RATING REPORT

Sheikhoo Sugar Mills Limited

REPORT DATE:
February 03, 2022

RATING ANALYST:
Muhammad Tabish
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RATING DETAILS				
Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A-	A-2	A-	A-2
Rating Outlook	*Stable*		*Stable*	
Rating Date	*Feb 03, 2022*		*Dec 29, 2020*	

COMPANY INFORMATION	
Incorporated in 1990	**External Auditors:** Kreston Hyder Bhimji & Co., Chartered Accountants
Public Unlisted Company	**Chairman:** Mr. Idrees Ahmed
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Aziz Ahmed
Mr. Anis Ahmed ~ 29.33%	
Mr. Idrees Ahmed ~ 29.33%	
Mr. Aziz Ahmed ~ 29.33%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: Industrial Corporates (August 2021) *https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf*

Sheikhoo Sugar Mills Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

OVERVIEW OF THE INSTITUTION

Sheikhoo Sugar Mills Limited was incorporated in 1990, under the Companies Ordinance, 1984 (now Companies Act, 2017). The principal activity of the company is to manufacture and sale white crystalline sugar and its by-products. Moreover, it has recently diversified into steel business. Head office is situated in Lahore, while manufacturing units including mill/plant are located at Tehsil Kot Addu, District Muzaffargarh – Punjab.

Profile of Chairman

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

Profile of CEO

Mr. Aziz Ahmed has around 40 years of experience in shipping and sugar industries.

RATING RATIONALE

Sheikhoo Sugar Mills Limited (SSML) is principally engaged in manufacturing and sale of sugar and its by-products with operating track record of more than two decades. The company has recently diversified into steel business with billets plant commencing operations from Feb'20. Headquartered in Lahore, the company has manufacturing units including mill/plant located at Tehsil Kot Addu, District Muzaffargarh. Average staff strength during the year stood at ~1.6K employees. During the period under review, Mr. Aziz Ahmed was appointed as the CEO, replacing his brother Mr. Anis Ahmed.

At present, power requirement of both sugar and steel division is met entirely through bagasse based boilers of 49 MW capacity. However, the management has planned to increase total available capacity to 60 MW for which a high-pressure boiler along with steam turbine is currently in the installation phase.

Regulatory Matter (Update on Penalty Imposed)

The ratings have incorporated the developments with regards to penalties imposed by CCP on certain sugar mills and legal proceedings for interim relief initiated by the subject company. However, in the meanwhile, uncertainty of the outcome would persist on the sector. The material impact of penalty imposed (amounting to Rs. 1.4b) on SSML will be significant and hence VIS will continue to monitor further development in this matter.

Long-term Investments

The company has two wholly-owned subsidiaries namely; Southern Steel Mills (Private) Limited & Sheikhoo Power (Private) Limited (26 MW power project); both the entities are currently non-operational. At end-Sept'21, total long-term investments amounted to Rs. 57.1m.

Value-addition in steel segment by establishing a steel re-rolling mill

SSML has planned to go for value-addition in steel segment by establishing a re-rolling mill (with annual stated capacity of ~150,000 MT). At present, the re-rolling project has a completion status of ~80% and is expected to commence operations in the ongoing year. Post completion, entire billets production will have an in-house consumption. The high-pressure boiler along with steam turbine is already in the installation phase to meet energy requirement of the re-rolling mill. Total estimated cost of the project is Rs. 4.3b; of which one-third is being financed through TERF facility and the remaining is arranged through long-term loans with average tenure of 7-8 years. The management has expressed interest in doubling the production capacity of re-rolling mill through installation of 400 MT furnace in the medium term.

Operational Performance:

Sugarcane crushing capacity remains unchanged at 16,000 tons per day (tpd) while the per day capacity of billets plant is ~400 tons. As per management, there are no plans to enhance the capacities in the near future.

Sugar Division

During the outgoing year, the mill operated for 111 days (MY20: 117 days; MY19: 96 days) which aligns with the industry. SSML crushed 1.71m MT of sugarcane which is 12% higher vis-à-vis previous year. Consequently, overall sugar production was also recorded higher at 166K MT (MY20: 154K MT) in MY21 despite slight decline in recovery rate (owing to industry-wide early commencement of crushing activity). Utilization levels have depicted considerable improvement in comparison to the previous year.

Figure: Sugar Mill (Capacity & Production)

	MY19	MY20	MY21
Sugarcane Crushing Capacity (TPD)	16,000	16,000	16,000
Total Cane Crushed (Tons)	1,425,138	1,531,632	1,711,922
Crushing Days	96	117	111
Crushing Per Day (Tons)	14,884	13,114	15,423
Capacity Utilization (%)	93%	82%	96%
Sugar Produced (Tons)	146,505	153,619	165,923
Sucrose Recovery (%)	10.28	10.03	9.69

Going forward, management expects sugar production to increase in the ongoing year given indication of higher crop coverage area, healthy crop size and attractive sugarcane prices available to farmers. Moreover, the management also expects recovery rate to be reported above 10% in the ongoing season.

Steel Division (Billets)

SSML's estimated market share (in terms of volume) in billets segment stands at around 25% with annual production capacity of ~120,000 MT (based on 300 days of operations). During MY21, billets production was recorded at 105,643 MT (Feb'20 to Sept'20: 53,888 MT).

Figure: Steel Billets (Capacity & Production)

	MY21
Installed Capacity (Tons)	120,000
Production (Tons)	105,643
Capacity Utilization (%)	88%

Key Rating Drivers:

Local demand supply dynamics of sugar sector are projected to depict some improvement in the ongoing year given the indication of higher crop coverage area.

The sugar sector has high business risk profile given inherent cyclicality in crop levels and raw material prices. Moreover, distortion in pricing mechanism of raw material prices and refined sugar also create challenges for sugar mills. Typically, sugarcane production has a 3-5 year cycle, driven largely by government support for farmers and crop yield. Sugarcane production has increased by ~13% to 75.5m MT during MY21 on account of increase in area under cultivation and improvement in crop yield. Based on ~76% sugarcane crushed by millers with average recovery rate of 10.2%, the sector has produced 6.0m MT (MY20: 4.9m MT) of sugar in MY21 while the annual domestic consumption stood at 5.8m MT.

As per USDA report estimates, given the indication of higher crop coverage area sugarcane production is projected to grow at ~83m MT which would culminate in sugar production of ~6.8m MT for the period MY22. Given the same, demand supply dynamics are expected to depict some improvement in the ongoing year while the government plans to purchase some buffer stock of ~0.5m MT to keep the prices in check. Also, margins may be curtailed due to increasing trend in sugarcane prices as the same has been recorded higher against minimum support price.

Business risk profile draws support from diversification into steel business. Positive demand outlook and significant duty protection provides added support.

The diversification of the company into steel business provides some cushion against inherent cyclicality of sugar sector. LSM sector growth hits 16-year high of ~15% (as per PBS) in FY21 as the government's pro-growth policies led to expansion in food, textile, automobile and construction-allied sectors. Billets manufacturing over the same period registered a strong growth of ~51% indicating sharp pick-up in demand. With GoP entering into last two years of its term, infrastructure spending has picked up pace driving the industry demand; particularly from GoP's PSDP allocation, CPEC related projects, Naya Pakistan Housing Scheme and Construction Sector Package. Nevertheless, downside risk remains elevated on account of worldwide continuation of Covid-19 with emerging new variants (such as Omicron) and uncertainty of its impact on overall economy and political environment.

The sector also continues to be supported by strong sovereign protection through import tariffs like ~ 39% (RD of 15%; ADD of 24%) and ~ 49.5% (RD of 30%, ADD of 19.15%) duty on Chinese imported billets and re-bars, respectively.

Sales revenue has more than doubled over the period of past two marketing years. Going forward, topline is targeted to cross the Rs. 30b mark by MY22 with the growth emanating from higher billets sales along with addition of re-bars.

Topline of the company has posted a 3-Year CAGR of ~36% and amounted to Rs. 24.9b (MY20: Rs. 16.7b; MY19: Rs. 11.6b) in MY21; of which 52% revenue pertained to sugar, 41% to billets and 7% to by-products. During the period under review, sizeable uptick in sales was mainly driven by volumetric growth in billets sales along with a mix of higher retail price and quantity sold of sugar. Institutional sales account for around one-half of total revenue from sugar segment while major clients in steel segment included FF Steel, Mughal Steel, Karachi Steel Re-Rolling Mills, Union Steel and Amreli Steel. Going forward, the management has targeted sales revenue to cross the Rs. 30b mark by MY22 with the growth emanating from higher billets sales along with the addition of re-bars.

Figure: Sales Data

	MY20	MY21
Sugar Sold - Quantity (MT)	149,401	164,966
Sugar Price (Rs. per MT)	66,680	78,531
Billets Sold (MT)	51,282	106,374
Billets Price (Rs. per MT)	96,239	95,000

Profitability margins have depicted considerable improvement on a timeline basis. This along with sizeable growth in revenue has translated into improved bottom-line.

In MY21, overall profitability margins on gross and net basis continue to witness an increasing trend despite higher average sugarcane procurement cost (MY21: Rs. 264 per 40kg; MY20: Rs. 224 per 40kg). As per management, gross margin from sugar sales stood at 15.8% while the steel billets segment contributed with the margin of 8.0%.

On the cost front, increase in administrative overheads largely remained in line with inflation whereas distribution cost noted a sizeable jump mainly associated with higher import freight charges. Other operating expenses which pertains to workers profit participation fund also registered a considerable jump in the outgoing year. Financial charges remained around prior's year level owing to lower average utilization of running finance. Nevertheless, the same is expected to trend upwards given the mobilization of long-term debt. Moreover, sizeable growth in topline along with higher margins translated into improved bottom-line which has witnessed a nearly three-fold increase.

Timeline growth in earning profile has improved debt coverage metrics and overall liquidity buffers.

SSML's cash flow generation has improved on a timeline basis in line with growth in earning profile. Funds from Operations (FFO) were reported higher at Rs. 1.9b (MY20: Rs. 994m; MY19: Rs. 537m) during MY21. Consequently, debt coverage metrics have also improved as reflected by DSCR of 2.40x (MY20: 1.40x) in MY21. Current ratio remains over 1.0x, while trade debts and stock in trade are sufficient to cover short term borrowings. Aging profile of trade debts is sound with no receivable outstanding for more than 90 days.

Sound capitalization levels; leverage indicators have improved on account of augmentation in equity base.

Equity base of the company has grown to Rs. 5.5b (MY20: Rs. 4.1b) at end-MY21 on account of profit retention and no dividend payout policy. Debt profile comprises a mix of short-term and long-term borrowings. At present, total outstanding long-term debt (inclusive of current portion) stood at Rs. 4.8b (MY21: Rs. 3.1b; MY20: Rs. 2.5b) as mobilized for setting up the re-rolling plant. Loan from directors to support working capital requirements amounted to Rs. 518m; loan is unsecured, interest free and payable on demand. Gearing and debt leverage indicators have improved to 0.97x (MY20: 1.13x) and 1.21x (MY20: 1.51x), respectively at end-MY21despite the increase in debt levels. Given sound profitability projected, gearing is expected remain within manageable limits.

FINANCIAL SUMMARY *(amounts in PKR millions)*				**Appendix I**
BALANCE SHEET	**MY18**	**MY19**	**MY20**	**MY21**
Property, Plant & Equipment	3,717	5,638	6,031	7,530
Long-term Investment	51	51	58	58
Stores, Spares. And Loose Tools	353	533	834	1,024
Stock in Trade	3,675	1,170	1,723	1,314
Trade Debts	166	109	420	1,141
Advances & Other Receivables	529	549	620	907
Cash & Bank Balance	760	145	371	190
Total Assets	**9,467**	**8,420**	**10,335**	**12,265**
Trade & Other Payables	1,562	951	1,197	1,063
Short-term Borrowings	3,318	857	1,622	1,735
Long-Term Borrowings *(Inc. current maturity)*	822	2,568	2,523	3,110
Total Liabilities	**6,160**	**4,880**	**6,212**	**6,707**
Paid-up Capital	450	450	450	450
Retained Earnings	1,957	2,190	2,763	4,199
Deposits for Purchase of Shares	900	900	910	910
Total Equity	**3,307**	**3,540**	**4,123**	**5,559**
INCOME STATEMENT				
Net Sales	9,990	11,640	16,716	24,906
Gross Profit	155	1,131	2,048	3,322
Operating Profit	(138)	775	1,483	2,648
Profit Before Tax	(403)	409	838	1,909
Profit After Tax	(288)	236	570	1,481
RATIO ANALYSIS				
FFO	(267)	537	994	1,899
Gross Margin (%)	1.5%	9.7%	12.3%	13.3%
Net Margin (%)	-2.9%	2.0%	3.4%	5.9%
Net Working Capital	469	141	472	1,194
FFO to Long-Term Debt (x)	(0.32)	0.21	0.39	0.61
FFO to Total Debt (x)	(0.06)	0.15	0.21	0.35
Debt Servicing Coverage Ratio (x)	(0.13)	1.96	1.40	2.40
ROAA (%)	-3.0%	2.6%	6.1%	13.1%
ROAE (%)	-8.7%	6.9%	14.9%	30.6%
Gearing (x)	1.31	1.01	1.13	0.97
Debt Leverage (x)	1.86	1.38	1.51	1.21
Current Ratio (x)	1.09	1.05	1.13	1.35
Inventory + Receivables to Short-term Borrowings (x)	1.10	1.26	1.00	1.09

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 Rating

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
03/02/2022	A-	A-2	Stable	Reaffirmed
29/12/2020	A-	A-2	Stable	Reaffirmed
11/11/2019	A-	A-2	Stable	Reaffirmed
16/10/2018	A-	A-2	Stable	Initial

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
Mr. Shakeel Ahmad	Chief Financial Officer	Jan 24, 2022