RATING REPORT

Sitara Chemical Industries Limited (SCIL)

REPORT DATE:
November 14th, 2018

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-1	A+	A-1
Rating Date	*14 November'18*		*17 November'17*	
Rating Outlook	Positive		Positive	
Outlook Date	*14 November'18*		*17 November'17*	

COMPANY INFORMATION

Incorporated in 1981	**External auditors:** M/s Deloitte Yousuf Adil & Co Chartered Accountants
Public Limited Company	**Chairman of the Board:** Mr. Muhammad Khalil
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mian Mohammad Adrees
Mian Mohammad Adrees – 63.64%	
General Public – 10.95%	
Bank, DFI & NBFCs – 8.94%	
Mutual Funds – 6.00%	

APPLICABLE METHODOLOGY(IES)

JCR-VIS Entity Rating Criteria *Industrial Corporate (May 2016)*
http://www.jcrvis.com.pk/docs/Corporate-Methodology-201605.pdf

Sitara Chemical Industries Limited (SCIL)

OVERVIEW OF THE INSTITUTION

SCIL was incorporated in 1981 as a public limited company under Companies Act, 1913 (now Companies Act, 2017). The principal activities include operation of Chlor-Alkali plant and textile unit. The chemical division is engaged in the production of caustic soda & other auxiliary products while textile division is involved in production of different types of yarn and high quality men's fabric under the brand name 'Rajahs' . The company is listed on Pakistan Stock Exchange.

Profile of the Chairman

Mr. Muhammad Khalil has around 29 years of experience in the field of Chemical Engineering, Marketing and Commerce. He joined SCIL as General Manager Process in 1992 for the Sitara Rayon Project. He holds a M.Sc. degree in Chemical Engineering.

Profile of the CEO

Mian Muhammad Adrees is a renowned businessman. He graduated from Punjab University. He is also the CEO of Sitara Developers and Aziz Fatima Medical & Dental College.

Financial Snapshot

Core Equity: FY18: Rs. 9.5b; FY17: Rs. 8.6b

Assets: FY18: Rs. 19.8b; FY17: Rs. 19.5b

Sales: FY18: Rs. 12.3b; FY17: Rs. 10.1b

Profit After Tax: FY18: Rs. 1.1b; FY17: 1.2b

RATING RATIONALE

The ratings assigned to Sitara Chemical Industries Limited (SCIL) take into account its leading position in the Chlor-alkali sector with the highest market share of around 45%. The ratings incorporate moderate business risk profile; the company has been able to maintain positive momentum in revenues and largely sustain margins in a highly competitive operating environment. The ratings draw comfort from low financial risk appetite emanating from its low leveraged capital structure and adequate debt service coverage. The company's strong sponsor profile remains a key rating factor. Further, conversion of investment property in to an earning asset and additional liquidity generation from its sale therein is considered a positive rating factor. Rising international coal prices, increase in natural gas tariff and cost of imported RLNG along with adverse exchange rate parity are key challenges being faced by the company.

Key Rating Drivers:

Market leader in the oligopolistic sector with sound business prospects: The chlor-alkali sector is oligopolistic in nature with three players operating in the country. Overall capacity utilization has remained moderate owing to imbalance in the demand and supply of product leading to competition driven market. The total volumetric caustic soda sales including export sales(liquid and flakes) of the sector were recorded around 321,105MT; SCIL reported a higher sale quantity of 145,847 MT (FY17: 129,680 MT) during FY18. Business prospects of the caustic soda sector remain positive, characterized by growing demand and sound margins. While the sector is power intensive, the companies have set up captive power plants to support the production process indigenously. In addition, the sizeable cost differential in the local and import prices of caustic soda due to heavy excise duty and freight charge has created a sustainable market for local players. As per the management, the locally produced caustic soda flakes is estimated around Rs. 79,500/ton while the imported product is priced at Rs. 100,000/ton.

Double digit growth in sales and before tax profitability during FY18 with positive trajectory exhibited in export revenues: Over the last five years, sales of the company have grown at a CAGR of around 9%. The chemical sector remains the major revenue driver; textile segment continues to supplements the sales. Caustic soda is the flagship product of the company accounting for almost two-thirds of the total revenue base. Net sales of the company increased during FY18 with both divisions reporting higher sales. The augmentation in sales was a combined outcome of increase in sales volumes and higher average retail prices of yarn, caustic soda and allied products. However, impact of higher output prices could not reflect in the gross margins of both divisions owing to considerable increase in input cost, mainly related to fuel and power. The distribution cost increased primarily as a result of higher freight expense owing to overall enhancement in the scale of operations and higher export opportunities availed primarily related to caustic flakes. The export revenues stood higher at Rs. 556m during FY18 as compared to Rs. 192m in the preceding year. Further, administrative expenses increased on a timeline basis owing to inflationary pressure, leading to annual salary adjustments together with higher headcount reported during FY18. The other expenses also stood higher at Rs. 114.5m (FY17: Rs. 67.5m) on account of ongoing contribution towards workers' welfare fund and loss reported on investments. The contribution to workers' welfare fund amounted to Rs. 97.4m (FY17: Rs. 67.5m); meanwhile, loss on investments of Rs. 17.1m (FY17: nil) was incurred on unquoted investments. In the backdrop of increasing average benchmark interest rates and higher average short-term borrowings, finance cost of the company increased during FY18. Despite increase in operating expenses and finance cost, SCIL's before tax profit posted growth in FY18 on the back of higher sales revenue. However, given higher tax expense, net profit declined slightly during FY18. Going forward, exports are projected to depict healthy growth; the management is focusing on new export markets with high demand potential. The management also projects 10% increase in caustic soda liquid and flake prices in FY19.

Strong liquidity profile as evident from healthy cash flows in relation to outstanding obligations and adequate debt service ability:
Liquidity profile of the company is considered sound in view of improving cash flows in relation to outstanding obligations and adequate debt service capacity. In line with higher profit before taxation along with higher non-cash adjustments, Funds from Operations (FFO) exhibited an increasing trend. Resultantly, with increase in FFO and overall decline in the total debt levels owing to repayment of long-term obligations, FFO to total debt improved on a timeline basis. Debt service coverage ratio, albeit decreased slightly owing to higher long-term contractual payments made, remained adequate at 1.6x (FY17: 1.7x) during FY18. According to the management, cash flows are expected to improve on account of increase in sales supported by incremental revenue from newly installed brick making unit and cost saving from improving operational efficiencies.

Given sale of investment property, liquidity profile to improve gradually:
The agreement signed with cooperative housing society in FY15 for the sale of investment property was cancelled during FY18 after litigation process pertaining to unresolved procedural issues. However, SCIL inked a fresh agreement for the sale of land measuring 1510 Kanals in March'18 with Sitara Developers (Pvt.) Limited for an aggregate price of Rs. 2.2b. An advance, representing 20% of the total agreed sale price, amounting to Rs. 438m has already been received; meanwhile the remaining balance of about Rs. 1.8b will be received over a period of five years in equal annual installments. The asset mix of the company includes loans and advances amounting to Rs. 2.4b (FY17: 2.3b) primarily pertaining to advance tax of Rs. 882.9m (FY17: Rs. 495.7m) and advances extended to suppliers and contactors of Rs. 815.0m (FY17: Rs. 678.6m) at end-FY18.

Projected Capex to provide support to revenues, add diversification and lead to operational efficiencies:
Non-current assets comprised around 71% of the total assets at end-FY18. SCIL made a CAPEX of Rs. 834.9m on plant and machinery including establishment of brick making unit, electrolytes membrane replacement of caustic soda plant, up gradation of carbon dioxide plant and modernization of coal fired power plant. The company commissioned its brick making plant which uses fly ash as raw material, produced from coal fired power plant as waste, to produce bricks. These bricks carry better strength and thermal insulation than red clay bricks. In addition, with installation of 4 new ring frames of 552 spindles each in textile division, the company has been able to reduce its overhead cost.

Going forward, SCIL has undertaken Balancing Modernization and Replacement (BMR) of one of the old membrane plants with total CAPEX estimated at Rs. 500m during FY19. The BMR will result in increased production of caustic soda at reduced electricity cost per ton. With the project expected to be completed by end-3QFY19, the excess produce is planned to be exported to the neighboring countries. The management has arranged for funding from a commercial bank with a tenor of six years including one-year grace payment. The installments will be made on quarterly basis; the loan is priced at 3 month KIBOR plus 1.0%. In addition, the management has also planned replacement of old machinery in the Textile division with latest Swiss machinery at an estimated cost of Rs. 350m. The project is planned to be completed by end-FY19; the same is projected to result in improved efficiency and better quality of yarn. The textile unit project is planned to be funded equally through internally generated capital and bank borrowing.

Conservative capital structure with gearing levels expected to improve further:
Core equity expanded by end-FY18 on account of internal capital generation. For the year ended-FY17, the company paid 125% dividend disbursed during FY18 amounting Rs. 267.9m. In addition, SCIL has also recommended a cash dividend of 130% for year ended-FY18. Despite increase in short-term borrowings, total borrowings decreased in line with repayments of long-term obligations. Leverage and gearing ratios decreased to 0.97x (FY17: 1.12x) and 0.59x (FY17: 0.69), respectively, by end-FY18. Although, the company plans on mobilize additional long-term funding during FY19, leverage and gearing are expected to improve further on account of sizeable repayments scheduled, going forward.

Adequate Corporate Governance
Ratings also incorporate adequate corporate governance infrastructure as evident from satisfactory board oversight, professional management team and adequate IT and controls. The senior management depicted stability with no vacant positions at the senior management level.

Sitara Chemical Industries Limited (SCIL) Appendix I

			(Amount in Millions)
BALANCE SHEET	**June 30, 2016**	**June 30, 2017**	**June 30, 2018**
Property Plant and Equipment	8,789	9,413	9,572
Stock-in-Trade	1,104	1,194	951
Trade Debts	1,125	1,164	1,138
Loans and advances	2,863	3,603	3,763
Stores and Spares	414	644	744
Investment Property	2,873	2,927	3,034
Cash & Bank Balances	188	131	80
Other Financial Assets	197	274	352
Other Assets	302	175	163
Total Assets	17,855	19,525	19,797
Trade and other Payables	2,791	2,537	2,293
Short Term Borrowings	2,672	2,976	3,525
Long-Term Borrowings *(Inc. current maturity)*	2,396	3,015	2,020
Other liabilities	1,119	1,146	1,322
Tier I Equity	7,535	8,625	9,473
Total Equity	8,891	9,851	10,637
INCOME STATEMENT	**June 30, 2016**	**June 30, 2017**	**June 30, 2018**
Net Sales	9,814	10,074	12,265
Gross Profit	2,129	2,312	2,633
Operating Profit	1,308	1,459	1,642
Profit After Tax	769	1,166	1,086
FFO	1,263	1,500	1,799
RATIO ANALYSIS	**June 30, 2016**	**June 30, 2017**	**June 30, 2018**

Gross Margin (%)	21.7	22.9	21.5
Net Working Capital	(1,584)	(762)	(1,076)
FFO to Long-Term Debt (x)	0.53	0.50	0.89
FFO to Total Debt (x)	0.25	0.25	0.32
Debt Service Coverage Ratio (x)	2.9	1.7	1.6
ROAE (%)	9.0	12.4	10.6
Gearing (x)	0.67	0.69	0.59
Debt Leverage (x)	1.19	1.12	0.97

ISSUE/ISSUER RATING SCALE & DEFINITIONS — Appendix II

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: JCR-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.jcrvis.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.jcrvis.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.

'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.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-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	Sitara Chemical Industries Limited					
Sector	Chemical					
Type of Relationship	Solicited					
Purpose of Rating	Entity Rating					
Rating History	**Rating Date**	**Medium to Long Term**	**Short Term**	**Rating Outlook**	**Rating Action**	
	RATING TYPE: ENTITY					
	11/14/2018	A+	A-1	Positive	Maintained	
	11/17/2017	A+	A-1	Positive	Maintained	
	06/07/2016	A+	A-1	Stable	Reaffirmed	
	12/31/2014	A+	A-1	Stable	Reaffirmed	
	3/07/2013	A+	A-1	Stable	Reaffirmed	
	2/22/2012	A+	A-1	Stable	Maintained	
	5/3/2011	A+	A-1	Negative	Downgrade	
Instrument Structure	N/A					
Statement by the Rating Team	JCR-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	JCR-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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