RATING REPORT

Sitara Chemical Industries Limited (SCIL)

REPORT DATE:
June 14, 2024

RATING ANALYSTS:
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RATING DETAILS	
Rating Category	**Preliminary Rating**
	Medium to Long-term
Instrument	AA-
Rating Date	*June 14, 2024*
Rating Outlook	Stable
Rating Action	Preliminary

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
VIS Instrument Rating Methodology – Rating the Issue
https://docs.vis.com.pk/docs/Rating-the-Issue-Aug-2023.pdf

APPLICABLE METHODOLOGY
VIS Entity Rating Criteria: Corporates
https://docs.vis.com.pk/docs/CorporateMethodology.pdf

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 'Rajahs'. The Company is listed on the 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" or "the Issuer") 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 are include 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 - Sheikhupura Road, Faisalabad, in the province of Punjab.

Proposed Sukuk Structure:

- SCIL plans to raise a medium to long term, rated, secured, and privately placed Sukuk of PKR 2.3 bln.
- The proceeds from the Sukuk will be utilized to install a new coal fired power plant (CFPP) of 50 megawatts (MW) capacity.
- The tenor of the instrument shall be seven (7) years inclusive of a grace period of twenty four (24) months.
- The principal will be paid in quarterly installments beginning from the end of the 27th month after issuance while profit payments will also be made in quarterly installments at a rate of 3M KIBOR + a spread (to be finalized later). The rentals shall be paid quarterly.
- Moreover, the Sukuk will be secured by an exclusive hypothecation charge over specified fixed assets of the Company as well as a ranking hypothecation charge over receivables from Collected Customers via a Letter of Hypothecation (LoH). Additionally, lien and right of set off over the debt payment account (DPA) and collection account (CA) are provided.
- SCIL shall establish a DPA under exclusive lien of the Investment Agent. The DPA shall be funded on a monthly basis.
- To provide further surety of timely payments to investors, a CA will be maintained which will direct all proceeds from the designated customers (Collected Customers). The Investment Agent shall have joint authorization on any outward remittance originating from the CA. Should the receivables prove insufficient to cover quarterly debt obligations, it is incumbent upon the Investment Agent to ensure that the Issuer addresses any shortfall using internal cash reserves.
- The DPA/CA shall be subject to a Waterfall Mechanism by virtue of which any remaining proceeds after meeting the required obligations for forthcoming principal and profit payments will be released to the Issuer.
- The Issuer may at any time upon expiry of 36 (thirty-six) months from the Issue Date, purchase all or any of the Sukuk Certificates from the Investors at their applicable Buy Out Price (Early Purchase) ("Call Option") to be calculated in terms of the Sale Undertaking and other Transaction Documents. The Issuer shall serve upon the Investors a prior written notice of at least [60 (sixty)] days to exercise the Call Option, which once issued shall be irrevocable and such purchase of Sukuk Certificates shall be in multiples of PKR 1,000,000/- (Pak Rupees One Million) or all the Sukuk Certificates. Such purchase shall be on a Rental Payment Date ("Call Option Date"). Upon exercise of Call Option, the Issuer will pay the Investors the Buy Out Price (Early Purchase) as per the Sale Undertaking. In case of exercise of Call Option in respect of certain Sukuk Certificates (not 100%), Rental Payments under the Payment Agreement will be revised by the Investment Agent (based on the outstanding Sukuk Certificates) in terms of the Payment Agreement, and any amounts received under the Call Option shall be applied in inverse order to which they were due and notified to the Issuer and the Investors, which in the absence of manifest error will be binding on all the parties.

Managing trustee of Aziz Fatima Trust.

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 sells chemicals both locally and internationally.

Gases Division: The Company has established a gases division for the production and marketing of food grade carbon dioxide (CO_2) with a production capacity of 80MT/day. SCIL has its own fleet of vehicles for delivery of carbon dioxide (CO_2) 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 in the chemicals and allied market, the combined market presence of these competitors constitutes the remaining 50%.

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 based coal fired 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-savings in electricity expense. The Commercial Operation Date (COD) for the project is projected to be achieved by June 2025.

Key Rating Drivers:

Strong security structure, establishment of dedicated accounts, and call option supports the assigned ratings

The security structure of the Sukuk provides adequate collateral, underpinning the assigned ratings. The establishment of a DPA and CA along with the lien on receivables from the specified customers, and a waterfall mechanism for repayment prioritization, builds confidence in timely payments, further bolstering the ratings.

Medium to low business risk profile backed by medium cyclicality, lower competition, and highly capital intensive sector

VIS classifies the business risk of the chemical sector as medium to low, supported by moderate cyclicality, 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 due to higher profitability, nevertheless, 9MFY24 experienced weakening due to debt drawdown for the installation of forthcoming CFPP

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 due to higher debt procurement

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 owing to the CFPP.

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 with larger short term borrowings

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)				
BALANCE SHEET	**FY'21**	**FY'22**	**FY'23**	**9MFY'24**
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
LTBorrowings (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
INCOME STATEMENT	**FY21**	**FY22**	**FY23**	**9MFY'24**
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
RATIO ANALYSIS	**FY21**	**FY22**	**FY23**	**9MFY'24**
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	Sukuk Ratings
Rating History	see table below

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: SUKUK				
6/14/2024	AA-	-	Stable	Preliminary

Instrument Structure	SCIL plans to issue a Rated, Secured, Privately Placed, Medium to Long Term Sukuk of size PKR 2.3 bln. The proceeds from the issue will be utilized to finance the installation of CFPP. The tenor of the instrument shall be seven (7) years inclusive of a grace period of twenty four (24) months. The principal will be paid in quarterly installments beginning from the end of the 25th month after issuance while profit payments will also be made in quarterly installments at a rate of 3M KIBOR + a spread (to be finalized later). The rentals shall be paid quarterly. The Sukuk will be secured by an exclusive hypothecation charge over specified fixed assets of the Company as well as a ranking hypothecation charge over company receivables from Collected Customer via a Letter of Hypothecation (LoH). Additionally, lien and right of set off over the DPA and CA. Moreover, any shortfall in the same will necessitate cash injections by the Company. The Company is required to deposit one third of the upcoming payment each month in the CA, which will be transferred to the DPA ten working days preceding the due date.
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.

Due Diligence Meetings Conducted

Name	Designation	Date
N/A		