RATING REPORT

Sitara Chemical Industries Limited (SCIL)

REPORT DATE:
January 27, 2023

RATING ANALYSTS:
Sara Ahmed
sara.ahmed@vis.com.pk

M. Amin Hamdani
amin.hamdani@vis.com.pk

Shaheryar Khan Mangan
shaheryar@vis.com.pk

RATING DETAILS				
	Latest Rating		**Previous Rating**	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	A+	A-2	A+	A-1
Rating Outlook	Stable		Stable	
Rating Date	January 27, 2023		Nov 22, 2021	
Rating Action	Downgrade		Reaffirmed	

COMPANY INFORMATION	
Incorporated in 1981	**External auditors:** M/s. Yousuf Adil & Co Chartered Accountants
Public Limited Company	**Chairman of the Board:** Mr. Ahmad Hassan
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Mohammad Adrees
Mian Mohammad Adrees – 63.64%	
Jahangir Siddiqui & Company Limited – 10.46%	

APPLICABLE METHODOLOGY
VIS Entity Rating Criteria: Corporates (August 2021)
https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

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. Ahmad Hassan has vast experience as businessman. Currently he is working as CEO of Chenab Engineering Works & Foundries (Pvt.) Ltd. He is B.Sc. Metallurgical Engineering from University of Punjab, Lahore. He holds different positions including Chairman Standing Committee, R&D, FCCI, Vice President FCCI and Executive Member Pakistan Foundry Association.

Profile of the CEO

Mian Muhammad Adrees is a renowned businessman. He graduated from University of Punjab. He is also the CEO of Sitara Developers and Managing trustee of Aziz Fatima Trust.

RATING RATIONALE

Sitara Chemicals Industries Limited ('SCIL' or 'the Company') was incorporated in 1981 as a public limited company. SCIL is listed on Pakistan Stock Exchange (PSX). The principal activities of the Company are operation of Chlor-alkali plant, Oleo chemical plant and yarn spinning unit. The registered office of SCIL is located in Karachi, Sindh while the plant is located at Sheikhupura road, Punjab.

Sector Dynamics

- Chemical industry in Pakistan is considered as one of the robust industries, with the industry having witnessed many ups and downs in the past.
- However, the industry merely constitutes 1.72% of weight in large scale manufacturing. Pakistan meets only 10% of chemical needs through local production while import of chemicals account for 18% of total imports, second biggest after fuel imports.
- Since a large part of the chemical consumption is imported, industry remains exogenous to changes in international prices and exchange risk.
- Demand in the chemical sector of Pakistan has linkage with the performance of multiple industries ranging from plastic, paints, paper, leather, wherein the respective chemicals form an integral part of their input cost.
- In spite of the industry facing global competitive markets and lack of policy support from the government, it has grown progressively over the years, with earnings grown 24% per year over last three years and revenues 15% per year. Growth trends in chemical sector vary across different sub-sectors; some of which are highly dependent on specific sectors or combination of sectors. SCIL remains a leader in the caustic soda industry.
- Going forward, given the macroeconomic conditions and weakening in textile sector, we expect competitive pressure to prevail in the industry.

Key Rating Drivers:

Uncertain demand outlook is likely to exert higher competitive pressure

- Demand outlook for the caustic soda industry remains uncertain on account of slowdown in demand in the textile sector which remains a major consumer of caustic soda. While demand is showing signs of slow down, leading market position (~50% market share) of SCIL in the caustic soda market provides comfort in the medium term.
- We expect with demand weakening competitive pressures in the industry to remain high. Other leading players after SCIL are Ittehad Chemicals and Engro Polymer.
- Competitiveness in the textile segment is also likely to remain high given weakening in international demand.

Revenues growth has continued till Q1'23, although future growth may be subdued.

- Net Sales of SCIL increased substantially to Rs.21.6b (FY21: Rs.14.8b) on account of increased quantitative sale of both caustic and other allied products.

- Net Revenue of chemical division was recorded at Rs.18.07b (FY21: Rs.11.45b), accounting for 84% of the total net revenue of the Company, with caustic soda being their flagship product.

Rs. In M	Q1'23		FY22		FY21	
	Chemical	Textile	Chemical	Textile	Chemical	Textile
Revenue	4,895	303	18,073	3,552	11,455	3,330
Segment Profit	-214	42	220	745	1,183	599

- Volumetric sales of caustic soda in liquid form and flakes were recorded at 109,605 MT (FY21: 99,295MT), indicative of an increase of 10%. Average selling prices were also higher for the year.

- In the textile division, sales depicted an uptick with a net revenue reported at Rs.3.55b (FY21: Rs.3.3b) mainly on the back of improved yarn prices and timely buying of cotton at competitive rates.

- Q1'23 revenues have continued to grow in the chemical division, however, the spinning segment revenues have been impacted, reducing by more than 50% vis-à-vis comparable period last year.

Margins impacted due to rising energy costs; to be recouped post completion of coal power plant

- Energy costs account for a large share of manufacturing cost of caustic soda. Amidst increase in commodity prices of coal, RLNG, SCIL shifted increasingly to WAPDA 67.07% (FY21: 6.75%) for power generation which also registered a hike in in electricity tariff as well as higher fuel cost adjustment, thereby increasing overall energy costs. Contribution by coal fired power plant and gas power plant contracted to 31.61% and 0.53% (FY21: 62.18% and 28.53%) respectively.

- The Company was not able to pass on the rising energy costs to the end price due to market conditions, thereby leading to margin decline. Cost pressure has continued in Q1'23, impacting margins of the Chemical segment. Gross margins declined from 19.8% in FY21 to 13.3% in FY22 and 9.2% in Q1'23.

- Distribution cost increased to Rs.395m (FY21: Rs.288m). The increase is mainly the function of an increase in freight, octroi and insurance. Administrative cost was recorded at Rs.763m as against Rs.646m in FY21, largely driven by higher salaries, wages and benefits.

- Finance cost of SCIL surged to Rs.897m (FY21: Rs.604m). The increase emanated from increase in policy rate as well as higher working capital requirements.

- Net margins as a result dropped to 3% in FY22 (FY21: 9%) and further eroding to negative margins at the end of Q1'23. Last year net margin were also supported by one off gain on sale of property which was absent in FY22.

- In the wake of higher import price of coal prices, SCIL has managed to redesign its expansion project of coal fired power plant on use of either local lignite coal or imported lignite coal as feed stock. The Coal power plant expansion of 50MW is currently underway.

- Going forward, amidst vulnerability to any increase in electricity tariff coupled with withdrawal of relief package, prices of coal, exchange rate, interest rate increase and prolonged restriction by SBP on opening letter of credits, improvement in margins will remain critical for ratings.

Improvement in product portfolio. Addition of soap noodle and stearic acid may provide added revenue support.

- Caustic soda (in liquid form and flakes form) accounted for 71% of total sales, which compared to last year has declined (FY21: 78%) on account of new product additions. Sale of other products account for 29% of the sales (FY22: 22%), paving for increased product diversification. These products include sodium hypo, soap noodles, HCL, liquid chlorine, bleaching powder, carbon dioxide, stearic acid, calcium chloride prill etc. This would help in providing impetus to the topline, going forward.

- Soap noodle plant, which started its operations in June'21, has posted production of oleo chemicals at 8192MT. Company expects a greater contribution from sale of soap noodles to total revenue.

- Negotiations with technology suppliers and engineering design have been completed with major BTG (Boiler, Turbine and Generator) equipment and their Letter of Credit (LCs) also been established with banks. Civil work of the project has also been started which expected to be completed during the ongoing financial year.

Liquidity indicators depict weakening

- In line with decline in profitability primarily on account of margin compression, Funds from Operations (FFO) decreased to Rs.2.0b in FY22 (FY21: Rs.2.3b). FFO to total debt and FFO to long term debt deteriorated to 0.21x (FY21: 0.25x) and 0.75x (FY21: 0.89x) respectively as a result. Additionally, debt service coverage also declined, albeit manageable.

- Liquidity metrics on a timeline basis do not reflect any improvement. With a current ratio of 0.94x and short term borrowing coverage 71% in 1QFY'23, liquidity indicators do not commensurate with the assigned rating. Furthermore, we expect that with the slowdown in the textile sector, pressure on working capital cycle will increase, impacting liquidity further.

- Improvement in the same will be a key rating driver.

Capitalization indicators remain adequate

- Core equity of SCIL stood higher at Rs.12.5b (FY21: Rs.11.8b). Total equity, after incorporating surplus on revaluation of property, plant and equipment of Rs.54m and reserve on re-measurement of equity of Rs.3.5b (FY21: Rs.4.0b), amounted to Rs.16b (FY21: 15.9b).

- Long term borrowings have largely been contained with no major increase, however, on account of working capital requirements, short term debt has increased at the end of Q1'23.

- This, together with loss in Q1'23 led to increase in gearing 0.87x (FY22: 0.76 x; FY21: 0.79x), albeit remaining within manageable levels vis-à-vis equity size.

- Leverage also inched up to 1.33x and subsequently to 1.40x in FY22 and 1QFY'23 respectively.

- However, improvement in profitability metrics and maintenance of capitalization indicators will remain important for ratings.

FINANCIAL SUMMARY				(amounts in PKR millions)	
BALANCE SHEET	**FY19**	**FY20**	**FY21**	**FY22**	**1QFY23**
Property, Plant and Equipment	15,516	14,935	16,923	17,345	17,344
Investment Property	3,297	3,316	3,313	3,259	3,258
LT Investments	20	25	25	25	25
Stock-in Trade	1,328	2,327	2,745	4,325	4,126
Trade Debts	1,177	1,201	1,363	1,387	1,614
Cash & Bank Balances	103	82	191	323	180
Other Assets	5,387	4,710	5,980	5,891	6,696
Total Assets	**26,827**	**26,596**	**30,540**	**32,554**	**33,244**
Trade and Other Payables	2,416	1,991	2,230	3,582	3,306
ST Borrowings	4,333	4,984	6,749	6,840	8,136
LT Borrowings (incl. current maturity)	2,776	2,100	2,584	2,655	2,623
Deferred Liabilities	2,436	2,418	2,564	2,858	2,797
Other Liabilities	246	411	532	581	510
Total Liabilities	**12,208**	**11,903**	**14,658**	**16,516**	**17,372**
Paid Up Capital	214	214	214	214	214
Tier-1 Equity	10,055	10,415	11,801	12,458	12,396
Total Equity	**14,620**	**14,693**	**15,882**	**16,038**	**15,872**
INCOME STATEMENT	**FY19**	**FY20**	**FY21**	**FY22**	**1QFY23**
Net Sales	12,698	11,793	14,785	21,626	5,199
Gross Profit	2,760	2,279	2,933	2,873	477
Profit Before Tax	1,065	211	1,670	898	(172)
Profit After Tax	885	100	1,348	656	(171)
RATIO ANALYSIS	**FY19**	**FY20**	**FY21**	**FY22**	**1QFY23**
Gross Margin (%)	21.7%	19.3%	19.8%	13.3%	9.2%
Net Margin (%)	7.0%	0.9%	9.1%	3.0%	-3.3%
Current Ratio	0.88	0.88	0.90	0.95	0.94
Funds from Operations (FFO)	1,738	1,332	2,310	1,992	138
FFO to Total Debt (x)	0.24	0.19	0.25	0.21	0.05
FFO to Long Term Debt (x)	0.63	0.63	0.89	0.75	0.21
Debt Leverage	1.21	1.14	1.24	1.33	1.40
Gearing	0.71	0.68	0.79	0.76	0.87
Debt Servicing Coverage Ratio (x)*	1.90	1.34	2.23	1.77	1.03
ROAA (%)	3.3%	0.4%	6.3%	2.8%	-2.1%
ROAE (%)	6.1%	0.7%	11.7%	5.5%	-4.3%
(SIT+TD)/ST Borrowing (x)	0.58	0.71	0.61	0.84	0.71

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	Sitara Chemical Industries Limited
Sector	Chlor-alkali (Chemical Sector Sub-set)
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see table below
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. Copyright 2023 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.
Due Diligence Meetings Conducted	see table below

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
01/27/2023	A+	A-2	Stable	Downgrade
11/22/2021	A+	A-1	Stable	Reaffirmed
10/27/2020	A+	A-1	Stable	Reaffirmed
11/08/2019	A+	A-1	Stable	Maintained
11/14/2018	A+	A-1	Positive	Reaffirmed
11/17/2017	A+	A-1	Positive	Maintained

Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Zakir Hussain	CFO	22-Dec-2022
Mr. Mubin Ul Haq	Sr. Deputy Manager Finance	22-Dec-2022