RATING REPORT

RYK Mills Limited

REPORT DATE:
Oct 05, 2023

RATING ANALYST:
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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	*Positive*		*Stable*	
Rating Date	*Oct 05, 2023*		*Feb 15, 2022*	

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: Corporates (May 2023)
https://docs.vis.com.pk/docs/CorporateMethodology.pdf

VIS Rating scale (2023)
https://docs.vis.com.pk/docs/VISRatingScales.pdf

RYK Mills Limited

OVERVIEW OF THE INSTITUTION

RYK Mills Limited (RYK) was incorporated in June 2007 under the repealed Companies Ordinance, 1984 (now Companies Act, 2017).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.

Financial Snapshot

Tier-1 Equity: end-1H'MY23: Rs. 8.3b; end-MY22: Rs. 7.7b; end-MY21: Rs. 6.9b

Assets: end-1H'MY23: Rs. 27.9b; end-MY22: Rs. 23.0b; end-MY21: Rs. 19.7b

Profit After Tax: 1H'MY23: Rs. 582.5m; MY22: Rs. 989.7m; MY21: Rs. 582.2m

RATING RATIONALE

RYK Mills Limited (RYK) is primarily engaged in manufacturing and sale of sugar. 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 ~35K tons per day (tpd) along with presence in power generation (30 MW of bagasse-based independent power plant). The distillery plant installed by the company at Tillo Bangla, Sadiqabad, started commercial operations in Jan'23, with a total capacity of 125,000 liters/day. Headquartered in Lahore, RYK has production units including sugar mill and power generation facility located at District Rahim Yar Khan, Punjab.

<u>Key Rating Drivers</u>

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 1.7m 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 sugar report published on April 12, 2023, sugarcane production is expected at 83.5m MT during 2023-24, three percent above 2022-23 production, on account of expected recovery in yield in areas which were previously impacted by the floods. For the season 2023-24, the estimated harvesting area is also expected to increase to 1.25 million hectares (2022-23: 1.23 million hectares). Sugar output for the forthcoming season is expected to clock at 7.05 million MT, a marginal increase from that in 2022-23. Moreover, due to population growth and demand from the developing food processing industry, sugar consumption is projected to rise by around 3% to 6.3 MT. In view of accumulating sugar stocks, the Govt. has so far allowed 250,000 tons of sugar exports in the ongoing year. Sugar prices have shown rising trend in line with inflationary pressure in the ongoing year. However, elevated markup rates would likely to suppress bottomline of companies with high leveraged capital structure.

Operational Performance:

<u>Sugar Division:</u>

The crushing season 2022-23 started on November 24th, 2022 compared to November 15th in previous season and lasted for a total of 111 days (MY22: 142 days) primarily due to contraction in sugarcane yield induced by floods. Accordingly, cane crushed stood at 2.0m MT (MY22: 2.4m MT;

MY21: 1.9m MT) during 2022-23 season. On the other hand, sucrose recovery rates improved to 10.58% (MY22: 9.97%; MY21: 9.96%) while sugar production was recorded lower at 215,217 MT (MY22: 243,965 MT; MY21: 187,953 MT) due to lower crushing. Molasses production declined by ~17% to 92,870 MT (MY22: 112,130 MT; MY21: 87,255 MT) while recovery rates marginally increased. During the ongoing year, crushing capacity of RYK was regularized to 20,000 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 has paid a requital fee of Rs. 10,000/ton in lieu of this regularization. A snapshot of production related information of sugar segment is tabulated below:

Crushing Season	2019-20	2020-21	2021-22	2022-23
Crushing Capacity – tpd	14,500	19,500	19,500	20,000
Cane Crushed – tpd	12,974	15,725	17,235	18,315
Crushing Days	112	120	142	111
Capacity Utilization – %	89.47	80.64	88.39	91.58
Sucrose Recovery – %	10.27%	9.96%	9.97%	10.59%
Sugar Produced – tons	149,200.0	187,953.0	243,965.0	215,217.0
Molasses Produced-Tons	77,955	87,255	112,130	92,870
Molasses Recovery Rate-%	5.37%	4.61%	4.54%	4.57%

Power Division

Power division of RYK has installed capacity of 262,800 MWh. During the first five months of MY23, the power unit has remained operational for 151 days (MY22: 276 days; MY21: 220 days) while total units generated stood at 47,700 MWh (MY22: 127,212 MWh; MY21: 99,582 MWh. Out of the total output, around 79.5% (MY22: 82.9%; MY21: 77.4%) units were sold to CPPA. Capacity factor declined in the outgoing year, while average tariff rate increased by 10.8%. Please note that 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). As per management, electricity generation is expected to remain around similar levels, going forward.

	MY20	MY21	MY22	5M'MY23
Installed Capacity (MWh)	262,800	262,800	262,800	262,800
Electricity Produced (MWh)	97,387	99,582	127,212	47,700
In-house Consumption	23,713	22,478	21,798	9,770
Operating Days	183	220	276	151
Capacity Factor (%)	37.10%	37.90%	48.40%	18.20%
Average Tariff Rate/MWh	13,450	12,611	12,489	13,846

Distillery:

During CY22, the Company completed the project of setting up a distillery plant at Tillo Bangla, Sadiqabad, with a production capacity of 125,000 liters per day. The plant is located at middle point of group's two sugar mills (Alliance Sugar & RYK Mills) which facilitates easy availability of molasses from both sugar mills (Alliance at Ubarau and RYK at Janpur/Rahim Yar Khan) for value addition and export through Karachi seaport. Thereby ensuring around 90% of molasses requirement to be met through in-house production. Installation of distillery plant was completed in Nov'22 and following the completion of initial tests and necessary process alignments, it started commercial operations in Jan'23. Total cost incurred on the project amounted to Rs. 5.5b, which has been financed through a debt-to-equity mix of 60:40. Power requirement of distillery segment operations is around 2.2 MWh, which is met through 3.0 MWh turbine of Chinko/Japan and Toyodonkey generator.

Revenues and Profitability:

During MY22, the company posted a growth of ~42% in topline amounting to Rs. 19.8b (MY21: Rs. 13.9b), primarily on account of 49% increase in volumetric sugar sales. Average selling prices of sugar, on the other hand, decreased by 4.5% owing to excess stocks available in the country. During the outgoing year, the company has shifted completely towards open market sales owing to cash or advance payment vis-à-vis credit sales in majority of the corporate sales orders. Total gross sales stood higher at Rs. 22.8b (MY21: Rs. 16.1b), out of which sugar sales amounted to 84.9% (MY21: 84.4%), followed by molasses sales standing at 8.5% (MY21: 8.8%). Molasses sales were recorded higher at Rs. 1.9b (MY21: Rs. 1.4b) during MY22 on account of 26% increase in average selling prices, coupled with 7.6% increase in quantity sold. Revenue from power division contributed 6.4% (MY21: 6.6%) to the gross sales mix. Breakdown of sugar and molasses sold along with their average prices are tabulated below:

Rs. Million	MY20	MY21	MY22	5M'MY23
Sugar Sold (MT)	197,211	155,079	231,277	86,177
Sugar Price/MT	62,237.00	74,590.97	71,220.97	73,154.66
Molasses Sold (MT)	77,849	87,357	94,032	50,214
Molasses Price/MT	13,750.51	16,120.03	20,330.84	22,289.97
Units Sold to CPPA - MWh	73,674	77,104	105,414	37,930

Although sugarcane procurement cost was relatively higher in the outgoing year, gross margins improved to 19.0% (MY21: 17.9%), due to economies of scale and inventory gains emanating from selling low cost carryover sugar stock in MY22. Distribution expenses mainly increased with inflationary pressures while administrative expenses increased due to increase in legal and professional fee coupled with higher salaries and others benefits due to inflationary pressure and increase in executives' headcount amid expansion in operations. Other expenses were recorded lower at Rs. 510.7m (MY21: Rs. 761.0m) as in the preceding year the company wrote off receivables to the tune of Rs. 683.1m. However, in MY22, other expenses include receivables amounting to Rs. 265.3m (MY21: nil) due from SW Sugar Mills (associated company) that were written off. Other income decreased to Rs. 257.6m (MY21: Rs. 369.5m) mainly due to lower delayed payment interest on electricity sales coupled with lower markup received on loans made to related parties. Finance cost increased to Rs. 1.6b (MY21: Rs. 1.3b) on account of sharp hike in average markup rates and higher average short-term borrowings. Effective tax rate during the outgoing year stood at 24.4% compared to tax credit in the preceding year. In addition, the company also recorded provision for super tax amounting Rs. 23.9m during MY22. Net profit was recorded higher at Rs. 989.7m (MY21: Rs. 562.2m) with improvement in net margin to 5.0% (MY21: 4.2%) during MY22.

During 1H'MY23, the company generated net revenues of Rs. 11.2b. Gross margins remained under pressure largely owing to overall suppressed sugar prices during this period. Average sugar prices exhibited notable increase in line with inflationary pressure after the end of crushing season. RYK was allocated an export quota for sugar amounting to 6,798 MT, which has been exported at an average rate of $500/MT. Sugar prices are expected to remain high amidst significant gap in imported sugar prices and the locally produced due to rupee devaluation and lower available sugar stocks by the end of this year. Meanwhile, incremental revenue from ethanol operations were reported at ~Rs. 5b in 9M'23, which makes up ~22% of the total revenue mix on annualized basis while ethanol plant was operational at ~62% capacity during this period. As a result of higher contribution margins of ethanol and increase in retail prices of sugar, gross margins are expected to improve notably in full year. The management expects to operate distillery at higher capacity, with contribution from ethanol in revenue mix reaching at around 30%, leading to overall improvement in risk profile of the company, going forward.

Liquidity Profile:
During MY22, funds from operations (FFO) were recorded higher at Rs. 2.3b (MY21: Rs. 1.8b) primarily on the back of higher profitability. Liquidity profile of the company is underpinned by adequate cash flows in relation to outstanding obligation. FFO to total-debt and FFO to long-term debt remained adequate at 0.21x (MY21: 0.20x) and 0.52x (MY21: 0.41x), respectively. Similarly, debt service coverage ratio (DSCR) stood at 1.35x (MY21: 1.39x) despite higher principal repayments amounting to Rs. 1.4b (MY21: Rs. 979.2m) during the outgoing year. Cash flow coverages weakened slightly owing to higher outstanding short-term borrowings in 1H'MY23.

Stock in trade augmented to Rs. 12.1b (MY22: 4.9b; MY21: Rs. 4.1b) as of Mar'23, largely in line with higher sugar inventory. Trade receivables stood lower at Rs. 854.7m (MY22: Rs. 1.4b; MY21: Rs. 1.1b) with satisfactory ageing profile. As of Sep'22, nearly 60% (MY22: 78%) of the outstanding receivables were due from CPPA against sale of electricity while the rest were outstanding against sugar sales. Receivables from CPPA are secured by a guarantee from the GoP under the Implementation Agreement (IA); however, a delayed payment markup of 3MK plus 2-4% p.a (MY21: 3MK plus 4.5% p.a) is charged in case the amount is not paid within due dates. Loans and advances were reported lower at Rs. 97.0m (MY22: Rs. 2.0b; MY21: Rs. 1.1b) largely due to reduction in advances made to Alliance Sugar Mills (associate company) against purchase of molasses. Trade and other payables stood at Rs. 3.1b (MY22 & 21: Rs. 3.3b), which largely included contract liabilities, amount owed to associates and trade creditors. Current ratio has remained depressed largely owing to increase in short term borrowings whereas coverage of short-term borrowings via stock in trade and trade debts has remained adequate on a timeline basis. Cash flow coverages are expected to improve further in full year on the back of projected growth in profitability along with improvement in working capital management in line with inventory off take and reduction in short-term borrowings.

Capitalization:

Tier-1 equity augmented to Rs. 8.3b (MY22: 7.7b; MY21: Rs. 6.9b) by end-1H'MY23 on account of internal capital generation. This also includes share deposit money amounting to Rs. 1.2b (MY22: Rs. 1.2b; MY21: Rs. 905.9m) contributed by sponsors to support operations over the last few years. During MY22, the company disbursed interim dividends to the tune of Rs. 497.0m (MY21: Nil).

Total long-term financing inclusive of current portion stood at Rs. 4.3b (MY22: Rs. 4.5b; MY21: Rs. 4.4b) at end-Mar'23. For the distillery project, the company has obtained long-term loan to the tune of Rs. 2.5b in MY22 and loan amounting Rs. 622.7m has been mobilized in the subsequent period. These included sum of Rs. 315.0m and Rs. 250.0m obtained under Temporary Economic Refinance Scheme (TERF) by SBP, priced at SBP-TERF rate plus 2%, with repayments starting from March and August, 2024, respectively. Long-term loan mobilized under subsidized Long-Term Financing Facility (LTFF) scheme amounted to Rs. 600.0m, priced at SBP LTFF rate plus 400 bps, with principal repayments starting from April'24. Long-term financing of Rs. 400.0m, Rs. 700.0m and Rs. 225.0m were obtained under Export Refinancing Scheme charged at 3M KIBOR plus 165-250 bps from various financial institutions, with repayments starting from Jun'23, Feb'24 and Dec'24, respectively. In addition, term finance loan of Rs. 425.0m and Rs. 150.0m, carrying markup at rate of 3M KIBOR plus 200 to 225 bps, were mobilized, with repayments starting from Mar and Apr'24, respectively.

Short-term borrowings augmented to Rs. 11.4b (MY22: 6.3b; MY21: Rs. 4.5b) in line with seasonal working capital requirements, which led to increase in gearing and debt leverage by end-1H'MY23. Going forward, capitalization profile of the company is expected to improve primarily on account of growth in equity base led by profit retention and scheduled repayments of long-term loans.

Regulatory Matter (Update on Penalty Imposed)

The ratings have incorporated the developments in relation to penalties imposed by Competition Commission of Pakistan (CCP) on selected sugar mills and the subsequent legal proceedings initiated by the subject company. The impact of the imposed penalty amounting Rs. 1.51b on RYK would be significant. The Company has filed a petition before Lahore High Court, Lahore against the impugned order dated 13 August 2021 by the Competition Commission of Pakistan (CCP) in which a penalty of Rs. 1.51b was imposed on the Company for distorting competition in the market by sharing sensitive commercial stock information. The Lahore High Court, Lahore vide order dated 26 October 2021 suspended the impugned order and restrained the authorities from recovering any amounts from the Company till the next date of hearing. The case is pending adjudication.

RYK Mills Limited

FINANCIAL SUMMARY *(amounts in PKR millions)*		Appendix I		
BALANCE SHEET	**MY20**	**MY21**	**MY22**	**1H'MY23**
Property, Plant & Equipment	7,380	8,253	11,850	12,227
Long term Investments	3,739	1,439	1,492	1,544
Stores, Spares. And Loose Tools	214	335	381	499
Stock-in-Trade	1,328	4,074	4,948	12,129
Trade Debts	2,164	1,127	1,371	855
Loan and Advances	1,019	1,128	2,024	97
Other Receivables	513	208	332	285
Cash and Bank Balances	490	418	236	37
Assets classified for sale	-	2,300	-	-
Total Assets	**17,129**	**19,724**	**22,961**	**27,927**
Trade and Other Payables	2,828	3,259	3,320	3,052
Accrued mark-up/Profit	185	388	737	471
Short-Term Borrowings	3,048	4,502	6,282	11,447
Long-Term Borrowings *(Inc. current maturity)*	4,109	4,384	4,458	4,304
Total Liabilities	**10,765**	**12,781**	**15,213**	**19,622**
Paid-Up Capital	1,420	1,420	1,420	1,420
Tier-1 Equity/Total Equity	6,364	6,943	7,748	8,304
INCOME STATEMENT	**MY20**	**MY21**	**MY22**	**1H'MY23**
Net Sales	14,368	13,986	19,790	11,204
Gross Profit	2,890	2,499	3,779	1,888
Finance Cost	1,762	1,297	1,620	709
Other Income	302	370	258	1
Profit Before Tax	893	389	1,310	741
Profit After Tax	863	582	990	583
FFO	703	1,784	2,300	971
RATIO ANALYSIS	**MY20**	**MY21**	**MY22**	**1H'MY23**
Gross Margin (%)	20.1%	17.9%	19.1%	16.8%
Net Margin (%)	6.0%	4.2%	5.0%	5.2%
Current Ratio (x)	0.84	1.01	0.81	0.89
FFO to Long-Term Debt	0.17	0.41	0.52	0.45*
FFO to Total Debt	0.10	0.20	0.21	0.12*
Debt Servicing Coverage Ratio (x)	1.05	1.39	1.35	1.23
ROAA (%)	5.0%	3.0%	4.3%	4.6%*
ROAE (%)	15.8%	9.6%	15.2%	17.1%*
Gearing (x)	1.12	1.28	1.39	1.90
Debt Leverage (x)	1.7	1.8	2.0	2.36
Inventory + Receivable/Short-term Borrowings (x)	1.1	1.2	1.0	1.13

**Annualized*

REGULATORY DISCLOSURES Appendix IV

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				
05/10/2023	A	A-2	Positive	Maintained
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.
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Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Irfan Qamar	Head of Internal Audit	Apr 11,2023
		Aug 22, 2023
Tarik Jawaid	Non-Executive Director	Aug 22, 2023
		Oct 4, 2023