RATING REPORT

Sheikhoo Sugar Mills Limited

REPORT DATE
August 05, 2024

RATING ANALYSTS:
Saeb Muhammad Jafri
saeb.jafri@vis.com.pk
Muhammad Subhan
subhan@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 Date	*August 05, 2024*		*June 20, 2023*	
Rating Outlook/Rating Watch	Stable		Stable	
Rating Action	Reaffirmed		Reaffirmed	

COMPANY INFORMATION

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

APPLICABLE METHODOLOGY(IES)

Applicable Rating Criteria: Corporates:
https://docs.vis.com.pk/docs/CorporateMethodology.pdf

APPLICABLE RATING SCALE(S)

VIS Issue/Issuer Rating Scale:
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 also 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.*

Chairman Profile: 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.*

CEO Profile: Mr. Aziz Ahmed *is one of the founding members of SSML and has around 40 years of experience in shipping and sugar industries.*

RATNG RATIONALE

Company Profile:

Sheikhoo Sugar Mills Limited ("SSML" or "the Company") was incorporated in Pakistan on January 03, 1990 as an unquoted public limited company. The principal activity of the Company is the manufacture and sale of white refined sugar and its by-products as well as steel products (billets and bars). The registered office of the Company is situated at Lahore.

Group Profile:

Four brothers, S.M. Maulabaksh, S.M. Iqbal, S.M. Anwar, and S. Maqbool Ahmed established the Baksh Group of Companies ("the Group") in 1947. Initially focusing on cotton exports through United Cotton and Wool, the group expanded into shipping with United Oriental Steamship Co., which boasted Pakistan's largest fleet by 1959. The Group further expanded into maritime with shipbuilding and repair capabilities in collaboration with Carstairs and Cummings Ltd. In subsequent years, the Group diversified into jute mills, textiles, and paints by establishing United Paints (Pak) Ltd. in 1970. The Group then ventured into sugar mills with Sheikhoo Sugar Mills Ltd. and recently entered the steel industry through Sheikhoo Steel, specializing in billets and bars production.

Business Segments:

Sugar: The Company operates a sugar mill with a cane crushing capacity of 25,000 tons per day (MY22: 25,000 TPD). In 1HMY24, this segment accounted for approximately 27.7% (MY23: 43.1%, MY22: 51%) of total gross sales.

Steel: The Company has set up a steel billet plant of an annual installed capacity of 150,000 tons. Moreover, the Company has also set up a re-rolling mill of with an annual installed capacity of 300,000 tons which came into operation in October 2022 and its sale proceeds were reflected in MY23 financials. The steel segment contributed approximately 72.3% (MY23: 56.9%, MY22: 49%) to the total company gross sales of 1HMY24.

Operational Performance:

The Company's business units including sugar mill and steel plant is situated at Tehsil Kot Addu, District Muzaffargarh, Punjab, Pakistan.

Sugar Segment:

Crushing Season	MY21	MY22	MY23	MY24
Crushing Capacity (In TPD)	16,000	25,000	25,000	25,000
Crushing Period in days	111	136	101	102
Cane Crushed (MT)	1,711,922	2,255,524	1,939,704	1,986,317
Sugar Production (MT)	165,923	231,386	210,728	202,676
Sucrose Recovery	10%	10.3%	10.9%	10.2%
Molasses Produced	78,700	107,237	88,450	88,360
Molasses Recovery	4.6%	4.8%	4.6%	4.5%

During the MY24 crushing season, the Company's operational performance showed a minor increase in both crushing days and the quantity of cane processed. This was driven by the revival of sugarcane production post-flood recovery, leading to higher availability. However, a slight decline in sucrose recovery rates indicated a reduction in cane quality.

Steel Segment:

Steel Billet Plant	MY21	MY22	MY23	9MMY24
Installed Capacity (Tons)	150,000	150,000	150,000	150,000
Production (Tons)	105,646	107,039	128,000	104,307
Capacity Utilization (%)	70.4%	71.4%	85.3%	69.4%
Re-Rolling Mills	**MY23**		**9MMY24**	
Installed Capacity (Tons)	300,000		300,000	
Production (Tons)	102,910		95,553	
Capacity Utilization (%)	34.3%		31.9%	

The Company's steel billet production shifted to full capacity in MY23, as the Company commenced its rerolling operations before normalizing to ~69.4% in 9MMY24, slightly lower than MY22 ~71.4%. Re-rolling activity remained muted as demand in the steel sector was subdued by inconducive economic activity, particularly in the construction sector between MY23 and 9MMY24.

Key Rating Drivers:

Business risk profile of the sugar industry is considered moderate, characterized by inelastic demand and low risk of substitute products, albeit in a highly fragmented market. However, industry is highly seasonal and sensitive to sugarcane production levels and quality.

The business risk profile of the sugar sector is assessed as medium, with low exposure to economic cyclicality but high seasonality and sensitivity to sugarcane production levels and quality. Competition risk in the industry is considered medium to low, with a low risk of substitute products for sugar. However, the industry is characterized by high fragmentation with elevated competition within the sector.

The industry experiences inelastic demand linked to the growing population, and government measures allowing exports support its stable demand.

The future outlook for the sugar industry appears challenging due to the country's prevailing economic conditions, the State Bank of Pakistan's elevated discount rate maintaining pressure on finance costs, increases in sugarcane prices in provinces, inventory pileups, and lower crushing seasons coupled with sugarcane availability issues. Moreover, prices of sugar has stagnated in recent months.

Ratings also consider the high business risk profile of steel sector which is characterized by heightened exposure to supply chain disruptions, intense competition and exchange rate risk. Risk profile of the steel industry is taken into account due to major contribution of the Company's steel segment on its topline.

Ratings also consider the risk profile of the steel industry, with a major chunk of the Company's topline now contributed by its steel segment. VIS categorizes the long steel industry's business risk profile as high. The industry's performance was marred by major supply chain disruptions due to the Russia-Ukraine War, surging inflation, the depreciation of the local currency and depleting foreign exchange reserves in FY23. Moreover, the long steel sector in Pakistan is highly fragmented and intensely competitive, hosting more than 300 melting and re-rolling mills mostly in unorganized sector. However, only a handful of companies are considered top-tier players. Additionally, the sector is considered highly cyclical with demand dependent upon the level of construction activity in the country and expenditure on public sector development programs.

The long steel industry is a sub-segment of 'Iron & Steel Products' group within the large-scale manufacturing sector, accounting for ~3.5% of the Large-Scale Manufacturing (LSM) sub-segment of the economy. As the demand for steel is derived from various industries like construction, automotive, and appliances, economic downturn in these industries due to multiple factors like poor economic conditions, rupee depreciation and rising inflation has greatly contributed to the decline in demand for steel.

Although there is a slight hint of stability observed in the macroeconomic conditions in FY24, persistent issues such as high-energy costs, inflation, and high interest rates will continue to pose as significant hurdles to the industry's growth prospects going forward.

Diversification provides support to assigned ratings.

The Company has expanded its business operations by introducing a re-rolling mill alongside an existing steel billet plant. Therefore, despite challenges such as stagnated sugar prices amid inventory buildup affecting revenues and inventory valuation, the Company's diversification into steel, including the establishment of a re-rolling mill, provides buffer to its revenue streams. However, management has stated that they will focus on their bars production rather than compete in the billet market. The addition of a distillery will add further support to assigned ratings.

Profitability profile depicts improvement with topline growth in MY23 and gross margins. However, net margins are strained by the increased financial burden.

SSML's revenue streams include proceeds from the sale of sugar, its by-products, and steel. In MY23, the Company recorded a 51.1% increase in sales, driven by a 10.5% rise in sugar sales and a 16.1% increase in steel sales. The rise in sugar and steel sales resulted from a 6.3% increase in average selling prices and the introduction of value added steel bars from the re-rolling mill. The gross margin improved to 14.9% (MY22: 12.9%) in MY23, supported by higher sugar prices, which offset increased sugarcane procurement costs. Gross margins further improved to 16.1% in 6MMY24, due to a 30.3% increase in average sugar prices, offsetting the 23.8% rise in sugarcane procurement costs.

However, net margins declined to 2.6% (MY22: 3.5%) in MY23 due to higher financial costs from a contractionary monetary environment, despite lower debt drawdown. This trend continued in 6MMY24, with net margins further declining to 2.4% due to increased finance costs with increased short-term borrowing.

Capitalization considered manageable, albeit elevated metrics in 1HMY24 due to seasonal inventory buildup.

The Company's capitalization profile improved in MY23, evidenced by reductions in its gearing and leverage ratios to 1.1x (MY22: 2.3x) and 2.9x (MY22: 3.0x), respectively. This improvement was due to SSML's reduced short-term debt drawdown, as sufficient cash flow from operations met its working capital needs in MY23. However, the seasonal buildup of inventory led to increased utilization of short-term lines to fund inventory procurement, resulting in gearing and leverage ratios of 3.5x and 5.5x, respectively. Going forward, to set up a distillery SSML plans on raising PKR 5,500 mln through a syndicated finance facility, to fund the estimated PKR 7,500 mln project which is expected to constrain the capitalization metrics.

Adequate liquidity profile, albeit at sensitive level.

The Company has historically maintained an adequate liquidity profile with an average 5-year current ratio of 1.1x between MY18-22. However, after dipping below 1.0x benchmark in MY22 the current ratio recovered to 1.0x (MY22: 0.9x) in MY23, remaining stable in 1HMY24. Meanwhile the cash conversion cycle ('CCC') has remained mostly stable between MY22 and MY23, only increasing by ~10 days mainly due to a higher collection period during the year.

Coverage profile considered commensurate with assigned ratings.

The Company's coverage profile remained stable between MY22 and 6MMY24, maintaining around 1.2x. Short-term debt coverage normalized to 1.3x in 1HMY24, following a peak of 2.6x in MY23 (MY22: 1.1x), commensurate with assigned ratings.

Considerations for Future Reviews

Going forward, the Company's ratings will be sensitive to key business and financial risk indicators, including the impact of economic conditions, finance costs, sugarcane prices, exchange rates, and inventory levels. The Company's management has committed to focusing on bar production and further diversifying its operations to support revenue streams. Ratings will depend on the Company's ability to maintain its profitability, capitalization, and liquidity profiles amidst these challenges, with particular attention to maintaining key ratios.

Sheikhoo Sugar Mills Limited — Appendix I

Financial Summary

Balance Sheet (PKR Millions)	MY22A	MY23A	1HMY24M	MY24P	MY25P
Property, plant and equipment	10,891.23	10,332.34	10,163.30	9,779.70	10,829.13
Stock-in-trade	9,198.47	8,247.04	25,900.55	7,810.60	8,302.31
Trade debts	1,520.05	5,835.40	6,510.92	1,114.48	1,165.55
Cash & Bank Balances	189.91	603.10	2,195.11	339.42	253.41
Other Assets	2,634.77	3,059.18	5,965.87	7,738.15	6,556.55
Total Assets	24,434.43	28,077.06	50,735.75	26,782.35	27,106.95
Creditors	2,781.92	4,099.46	2,082.78	7,287.81	5,797.39
Long-term Debt (incl. current portion)	4,373.48	3,398.50	2,958.40	2,342.93	2,348.80
Short-Term Borrowings	9,468.93	4,715.21	24,712.62	7,859.88	7,659.88
Total Debt	13,842.41	8,113.71	27,671.02	10,202.81	10,008.68
Other Liabilities	1,700.19	8,599.70	13,173.20	1,532.71	2,322.88
Total Liabilities	18,324.52	20,812.87	42,927.00	19,023.32	18,128.95
Paid up Capital	450.00	450.00	450.00	450.00	450.00
Equity (excl. Revaluation Surplus)	6,109.90	7,264.16	7,808.73	7,759.02	8,978.01

Income Statement (PKR Millions)	MY22A	MY23A	1HMY24M	MY24P	MY25P
Net Sales	29,591.40	44,706.85	22,255.34	58,587.30	60,137.63
Gross Profit	3,828.54	6,650.53	3,578.32	7,784.97	6,856.77
Operating Profit	3,059.76	4,843.01	2,800.60	5,849.77	4,733.27
Finance Costs	1,489.96	2,848.84	1,994.51	4,451.00	2,589.00
Profit Before Tax	1,569.80	1,994.17	806.09	1,398.77	2,144.27
Profit After Tax	1,030.41	1,143.87	521.91	645.44	1,369.35

Ratio Analysis	MY22A	MY23A	1HMY24M	MY24P	MY25P
Gross Margin (%)	12.94%	14.88%	16.08%	13.29%	11.40%
Operating Margin (%)	10.34%	10.83%	12.58%	9.98%	7.87%
Net Margin (%)	3.48%	2.56%	2.35%	1.10%	2.28%
Funds from Operation (FFO) (PKR Millions)	1,913.58	2,158.21	945.72	1,413.48	2,169.92
FFO to Total Debt* (%)	13.82%	26.60%	6.84%	13.85%	21.68%
FFO to Long Term Debt* (%)	43.75%	63.50%	63.93%	60.33%	92.38%
Gearing (x)	2.27	1.12	3.54	1.31	1.11
Leverage (x)	3.00	2.87	5.50	2.45	2.02
Debt Servicing Coverage Ratio* (x)	1.15	1.24	1.18	1.08	1.39
Current Ratio (x)	0.94	1.01	1.01	1.03	1.06
(Stock in trade + trade debts) / STD (x)	1.13	2.64	1.31	1.18	1.31
Return on Average Assets* (%)	5.62%	4.36%	2.65%	1.67%	5.08%
Return on Average Equity* (%)	17.68%	17.11%	13.85%	8.29%	16.36%
Cash Conversion Cycle (days)	68.95	79.26	171.56	104.00	20.71

Annualized, if required

A - Actual Accounts

P - Projected Accounts

M - Management Accounts

REGULATORY DISCLOSURES

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

Rating Date	Medium to Long Term	Short Term	Rating Outlook/Rating Watch	Rating Action
RATING TYPE: ENTITY				
05/08/2024	**A-**	**A-2**	**Stable**	**Reaffirmed**
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

Due Diligence Meetings Conducted

S.No.	Name	Designation	Date
1.	Mr. Saqib Hameed	Chief Finance Officer (CFO)	July 25, 2024
2.	Mr. Ghulam Husain	Group Manager Treasury	