RATING REPORT

Madina Sugar Mills Limited (MSML)

REPORT DATE:
October 22, 2020

RATING ANALYSTS:
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RATING DETAILS				
	Latest Rating		Previous Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	A-	A-2	A-	A-2
Rating Date	*October 22, 2020*		*July 24, 2019*	
Rating Outlook	Stable		Stable	

COMPANY INFORMATION	
Incorporated in 2007	External auditors: Kreston Hyder Bhimji & Co. Chartered Accountants
Public Limited Company – Unquoted	Chairman of the Board/CEO: Mian Muhammad Hanif
Key Shareholders (with stake 5% or more):	
Faisalabad Oil Refinery (Pvt.) Ltd. - 31.05%	
Mian Mohammad Hassan Rashid - 27.42%	
Mian Mohammad Rashid- 10.12%	
Mian Mohammad Hanif- 8.36%	
Mian Mohammad Haider Amin-7.20%	
Mrs. Arooj Fatima- 6.50%	

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

OVERVIEW OF THE INSTITUTION

Madina Sugar Mills Limited (MSML) was incorporated in 2007. The principal activity is production and sale of white crystalline sugar and ethanol.

Profile of the Chairman/CEO

Mr. Mian Muhammad Hanif has more than 25 years of experience in edible oils, sugar, steel, and education sectors. He is also acting chairman of Pakistan Edible Oils Refiners Association.

Financial Snapshot

Core Equity: end-9MFY20: Rs. 7.5b; end-FY19: Rs. 6.7b; end-FY18: Rs. 5.6b

Assets: end-9MFY20: Rs. 16.3b; end-FY19: Rs. 14.6b; end-FY18: Rs. 12.0b

Profit After Tax: 9MFY20: Rs. 764.7m; FY19: Rs. 1.1b; FY18: Rs. 324.7m

RATING RATIONALE

The ratings assigned to MSML take into account its association with Madinah Group, having business stake in various sectors encompassing edible oils, sugar, ethanol, power generation, mass media and steel. The assigned ratings also factor in diversification by the company into ethanol business to curtail the impact of sugar sector cyclicality. Profit margins stood significantly higher during FY19 on account of higher proportion of ethanol sales entailing sizeable margins. Some decrease in margins was witnessed during 9MFY20 due to higher lower contribution of sugar segment. However, uptrend in retail prices of sugar and also ethanol rates on account of surge in demand for sanitizing products due to Covid-19 have boded well for the company. Debt service coverage has remained adequate. Further, the ratings draw comfort from minimal reliance on long-term borrowings and comfortable gearing and leverage indicators. Meanwhile, the ratings are constrained due to inherent business risk present in sugar sector and any adverse changes in regulatory duties. Management of leverage and liquidity indicators along with additional contribution margins from the ethanol and sugar segments would be important, going forward.

Business risk is considered high due to inherent cyclicality in crop levels and raw material prices: According to Pakistan Economic Survey 2019-20, sugarcane crop contributes about 0.6% to GDP and 2.9% of the total value addition in agriculture. During 2019-20, sugarcane production decreased by 0.4% to 66.88 million tons vis-à-vis 67.17 million tons of preceding year. Lower output is mainly the result of decrease in area of cultivation i.e 1,040 thousand hectares in MY20 as compared to 1,102 thousand hectares in MY19, a decline of 5.6%. Meanwhile, the yield has improved by 5.5% compared to MY19. Average sugar prices have increased by 19% in MY19 and 16% in MY20. In order to control sugar prices and to maintain a strategic reserves of sugar, the GoP has allowed import of 300,000 tons of refined sugar, starting from Sep'20. Further, Economic Coordination Committee (ECC) has recently also allowed exemption of sales tax on supply of sugar, imported through Trading Cooperation of Pakistan. Contrarily no support or subsidy was awarded for sugar export. While business risk is considered high, diversification of major industry players into ethanol business provides some cushion to profitability of the companies.

Production and capacity utilization: Crushing capacity of sugar plant remained intact at 16,000 MT per day while capacity utilization increased to 95% (2018-19: 88%; 2017-18: 81%). The plant remained operational for 102 days (2018-19: 100 days; 2017-18: 131 days) during outgoing crushing season. Total cane crushed during 2019-20 season was recorded at 1,106,825.4 MT (2018-19: 1,184,524.3 MT; 2017-18: 1,834,000 MT). Total sugar production was recorded lower at 104,100 MT (2018-19: 112,610 M.T; 2017-18: 103,325 M.T) due marginal decrease in cane crushing and sucrose recovery (9.4%) during FY20 (2108-19: 9.5%; 2017-18: 9.5%).

	FY18	FY19	9MFY20
Crushing Capacity – tpd	14,000	16,000	16,000
Cane Crushed – tons	1,084,801	1,184,524	1,106,825
Crushing Days	131	100	102
Capacity Utilization – %	81	88	95
Sucrose Recovery – %	9.52	9.51	9.40
Sugar Produced – tons	103,325	112,610	104,100
Molasses Produced –Tons	56,335	60,980	55,640
Molasses Recovery Rate – %	5.19	5.15	5.03

Ethanol Capacity – tpd	200	300	300
Ethanol Produced – tons	188	250	261
Ethanol Recovery rate – %	19.66	22.18	23.66
Capacity Utilization – %	94	83	87
Operating Days	329	215	160

Distillery remained operational for 160 days (FY19: 215 days; FY18: 329 days) on account of obstruction in supply of molasses due to overall shortage from lower crushing. The company purchased 121,122 MT of molasses during 9MFY20 vis-à-vis 130,206 M.T in the preceding year while self-generated molasses also decreased to 55.6 MT vis-à-vis 61 MT last year. Overall molasses available for consumption, including opening stock, decreased to 185.9 MT during 9MFY20 as compared to 251.3 MT in the preceding year. However, ethanol production increased due to higher recovery rates (FY20: 23.7%; FY19: 22.2% & FY18: 19.7%).

Property, plant and equipment stood at Rs. 7.3b (FY19: Rs. 7.5b; FY18: Rs. 6.9b) at end-9MFY20. Addition of Rs. 40m pertained to polythene bags machinery and addition of Rs. 110.7m was related to distillery unit-III during 9MFY20.

Growth in topline driven by notable increase in sugar sales: The company recorded net sales of Rs. 10.5b (FY19: 10.3b; FY18: Rs. 9.5b) during 9MFY20. Proportion of sugar sales increased to 68% (FY19: 42.9%; FY18: 54.2%) while ethanol sales contributed around 31% (FY19: 56%; FY18: 45%) to the gross revenue during 9MFY20. Around 97% of ethanol was exported. Proportion of other by-products in gross sale remained minimal. The company sold 110,821 M.T of sugar (FY19: 74,358 M.T: FY18: 106,592 M.T) at an average rate of Rs. 71,014/M.T (FY19: Rs. 61,942/M.T; FY18: Rs. 51,141/M.T) during 9MFY20. The management expects the sugar prices to largely remain intact in the ongoing year on account of some increase in demand and largely stagnant sugar production.

Volumetric sale of ethanol was recorded lower at 32,215 MT (FY19: 66,476 MT; FY18: 61,734 MT) during 9MFY20 at a higher average rate of Rs. 112,329 MT (FY19: Rs. 90,875/MT; FY18: Rs. 73,942/MT). Ethanol prices spiked up after the emergence of Covid-19 owing to higher demand for sanitizing products. Prices are expected to remain largely intact in the short-term given sustained demand of sanitizing products.

Cost of sales was recorded at Rs. 8.8b (FY19: Rs. 8.2b; FY18: Rs. 8.4b) during 9MFY20. The company incurred average sugarcane procurement cost of Rs. 239.5/maund (FY19: Rs. 184.0/maund; FY18: Rs. 189.0/maund) during 9MFY20. Average cost of purchased molasses also increased to Rs. 17,803/MT (FY19: Rs. 10,087/MT). Gross margins decreased to 15.7% (FY19: 19.7%; FY18: 11.5%) due to higher contribution of sugar sales entailing negative margins. However, the sugar segment margins, though remained negative, improved during 9MFY20 on account of better retail prices. Administrative expenses amounted to Rs. 149.3m (FY19: Rs. 153.6m; FY18: Rs. 157.1m) and selling and distribution expenses were Rs. 60.3m (FY19: Rs. 72.8m; FY18: Rs. 107.8m) during 9MFY20. Other income decreased to Rs. 28.0m (FY19: Rs. 98.3m; FY18: Rs. 86.7m) owing to lower exchange gain as rupee and USD parity showed some stability in 1HFY20. Other expenses comprising provision for Workers' Profit Participation Fund amounted to Rs. 40.2m (FY19: Rs. 54.2m; FY18: Rs. 17.2m). Finance cost incurred during 9MFY20 was Rs. 653.1m (FY19: Rs. 808.9m; FY18: Rs. 567.2m). Finance cost for FY20 would be relatively lower than the preceding year on account of notable decrease in markup rates during 2HFY20. The company reported net profit of Rs. 764.7m (FY19: Rs. 1.1b; FY18: Rs. 324.7m) during 9MFY20. Given tax credit under section 65(B) of income tax ordinance the company has carried forward tax rebate, hence virtually no tax has been charged since 2017.

Decrease in Funds from Operations (FFO) mainly due to lower non-cash adjustments while debt service coverage has remained adequate: FFO amounted to Rs. 1.1b (FY19: Rs. 2.1b; FY18: Rs. 1.0b) due to lower non-cash adjustments pertaining to depreciation expense and write down in the value of stock in trade, along with marginal difference in incurred and paid finance cost during 9MFY20 relative to preceding year. FFO to total debt on annualized basis decreased to 0.17x (FY19: 0.28x; FY18: 0.17x) due to lower FFO and higher short-term debt. Meanwhile, FFO to long-term debt remained sizeable at 8.54x (FY19: 7.84x; FY18: 2.06x) on account of lower reliance of long-term financing. Debt service coverage have remained adequate at 2.28x (FY19: 2.95x; FY18: 1.90x) in 9MFY20.

Stock in trade was recorded higher at Rs. 5.7b (FY19: Rs. 4.9b; FY18: Rs. 3.7b) mainly due to higher ethanol stock in finished goods inventory at end-9MFY20. Trade debts increased to Rs. 1b at end-9MFY20 (FY19: Rs. 135m; FY18: Rs. 210.4m) pertained to sugar sales. All of these trade debts fall within three months' credit bracket and have been recovered in full subsequently. Advances, deposits, prepayments and other receivables amounting Rs. 1.4b (FY19: Rs. 1.4b; FY18: Rs. 352.9m) mainly pertained to advances to suppliers and growers. The increase in advances to suppliers in FY19 onwards is due to higher purchase of molasses as distillery unit III became operational in March'19. It also includes deposit of Rs. 377.8m with deputy registrar (Lahore High Court (LHC)) on account of the levy of tax duty on manufacturing of ethanol; the GoP has withdrawn this duty w.e.f. Aug'19. The tax was imposed by GoP and the companies including MSML filed an appeal before LHC against its levy. The company had to deposit the due amount till 05 Aug'19 and the final decision of the case is still pending adjudication, hence appearing under advances, deposits and other receivables. Further, tax refunds due from government amounted to Rs. 500.4m (FY19: Rs. 445.7m; FY18: Rs. 473.3m) at end-9MFY20. Trade and other payable increased to Rs. 403.1m (FY19: Rs. 162.2m; FY18: Rs. 56.7m) mainly related to cane growers and sales & federal excise duty. Current ratio slightly increased to 1.02x (FY19: 0.90x; FY18: 0.83x) by end-9MFY20. Coverage of short-term borrowings via stock in trade and trade debts remained low at 0.85x (FY19: 0.69x; FY18: 0.72x) at end-9MFY20.

Equity base enhanced on the back of profit retention: Core equity increased to Rs. 7.5b (FY19: Rs. 6.7b; FY18: Rs. 5.6b) at end-9MFY20. Short-term borrowings from financial institutions stood higher at Rs. 8.0b (FY19: Rs. 7.2b; FY18: Rs. 5.5b) at end-9MFY20. Unsecured and interest free directors' loan to support working capital requirements decreased to Rs. 18.0m (FY19: Rs. 21.8m; FY18: Rs. 191.2m) by end-9MFY20; the said loan is payable on demand of directors. Long-term debt decreased to Rs. 166.2m (FY19: Rs. 270.8m; FY18: Rs. 507.4m) in line with periodic repayments 9MFY20. Gearing and leverage indicators slightly remained at 1.09x and 1.18x (FY19: 1.13x & 1.19x; FY18: 1.11x & 1.14x). The gearing is expected to remain around the current levels as the company does not intend to mobilize long-term debt in the foreseeable future.

FINANCIAL SUMMARY *(amounts in PKR millions)*

BALANCE SHEET	Sep 30, 2017	Sep 30, 2018	Sep 30, 2019	Jun 30, 2020
Non-Current Assets	6,403.4	6,893.9	7,605.2	7,424.2
Stores, Spares & Loose Tools	116.1	190.6	116.8	147.5
Stock-in-Trade	2,347.9	3,735.0	4,864.9	5,738.4
Trade Debts	268.9	210.4	135.0	1,029.2
Advances, Deposits, Prepayments & Other Receivables	112.8	352.9	1,417.3	1,359.1
Tax Refunds Due from Government	446.7	473.3	445.7	500.4
Cash & Bank Balances	6.4	101.3	60.6	67.7
Total Assets	9,702.1	11,957.3	14,645.5	16,266.7
Trade and Other Payables	286.2	56.7	162.2	403.1
Short Term Borrowings	3,093.9	5,501.8	7,246.3	7,964
Director's Loan	1,064.4	191.2	21.8	18.0
Long-Term Borrowings *(Inc. current maturity)*	845.0	507.4	270.8	166.2
Other Liabilities	78.5	116.5	251.9	258.2
Tier-1 Equity/ Total Equity	4,334	5,583.7	6,692	7,457
Paid-Up Capital	3,725.4	4,360.4	4,360.4	4,360.4
INCOME STATEMENT	Sep 30, 2017	Sep 30, 2018	Sep 30, 2019	Jun 30, 2020
Net Sales	7,163.4	9,461.3	10,269.2	10,457.2
Gross Profit	729.9	1,087.8	2,019.8	1,639.8
Operating Profit	572.6	822.9	1,739.5	1430.1
Finance Cost	251.8	567.2	808.9	653.1
Profit Before Tax	309.1	325.3	1,028.7	764.7
Profit After Tax	370.1	324.7	1,108.9	764.7
FFO	682.8	1,044.7	2,122.7	1,066.5
RATIO ANALYSIS	Sep 30, 2017	Sep 30, 2018	Sep 30, 2019	Jun 30, 2020
Gross Margin (%)	10.2	11.5	19.7	15.7
Net Margin (%)	5.2	3.4	10.8	7.3
Net Working Capital	(1,571.9)	(1,062.1)	(743.8)	180.7
Current Ratio (x)	0.68	0.83	0.90	1.02
FFO to Long-Term Debt(x)	0.81	2.06	7.84	8.54*
FFO to Total Debt (x)	0.14	0.17	0.28	0.17*
Debt Servicing Coverage Ratio (x)	1.76	1.90	2.95	2.28
ROAA (%)	4.1	3.0	8.3	6.6*
ROAE (%)	8.9	6.6	18.1	14.4*
Gearing (x)	1.15	1.11	1.13	1.09
Debt Leverage (x)	1.24	1.14	1.19	1.18
Stock in Trade Plus Trade Debts to Short-Term Borrowings (x)	0.85	0.72	0.69	0.85

**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	Madina Sugar Mills Limited
Sector	Consumer Goods
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	
Instrument Structure	N/A
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.
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. For conducting this assignment, analyst did not deem necessary to contact external auditors or creditors given the unqualified nature of audited accounts and diversified creditor profile.
Due Diligence Meetings Conducted	

Rating History:

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
Oct 22, 2020	A-	A-2	Stable	Reaffirmed
Jul 31, 2019	A-	A-2	Stable	Reaffirmed
Jun 29, 2018	A-	A-2	Stable	Initial

Due Diligence Meetings Conducted:

	Name	Designation	Date
1	Mr. Malik Naeem	Chief Financial Officer	October 7, 2020