RATING REPORT

Sheikhoo Sugar Mills Limited

REPORT DATE:

June 20, 2023

RATING ANALYST:

Tayyaba Ijaz, CFA
tayyaba.ijaz@vis.com.pk

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	*June 20, 2023*		*Feb 03, 2022*	

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 (May 2023) https://docs.vis.com.pk/docs/CorporateMethodology.pdf
Rating Scales & Definitions: https://docs.vis.com.pk/docs/VISRatingScales.pdf

Sheikhoo Sugar Mills Limited

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. Idrees 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 is one of the founding members of SSML and 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 diversified into steel business with billets plant commencing operations from Feb'20 and steel bar re-rolling plant commencing its production in Oct. 2022. Headquartered in Lahore, the company has manufacturing units including mill/plant located at Tehsil Kot Addu, District Muzaffargarh. At present, power requirement of both sugar and steel division is met entirely through bagasse based boilers of 79 MW capacity.

Key Rating Drivers

Business Risk & Sector Update: Pakistan is the seventh-largest producer and the fifth-largest consumer of sugar. According to the Economic Survey of Pakistan, sugar industry is the country's second-largest agro-based business after the textile industry. In terms of sugarcane production, Punjab produces 67% of the sugarcane, followed by Sindh (25%), Khyber Pakhtunkhwa (KPK) (8%), and Baluchistan (less than 1%). Its production contributes 0.8% to GDP and 3.7% to agriculture's value addition. The country has the capacity to raise production by 4.0 million tons and export USD 2.0b worth of sugar and USD 500m worth of ethanol by using the same land but raising yields by 40 to 50 percent. According to the data collected by Ministry of Food Security, through September 30, 2022, at least 5.3 million metric tons (MT) of sugar has been removed from inventories or has been consumed. The volume of sugar consumed each day is around 15,980 tons. More than 1.2m MT surplus sugar was available at the start of crushing season MY23. Additionally, exporting this surplus sugar would have generated USD 1.0b in foreign currency. During CY22, almost 33% of the 22 million hectares of total cultivable land were inundated by flood while damage to the sugarcane crops resulted in a loss of USD 273m. On aggregate, direct losses from rice, cotton, and sugarcane were USD 1.30b (rice: USD 543m, cotton: USD 485m, and sugarcane: USD 273m).

The inherent cyclicality in crop yields and raw material prices is believed to have a substantial impact on the business risk profile of the sugar sector. Furthermore, there is a noticeable difference in pricing mechanisms, with the price of the end product, granulated sugar, being set by market forces whereas sugarcane cost being regulated by the government. A typical sugarcane crop has a 3- to 5-year production cycle, with government assistance to farmers and crop productivity playing a major role. In 2022-23 season, the crushing season took off a bit late owing to disagreement between PMSA, which represents the sugar mill owners, and Government of Pakistan, to allow export of 2 million tons of sugar, to cover up for the higher costs associated with producing sugar and pulling the industry out of crisis.

According to the most recent USDA semi-annual sugar report published on October 3, 2022, due to the damage brought on by the flood, the estimated harvested area is to contract by 4.7% to 1.23 million hectares. As a result, the forecast for sugarcane output in 2022–2023 has decreased to 82.4 million tons (2021-22: 89 million tons-2020-21: 81 million tons while sucrose recovery rates of majority of the sugar mills have improved. Resultantly, sugar output in 2022–2023 is also expected to reduce slightly. Meanwhile, due to population growth and demand from the developing food processing industry, sugar consumption is projected to rise by around 3% to 6.1 MT in MY23. In view of accumulating sugar stocks, the Govt. has so far allowed 250,000 tons of sugar in the ongoing year. Recently, sugar prices have shown rising trend in line with inflationary pressure. Sugar prices are expected to reach around Rs. 140 per Kg which would benefit the industry players in realizing inventory gains and increase in gross margins. However, elevated markup rates would likely to suppress bottomline of companies with high leveraged capital structure.

Update on Operations:

Sugar Division: The crushing season 2022-23 started on Nov 26, 2022 and lasted for 102 days vis-à-vis 136 days in the preceding crushing season 2021-22, as a result of contraction in sugarcane yield due to nationwide floods. Resultantly, cane crushed was recorded lower at 1.94m tons (2021-22: 2.26m tons; 1.71m tons). On the other hand, sucrose recovery rates improved to 10.86% (2021-22: 10.25%; 2020-21: 9.69%) as the crushing season began relatively late. During the ongoing year, crushing capacity of SSML has been regularized to 25,000 tpd. Please note that the crushing capacities of the mill was regularized in January 2023 in terms of section 11 of the Punjab industries (Control on Establishment and Enlargement) (Amendment) Act, 2022 and the company paid a requital fee of Rs. 10,000/ton in lieu of this regularization.

Crushing Season	2020-21	2021-22	2022-23
Sugarcane Crushing Capacity (TPD)	16,000	25,000	25000
Total Cane Crushed (Tons)	1,711,922	2,255,523.73	1,939,704
Crushing Days	111	136	101
Crushing Per Day (Tons)	15,423	16,584	19,016
Capacity Utilization (%)	96%	100%	76%
Sugar Produced (Tons)	165,923	231,386	210,728
Sucrose Recovery (%)	9.69	10.25	10.86
Molasses Produced (Tons)	78,700	107,237	88,450
Molasses Recovery rate (%)	4.60%	4.76%	4.56%

Steel Division: The re-rolling mill with an annual capacity of 300,000 tons started commercial operations in Oct'22. The capex has been executed with an outlay of Rs. 3.3b out of which Rs. 2b has been financed through subsidized financing scheme of Temporary Economic Refinance Scheme (TERF) by SBP. In addition, high pressure boiler of 170 tons and a turbine of 30 MW has also been involved to support re-rolling mill operations and achieve steam efficiency leading to less bagasse usage which is expected to fulfill the entire year requirement through in-house production. Total cost incurred on high pressure boiler and turbine amounted to Rs. 1.6b, which has been majorly met through long-term financing. Almost entire output of the billet plant is utilized in-house while in the outgoing year billet plant remained operational at 89% (MY21: 88%).

Steel Billet Plant	MY21	MY22
Installed Capacity (Tons)	120,000	120,000
Production (Tons)	105,646	107,039
Capacity Utilization (%)	88%	89%

At present, total power requirement of the company stands at around 46 MW for which the company has two high pressure turbine of 22 MW and 30 MW, three low pressure turbines of 6 MW each and three low pressure turbines of 3 MW each, aggregating to total power generation capacity of 79 MW. The demand dynamics for steel re-bars/billets have been impacted owing to slowdown in overall economic activities marked by various macroeconomic and socio-political factors. Moreover, import of steel scrap has also been facing disruptions as a result of restricted foreign exchange reserves. However, as per management, SSML's steel operations have been running at optimal levels given the company has carried over adequate raw material stock for the ongoing year. While there has been slowdown in construction sector, the demand is still there for the ongoing projects. In addition, being a new entrant, the company is selling re-bars at competitive rates to capture market shares. As of Mar 31, 2023, 43,000 tons of re-bars have been sold.

As per management, the company may add an additional turbine of 30 MW for steam efficiency in the ongoing year as the required financing has been secured from the bank. Furthermore, in the following year, the management intends to add a reheating furnace and an induction furnace to achieve enhanced efficiency in re-rolling process; the same is expected to cost around Rs. 600m which would be financed through own sources.

Growth in topline and some improvement in gross margins led by higher contribution from steel segment while sugar sales remained largely stagnant despite higher volumetric sales owing to suppressed sugar prices in MY22.

During the outgoing year, net revenues amounting to Rs. 29.6b (MY21: Rs. 24.9b) posting YoY growth of ~19% primarily on the back of increase in steel billets sales. Sugar sales, on the other hand, remained largely muted at Rs. 15.2b on account of depressed sugar prices in the outgoing year amid sizeable carry over sugar inventories and frequent intervention of government to control retail prices. Around 8% increase in quantity sold of sugar was largely offset by almost equal decrease in average selling prices. Molasses sales increased by around 29% mainly due to increase in average selling prices given it is sold as indirect export in production of ethanol; local currency depreciation has continued to support prices due to competitiveness in international markets. Overall sugar segment contribution in the sales mix has decreased to 51% (MY21: 59%) in MY22. Meanwhile, steel segment sales augmented to Rs. 14.4b (MY21: Rs. 10.2b) in line with ~53% increase in average selling prices despite some decrease in volumetric sales. Steel segment contribution in the sales mix has resultantly increased to 49% (MY21: 41%) in MY22. Institutional sales account for around nearly 70% 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. A snapshot of volumetric sales and average selling prices of key products is tabulated below:

	MY20	MY21	MY22
Sugar Sold - Quantity (MT)	174,013	165,239	177,222
Sugar Price (Rs. per MT)	65,894	78,401	73,255
Molasses Sold- Quantity (MT)	70,059	78,700	107,237
Molasses Price (Rs. Per MT)	16,398	21,116	20,220
Billets Sold (MT)	49,962	105,873	98,512
Billets Price (Rs. per MT)	80,150	96,694	145,696

Gross profit amounted to Rs. 3.8b (MY21: Rs. 3.1b) with some increase in gross margin to 12.9% (MY21: 12.3%), primarily on account of improvement in contribution margin of steel segment during MY22. The company procured sugarcane at a lower average rate of Rs. 248 per maund in MY22 as compared to Rs. 262/maund owing to bumper availability of crop and lower premium paid over and above the support price set by government. Average per metric ton of steel scrap cost has also witnessed an increasing trend in dollar terms while more pronounced impact on cost has been due to sharp devaluation of local currency in MY22 and the ongoing year. Nonetheless, favorable finished goods prices were more than offset the hike in input cost, which led to better margins in steel segment in the outgoing year. 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.

Administrative expenses increased to Rs. 595.0m (MY21: RS. 408.3m) largely due to inflationary pressure on compensation related expenses and other heads. Also, given expansion in operations, the company has also hired new resources at key positions to improve internal controls and productivity. During the outgoing year, SSML has hired Group CFO, GM Accounts and Finance-Steel Division, GM Internal Audit and Group Manger Treasury. In addition, the company made donations amounting Rs. 63.8m (MY21: 2.9m) to various charitable institutions; the directors and their spouses have no interest in these donees. Distribution expenses also increased mainly due to revision in salaries, wages and other benefits and overall increase due to inflationary pressure. Other income of Rs. 25.0m (MY21: RS. 38.3m) included gain on disposal of fixed assets, old credit balances written back, scrap sales and profit on bank deposits. Other expenses were recorded lower at Rs. 136.4m (MY21: RS. 233.6m) during MY22, as in the preceding year, the company booked sizeable provisioning for diminution in the value of its long-term investment *(Sheikhoo Power (Pvt.) Ltd.)* amounting Rs. 57.8m and provision for obsolete stores and spares of Rs. 32.5m. A major part of other expenses largely included employee related fund contributions and unrealized fair value loss on biological assets. Finance cost nearly doubled to Rs. 1.5b (MY21: 747.1m) owing to sharp hike in markup rates and higher average borrowings. Accounting for taxation, the company generated Rs. 1.03b (MY21: Rs. 1.11b) in net profits while net margins were lower at 3.5% vis-à-vis 4.4% in the preceding year, largely on account of increase in finance cost and operating expenses.

Revenues and gross profitability further strengthened in 1HY'23 on the back of higher retail prices of sugar and sale of re-bars, however, elevated markup rates and inflationary pressure on operating expenses constrained the net margins.

During 1HY'23, the company recorded net revenues of Rs. 18.5b, with 59% contribution from steel segment. With Steel re-rolling plant becoming operational in the ongoing year, revenue amounting Rs. 7.8b emanated from sale of re-bars while Rs. 4.2b of the sales pertained to steel billets sales. Total sugar sales amounted to Rs. 6.04b in HY'23, out of which Rs. 941.4m were related to export sales of sugar. SSML was allocated an export quota of 6,431 MT of sugar, which was sold to institutional clients primarily in Afghanistan, Tajikistan and Kirgizstan at an average rate of USD 525/ton. During first quarter of the ongoing year, sugar prices further depressed owing to substantial carry over sugar stocks by the firms. Meanwhile, with the announcement of sugar exports by the government, retail prices trended upward. Accordingly, in 1HY'23, sugar segment profitability depicted some improvement on the back of increase in average selling prices to Rs. 81,471/MT while volumetric sales are reported at 74,164 MT. In addition, with the sale of re-bars, entailing better margins, profitability of steel segment also improved. Resultantly, gross margins improved notably to 14.3%. Re-rolling bars have been majorly sold to various retail clients in Punjab while in KPK and Baluchistan, sales are made to some corporate clients including construction companies and real estate developers. Increase in administrative expenses during 1HY'23 has largely been rationalized with inflationary pressure and expansion in operations. Selling and distribution expenses increased notably majorly owing to higher advertisement expenses incurred. Furthermore, inflated markup rates continued to drag bottomline. Resultantly, despite higher gross profitability, net margins remained largely unchanged at 3.6%; profit after tax amounted to Rs. 661.7m.

On annualized basis, net sales are expected to post YoY growth of ~60% in MY23, with nearly equal contribution from sugar and steel segments projected by the management. The gross margins are expected to remain range bound owing to rupee devaluation impact on steel segment margins, however, sugar segment margins are expected to be supported by efficiency gains, favorable prices and economies of scale, going forward. The bottomline is projected to strengthen on the back of enhanced scale of operations and rationalized operating costs. The current price outlook for sugar remains positive until and unless the government takes concrete steps to curb its smuggling to Afghanistan, where sugar prices are almost double the retail prices in Pakistan. In addition, the price differential between imported and local sugar is significant which would tend to support sugar prices in at least short-term to medium term. Nonetheless, stability in socio-political and economic environment is crucial for overall industrial growth in the country.

Cash flow coverages remained under pressure in the outgoing year and 1HY'23, however, the same are expected to improve in full year on account of growth in earning profile and decrease in debt levels by end of the marketing year.

Despite sizeable cash flow generation cash flow coverages weakened primarily on account of higher short-term borrowings to support working capital requirements. The company generated Rs. 1.1b (MY22 & MY21: Rs. 1.9b) in funds from operations (FFO) in 1H'23. Annualized FFO to total debt stood at 0.11x (MY22: 0.13x; MY21: 0.32x). Debt service coverage ratio decreased to 1.33x (MY22: 1.65x; MY21: 2.43x) as a result of higher interest and principal repayments during 1H'23 and the outgoing year.

Stock in trade augmented to Rs. 16.7b (MY22: Rs. 9.2b; MY21: Rs. 1.3b) primarily on account of elevated sugar inventory by end-1H'MY23 i.e., Rs. 12.9b (MY22: Rs. 3.4b; MY21: Rs. 303.1m). Stock in trade value was also substantially higher at the end-MY22 due to the combined impact of higher steel scrap and sugar inventory carried by the company. By end-Mar'23, sugar stocks held by the company amounted to 195,527.3 MT which have reduced to 154,637 MT as of May31, 2023. Stores, spares and loose tools amounted to Rs. 1.1b (MY22: Rs. 1.3b; MY21: 0.9b). Trade debts amounted to Rs. 2.3b (MY22: Rs. 1.5b; MY21: Rs. 1.0b) at end-Mar'23. Given majority sales on cash/advance basis, trade debts as percentage of net sales have remained very limited on a timeline basis. Major chunk of the corporate sales in sugar segment is on advance basis while for credit sales up to 20 days period is extended. Steel billets/re-bars sales are also majorly conducted on advance payment basis while in credit sales payments are usually cleared within 15 days on average. Advances, deposits and prepayments increased to Rs. 930.8m (MY22: Rs. 720.5m; MY21: Rs. 907.1m) mainly due to higher advances extended to suppliers of raw materials and increase in special excise duty/sales tax receivables. The company reported higher cash and bank balances of Rs. 1.9b (MY22: Rs. 189.9m; MY21: Rs. 285.2m) at end-1H'23. Trade and other payables increased to Rs. 5.1b (MY22: 2.9b; MY21: Rs. 983.8m) largely in line with higher advances from customers and trade creditors. Accrued markup on secured borrowings also increased to Rs. 651.4m (MY22: Rs. 410.6m; MY21: Rs. 48.8m) by end-1HY'23. As a result of sizeable outstanding short-term borrowings and other current liabilities as mentioned above, current ratio remained weak (HY'23: 0.98x; MY22: 0.94x; MY21: 1.10x). With lifting of major portion of sugar stock, pressure on working capital management would also be relieved to a greater extent. In addition, cash flow coverages also expected to improve notably in full year and going forward on the back of growth in profitability.

Leverage indicators witnessed increase primarily owing to higher short-term financing while equity base continued to grow on the back of profit retention.
The equity base augmented to Rs. 6.8b (MY22: Rs. 6.1b; MY21: Rs. 5.2b) as a result of internal capital generation. However, gearing and debt leverage trended upward on account of elevated short-term seasonal borrowings to support working capital needs. Debt leverage and gearing adjusted for available cash and bank balances stood at 3.77x (MY22: 2.97x; MY21: 1.44x) and 2.79x (MY22: 2.32x; My21: 1.13x), respectively, by end-Mar'23. Long-term financing, inclusive of current portion, decreased to Rs. 3.9b (MY22: Rs. 4.4b; MY21: Rs. 3.9b) in line with principal repayments. The management does not intend to obtain any new sizable long-term financing in short to medium term. In addition, with subsequent repayments of long-term loans and lifting of sugar inventory, leverage indicators are expected to recede by the year-end. Also, given sound profitability projected, capitalization profile is expected to strengthen, going forward.

FINANCIAL SUMMARY *(amounts in PKR millions)*			Appendix I	
BALANCE SHEET	**MY20**	**MY21**	**MY22**	**1HY'23**
Property, Plant & Equipment	6,031	8,283	10,891	10,800
Long-term Investment	58	-	-	
Stores, Spares. And Loose Tools	834	906	1,289	1,116
Stock in Trade	1,723	1,273	9,198	16,695
Trade Debts	420	1,030	1,520	2,334
Advances & Other Receivables	620	907	721	931
Cash & Bank Balance	371	285	190	1,919
Total Assets	**10,335**	**12,863**	**24,434**	**34,188**
Trade & Other Payables	1,197	984	2,782	5,128
Short-term Borrowings	1,622	1,735	9,469	16,411
Long-Term Borrowings *(Inc. current maturity)*	2,523	3,850	4,381	3,893
Total Liabilities	**6,212**	**7,705**	**18,325**	**27,417**
Paid-up Capital	450	450	450	450
Retained Earnings	2,763	3,801	4,750	5,412
Deposits for Purchase of Shares	910	910	910	910
Total Equity	**4,123**	**5,161**	**6,110**	**6,772**
INCOME STATEMENT	**MY20**	**MY21**	**MY22**	**1HY'23**
Net Sales	16,716	24,906	29,591	18,542
Gross Profit	2,048	3,058	3,829	2,648
Operating Profit	1,483	2,445	3,060	2,066
Profit Before Tax	838	1,698	1,570	932
Profit After Tax	570	1,105	1,030	662
RATIO ANALYSIS	**MY20**	**MY21**	**MY22**	**1HY'23**
FFO	994	1,924	1,914	1,144
Gross Margin (%)	12.3%	12.3%	12.9	14.3
Net Margin (%)	3.4%	4.4%	3.5	3.6
Net Working Capital	472	426	(798)	(369)
FFO to Long-Term Debt (x)	0.39	0.50	0.44	0.59*
FFO to Total Debt (x)	0.21	0.32	0.13	0.11*
Debt Servicing Coverage Ratio (x)	1.40	2.43	1.65	1.33
ROAA (%)	6.1%	9.5%	5.5%	4.5*
ROAE (%)	14.9%	23.8%	18.3%	20.5*
Gearing (x)	1.13	1.18	2.35	2.79
Debt Leverage (x)	1.51	1.49	3.00	3.77
Current Ratio (x)	1.13	1.10	0.94	0.98
Inventory + Receivables to Short-term Borrowings (x)**	1.83	1.85	1.27	1.23

**Annualized*

*** Also includes stores, spares and loose tools*

REGULATORY DISCLOSURES Appendix II

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				
20/06/2023	A-	A-2	Stable	Reaffirmed
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.
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. Copyright 2023 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.

Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Saqib Hameed	Group CFO	May 10, 2023
Mr. Ghulam Hussain	Group Manager Treasury	