RATING REPORT

Sheikhoo Sugar Mills Limited (SSML)

REPORT DATE:
December 18, 2019

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-2	A-	A-2
Rating Outlook	Stable		Stable	
Rating Date	*November 11,'19*		*October 16,'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)
VIS Entity Rating Criteria: *Industrial Corporates (May 2019)* **https://www.vis.com.pk/kc-meth.aspx**

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-9MFY19: Rs. 3.5b; end-FY18: Rs. 3.3b; end-FY17: Rs. 2.9b

Assets: end-9MFY19: Rs. 11.4b; end-FY18: Rs. 9.5b end-FY17: Rs 7.3b

Profit/ (Loss) After Tax: 9MFY19: Rs. 234m; FY18: (Rs. 288); FY17: Rs. 427m

RATING RATIONALE

The ratings assigned to Sheikhoo Sugar Mills Limited (SSML) 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 long-standing strong business relationships with institutional customers. In addition, the company's recent efforts towards creation of multifold revenue streams through establishment of steel billet manufacturing plant is expected to result in improved profitability of the company coupled with assistance in withstanding the impact of cyclical slumps in sugar prices. The ratings also derive strength from sound financial risk profile as depicted by sustained profit margins, manageable gearing and leverage indicators and adequate debt coverage. However, the ratings remain constrained on account of cyclicality inherent in the sugar sector impacting the overall business risk profile of the company from time to time. Material delays and cost overruns in steel project and loss of major institutional clients may negatively impact the ratings. Moreover ratings remain dependent upon sustenance of margins and profitability indicators going forward.

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. As per the management, Nestle was added in the customer profile during the rating review period. Moreover, the credit risk is deemed low owing to the company's policy of making sales on advance payment terms to the corporate clients.

SSML's crushing capacity remained intact at 16,000 M.T. per day. Further, 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. 2.5b, which is primarily financed through long-term debt. The project is expected to generate Rs. 8.2b in incremental sales during the first full year of operations and is expected to start commercial operations in Nov'19; hence overall business risk profile is likely to improve through diversification once the project comes online. Going forward, the management plans to diversify into production of steel bars by Dec'20.

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.53.0 per kg during FY18, 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 company. The company reported after tax losses of Rs. 287.6m (FY17: Rs. 426.6m) during FY18 primarily on account sharp decline in margins to 1.5% (FY17: 8.8%) coupled with higher finance cost incurred as a result piled up inventory stock; the decline in margins was an outcome of drop in average retail prices of sugar.

SSML crushed 1.4m M.T. of sugarcane by operating the mill for 100 days during crushing season of FY18-19 as compared to 2.0m M.T in the preceding year; the crushing season was cut short by around 40 days to avoid further accumulation of inventory given the company already had sizeable carryover stocks pertaining to last crushing season. The sugar production for the crushing season FY18-19 was recorded at 145,505 MT as compared to 195,006 to last year's crushing season. The profitability indicators of the company exhibited improvement during the ongoing year with the company reporting a profit of Rs. 234.5m during 9MFY19. The improvement in the operational performance of the company was a combined outcome of increase in volumetric sales, higher margins and increase in sucrose recovery levels. SSML was able to sell 193,538 MT (FY18: 179,915 MT) sugar during the ongoing year; hence alleviating the pressure on upheld inventory levels. Moreover, the margins were recorded higher at 10.1% (FY18: 1.5%; FY17: 8.8%) as the company fetched better retail prices of end product coupled with improvement in sucrose recovery to 10.28% (FY18: 9.77%) during the ongoing year. The increase in selling and administrative expense was mainly a function of higher employee related expense as a result of annual salary adjustments together with increase in director's remuneration. Moreover, SSML incurred higher finance cost amounting to Rs. 302.6m during the 9MFY19 as compared to Rs. 264.6m in FY18 primarily as a result of increase in the benchmark interest rates. Going forward, VIS expects margins and profitability to remain a function of average retail prices of sugar in the coming years. Given the sugar sector is highly cyclical in nature, the next two crushing seasons are expected to bear normal yields followed by a season of bumper crop.

Adequate liquidity and debt coverage profile with manageable inventory risk

In line with improved profitability, Funds from Operations (FFO) increased sizably during 9MFY19. Despite increase in debt levels, FFO to total debt improved to 0.17x (FY18: negative) during 9MFY19 in line with improved cash generation. Further, stock in trade declined sizably on a timeline basis on account of offloading of carryover stocks in line with favorable market retail prices coupled with curtailed production levels. The remaining unsold inventory, which the company intends to carry over to the next year, is being financed by short-term borrowings. 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. However, trade payables demonstrated upward trajectory by end-9MFY18 owing to increased advances received from customers against sale of sugar. The situation is likely to self-correct moderately given the sugar stock held is expected to be sold to customers against which payables are outstanding. The debt service coverage was sizable at 3.64x (FY18: negative) at end-9MFY19. In addition, the company has given loans to sugarcane growers amounting to Rs. 644.2m (FY18: Rs. 139.2m) at end-FY9MFY19 to assist them in purchase of seeds, fertilizer and pesticides.

Gearing indicators remain within manageable levels

Equity base augmented in line with internal capital generation. Moreover, the capitalization levels were further enhanced by equity injection by the sponsors to the tune of Rs. 900m during FY18. The debt profile of the company comprised a mix of both long-term and short-term borrowings. During 9MFY19, SSML raised a long-term debt of Rs. 1.8b to fund the setup of billet manufacturing facility with the total capacity of producing 150,000 MT billets annually. The utilization of short-term borrowings decreased to Rs. 2.3b (FY18: Rs. 3.3b) at end-9MFY19 on account of sale of inventory. Subsequently in line with procurement of sizable long-term financing to diversify the revenue stream of the company, gearing and debt leverage ratios increased to 1.28x (FY18: 1.19x) and 2.09x (FY18: 1.72x), respectively by end-9MFY19. However, gearing and leverage indicators are still considered to be within manageable levels .As per the management, the company does not plan on obtaining further long-term funding with in the rating horizon; therefore, in line with periodic contractual repayments the leverage indicators are expected to decline going forward.

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	**FY6**	**FY17**	**FY18**	**9MFY19**
Non-Current Assets	2,091	2,718	3,717	5,363
Long Term Investments	51	35	51	51
Store, spares & stock	286	394	353	635
Stock in Trade	504	3,108	3,675	2,955
Trade Debts	2	227	166	477
Other Assets	637	634	745	1,130
Cash & Bank Balances	214	218	760	805
Total Assets	3,785	7,334	9,467	11,416
Trade and Other Payables	1,032	2,085	1,562	2,747
Short Term Borrowings	-	1,977	3,318	2,299
Long Term Finances (*incl current maturity)	-	-	822	2,435
Deferred Liabilities	298	346	226	235
Other Liabilities	-	24	232	158
Paid Up Capital	450	450	450	450
Core Equity	2,455	2,902	3,307	3,542
INCOME STATEMENT	**FY6**	**FY17**	**FY18**	**9MFY19**
Net Sales	8,552	9,987	9,990	9,378
Gross Profit	738	881	155	948
Operating Profit	722	695	(154)	653
Profit Before Tax	529	529	(403)	371
Profit After Tax	516	427	(288)	234
FFO	660	524	(267)	586
RATIO ANALYSIS	**FY6**	**FY17**	**FY18**	**9MFY19**
Gross Margin (%)	8.6%	8.8%	1.5%	10.1%
Net Margin (%)	6.0%	4.3%	-2.9%	2.5%
Net Working Capital	610	495	765	956
Current Ratio (x)	1.12	1.07	1.09	1.07
FFO to Total Debt (x)	-	0.27	-	0.17
FFO to Long Term Debt (x)	-	-	-	0.32
Debt Servicing Coverage Ratio (x)	6.15	4.67	-	3.64
ROAA (%)	14.9%	7.7%	-	3.0%
ROAE (%)	23.5%	15.9%	-	11.6%
Gearing (x)	-	0.68	1.19	1.28
Debt Leverage (x)	0.54	1.53	1.72	2.09

**Annualized*

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	Sheikhoo Sugar Mills Limited				
Sector	Sugar				
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				
	11/11/2019	A-	A-2	Stable	Reaffirmed
	16/10/2018	A-	A-2	Stable	Initial
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.				
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