax	92	194	393
FFO	899	836	1,057
RATIO ANALYSIS	**FY17**	**FY18**	**9MFY19**
Gross Margin (%)	9.8	12.4	16.5
Net Working Capital	(946)	(1,015)	(807)
FFO to Long-Term Debt (x)	0.32	0.36	0.64*
FFO to Total Debt (x)	0.17	0.14	0.20*
Debt Servicing Coverage Ratio (x)	1.34	1.31	2.29
ROAA (%)	0.9	1.6	3.7*
ROAE (%)	6.7	11.9	25.3*
Gearing (x)	3.62	3.43	2.95
Debt Leverage (x)	4.46	4.48	3.71
Inventory + Receivables to Short-term Borrowings (x)	0.61	0.65	0.83

**Annualized*

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.vis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details.www.vis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES — Appendix III

Name of Rated Entity	Chashma Sugar Mills Limited
Sector	Sugar
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	(see below)

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
10/18/2019	A-	A-2	Stable	Upgrade
11/15/2018	BBB+	A-2	Stable	Initial

Statement by the Rating Team	VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
Probability of Default	VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.
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