The Pakistan Credit Rating Agency Limited

# Rating Report

## SGM Sugar Mills Limited

**Report Contents**



**Rating History**

| Dissemination Date | Long Term Rating | Short Term Rating | Outlook | Action | Rating Watch |
|---|---|---|---|---|---|
| 06-Apr-2023 | BBB | A2 | Stable | Maintain | - |
| 08-Apr-2022 | BBB | A2 | Stable | Maintain | - |
| 27-Sep-2021 | BBB | A2 | Stable | Upgrade | - |
| 02-Oct-2020 | BBB- | A3 | Positive | Maintain | - |
| 06-Nov-2019 | BBB- | A3 | Stable | Maintain | - |
| 07-May-2019 | BBB- | A3 | Stable | Maintain | - |
| 31-Dec-2018 | BBB- | A3 | Stable | Initial | - |

### Rating Rationale and Key Rating Drivers

Pakistan’s sugar industry is the country's 2nd largest agro-based industry, comprising 90 mills with an annual crushing capacity estimated ~ 80–90mln MT. The industry has overcome the raw material supply challenges, lately. However, support price of sugarcane, set by the Government considering the cost incurred by farmers, remains a constraint. During MY22, the support prices for sugar-cane in Punjab were fixed at PKR 230/maund and PKR 250/maund in Sindh. Actual realized sugarcane prices at the mill gate were even higher. During MY22, the overall sugar production increased by 9%, YoY, to 7.1msln MT (MY21: 6.5mln MT) due to better crop availability and an increase in area under cultivation. Subsequently, sugar prices witnessed ~12% decrease during MY22 compared to the preceding year. Furthermore, the Government has allowed exports of 0.5mln MT considering the surplus sugar production in the country. During the current crushing season (MY23), loss of area under cultivation of roughly 4.7% amidst flash floods; the forecast of sugar production is affected and is estimated to be ~7mln MT. The support prices have been fixed at PKR 300/maund for Punjab and PKR 302/maund for Sindh. Low sugar prices locally, and increased sugar-cane prices has led to the closure of several mills. However, sugar export, is anticipated to be favorable for millers.
The ratings reflect a strong business performance of SGM Sugar Mills Limited ('SGM' or 'the Company'). The Company was acquired by 'United Group' of Essarani family, which has long standing experience in agriculture sector and commodity trading including trading in fertilizer and coal, operating a sugar mill (Sindh Abadgars Sugar Mills Ltd.) and ethanol distillery (United Ethanol Ltd.). Given the size of mill and steps taken by new management, a turnaround in profitability is visible over the years. Margins remained strong during MY22 owing to better sugar prices despite increased procurement costs. However, during the ongoing MY23, the financial performance could potentially witness slight dip owing to high procurement costs and local prices challenge. The management's consistent attention to improving efficiencies and to assure ample supply of sugarcane supplements margins. The financial risk profile is characterized by moderate leverage and a stable working capital cycle. However, coverages have stretched further. Sponsors' commitment to providing financial support provides comfort to the ratings.

The ratings are dependent on optimizing capacity utilization and achieving operational efficiency consistently by the management. Deterioration in margins and/or cashflows will negatively impact the ratings.

**Disclosure**

| | |
|---|---|
| **Name of Rated Entity** | SGM Sugar Mills Limited |
| **Type of Relationship** | Solicited |
| **Purpose of the Rating** | Entity Rating |
| **Applicable Criteria** | Methodology \| Corporate Rating(Jun-22),Methodology \| Correlation Between Long-term & Short-term Rating Scales(Jun-22),Methodology \| Rating Modifiers(Jun-22) |
| **Related Research** | Sector Study \| Sugar(Apr-22) |
| **Rating Analysts** | Faiqa Qamar \| faiqa.qamar@pacra.com \| +92-42-35869504 |

## Profile

**Legal Structure** SGM Sugar Mills Limited ( "SGM" or "the Company") is a public unlisted company.

**Background** The Company was incorporated in Sep-07 and was formerly owned jointly by Dhabi Group (~44%), Etihad Group (~22%) and Mehar Family (~34%). During May-18, United Group, represented by the Essarani Family, acquired shareholding of the Company. The Mehar Family still retains their shareholding in the Company.

**Operations** The primary business of the Company involves the sale and manufacturing of crystalline sugar along with ensuing by-products (Molasses and Bagasse). The Company has a crushing capacity of 12,000 TCD with its mill located in Ghotki, Sindh, whereas the head office is located in Karachi. During marketing year (MY) 22, the Company produced a total of 97,497 MT of sugar, crushing 981,285 MT of sugarcane while achieving a recovery rate of 9.9%.

## Ownership

**Ownership Structure** Major shareholding of the Company rests with Essarani Family (~77%), through Mr. Deoo Mal Essarani (~16%) and his three sons – Mr.Asha Ram (~29%), Mr. Mahesh Kumar (~13%) and Dr. Tara Chand (~20%). Remaining shareholding resides with Mehar Family, through Mr. Sardar Muhammad Baksh Khan Mehar (~10%) and Mr. Sardar Ali Gohar Khan Mehar (~13%).

**Stability** Ownership is stable as the Company's controlling interest now vests with one family. Each individual in the family holds a defined share in the Company.

**Business Acumen** Essarani family has been involved in agriculture sector for a significant period of time and owns entities collectively represented under 'United Group'. The Group's entities include Sindh Abadgar's Sugar Mills Limited, United Ethanol Industries Limited, Agro Trade Private Limited, and United Agro Chemicals.

**Financial Strength** The Company has adequate financial strength derived from its Group and support of sponsors. The Group had total assets worth PKR 18bln, supported by an equity base of PKR 11.5bln as of MY20. The Group posted a net profit worth PKR 920mln during MY20. Total debt as at MY20 stood at PKR 6.7bln.

## Governance

**Board Structure** Board of Directors comprises four members including the Chairman, Chief Executive Officer and two Non-Executive Director. All four members belong to Essarani Family, with no representation of Mehar Family.

**Members' Profile** Mr. Deo Mal Essarani acts as the Chairman of the Board. He has over 46 years of diversified experience and also acts as the Chairman for two other group companies - Sindh Abadgar's Sugar Mills and United Ethanol Industries Limited. Dr, Tara Chand acts as a Non-Executive Director. Mr. Chand has more than 15 years of experience in the sugar industry.

**Board Effectiveness** Low frequency of Board meetings and lack of Board committees reflects a room for improvement on effectiveness of the Board.

**Financial Transparency** M/s Rahman Sarfaraz Rahim Iqbal Rafiq Chartered Accountants, classified in Category 'A' by the SBP with a satisfactory QCR rating by ICAP, have been appointed as the external auditors of the Company. They have expressed an unqualified opinion on the financial statements for the year Sep-22.

## Management

**Organizational Structure** Highest level of authority lies with the Chief Executive, who is supported by Resident Director Mills and Chief Financial Officer. The Company has established functions for cane procurement, production, mechanical etc at mill location that report to the Resident Director. All functions at head office pertaining report to CFO.

**Management Team** Mr. Asha Ram has been appointed as CEO. However, key responsibility for managerial oversight and decision making rests with Dr. Tara Chand Essarani. Dr. Tara Chand is a medical doctor by profession and a member of Pakistan Sugar Mills Association. He is also the CEO of Sindh Abadgar's Sugar Mills Limited and United Ethanol Industries Limited. He has over fifteen years of experience in the Sugar Industry.

**Effectiveness** The Company has no management committees in place. However, meetings are conducted fortnightly to discuss business performance and organizational structure changes. All HODs and CEO are present at the meetings. In addition, further meetings are called as required.

**MIS** The Company has deployed ERP software from Cosmosoft.

**Control Environment** Oversight and effective management is maintained through the internal audit department which is shared on a group level. The department is headed by Mr. Ali Raza Shamjee, who acts as the Group Internal Auditor. The group has expanded the internal audit department by inducting more individuals recently.

## Business Risk

**Industry Dynamics** During MY22, the support prices for sugar-cane in Punjab were fixed at PKR 230/maund and PKR 250/maund in Sindh. Actual realized sugarcane prices at the mill gate were even higher. During MY22, the overall sugar production increased by 9%, YoY, to 7.1mln MT (MY21: 6.5mln MT) due to better crop availability and an increase in area under cultivation. Subsequently, sugar prices witnessed ~12% decrease. During the current crushing season (MY23), loss of area under cultivation of roughly 4.7% amidst flash floods; the forecast of sugar production is affected and is estimated to be ~7mln MT. The Government has allowed exports of 0.25mln MT on the basis of production during MY22. The support prices have been fixed at PKR 300/maund for Punjab and PKR 302/maund for Sindh. Although low sugar prices locally and increased sugarcane prices have prompted many sugar mills to close the crushing early in MY23, sugar exports are expected to be favorable for the industry, ensuring liquidity remains intact.

**Relative Position** Due to high number of players in industry, companies relatively have low market share. The Company had a market share of ~ 1.3% during MY22.

**Revenues** During MY22, sales mix was dominated by sugar (~84%), molasses (~13%), and bagasse (~3%). The Company posted sales worth PKR 5,202mln in comparison to PKR 4,705mln in MY21 owing to higher volumetric sales amidst higher production of sugarcane. Going forward, during MY23, the Company's revenues are anticipated to remain similar to the preceding, however, the export of sugar is expected to aid the Company's topline.

**Margins** Gross margin posted nominal growth (MY22: 14.6%, MY21: 14.2%), though the average prices of sugarcane incurred by the Company were higher compared to the preceding year. However, better sugar prices benefitted the margins. Similarly, operating margins beefed up (MY22: 12%, MY21: 11.8%) on the back of trickledown effect. At net level, the Company posted net loss of PKR 102mln (MY21: Net Profit PKR 168mln) amidst significant increase in the Company's finance cost (MY22: PKR 748mln, MY21: PKR 371mln). Subsequently, the Company's net margin dipped to -2% (MY21: 3.6%). Going forward, during MY23, the Company's margins are expected to dip slightly owing to the increase in the procurement costs and low sugar prices in the local market. However, export sales may add some support.

**Sustainability** Going forward, the management aims to improve business performance through efficient operations with no major expansion activity planned.

## Financial Risk

**Working Capital** The Company witnessed deterioration in working capital cycle during MY22 on the back of higher stocks. During the period, inventory days stood at 141 days as compared to 60 days as at MY21. This was the primary reason behind high net working capital days of 135 days (MY21: 53 days). Borrowing cushion for additional short-term funds has remained negative for the Company. Going forward, borrowing cushion is expected to be further impacted due to higher funds required to manage the working capital requirement.

**Coverages** The Company's free cash flows stood at PKR 1,021mln in MY22 (MY21: PKR 805mln). However, finance cost witnessed significant increase amidst interest rate hike and stood at ~PKR 748mln as compared to ~PKR 371mln in MY21. Subsequently, the Company's coverages dipped with interest coverage standing at 1.4x (MY21: 2.2x) and debt coverage standing at 0.7x (MY21: 1x). Going forward, in MY23, the Company's coverages are expected to remain stretched.

**Capitalization** The Company has a moderately leveraged capital structure represented by a leveraging ratio of ~68.6% as at MY22. Total debt (MY22: PKR 5bln, MY21: PKR 3.4bln) is constituent of short-term borrowings (50% of total debt) (MY22: PKR 2.2bln, MY21: PKR 894mln) undertaken for working capital requirements, and long-term debt undertaken for BMR (MY22: PKR 2.1bln, MY21: 2.5bln). Additionally, the Company's equity base stood at PKR 2.4bln as at MY22. Going forward, leveraging ratio is expected to stretch further due to increased borrowings for managing working capital requirement.

PACRA

The Pakistan Credit Rating Agency Limited

*Financial Summary*
*PKR mln*

| SGM Sugar Mills Limited | Sep-22 | Sep-21 | Sep-20 | Sep-19 |
|---|---|---|---|---|
| Sugar | 12M | 12M | 12M | 12M |
| **A BALANCE SHEET** | | | | |
| 1 Non-Current Assets | 6,477 | 6,691 | 5,638 | 5,436 |
| 2 Investments | - | - | - | - |
| 3 Related Party Exposure | - | - | - | - |
| 4 Current Assets | 3,278 | 1,562 | 839 | 1,590 |
| *a Inventories* | *2,824* | *1,194* | *348* | *939* |
| *b Trade Receivables* | *0* | *21* | *32* | *0* |
| **5 Total Assets** | 9,755 | 8,252 | 6,477 | 7,026 |
| 6 Current Liabilities | 1,478 | 623 | 887 | 844 |
| *a Trade Payables* | *91* | *88* | *132* | *90* |
| 7 Borrowings | 4,291 | 3,369 | 2,600 | 3,444 |
| 8 Related Party Exposure | 860 | - | - | - |
| 9 Non-Current Liabilities | 763 | 836 | 628 | 698 |
| **10 Net Assets** | 2,363 | 3,426 | 2,361 | 2,040 |
| **11 Shareholders' Equity** | 2,363 | 3,425 | 2,362 | 2,040 |
| **B INCOME STATEMENT** | | | | |
| **1 Sales** | 5,202 | 4,705 | 5,467 | 3,409 |
| *a Cost of Good Sold* | *(4,443)* | *(4,036)* | *(4,767)* | *(2,851)* |
| **2 Gross Profit** | 759 | 670 | 700 | 559 |
| *a Operating Expenses* | (135) | (116) | (86) | (92) |
| **3 Operating Profit** | 624 | 554 | 615 | 467 |
| *a Non Operating Income or (Expense)* | *22* | *(6)* | *10* | *79* |
| **4 Profit or (Loss) before Interest and Tax** | 646 | 548 | 625 | 545 |
| *a Total Finance Cost* | *(752)* | *(374)* | *(528)* | *(497)* |
| *b Taxation* | *4* | *(6)* | *(10)* | *32* |
| **6 Net Income Or (Loss)** | (102) | 168 | 87 | 81 |
| **C CASH FLOW STATEMENT** | | | | |
| *a Free Cash Flows from Operations (FCFO)* | *1,021* | *805* | *951* | *888* |
| *b Net Cash from Operating Activities before Working Capital Changes* | *447* | *448* | *336* | *479* |
| *c Changes in Working Capital* | *(793)* | *(1,247)* | *878* | *(971)* |
| **1 Net Cash provided by Operating Activities** | (347) | (799) | 1,214 | (492) |
| **2 Net Cash (Used in) or Available From Investing Activities** | (426) | (134) | (634) | (172) |
| **3 Net Cash (Used in) or Available From Financing Activities** | 1,022 | 778 | (544) | 759 |
| **4 Net Cash generated or (Used) during the period** | 250 | (156) | 36 | 96 |
| **D RATIO ANALYSIS** | | | | |
| **1 Performance** | | | | |
| *a Sales Growth (for the period)* | 10.5% | -13.9% | 60.4% | -- |
| *b Gross Profit Margin* | 14.6% | 14.2% | 12.8% | 16.4% |
| *c Net Profit Margin* | -2.0% | 3.6% | 1.6% | 2.4% |
| *d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)* | 4.4% | -9.4% | 33.4% | -2.4% |
| *e Return on Equity [ Net Profit Margin * Asset Turnover * (Total Assets/Sh* | -3.5% | 5.8% | 3.9% | 4.0% |
| **2 Working Capital Management** | | | | |
| *a Gross Working Capital (Average Days)* | 142 | 62 | 44 | 101 |
| *b Net Working Capital (Average Days)* | 135 | 53 | 37 | 91 |
| *c Current Ratio (Current Assets / Current Liabilities)* | 2.2 | 2.5 | 0.9 | 1.9 |
| **3 Coverages** | | | | |
| *a EBITDA / Finance Cost* | 1.5 | 2.5 | 1.9 | 1.9 |
| *b FCFO / Finance Cost+CMLTB+Excess STB* | 0.7 | 1.0 | 1.2 | 1.0 |
| *c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)* | 12.3 | 5.7 | 6.2 | 7.1 |
| **4 Capital Structure** | | | | |
| *a Total Borrowings / (Total Borrowings+Shareholders' Equity)* | 68.6% | 49.6% | 52.4% | 62.8% |
| *b Interest or Markup Payable (Days)* | 108.6 | 78.2 | 45.3 | 111.8 |
| *c Entity Average Borrowing Rate* | 15.4% | 9.3% | 13.4% | 14.4% |

## Credit Rating

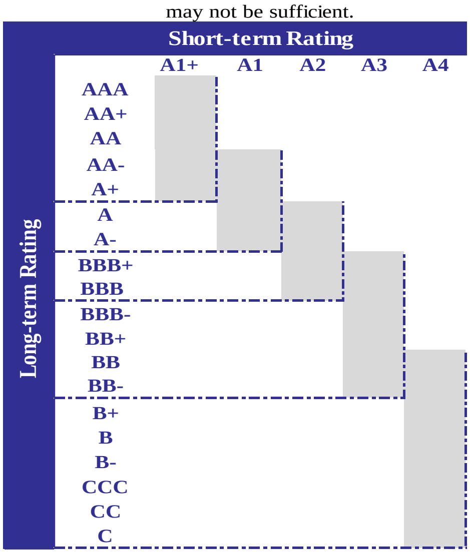
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

**Long-term Rating**

| Scale | Definition |
|---|---|
| AAA | **Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments |
| AA+ AA AA- | **Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events. |
| A+ A A- | **High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions. |
| BBB+ BBB BBB- | **Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity. |
| BB+ BB BB- | **Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met. |
| B+ B B- | **High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment. |
| CCC CC C | **Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default. |
| D | Obligations are currently in default. |

**Short-term Rating**

| Scale | Definition |
|---|---|
| A1+ | The highest capacity for timely repayment. |
| A1 | A strong capacity for timely repayment. |
| A2 | A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions. |
| A3 | An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial |
| A4 | The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient. |




**The correlation shown is indicative and, in certain cases, may not hold.*

**Outlook (Stable, Positive, Negative, Developing)** Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

**Rating Watch** Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

**Suspension** It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

**Withdrawn** A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

**Harmonization** A change in rating due to revision in applicable methodology or underlying scale.

**Surveillance.** Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

**Note.** This scale is applicable to the following methodology(s):

a) Broker Entity Rating
b) Corporate Rating
c) Debt Instrument Rating
d) Financial Institution Rating
e) Holding Company Rating
f) Independent Power Producer Rating
g) Microfinance Institution Rating
h) Non-Banking Finance Companies Rating

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(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term “family members” shall include only those family members who are dependent on the analyst and members of the rating committee

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**Conduct of Business**
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report | Clause 11-(A)(p).
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(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers’ associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
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(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)
**Probability of Default**
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)
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