

RATING REPORT

Shahtaj Sugar Mills Limited

REPORT DATE:

June 14, 2024

RATING ANALYSTS:

Muhammad Subhan

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Rating Category	Rating
Entity	A-/A-2
Rating Date	June 14, 2024
Rating Outlook	Stable
Rating Action	Initial

COMPANY INFORMATION

Incorporated in 1965	External auditors: BDO Ebrahim & Company, Chartered Accountants
Public Listed Company	Chief Executive Officer (CEO): Mr. Muneer Nawaz
Key Shareholders (with stake 10% or more):	
Mr. Muneer Nawaz ~ 12.15%	

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>

Shahtaj Sugar Mills Limited

OVERVIEW OF
THE INSTITUTION

RATING RATIONALE

Shahtaj Sugar Mills Limited was incorporated in Pakistan on 27 March 1965 as a public limited Company under the Companies Act, 1913 (Now Companies Act, 2017). The Company is listed on PSX and is engaged in the manufacture and sale of sugar whereas molasses and bagasse are its significant by-products.

Company Profile:

Shahtaj Sugar Mills Limited (“SSML” or “the Company”) was incorporated in Pakistan on 27 March 1965 as a public limited Company under the Companies Act, 1913 (Now Companies Act, 2017). The Company is listed on Pakistan Stock Exchange Limited (PSX) and is engaged in the manufacture and sale of sugar whereas molasses and bagasse are its significant by-products.

The Company's registered office and the Head Office are located in Karachi and Lahore respectively, while the mill is situated in Kuthiala Saidan, Mandi Bahauddin.

Group Structure:

The Company is a part of the Shahnawaz Group, a conglomerate comprising five distinct entities: Shahtaj Sugar Mills Ltd., Shezan International Ltd., Shahtaj Textiles Ltd., Shahnawaz Pvt. Ltd., and Information Systems Associates Ltd. These companies are engaged in diverse sectors including sugar production, food processing, textiles manufacturing, automobiles, distribution, and integrated systems development.

Operational Performance:

	Units	MY24	MY23
Crushing Capacity per day	Tons	12,000	12,000
Crushing Period in days	Numbers	83	91
Cane Crushed	Tons	679,859	786,325
Sugar Production	Tons	67,793	77,600
Sucrose Recovery	% age	9.97%	9.87%
Molasses Produced	Tons	28,152	32,644
Molasses Recovery	% age	4.14%	4.15%

The Company grappled with production challenges attributed to the constrained availability of sugarcane, precipitated by floods during MY23. Consequently, a shortened crushing period of 91 days was documented. The recorded cane crushed figure stood notably lower at 786,325 metric tons (MT), thereby inducing a decline in the production output of sugar, molasses, and bagasse.

In MY24, the Company continues to struggle with sugar cane availability challenges, exemplified by a reduction in the crushing period to 83 days (MY23: 91 days). Correspondingly, the quantity of cane crushed further decreased to 679,859 metric tons (MT) (MY23: 786,325 MT). Resultantly, sugar production saw a decline, registering at 67,793 tons (MY23: 77,600) in MY24. However, there was a slight improvement in sucrose recovery, reaching 9.97% (MY23: 9.87%) in MY24.

Key Rating Drivers:

Installation of power plant as to contribute to the revenue

The Company is in the process of establishing a 32 MW bagasse-based co-generation power project, financed through debt and equity, with necessary licenses and approvals in place from NEPRA and AEDB. Despite achieving financial close and signing agreements, delays in interconnection with GEPCO have postponed the Commercial Operation Date (COD) to an estimated June 2024. This power project is expected to contribute around PKR 1.1 bln to the total sales of company, contributing approximately 10.6% to the total revenue.

Moving forward, ratings will remain dependent on the successful implementation of the power project and its impact on the Company's financial performance.

Medium business risk profile characterized by high cyclicality and moderate capital and competitive intensity

VIS has assigned a medium business risk to the sugar industry given its moderate level of barriers of entry, technology risk, and capital-intensive nature. However, industry's high cyclicality with the production of sugarcane possess a raw material availability risk.

The industry faces an inelastic demand linked with the growing population in the country coupled with government's measure to allow exports further supporting its stable demand. However, unfavorable sugar prices expose the industry to lower revenue gains.

The future outlook of the sugar industry appears challenging due to prevailing economic conditions of the country, SBP discount rate remaining elevated despite expectation of rate cut, which will maintain pressure on finance cost of the Company, increase in sugarcane price in the provinces, and lower crushing season coupled with sugarcane unavailability.

Improvement in the profitability performance

In MY23, the Company experienced a notable 43.2% growth in its revenue, with net sales reaching PKR 9.5 bln (MY22: PKR 6.6 bln). This growth was driven by higher average selling prices of sugar, which rose to PKR 86 thousand per metric ton (MY22: PKR 73 thousand per metric ton) in MY23, along with support from lucrative export sales. The gross margin also saw an improvement, reaching 16.8% (MY22: 11.7%) in MY23. This improvement is attributed to inventory gains on previous year coupled with significant increase in sugar prices. Top line improvement also elevated the net margin to 4.3% in MY23 from near breakeven position in MY22.

In 1QFY24, the Company reported net sales of PKR 2.5 bln, leading to continued improvement in the gross margin, which reached at 24.2%. This increase in gross margin during 1QFY24 is primarily attributed to a further rise in the average selling price of sugar at PKR 109,004/MT. Consequently, the revenue growth led to a higher net margin of 10.9% during the quarter (MY23: 4.3%).

Coverage profile on a strengthening trend

SSML's coverage profile experienced an enhancement, with its debt service coverage ratio (DSCR) reaching 2.2x (MY22: 0.5x) in MY23. This improvement in the DSCR is on account of higher funds flow from operations (FFO), which amounted to PKR 641.2 mln (MY22: PKR 60 mln) in MY23. The increase in FFO is a result of the higher profitability achieved during the year.

In 1QFY24, the DSCR further strengthened to 8.4x due to FFO reporting at PKR 395.1 mln. This improvement in the FFO is on account of higher profitability coupled with lower financial burden during the quarter.

Capital structure showed improvement in MY23, while, 1QFY24 witnessed a decline

In MY23, both the gearing and leverage ratios showed improvement, reporting at 1.6x (MY22: 3.5x) and 2.1x (MY22: 3.9x), respectively. This enhancement in the capital structure is due to improvement in the equity base resulting from higher profit retention along with regular debt repayments.

However, in 1QFY24, the capitalization metrics experienced a decline, with gearing and leverage weakening to 2.2x and 3.3x, respectively. This deterioration in the capital structure is attributed to the seasonal borrowing in the sugar sector to meet the working capital requirements of the quarter.

Adequate liquidity profile

Historically, the Company has maintained an average current ratio of 0.9x over the past four years. In MY23, SSML's current ratio showed a slight improvement, reaching 1.0x (MY22: 0.8x), and further improved to 1.1x in 1QMY24.

Additionally, the short-term debt (STD) coverage improved in MY23, reaching 1.4x (MY22: 0.8x). This improvement is attributed to a larger reduction in short-term borrowings during the period. Furthermore, in 1QMY24, the STD coverage further improved to 1.8x due to a larger sugar stockpile accumulated during the crushing season.

Pending Litigation:

The developments in relation to penalties imposed by Competition Commission of Pakistan (CCP) on Pakistan Sugar Mills Association (PSMA) along with majority of the sugar mills and the subsequent legal proceedings initiated by the subject company is still pending. The impact of the imposed penalty amounting PKR 553 mln on SSML would be significant. However, The Company has filed an appeal before the Competition Appellate Tribunal against the order of CCP, along with other sugar mills in Punjab zone. The Appellate Tribunal has restrained the CCP from adopting any coercive measures against The Company for recovery of the fine. The Company also challenged the same order of CCP before the Lahore High Court (LHC) in a writ petition, along with other sugar mills in the Punjab zone. The operation of the said order has been suspended and CCP has been restrained from recovering penalty imposed in terms of the order of the LHC dated Oct 18, 2021. The matter is pending adjudication before the LHC. Given uncertainty and materiality of the outcome, VIS will continue to monitor further developments in this matter.

Shahtaj Sugar Mills Limited
Appendix I

Financial Summary						
Balance Sheet (PKR Millions)	MY21A	MY22A	MY23A	1QMY24A	FY24P	FY25P
Property, plant and equipment	3,761.2	4,226.0	4,563.5	4,893.0	5,242.3	5,197.0
Stock-in-trade	958.1	2,074.2	1,081.6	2,283.1	600.9	491.0
Trade debts	105.4	188.1	65.9	361.8	38.5	79.7
Cash & Bank Balances	21.6	36.5	89.3	182.3	91.5	93.8
Total Assets	5,497.2	7,241.5	6,421.3	8,537.3	6,691.6	6,648.7
Trade and Other Payables	155.8	165.7	307.1	1,276.5	327.0	154.4
Long-term Debt (incl. current portion)	1,258.4	900.0	1,342.8	1,579.2	2,005.8	2,002.7
Short-Term Borrowings	1,169.7	2,872.6	979.5	1,657.7	521.6	416.9
Total Debt	2,428.1	3,772.6	2,322.4	3,236.9	2,527.4	2,419.6
Total Liabilities	2,852.4	4,238.3	3,031.7	4,878.7	3,261.6	2,989.5
Paid up Capital	120.1	120.1	120.1	120.1	120.1	120.1
Equity (excl. Revaluation Surplus)	1,138.7	1,074.7	1,461.1	1,461.1	1,501.5	1,730.7
Income Statement (PKR Millions)	MY21A	MY22A	MY23A	1QMY24A	FY24P	FY25P
Net Sales	6,314.3	6,615.1	9,476.1	2,469.5	10,167.5	10,680.2
Gross Profit	810.7	773.8	1,591.0	598.4	1,228.2	1,279.3
Operating Profit	547.7	481.4	1,148.1	472.5	783.0	767.8
Finance Costs	264.4	431.3	503.1	44.2	433.6	424.9
Profit Before Tax	314.3	85.4	661.8	428.3	369.8	363.3
Profit After Tax	204.8	1.1	405.5	269.1	208.6	229.2
Ratio Analysis	MY21A	MY22A	MY23A	1QMY24A	FY24P	FY25P
Gross Margin (%)	12.8%	11.7%	16.8%	24.2%	12.1%	12.0%
Operating Margin (%)	8.7%	7.3%	12.1%	19.1%	7.7%	7.2%
Net Margin (%)	3.2%	0.0%	4.3%	10.9%	2.1%	2.1%
Funds from Operation (FFO)	329.9	59.8	641.2	395.1	129.5	172.3
FFO to Total Debt* (%)	13.6%	1.6%	27.6%	48.8%	5.1%	7.1%
FFO to Long Term Debt* (%)	26.2%	6.6%	47.7%	100.1%	6.5%	8.6%
Gearing (x)	2.1	3.5	1.6	2.2	1.7	1.4
Leverage (x)	2.5	3.9	2.1	3.3	2.2	1.7
Debt Servicing Coverage Ratio* (x)	0.9	0.5	2.2	8.4	1.3	1.4
Current Ratio	0.8	0.8	1.0	1.1	1.0	1.3
(Stock in trade + trade debts) / STD (x)	0.8	0.8	1.4	1.8	1.7	2.0
Return on Average Assets* (%)	4.0%	0.0%	5.9%	14.4%	3.1%	3.4%
Return on Average Equity* (%)	19.8%	0.1%	32.0%	73.7%	13.9%	13.2%
<i>*Annualized, if required</i>						
A - Actual Accounts						
P - Projected Accounts						
M - Management Accounts						

Shahtaj Sugar Mills Limited
Appendix II

REGULATORY DISCLOSURES					
Name of Rated Entity	Shahtaj 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
	<u>RATING TYPE: ENTITY</u>				
	6/14/2024	A-	A-2	Stable	Initial
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.				
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Due Diligence Meetings Conducted	S.No.	Name	Designation	Date	
	1.	Mr. Waqar Ahmed	Chief Financial Officer	May 10, 2024	
	2.	Mr. Ata Ul Ghani Saqib	Deputy Manager Audit & Accounts		
	3.	Mr. Kashif Iqbal	Deputy Manager Accounts		