RATING REPORT

Sheikhoo Sugar Mills Limited (SSML)

REPORT DATE:
October 16, 2018

RATING ANALYSTS:
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RATING DETAILS		
Rating Category	Initial Rating	
	Long-term	Short-term
Entity	A-	A-2
Rating Outlook	*Stable*	
Rating Action	Initial	
Rating Date	*October 16th, '18*	

COMPANY INFORMATION	
Incorporated in 1990	**External auditors:** Kreston Hyder Bhimji & Co., Chartered Accountants
Public Limited – Unquoted	**Chairman of the Board:** Mr. Idrees Ahmed **Chief Executive Officer:** Mr. Anis Ahmed
Key Shareholders (with stake 5% or more):	
Mr. Anis Ahmed – 29.33%	
Mr. Idrees Ahmed – 29.33%	
Mr. Aziz Ahmed – 29.33%	

APPLICABLE METHODOLOGY(IES)
JCR-VIS Entity Rating Criteria: *Industrial Corporates (October 2016)* *http://jcrvis.com.pk/docs/Corporate-Methodology-201605.pdf*

Sheikhoo Sugar Mills Limited (SSML)

OVERVIEW OF THE INSTITUTION

Shekihoo Sugar Mills Limited (SSML) was incorporated in 1990 as an unquoted public limited under the Companies Ordinance, 1984. The principal business activity of the company is manufacturing and sale sugar and its byproducts. The company is currently establishing a billets manufacturing facility.

Profile of Chairman

Mr. Idress Ahmed is one of the founding members of SSML and currently serves as the Chairman of the Board. He has over 40 years of experience in shipping and sugar industries.

Profile of CEO

Mr. Anis Ahmed is the Chief Executive Officer (CEO) of SSML. He has over 47 years of experience in shipping and sugar industries.

Financial Snapshot

Total Equity: end-9MFY18: Rs. 3.1b; end-FY17: Rs. 2.9b; end-FY16: Rs. 2.5b

Assets: end-9MFY18: Rs. 11.4b; end-FY17: Rs 7.3b; end-FY16: Rs. 3.8b

Profit After Tax: 9MFY18: Rs. 131m; FY17: Rs. 427m; FY16: Rs. 516m

RATING RATIONALE

Sheikhoo Sugar Mills Limited (SSML) is a sugar manufacturing company located in the Southwestern Punjab. Shareholding of the company is vested with the sponsoring family, which owned Baksh Group of Companies in the early 50s. The assigned ratings take into account moderate business profile of the company, largely underpinned by ample experience of sponsors led management in the sugar sector, sizeable crushing operations, and strong business relationships with institutional customers. Planned steel billets manufacturing plant is expected to provide a cushion against cyclicality risk of sugar sector. The ratings also derive strength from sound financial risk profile as depicted by sustained profit margins, low gearing and leverage indicators, and adequate debt coverage. However, the ratings are constrained by vulnerability in sugar prices and increased susceptibility of business performance to oversupply in the market, thereby propelling the company to carry over considerable inventory into the next financial year. Material delays and cost overruns in steel project and loss of major institutional clients may negatively impact the ratings.

Key Rating Drivers:

Effective business strategy

SSML is involved in the manufacturing and sale of white crystalline sugar since 1995; the company has, over the years, established sound business relationships with the sugarcane growers and customers. The business model of SSML is considered relatively medium-risk as its customer base is largely comprised institutional customers, including Coca-Cola Pakistan, Unilever Walls, Murree Brewery, Qarshi Industries, Riaz Bottlers (Pvt.) Ltd., and Shamim & Co. (Pvt.) Ltd., which on average account for ~80% of total volumetric sales. Meanwhile, the credit risk is deemed low owing to the company's policy of making sales on advance payment terms to the corporate clients.

SSML has augmented its crushing capacity by 4,000 M.T. per day over the past two years to 18,000 M.T. per day in response to higher demand from existing institutional customers. Additionally, the company is establishing a steel billets manufacturing plant with a production capacity of 150,000 M.T. per annum. The electricity generated from internally produced bagasse will power the steel plant, resulting in potential cost saving of Rs. 5 per unit. The estimated cost of the project is Rs. 2b, which will be financed through long-term debt. The project is expected to generate Rs. 8.2b in incremental sales during the first full year of operations when it comes online in June 2019, and hence is expected to have a positive impact on the overall business risk profile.

Susceptibility of business performance to oversupply

Sugar prices are largely driven by market forces, and are dependent on production during the sugar season and prevailing inventory levels. The average retail price of sugar declined to Rs. Rs. 53.0 per kg during HY18, as compared to Rs. 61.4 per kg during FY17, driven largely by oversupply in the market which emanated from the bumper crop, hence higher production in the last crushing season. The aforementioned factors and unchanged sugarcane price have negatively impacted the overall profitability and inventory levels of the sector as a whole.

SSML crushed 2.34m M.T. of sugarcane by operating the mill for 158 days during crushing season of FY16-17, representing a growth rate of 60% from a year ago. Albeit a 47 basis points decline in the sucrose recovery rate, sugar production increased by 52% to 222,539 M.T., of which the company was able to sell 167,740 M.T. during FY17 and carried over the remaining inventory to the next year. Gross margins remained largely stable at 8.8% as the company fetched better prices along with higher orders from corporate customers during FY17, particularly Coca-Cola Pakistan. During crushing season FY17-18, sugarcane crushing declined by 15% to 2.0m M.T. though recovery rate improved to 9.77% (FY17: 9.51%; FY16: 9.98%), resulting in sugar production of 195,006 M.T. SSML has sold

169,126 M.T. of sugar during 11MFY18 and intends to carry over approximately 25% total inventory to the next year. During 9MFY18, gross margins of the company stood lower at 6.9% mainly on account of weak selling prices.

Adequate liquidity and debt coverage profile with manageable inventory risk

Stock in trade stood higher Rs. 6.4b by end-9MFY18 due to cyclicality impact, higher production during last crushing season, and oversupply in the market. However, almost half of the inventory had already been sold to large corporate customers, with upfront payment of Rs. 3.4b received during the period reflecting in trade and other payables. SSML manages the credit and inventory risk by taking advance payments from corporate customers for future sugar deliveries, reflecting in historically low levels of sugar inventory. The remaining unsold inventory, which the company intends to carry over to the next year, is being financed by short-term borrowings. Funds from operations (FFO) decreased in line with lower profits during 9MFY18. However, coverages remained at adequate levels as depicted by FFO to long-term debt ratio of 0.66x and debt service coverage ratio of 3.41x.

Gearing indicators remain low

Equity base augmented with the continued retention of profits. The debt profile of the company comprised a mix of both long-term and short-term borrowings. During 9MFY18, SSML raised a long-term debt of Rs. 475m to fund the import of crushing machines and falling film evaporators. The company also took another long-term debt of Rs. 172m to commence civil work on steel project. The utilization of short-term borrowings increased to Rs. 3.7b to finance working capital. Consequently, gearing and debt leverage ratios increased to 1.43x and 2.72x, respectively. However, gearing and leverage indicators are considered low vis-à-vis peer companies. Debt leverage is in vicinity of gearing, if trade payables are netted off advances from corporate customers.

Room for improvements in corporate governance framework

The Board of Directors (BoD) of SSML comprise seven members, including three executive directors and four non-executive directors. Informal meetings of active directors are held on ad hoc basis. No Board Committees have been formed. The senior management team consists of experienced resource from the industry and has depicted stability. The corporate governance framework of the company has considerable room for improvement.

Sheikhoo Sugar Mills Limited (SSML) — Appendix I

Financial Statement *Amount in Million (Rs.)*				
BALANCE SHEET	**FY15**	**FY6**	**FY17**	**9MFY18**
Non-Current Assets	1,817	2,091	2,718	3,408
Long Term Investments	32	51	35	50
Store, spares & stock	353	286	394	394
Stock in Trade	331	504	3,108	6,381
Trade Debts	71	2	227	210
Other Assets	358	637	634	475
Cash & Bank Balances	170	214	218	445
Total Assets	3,132	3,785	7,334	11,363
Trade and Other Payables	697	1,032	2,085	3,605
Short Term Borrowings	236	-	1,977	3,714
Long Term Finances (*incl current maturity)	-	-	-	647
Deferred Liabilities	259	298	346	346
Other Liabilities	8	-	24	-
Core Equity	1,932	2,455	2,902	3,051
INCOME STATEMENT	**FY15**	**FY6**	**FY17**	**9MFY18**
Net Sales	8,456	8,552	9,987	7,362
Gross Profit	726	738	881	509
Operating Profit	554	722	695	401
Profit After Tax	340	516	427	131
FFO	519	660	524	321
RATIO ANALYSIS	**FY15**	**FY6**	**FY17**	**9MFY18**
Gross Margin (%)	8.6%	8.6%	8.8%	6.9%
Net Margin (%)	4.0%	6.0%	4.3%	1.8%
Net Working Capital	343	610	495	585
FFO to Total Debt (x)	2.2	-	0.27	0.10*
FFO to Long Term Debt (x)	-	-	-	0.66*
Debt Servicing Coverage Ratio (x)	4.90	6.15	4.67	3.41
ROAA (%)	-	14.9%	7.7%	1.9%*
ROAE (%)	-	23.5%	15.9%	5.9%*
Gearing (x)	0.12	-	0.68	1.43
Debt Leverage (x)	0.62	0.54	1.53	2.72

**Annualized*

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	Sheikhoo Sugar Mills Limited
Sector	Sugar
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings
Rating History	see table below
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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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
16/10/2018	A-	A-2	Stable	Initial