

Al-Abbas Sugar Mills Limited

OVERVIEW (January 03, 2013) : Al-Abbas Sugar Mills Limited (AASML) was incorporated in May 1991. The shares of the Company were listed on April 1992 at the Karachi Stock Exchange. The company produces sugar, quality industrial alcohol and several alloys. AASML has also been generating its own electricity for its industrial units since 2010. In total, the company has a sugarcane-crushing capacity of 7.5 tons per day; processing capacity of molasses into industrial alcohol of 170,000 liters per day; and the capacity to manufacture 27,220 megatonnes of different alloys per annum. AASML's growth has come organically and through mergers. Expansion into the ethanol industry significantly contributed to the company's bottom line and purported risk diversification aims. The utility of state-of-the-art technology allows for high quality output with conservation of energy to minimise costs. As part of Company strategic planning, the Company ventured into inorganic growth by acquiring Al-Abbas Industries Limited in 2007 and thus gained its alloy-producing capabilities. **Industry**

Overview

The sugar industry as a whole is facing a tough year. Local demand this year is expected to be 4.6 million tonnes, while anticipated production is placed at five million tonnes. The surplus production will be exacerbated by the fact that surplus production last year amounted to a total of 1.2 million tonnes. Trade Corporation of Pakistan has committed to purchasing 300,000 tonnes of sugar this year, which will alleviate the woes of the industry to a certain extent. However, with the increase in support prices for sugar by the Government of Pakistan, profits are likely to be further dampened. Allowable exports this year have been increased to 500,000 tonnes. Supply surpluses internationally, however, have resulted in unfavourable price adjustments down to \$515 per tonne, and sugar manufacturers are reluctant, therefore, to export their product. The key challenge is that if surpluses are not exported, superfluity in the local markets will have a drastic impact, thus squeezing margins further. India has recently imposed a 10 percent anti-dumping duty on Pakistan's sugar. Pakistan's exported sugar is in great demand there due to the fact that it is INR15-20 cheaper than locally manufactured sugar. The demand there has thus been dampened. Simultaneously, Iran is now importing raw sugar as opposed to white sugar, thus further aggravating the economic conditions for the sugar industry.

Performance Snapshot 9MFY12

Compared to the 9MFY11, AASML saw a 7.95 percent reduction in sales, but with increasing efficiency in operations, the bottom line swelled by 46.67 percent. A significant contribution to this paradox was the elimination of losses from discontinued operations which the company has been facing for the past two years. A significant reduction in finance costs was also significant in this contribution. From the shareholders' perspective, the 9MFY12 depicted a significant improvement from the previous comparable period; return on equity (ROE) grew from 19.58 percent in 9MFY11 to 24.32 percent despite a reduction in the financial leverage position from 3.86 to 3.33 which also improved the risk profile of the company, as reflected in the increase in interest cover ratio from 2.26 times in 9MFY11 to 3.12 times in 9MFY12. The increase in ROE

was primarily fuelled by the increase in operating efficiency (reflected primarily by an increase in gross profit margin from 15.99 percent in 9MFY11 to 20.65 percent in 9MFY12), reduction in finance costs, and the elimination of losses from discontinued operations. These factors translated into an increase in the return on assets (ROA) from 5.08 percent in 9MFY11 to 7.30 percent in 9MFY12; and an increase in the net profit margin from 5.70 percent to 9.09 percent. On the other hand, a 110.09 percent increase in distribution costs limited the growth in operating profits to 5.79 percent. The liquidity position of AASML, however, is not quite as optimistic in its outlook as the profitability calculus above. The current ratio posted a negligible increase from 0.95 in 9MFY11 to 0.96 in 9MFY12. However, the acid test ratio declined from 0.2 to 0.15 primarily fuelled by an 11 percent increase in inventory levels, corresponding to an increase in days in inventory from 165 days to 200 days. The ratio of net operating cash flows to short-term debt registered a positive number, as compared to 9MFY11's -0.15, but was still a dismal 0.01. Cash flow margins as a percentage of sales remained low at 0.81 percent (compared with a net profit margin of 9.09 percent). Price performance for the company in the stock market was fairly disappointing, and reflects the general bearish sentiment of investors regarding the sugar industry. Price-to-earnings ratio fell from Rs 6.44 to Rs 3.7, while the price-to-book ratio fell from Rs 1.26 to Rs 0.9. Dividend yields have historically been a stable average of 5.22 percent, and given profits this year, are expected to remain in line with that.

Performance over the years

Over the three-year period of FY09 to FY11, AASML has seen an annual average growth rate in sales of 31.13 percent. However, it must be noted that the most recent two growth figures (between FY10 and FY11, and between 9MFY11 and 9MFY12) have been -2.12 percent and -7.95 percent respectively. The rate of change of net profit has been volatile, with a high point of 276.43 percent growth in FY09 against a 27.47 percent reduction in FY10. On average, however, the net profit has seen an annual growth of 44.59 percent. While profitability has looked sound for the company over the three year period, liquidity has been a worrisome issue. Current assets have consistently been less than current liabilities thus casting doubt on the company's ability to meet obligations as they fall due; the acid test ratio declined from 0.25 times to 0.2 times over the same period. The cash conversion cycle increased from 43 days to 56 days between FY09 and FY11. Operating cash flows declined from Rs 627,689,000 in FY09 to negative Rs 531,453 in FY11; a 185 percent decrease in net operating cash flows. In terms of operations, the recovery rate (a measure of the efficiency with which sugar is extracted from the crushed sugarcane) has not been encouraging. From the high-water mark of 10.40 percent in FY10, the recovery rate has steadily been declining to 9.83 percent in 9MFY12. With support prices on the sugar cane for farmers increasing, and downward price pressure precipitating for surplus supply in the domestic and international markets, the pressure on profitability is on, and a squeeze is likely to emanate sans corrective measures. The price of AASML stocks has steadily been increasing from Rs 78.99 at the close of FY09 to Rs 100.26 at the close of FY11. This largely explains the steadily increasing P/E and P/B ratios. However, as per predictions of overpricing by several brokerage houses, a downward correction has occurred and the price at the close of 9MFY12 was Rs 84.45 thus leading to a reduction in both ratios to Rs 3.7 and Rs 0.9 respectively.

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	9MFY12	9MFY11	2011	2010	2009	
PROFITABILITY						
Gross profit margin	%	20.65%	15.99%	15.08%	11.91%	18.85%
Operating profit Margin	%	15.02%	13.07%	10.96%	8.98%	14.61%
Net profit margin	%	5.70%	3.65%	3.22%	6.78%	9.09%
ROA	%	7.57%	24.32%	19.58%	16.42%	16.43%
ROE	%					25.09%
LIQUIDITY						
Current ratio	times	0.95	0.95	0.81	1.00	0.96
Acid Test Ratio	times	0.15	0.20	0.20	0.26	0.25
Days in Receivables	days	23.77	27.77	24.38	15.84	10.79
Days in Payables	days	111.28	107.71	87.32	61.15	67.57
Days in Inventory	days	164.78	118.27	58.86	99.85	199.56
LEVERAGE						
Financial Leverage	times	3.33	3.86	3.86	3.24	3.32
Interest Cover Ratio	times	1.91	1.94	2.24		3.12
MARKET/INVESTMENT						
Price-to-Earnings Ratio	Rs	0.00	0.00	0.00	0.00	0.00
Price-to-Book Ratio	Rs	0.90	1.26	1.26	1.24	1.22
Dividend Yield	%	4.99%	5.62%	5.06%		0.00%
CASH FLOW RATIOS						
Operating Cash Flow Ratio	times	0.01	-0.50	-0.15	0.14	0.46
Cash Flow Margin Ratio	%	0.81%	-36.59%	-8.55%	4.77%	15.06%
Cash Flow Coverage Ratio	times	-0.55	2.03	3.32		1.32