# RATING REPORT

## RYK Mills Limited

**REPORT DATE:**
February 15, 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 15, 2022* | | *Feb 19, 2021* | |

| COMPANY INFORMATION | |
|---|---|
| **Incorporated in 2007** | **External Auditors:** HBL Ijaz Tabussum & Co. Chartered Accountants |
| **Public Unlisted Company** | **Chairman/ CEO:** Mr. Makhdum Omer Shehryar |
| **Key Shareholders (with stake 5% or more):** | |
| *Makhdum Omer Shehryar ~20.0%* | |
| *Cascade Tek (Private) Limited ~18.6%* | |
| *Axe Capital Limited ~16.2%* | |
| *Mr. Tarik Jawaid ~10.6%* | |
| *Mr. Wajid Ahmad Khan Bhatti ~9.6%* | |
| *Ms. Mahrukh Jahangir ~9.4%* | |
| *Ms. Iram Amin ~5.0%* | |

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

# RYK Mills Limited

| OVERVIEW OF THE INSTITUTION | RATING RATIONALE |
|---|---|

*RYK Mills Limited (RYK) was incorporated in June 2007 under the repealed Companies Ordinance, 1984 (now Companies Act, 2017). Head office is located at 75-D/4 Sarfraz Rafique Road, Cantt Lahore.*

**Profile of Chairman/CEO**

*Makhdum Omer Shehryar is a graduate from NYU Stern School of Business (USA). Mr. Shehryar is one of the founders and major shareholders of RYK Group. He has more than 20 years of experience in banking, industrial and power sectors.*

RYK Mills Limited (RYK) is principally engaged in manufacturing and sale of sugar and by-products. The company is also involved in generation and sale of electricity while being self-sufficient for in-house consumption. Total sugarcane crushing capacity of the company with its subsidiary stands at ~33K tons per day (tpd) along with presence in power generation (30 MW of bagasse-based independent power plant). Headquartered in Lahore, RYK has production units including sugar mill and power generation facility located at District Rahim Yar Khan, Punjab.

**Long-term Investments**

During the ongoing year, the company fully divested its wholly-owned subsidiary, SW Sugar Mills Limited, at a total consideration of Rs. 2.3b with immediate payment settlement. At present, remaining long-term investments amounted to Rs. 1.4b constituting 100% stake in Alliance Sugar Mills Limited.

**Regulatory Matter (Update on Penalty Imposed)**

The ratings have incorporated the developments with regards to penalties imposed by Competition Commission of Pakistan (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. 1.5b) on RYK will be significant and hence VIS will continue to monitor further development in this matter.

**Diversification planned in revenue stream through forward integration into ethanol production**

The management has planned to set up a new distillery plant with stated ethanol production capacity of 125,000 liters per day. At present, the project has a completion status of ~60%. The production unit will be located off-site in the district Rahim Yar Khan, near existing sugar manufacturing units. This would facilitate in smooth procurement of molasses from RYK and ASML. Moreover, a turbine of ~16MW is also in the installation phase. Total estimated cost of the project is Rs. 3.5b; of which 30% will be funded through internal capital generation. Remaining cost is being financed through a 10-year (inclusive of 2 years grace period) long term financing facility. Pertaining to the project, the company has already acquired Rs. 765.5m (as at end-Sept'21) while further mobilization of Rs. ~1.7b is planned in the ongoing year. The project is expected to come online in Nov'22.

**Operational Performance:**

Sugarcane crushing capacity has increased by ~24% (from 16,500 tpd to 18,000 tpd) over the period of last two years on the back of significant capital expenditures which largely pertained to steam efficiency enhancement and reduction of process bottlenecks. Since last review, vaccum pans, extension in cane carrier, crystallizers (U-shaped) were the major additions to fixed assets.

***Sugar Division***

During the outgoing year, the mill operated for 120 days (MY20: 112 days; MY19: 99 days) which aligns with the industry. RYK crushed 1.89m MT of sugarcane which is ~30% higher vis-à-vis previous year. Consequently, overall sugar production was also recorded higher at 188K MT (MY20: 149K MT) in MY21 despite the decline in sucrose recovery rate (owing to industry-wide early commencement of crushing activity during the month of November as per government directives). In line with higher cane crushing, molasses production also stood higher while its recovery rate has declined on a timeline basis. Utilization levels have depicted considerable improvement in comparison to previous crushing season.

**Figure: Sugar Mill (Capacity & Production)**

| | MY20 | MY21 | 4M'MY22 |
|---|---|---|---|
| Sugarcane Crushing Capacity (TPD) | 14,500 | 16,500 | 18,000 |
| Total Cane Crushed (Tons) | 1,453,034 | 1,887,016 | 1,304,488 |
| Crushing Days | 112 | 120 | 78 |
| Crushing Per Day (Tons) | 12,974 | 15,725 | 16,724 |
| Capacity Utilization (%) | 89% | 95% | 93% |
| Sugar Produced (Tons) | 149,200 | 187,953 | 122,035 |
| Sucrose Recovery (%) | 10.27 | 9.96 | 9.50 |
| Molasses Recovery (%) | 5.36 | 4.61 | 4.26 |

Going forward, given indication of higher crop coverage area, healthy crop size and attractive prices, the management anticipates total sugarcane crushed to close at 2.2m MT with crushing activity to last for more than 120 days.

***Power Division***

With total installed capacity of 262,800 MWh, the power unit has remained operational for 220 days (MY20: 183 days) during MY21 resulting in higher number of units produced. The capacity factor noted some recovery in the outgoing year; however, total plant capacity is capped at 45% (as per CPPA for payment of tariff and dispatch of electricity from bagasse based co-generation power plants). Electricity generation is expected to remain around similar levels going forward.

**Figure: Power Generation Facility (Capacity & Production)**

| | MY19 | MY20 | MY21 |
|---|---|---|---|
| Installed Capacity (MWh) | 262,800 | 262,800 | 262,800 |
| Electricity Produced (MWh) | 110,012 | 89,603 | 99,582 |
| In-house Consumption | 24,743 | 15,928 | 22,479 |
| Operating Days | 221 | 183 | 220 |
| Capacity Factor (%) | 41.9 | 34.1 | 37.9 |
| Average Tariff Rate/MWh | 12,945 | 13,653 | 12,771 |

**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. Diversification in to power division provides some comfort to business risk profile.**

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. However, sector's risk profile draws support from diversification into power, distillery and other segments.

**Lower quantity of sugar sold has impacted the sales revenues in MY21. The management expects healthy growth in topline during the ongoing year on account of higher carry over stock and improvement in sugar retail prices.**
After registering a double-digit annual growth in the past two consecutive years, topline of the company has declined by ~3% and amounted to Rs. 13.9b (MY20: Rs. 14.4b; MY19: Rs. 12.6b) in MY21; of which 84% revenue pertained to sugar, 9% to by-products and the remaining to electricity segment. The decline in sales is mainly attributable to lower quantity of sold sugar (despite higher production) during the outgoing year whereas average sugar sale price stood considerably higher at Rs. 74,590 per ton (MY20: Rs. 62,237 per ton). In MY21, institutional sales in sugar segment accounted for ~10% of total revenue. The management expects the same to increase to 25-30% given that negotiations are underway with key customers belonging to FMCG, confectionery and beverages sectors. Going forward, healthy growth in topline is projected on account of higher carry over stock and sugar production along with improvement in average sale prices.

**Figure: Sales Data**

| | MY20 | MY21 | 4M'MY22 |
|---|---|---|---|
| Sugar Sold - Quantity (MT) | 197,211 | 155,079 | 122,035 |
| Sugar Price (Rs. per MT) | 62,237 | 74,590 | 86,000 |

Since last review, revenue from power division has largely remained stagnant while decline in average tariff rate was partially offset by higher electricity generated and delivered to CPPA. On the other hand, revenue contribution (both in absolute and proportionate terms) from molasses segment has registered a two-fold increase over the two year period.

**Operating margins have depicted weakening while the bottom-line has suffered significantly due to CPPA related bad debts write-off.**
Gross margins continue to witness a downward trend (MY21: 17.7%; MY20: 20.1%; MY19: 25.0%) on account of ~43% upsurge in average sugarcane procurement cost over the period of last three years (MY21: Rs. 257/40kg; MY20: Rs. 224/40kg; MY19: Rs. 180/40kg). However, the same has decreased slightly to Rs. 252/40kg (as per four month average cost in the ongoing season). The management expects the same to decline further given efficient procurement and timely payments to farmers which results in favorable sugarcane prices.

On the cost front, administrative overheads largely remained stagnant while distribution cost reduced by nearly one-half mainly due to lower freight and handling expenses. Financial charges declined by ~27% owing to lower average utilization of running finance and the same trend is expected to continue going forward. Moreover, CPPA related bad debts write-off amounting to Rs. 683.1m significantly impacted the bottom-line. As a result, net margin declined from 6.0% in MY20 to 1.5% in MY21.

**Inflows from the sale of subsidiary are expected to ease the pressure on liquidity profile.**
In MY21, Funds from Operations (FFO) were reported lower at Rs. 668.4m (MY20: Rs. 702.7m; MY19: Rs. 1.3b) and thus, affected the debt coverage metrics as reflected by the decline in DSCR to 0.90x (MY20: 1.05x). Nevertheless, inflows of Rs. 2.3b from the sale of subsidiary are expected to ease the pressure on liquidity profile. The management plans to channel the inflows towards financing working capital and other needs.

Current ratio continues to remain below 1.0x indicating room for improvement while coverage of short-term borrowings in relation to stock in trade and trade debts is satisfactory. Stock levels at end-Sept'21 were reported higher at Rs. 3.8b; which has been sold subsequently on improved retail prices. Trade debt were reported at Rs. 1.1b at end-MY21; of which three-fourth pertains to NTDC/CPPA against sale/supply of electricity. Around 23% of total receivables are outstanding for over six months.

**Sound capitalization levels; leverage indicators have trended upwards.**
Equity base of the company has increased to Rs. 6.6b (MY20: Rs. 6.4b) at end-MY21 on account of profit retention and no dividend payout for the previous year. 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. 4.4b (MY20: Rs. 4.1b; MY19: Rs. 2.9b) while further addition of Rs. ~1.7b for distillery project is planned in the ongoing year. Leverage and gearing ratios have trended upwards in MY21. Going forward, ratings remain dependent on managing leverage indicators within prudent levels.

| FINANCIAL SUMMARY *(amounts in PKR millions)* | | | | Appendix I |
|---|---|---|---|---|
| **BALANCE SHEET** | **MY18** | **MY19** | **MY20** | **MY21** |
| Property, Plant & Equipment | 7,364 | 7,345 | 7,380 | 8,405 |
| Long-term Investment | 3,739 | 3,739 | 3,739 | 3,739 |
| Stock in Trade | 4,814 | 3,186 | 1,328 | 3,854 |
| Trade Debts | 1,819 | 1,616 | 2,164 | 1,141 |
| Advances & Other Receivables | 1,786 | 996 | 1,531 | 1,086 |
| Cash & Bank Balance | 186 | 116 | 490 | 489 |
| Total Assets | **20,027** | **17,373** | **17,129** | **19,330** |
| Trade & Other Payables | 3,493 | 2,366 | 2,828 | 2,799 |
| Short-term Borrowings | 7,369 | 5,427 | 3,048 | 4,624 |
| Long-Term Borrowings *(Inc. current maturity)* | 3,185 | 2,856 | 4,109 | 4,357 |
| Total Liabilities | **15,228** | **11,803** | **10,765** | **12,755** |
| Paid-up Capital | 1,420 | 1,420 | 1,420 | 1,420 |
| Retained Earnings | 3,064 | 3,174 | 4,038 | 4,249 |
| Deposits for Purchase of Shares | 316 | 976 | 906 | 906 |
| Total Equity | **4,800** | **5,570** | **6,364** | **6,575** |
| | | | | |
| **INCOME STATEMENT** | | | | |
| Net Sales | 10,723 | 12,568 | 14,368 | 13,985 |
| Gross Profit | 2,540 | 3,139 | 2,890 | 2,471 |
| Operating Profit | 2,208 | 2,682 | 2,655 | 1,670 |
| Profit Before Tax | 1,142 | 918 | 893 | 389 |
| Profit After Tax | 1,002 | 724 | 863 | 212 |
| | | | | |
| **RATIO ANALYSIS** | | | | |
| FFO | 1,511 | 1,274 | 703 | 668 |
| Gross Margin (%) | 23.7% | 25.0% | 20.1% | 17.7% |
| Net Margin (%) | 9.3% | 5.8% | 6.0% | 1.5% |
| Net Working Capital | (3,530) | (3,069) | (1,132) | (2,092) |
| FFO to Long-Term Debt (x) | 0.47 | 0.45 | 0.17 | 0.15 |
| FFO to Total Debt (x) | 0.14 | 0.15 | 0.10 | 0.07 |
| Debt Servicing Coverage Ratio (x) | 1.65 | 1.15 | 1.05 | 0.90 |
| ROAA (%) | 5.3% | 4.2% | 5.0% | 1.1% |
| ROAE (%) | 23.6% | 15.8% | 15.8% | 3.7% |
| Gearing (x) | 2.20 | 1.49 | 1.12 | 1.37 |
| Debt Leverage (x) | 3.17 | 2.12 | 1.69 | 1.94 |
| Current Ratio (x) | 0.72 | 0.67 | 0.84 | 0.77 |
| Inventory + Receivables to Short-term Borrowings (x) | 0.90 | 0.88 | 1.15 | 1.08 |

# 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** | RYK 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** | | | | |
| | 15/02/2022 | A | A-2 | Stable | Reaffirmed |
| | 19/02/2021 | A | A-2 | Stable | Reaffirmed |
| | 17/01/2020 | 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. Irfan Qamar** | Head of Internal Audit | | Feb 07, 2022 | |