

RATING REPORT

Sitara Chemical Industries Limited (SCIL)

REPORT DATE:

June 14, 2024

RATING ANALYSTS:

Muhammad Subhan
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RATING DETAILS				
Rating Category	Latest Rating		Previous Ratings	
	Long-term	Short-term	Long-term	Short-term
Entity	A+	A-2	A+	A-2
Rating Date	June 14, 2024		January 27, 2023	
Rating Outlook	Stable		Stable	
Rating Action	Reaffirmed		Downgrade	

COMPANY INFORMATION

Incorporated in 1981	External Auditors: M/s Yousuf Adil Chartered Accountants
Public Listed Company	Chairman of the Board: Mr. Ahmad Hassan
Key Shareholders (with stake 5% or more):	Chief Executive Officer (CEO): Mr. Muhammad Adrees
Mr. Muhammad Adrees, Chief Executive – 63.64%	
Jahangir Siddiqui & Company Limited – 10.94%	

APPLICABLE RATING SCALE(S)

VIS Issue/Issuer Rating Scale:

<https://docs.vis.com.pk/docs/VISRatingScales.pdf>

APPLICABLE METHODOLOGY

VIS Entity Rating Criteria: Corporates

<https://docs.vis.com.pk/docs/CorporateMethodology.pdf>

Sitara Chemical Industries Limited

OVERVIEW OF THE INSTITUTION RATING RATIONALE

Sitara Chemical Industries Limited was incorporated in 1981 as a public limited company under the Companies Act, 1913 (now the Companies Act, 2017). The principal activities include operating a Chlor-Alkali plant, an oleo chemical plant and a 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 'Rajah's'. 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 the University of Punjab. He is also the CEO of Sitara Developers and

Corporate Profile

Sitara Chemical Industries Limited ("SCIL" or "the Company") was incorporated in Pakistan on September 08, 1981 as a public limited Company under the Companies Act, 1913 (now the Companies Act, 2017). The Company is listed on the Pakistan Stock Exchange Limited. The Company is a Shariah Compliant Company certified by Securities & Exchange Commission of Pakistan (SECP) under the Shariah Governance Regulation 2018 (now the Shariah Governance Regulations, 2023). The principal activities of the Company includes operating a Chlor Alkali plant, an Oleo Chemical plant and a yarn spinning unit. The registered office of the Company is situated at 601-602, Business Centre, Mumtaz Hasan Road, Karachi, in the province of Sindh and the manufacturing facilities are located at 28/32 K.M., Faisalabad - Sheikhpura Road, Faisalabad, in the province of Punjab.

Group Profile:

Sitara Chemical Industries Limited, the group flagship company, is a public listed company and part of Mian Muhammad Adrees Group, which came into existence following division of the Sitara Group into four independent groups. The group's portfolio encompasses SCIL, a key player in the chemical sector, alongside Sitara Developers, a real estate enterprise. Additionally, the group's diversification extends to include Aziz Fatimah Medical and Dental College and Aziz Fatimah Hospital, along with Sitara Technopark and Alief TV.

Business Segments:

Chemicals Division: The Company manufactures caustic soda, soap noodles and allied products through this segment. The Company started its caustic soda production in 1985 with the capacity of 30 metric tons (MT)/day and the production capacity was gradually increased over the years up to 630 MT/day. SCIL is the largest producer of chlor-alkali products in Pakistan, which also involves production of caustic soda, liquid chlorine, specialty chemicals, gases and oleo chemicals. The chemical sales contributes around 87.7% to the total sales of the Company. SCIL sale chemicals both locally and internationally.

Gases Division: The Company has established gases division for the production and marketing of food grade carbon dioxide (CO₂) with a production capacity of 80MT/day. SCIL has its own fleet of vehicles for delivery of carbon dioxide (CO₂) to corporate customers. The revenue earned from this segment is incorporated in the chemicals segment.

Specialty Division: The Company established this division to meet the growing needs of customers where calcium chloride, magnesium chloride, magnesium sulphate, nickel sulphate hex hydrate and ferric chloride are produced. This division is catered as a chemical segment in the financial statements.

Textile Division: SCIL is involved in manufacturing of yarn and trading of fabric The textile unit comprises spinning capacity of around 28,512 spindles. The spinning unit produce all sorts of blends like 100% Polyester, Viscose, Acrylic, PV, AV, PC, CVC, Recycled polyester Fiber& MVS yarn. This division constitutes about 12.3% of the total sales of the Company.

Rajah's: Rajah's is the well-known product of SCIL which operates as a men's clothing brand in the region of Punjab. Its revenue contribution is captured within the textile division.

Competitive Profile:

The Company faces competition from three major players: Ittehad Chemicals Ltd., Engro Polymers & Chemicals Ltd., and Nimir Industrial Chemicals Ltd. While SCIL holds a 50% market share in the chemicals and allied market, the combined market presence of these competitors constitutes the remaining 50%.

*Managing trustee of
Aziz Fatima Trust.*

Clientele:

Major clients of the Company include S.M. Ismail & Co., Rafhan Maize Products Company Ltd, Coca Cola Beverages Pakistan Ltd., Nestle Pakistan Ltd. Etc. while SCIL also exports to countries like United Arab Emirates (UAE) and Africa.

Installation of 50 MW coal based power plant:

The Company is currently in the process of installing a new CFPP with a capital structure consisting of 77% debt and 23% equity. The total project cost is PKR 10.5 bln, of which PKR 4.8 bln has already been secured through bank financing. The remaining funding requirements will be met through an additional PKR 1 bln loan from a bank and PKR 2.3 bln from the issuance of Sukuk. The equity portion, constituting 23% of the total project cost, will be financed through internal cash generation. This project is anticipated to yield positive results, as it is expected to enhance gross profits through cost-saving electricity expenses. The Commercial Operation Date (COD) for the project is projected to be achieved by June 2025.

Key Rating Drivers:**Medium to low business risk profile backed by medium cyclical, lower competition, and highly capital intensive sector**

VIS classifies the business risk of the chemical sector as medium to low, supported by moderate cyclical, low competition, and high capital-intensive nature. Demand in the chemical sector of Pakistan originates from industries such as plastics, paints, paper, leather, soaps, detergents, shampoos, textiles wherein the respective chemicals form an integral part of input materials. Additionally, as a large proportion of chemical demand is met through imports, making the industry susceptible to dumping, albeit the Government of Pakistan has put in place protectionist duties for local industry, which are regularly reviewed. However, a significant part of the raw material is imported; the industry does depict sensitivity to exchange risk.

Significant improvement in the profitability in FY23, however, margins slightly witnessed a decline in 9MFY24 on account of higher energy and finance costs

In FY23, the Company demonstrated a notable 27.1% surge in its top-line, reaching PKR 27.5 bln (FY22: PKR 21.6 bln). The revenue composition comprised predominantly of contributions from the chemicals division (87.9%) and a smaller portion from the textile division (12.0%). This increase in sales mainly came from the chemicals segment, buoyed by elevated average selling prices both domestically and internationally. The Company successfully passed on the escalation in production costs and other input expenses such as energy (including electricity, RLNG costs in PKR terms, and POL) to the selling process of chemical products. Resultantly, the Company witnessed a substantial uptick in gross profit in FY23, amounting to PKR 4.5 bln (FY22: PKR 2.9 bln), translating to a gross profit margin of 16.3% (FY22: 13.3%).

Furthermore, the Company reported a net profit of PKR 993 mln (FY22: PKR 656 mln) in FY23, underpinned by the significant revenue growth. Consequently, the net margin marginally increased to 3.6% (FY22: 3.0%) in FY23.

In the 9MFY24, SCIL displayed a top-line figure of PKR 23.3 bln, which annualizes to PKR 31.1 billion, accompanied by a gross profit of PKR 3.7 bln (PKR 5 bln annualized). Despite this, the gross margin experienced a slight dip to 16.1% compared to FY23, primarily attributed to the escalation in electricity tariffs. Moreover, the net margin also reported a decline, standing at 2.8%, primarily influenced by an increase in financial costs incurred during the period. This rise in financial costs is attributed to the elevated SBP Policy rate compared to the corresponding period of the previous year and elevated debt level.

Moving forward, the installation of the CFPP is expected to enhance the Company's gross margins by reducing production costs.

Coverage profile strengthened in FY23, nevertheless, 9MFY24 experienced weakening

The Company's coverage profile witnessed a positive trajectory, marked by enhancement in its debt service coverage ratio (DSCR), which stood at 1.9x (FY22: 1.7x) in FY23. This improvement in DSCR is mainly attributed to increased funds flow from operations (FFO), a result of elevated profitability. The 9MFY24 saw a decline in the Company's DSCR, which reduced to 1.4x. This decline is attributed to a decrease in SCIL's FFO during the period. The lower FFO was primarily a consequence of diminished profitability experienced in the quarter, compounded by higher finance costs incurred.

Moreover, the substantial debt drawdown associated with the CFPP installation may present a potential debt coverage risk for the Company in the near terms. However, as per the Company's anticipation, the proceeds from the sale of agricultural and other lands will help maintain the coverage going forward.

No material change in the capital structure in FY23, while 9MFY24 witnessed deterioration

In FY23, SCIL's capitalization metrics exhibited stability, with gearing remaining unchanged at 0.8x and leverage experiencing a slight weakening to 1.4x (FY22: 1.3x). This marginal decline in leverage was primarily attributed to a 11% increase in the Company's financial obligations. Also, during 9MFY24, both gearing and leverage showed signs of slight weakening, with gearing reporting at 0.9x and leverage recording at 1.5x. Weakening in both metrics was driven by an increase in SCIL's debt and obligations.

Furthermore, the capitalization metrics are expected to further escalate on account of debt drawdown associated with the installation of CFPP.

Liquidity position remains under stress

The liquidity position of SCIL continues to remain strained, as evidenced by its 5-year average current ratio and short-term debt (STD) coverage standing at 0.9x and 0.8x, respectively. Moreover, there was no observed change in both the current ratio and STD coverage during the third quarter of fiscal year 2024.

Key Rating Considerations:

Going forward, the ratings will continue to be sensitive to any strain on the Company's coverages, as well as SCIL's strategies to address and mitigate this gap.

Sitara Chemical Industries Limited
Appendix I

FINANCIAL SUMMARY (amounts in PKR millions)				
<u>BALANCE SHEET</u>	<u>Jun'21</u>	<u>Jun'22</u>	<u>Jun'23</u>	<u>Mar'24</u>
Property, Plant and Equipment	16,923	17,345	18,459	21,033
Investment Property	3,313	3,259	3,321	3,466
LT Investments	25	25	25	20
Stock-in Trade	2,745	4,325	3,582	4,572
Trade Debts	1,363	1,387	2,233	2,792
Cash & Bank Balances	191	323	334	263
Total Assets	30,540	32,554	34,940	38,769
Trade and Other Payables	2,230	3,582	3,793	3,795
ST Borrowings	6,749	6,840	7,035	9,388
LT Borrowings (incl. current maturity)	2,584	2,655	3,148	3,806
Total Debt	9,333	9,495	10,183	13,194
Deferred Liabilities	2,564	2,858	262	244
Total Liabilities	14,658	16,516	18,336	21,603
Paid Up Capital	214	214	214	214
Tier-1 Equity	11,899	12,512	13,489	14,180
Total Equity	15,882	16,038	16,604	17,165
<u>INCOME STATEMENT</u>	<u>FY21</u>	<u>FY22</u>	<u>FY23</u>	<u>Mar'24</u>
Net Sales	14,785	21,626	27,493	23,327
Gross Profit	2,933	2,873	4,480	3,748
Profit Before Tax	1,670	898	1,476	832
Profit After Tax	1,348	656	993	655
<u>RATIO ANALYSIS</u>	<u>FY21</u>	<u>FY22</u>	<u>FY23</u>	<u>Mar'24</u>
Gross Margin (%)	19.8%	13.3%	16.3%	16.1%
Net Margin (%)	9.1%	3.0%	3.6%	2.8%
Current Ratio	0.90	0.9	0.9	0.9
Funds from Operations (FFO)	2,310	1,992	2,492	1,391
FFO to Total Debt (x)	0.25	0.21	0.24	0.08
FFO to Long Term Debt (x)	0.89	0.75	0.79	0.27
Debt Leverage	1.23	1.3	1.4	1.52
Gearing	0.78	0.8	0.8	0.93
Debt Servicing Coverage Ratio (x)*	2.23	1.77	1.94	1.37
ROAA (%)*	6.3%	2.8%	3.9%	1.4%
ROAE (%)*	11.7%	5.4%	8.1%	3.0%
(SIT+TD)/ST Borrowing (x)	0.61	0.8	0.8	0.8
*Annualized if required				

REGULATORY DISCLOSURES				Appendix II	
Name of Rated Entity	Sitara Chemical Industries Limited				
Sector	Chlor-alkali (Chemical Sector Sub-set)				
Type of Relationship	Solicited				
Purpose of Rating	Entity Ratings				
Rating History	Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
	RATING TYPE: ENTITY				
	06/14/2024	A+	A-2	Stable	Reaffirmed
	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
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.				
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Due Diligence Meetings Conducted	Name	Designation		Date	
	Mr. Zakir Hussain	Chief Financial Officer (CFO)		20 th May 2024	
	Mr. Hassan Farooq	Senior Manager – Finance & Accounts			