RATING REPORT

Sheikhoo Sugar Mills Limited (SSML)

REPORT DATE:
December 29, 2020

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			
Rating Date	*December 29, '20*		*November 07,'19*	

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

Sheikhoo Sugar Mills Limited (SSML) was incorporated in 1990 as an unquoted public limited under the Companies Ordinance, 1984 (now Companies Act, 2017). The principal business activity of the company is manufacturing and sale sugar and its byproducts. During FY20, the company has started manufacturing and sale of steel billets.

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 has over 47 years of experience in shipping and sugar industries.

Financial Snapshot

Total Equity: end-9MFY20 Rs. 4.7b; end-FY19: Rs. 3.5b; end-FY18: Rs. 3.3b

Assets: end-9MFY20: Rs. 14.2b; end-FY19: Rs. 8.4b end-FY18: Rs 9.5b

Profit/ (Loss) After Tax: 9MFY20 Rs. 766.8m FY19: 236.4m; FY18: Rs. (287.6)m

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. Moreover, the ratings derive strength from steel billet plant becoming operational in Feb'20, which is expected to provide some cushion against cyclicality of sugar sector. The company is going into value-addition in steel segment by establishing a steel re-rolling mill which is expected to become operational by end-Mar'22. Current power requirement of the sugar division and steel division is entirely met through bagasse based boilers of 49 MW capacity. Installation of high-pressure boiler of 30 MW is in the pipeline to replace some old boilers for efficient bagasse consumption. Profit margins exhibited a notable improvement mainly on back of higher sugar prices. Revenue generated from billet sales has also contributed positively to the bottom line during 9MFY20. Liquidity has remained adequate as reflected by cash flows in relation to outstanding obligations. The ratings also factor in fresh equity injection by sponsors and their continued support for working capital requirements by extending interest-free loans. Despite increase in borrowings, leverage indicators have remained manageable. Meanwhile, the ratings are constrained due to inherent business risk present in sugar sector and any adverse changes in regulatory duties. Management of capitalization indicators within acceptable levels and realization of expected revenues and profits from steel plant are considered important, going forward.

Key Rating Drivers:

Business risk is considered moderate as steel business is expected to provide some cushion against inherent cyclicality of sugar sector: According to Pakistan Economic Survey 2019-20, sugarcane crop contributes about 0.6% to GDP and 2.9% of the total value addition in agriculture. During 2019-20, sugarcane production decreased by 0.4% to 66.880 million tons vis-à-vis 67.174 million tons of preceding year. Lower output is mainly the result of decrease in area of cultivation i.e 1,040 thousand hectares in MY20 as compared to 1,102 thousand hectares in MY19, a decrease of 5.6%. Meanwhile, the yield has improved by 5.5% compared to MY19. Average sugar prices have increased by 19% in MY19 and 16% in MY20. In order to control sugar prices and to maintain a strategic reserves of sugar, the GoP has allowed import of 300,000 tons of refined sugar, starting from Sep'20. Further, Economic Coordination Committee (ECC) has recently allowed exemption of sales tax on supply of sugar, imported through Trading Cooperation of Pakistan. Contrarily no support or subsidy was awarded for sugar export. While business risk is considered high, diversification of major industry players into ethanol and steel business provides support to profitability of the companies.

Operational performance: SSML's crushing capacity remained intact at 16,000 MT per day. The mill was operational for 117 days (2018-19: 96 days) and crushed 1.5m MT of sugarcane (2018-19: 1.4m MT) during 2019-20 crushing season. Recovery rate decreased slightly to 10.03% (2018-19: 10.28%) due to quality of sugarcane while production of sugar increased to 153,619 MT (2018-19: 146,505 MT) on account of increase in crushing days during the outgoing season. Molasses recovery rate also decreased to 4.57% (2018-19: 5.02%) on account of production losses and quality of sugarcane.

	FY18	FY19	9MFY20
Crushing Capacity – tpd	16,000	16,000	16,000
Cane Crushed – tons	1,996,142	1,425,138	1,531,632
Crushing Days	146	96	117
Capacity Utilization – %	85	93	82
Sucrose Recovery – %	9.77	10.28	10.03
Sugar Produced – tons	195,006	146,505.0	153,619.5
Molasses Produced-Tons	112,297	71,479	70,059
Molasses Recovery Rate (%)	5.63	5.02	4.57

Property, plant and equipment increased to Rs. 6.0b (FY19: Rs. 5.6b; FY18: Rs. 3.7b) by end-9MFY20. Major additions entailed civil work on building for steel re-rolling plant costing Rs. 346.9m while work in progress related to steel billet plant was capitalized during 9MFY20. Long-term investment amounting Rs. 57.1m (FY19: Rs. 51.3m; FY18: Rs. 50.7m) constituted investment recorded at cost in Sheikhoo Power (Pvt.) Limited (SPL), representing security held with National Electric Power Regulatory Authority (NEPRA). SPL is a 26 MW power project; currently negotiations of tariff finalization are underway with GoP.

Diversification through production of steel bars and potential cost saving through addition of boiler: The addition of re-rolling mill and installation of a new high pressure boiler is underway, which is expected to be completed by Mar'22. Capital expenditure amounting Rs. 3b is projected to be incurred on re-rolling mill and high pressure boiler of 30 MW capacity. The expenditure would be financed through SBP scheme of Temporary Economic Refinance Facility (TERF) charged at markup rate of 5%. The new boiler has a payback of around 4 years and would result in expected annual saving of around Rs. 125m in bagasse consumption. Current power requirement of sugar mill and steel billets mill is 22 MW and 18 MW respectively, which is met through four boilers of 21 MW and one high pressure boiler of 22 MW while two turbines of 3 MW each are used as a backup source. Re-rolling mill would require power of 4 MW. The new high pressure boiler would replace the old four boilers as these consume high bagasse; thereby total capacity would increase to 58 MW after installation of new boiler.

Improved profit margins mainly on account of higher sugar prices while billet sales provided support to the topline after commencement of operations: The company recorded net sales of Rs. 11.6b (FY19: Rs. 11.6b; FY18: Rs. 10.0b) during 9MFY20, out of which 72% revenue pertained to sugar, 10% to by-products, and around 17% to billets. During 9MFY20, no sugar exports sales were made (FY19: Rs. 1.0b; FY18: Rs. 1.5b) given restrictions imposed by GoP to control sugar prices. Around 50% (FY19: 33%; FY18: 29%) of the sugar sales comprised sale in open market while the rest were related to institutional clients. Gross revenue from sugar was recorded at Rs. 8.3b (FY19: Rs. 10.7b; FY18: Rs. 9.4b) during 9MFY20. The company sold 124,588 M.T of sugar (FY19: 197,756 MT) at an average rate of Rs. 66,680 per M.T (FY19: 53,654 per M.T) during 9MFY20. Sale of molasses was also recorded higher at Rs. 1.1b (FY19: Rs. 680.8m; FY18: FY18: Rs. 674.6m). The company sold 70,059 MT (FY19: 71,479 MT) of molasses on higher average rate of Rs. 16,398 per MT in 9MFY20 vis-à-vis 9,524 per MT in FY19. Bagasse sales were lower due to internal consumption whereas agricultural produce sales increased slightly.

The steel division (Hadeed) started operations on Feb 1, 2020, with a production capacity of 96,000 MT per annum. During first five months of operations including about 40 days shutdown due to Covid-19, billets production was recorded at 32,152 M.T while the company sold 21,502 MT of billets at an average rate of Rs. 93,358 per MT, generating a revenue of Rs. 2b. Major clients included FF Steel, Union Steel, Mughal Steel, Indus Steel and Concast Steel.

Gross margins were recorded higher at 14.8% (FY19: 9.9%; FY18: 1.5%) during 9MFY20. Cost of sales amounted to Rs. 9.8b (FY19: Rs. 10.5b; FY18: Rs. 9.8b) during 9MFY20. On an annualized basis, cost of sales was higher mainly on account of increase in average sugarcane procurement price to Rs. 223.8 per maund during FY2019-20 crushing season vis-à-vis Rs. 185.5 per maund in the previous season. Moreover, raw material for steel billets production also contributed to increase the cost during 9MFY20; for steel plant, raw material constituted around 90% of the cost of goods manufactured. Consumption of chemicals increased to Rs. 179.2m (FY19: Rs. 79.8m; FY18: Rs. 112.3m) mainly owing to billets production. Selling and administration expenses of Rs. 260.7m (FY19: Rs. 390.4m; FY18: Rs. 308.9m) were incurred during 9MFY20. Finance cost was recorded higher at Rs. 446.4m (FY19: Rs. 336.2m; FY18: Rs. 264.6m) during 9MFY20 in line with increase in borrowings. Other income was lower at Rs. 10.3m (FY19: Rs. 54.5m; FY18: Rs. 29.0m) mainly due to absence of exchange gain. Other expenses of Rs. 67.6m (FY19: Rs. 43.6m; FY18: Rs. 12.9m) were mainly related to employees related expenses. Higher gross profit, rationalization of operating expenses and lower effective tax rate resulted in notable increase in net margins to 6.6% (FY19: 2.0%; FY18: negative); net profit stood higher at Rs. 766.8m (FY19: Rs. 236.4m; FY18: Rs. (287.6m)) during 9MFY20.

As per provisional numbers provided by management for FY20, sales increased to Rs. 16.7b with 76% revenue emanating from sugar division and 24% from steel division. Gross margin of steel billets was recorded at 15.9% in FY20. Steel division is expected to generate Rs. 8.2b in incremental sales during FY21. The management is projecting lower margins in FY21 on account of slight increase in average sugarcane prices and relatively lower average sugar product prices.

Improvement in liquidity as reflected by higher cash flows in relation to outstanding obligations: Funds from Operations (FFO) increased sizably to Rs. 1.2b (FY19: Rs. 536.6m; FY18: Rs. (267.1)m) during 9MFY20 in line with higher profitability and higher positive difference between incurred and paid finance cost vis-à-vis FY19. Resultantly, FFO to long-term debt improved to 0.67x (FY19: 0.21x; FY18: negative) and FFO to total debt to 0.21x (FY19: 0.15x; FY18: negative) despite significant increase in total debt. The debt service coverage also increased to 2.66x (FY19: 1.73x; FY18: negative) due to higher FFO during 9MFY20.

Stock in trade stood higher at Rs. 4.0b (FY19: Rs. 1.2b; FY18: Rs. 3.7b) on account of higher sugar stock of Rs. 2.8b and steel plant inventory worth Rs. 1.2b at end-9MFY20. However, sugar stock has reduced considerably to Rs. 232.8m due to higher sugar offtake along with decrease in steel plant inventory to Rs. 851.5m by end-Sep'20. Trade debts of Rs. 1.1b (FY19: Rs. 108.6m; FY18: Rs. 165.8) were outstanding at end-9MFY20 out of which receivables amounting Rs. 592.3m pertained to steel billets sale while the rest pertained to sugar and other related products sales. Trade debts decreased to Rs. 454.3m by end-September 30, 2020, out of which Rs. 256.3m were related to sugar division and Rs. 198.1m to steel division. Advances, deposits and prepayments were higher at Rs. 1.5b (FY19: Rs. 548.7m; FY18: Rs. 529.2m) owing to increase in advances paid to suppliers and deposits for letter of credit. Cash and other balances stood higher at Rs. 694.2m (FY19: Rs. 145.3m; FY18: Rs. 759.8m) at end-9MFY20. Meanwhile, trade and other payables increased to Rs. 1.8b (FY19: Rs. 950.9m; FY18: Rs. 1.6b) mainly on account of higher advances from customers against sugar deliveries and trade creditors at end-9MFY20. The situation has partially self-corrected given the sugar stock held was sold to customers against which payables were outstanding; trade and other payables decreased to Rs. 1.0b by end-Sep'20. Current ratio remained at 1.09x (FY19: 1.05x; FY18: 1.09x) at end-9MFY20. Coverage of short-term borrowings via trade debts and inventory decreased slightly to 1.05x (FY19: 1.26x; FY18: 1.10x) at end-9MFY20.

Liquidity indicators are expected to improve in line with higher profitability. As per management, reliance on short-term borrowings would also decrease on account of higher internal cash flow generation, going forward.

Augmentation in equity on back of profit retention while equity injection by sponsors supported capital structure amid diversification: Tier-1 equity stood higher at Rs. 4.7b (FY19: Rs. 3.5b; FY18: Rs. 3.3b) on back of profit retention coupled with fresh equity injection by sponsors amounting Rs. 373m during 9MFY20. Long-term debt including current maturity stood at Rs. 2.3b (FY19: Rs. 2.6b; FY18: Rs. 822.2m) at end-9MFY20. Further, short-term borrowings increased sizably to Rs. 4.7b (FY19: 856.9m; FY18: Rs. 3.3b) at end-9MFY20 in line with higher working capital requirements; the same decreased to Rs. 1.8b by end-FY20. Loan from directors to support working capital requirements amounted to Rs. 156m (FY19: Rs. 156m; FY18: Rs. 178m); the loan is unsecured and interest free and payable on demand of directors. Gearing and debt leverage decreased to 0.88x and 1.14x (FY19: 1.01x & 1.38x; FY18: 1.31x & 1.86x) respectively, mainly on account of higher equity base at end-FY20. Despite increase in long-term borrowings, leverage indicators are projected to remain manageable on the back of augmentation in equity base in FY21.

Sheikhoo Sugar Mills Limited (SSML) — Appendix I

Financial Statement				*Amount in PKR (millions)*
BALANCE SHEET	**FY17**	**FY18**	**FY19**	**9MFY20**
Property, Plant & Equipment	2,718	3,717	5,638	5,969
Long Term Investments	35	51	51	57
Store, Spares & Loose Tools	394	353	533	646
Stock in Trade	3,108	3,675	1,170	4,003
Trade Debts	227	166	109	1,113
Advances, Deposits, Prepayments & Other Receivables	502	529	549	1,541
Other Assets	133	217	225	183
Cash & Bank Balances	218	760	145	695
Total Assets	7,334	9,467	8,420	14,207
Trade and Other Payables	2,085	1,562	951	1,834
Short Term Borrowings	1,977	3,318	857	4,717
Loan from Related Parties	205	178	156	156
Long Term Finances (including current maturity)	-	822	2,568	2,309
Other Liabilities	370	279	348	510
Total Liabilities	4,636	6,160	4,880	9,526
Paid-Up Capital	450	450	450	450
Total/Tier-1 Equity	2,697	3,307	3,540	4,680
INCOME STATEMENT	**FY17**	**FY18**	**FY19**	**9MFY20**
Net Sales	9,987	9,990	11,640	11,551
Gross Profit	881	155	1,155	1,704
Operating Profit	695	(138)	775	1,386
Finance Cost	166	265	366	446
Profit Before Tax	529	(403)	409	940
Profit After Tax	427	(288)	236	767
FFO	524	(267)	537	1,157
RATIO ANALYSIS	**FY17**	**FY18**	**FY19**	**9MFY20**
Gross Margin (%)	8.8	1.5	9.9	14.8
Net Margin (%)	4.3	-	2.0	6.6
Net Working Capital	291	469	141	674
FFO to Total Debt (x)	0.24	-	0.15	0.21*
FFO to Long Term Debt (x)	-	-	0.21	0.67*
Debt Servicing Coverage Ratio (x)	4.67	-	1.73	2.66
ROAA (%)	7.7	-	2.6	9.0*
ROAE (%)	17.2	-	6.9	24.9*
Gearing (x)	0.81	1.31	1.01	1.53
Debt Leverage (x)	1.72	1.86	1.38	2.04
Current Ratio (x)	1.07	1.09	1.05	1.09
Inventory plus Trade Debts to Short-Term Borrowings (x)	1.53	1.10	1.26	1.05

**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				
	29/12/2020	A-	A-2	Stable	Reaffirmed
	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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Due Diligence Meetings Conducted		Name	Designation	Date	
	1	Mr. Shakeel Ahmad Sheikh	Chief Financial Officer	21st September, 2020	
	2	Dilair Usman Bhatti	General Manager Finance	6th November, 2020	