



The Pakistan Credit Rating Agency Limited

Rating Report

SGM Sugar Mills Limited

Report Contents

1. Rating Analysis
2. Financial Information
3. Rating Scale
4. Regulatory and Supplementary Disclosure

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
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 ~ 65–70mln MT. The industry has overcome the raw material supply challenges. However, support price of sugarcane, set by considering the cost incurred by farmers, remains a constraint. The Government increased the support price of sugarcane to PKR 250 per maund for mills operating in Sindh (previously, it was increased to PKR 202). Actual realized sugarcane prices at the mill gate were even higher. During MY21, the overall sugar production increased by 15%, YoY, to 5.7mln MT (MY20: 4.9mln MT) due to better crop availability and an increase in area under cultivation. Moreover, in FY21's budget, the Government proposed to levy 17% GST on market retail price instead of PKR 60/kg, after Nov-21. This led to an increase in sugar prices in the local market. To curb this, the Government planned to import 0.8mln MT of sugar. Out of this, 0.3mln MT was imported till Jun-21, whereas, 0.3mln MT was imported till Nov-21. During the current crushing season (MY22), a surge of 10-15% is expected in sugarcane production resulting in increased total sugar production of ~7mln MT. This along with high sugar prices is expected to remain favorable for the 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 Abadgar's Sugar Mills Limited) and ethanol distillery (United Ethanol Limited). Given the size of mill and steps taken by new management, a turnaround in profitability is visible over the years. Margins remained strong at gross level on the back of favorable sugar prices. 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. The coverages have shown significant improvement and are in a strong position. Sponsors' commitment to providing financial support provides further comfort to the ratings.

The ratings are dependent upon 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-21),Criteria Correlation Between Long-term & Short-term Rating Scales(Jun-21),Criteria Rating Modifiers(Jun-21)
Related Research	Sector Study Sugar(Dec-21)
Rating Analysts	Shayan Farooq shayan.farooq@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 September, 2007 and was formerly owned jointly by Dhabi Group (44%), Etihad Group (22%) and Mehar Family (34%). During May, 2018, 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 the current season, sugar marketing year (MY) 2021, the Company produced a total of 74,179 MT of sugar, crushing 755,607 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. Deo 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 Sept, 2021.

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 Dosani, who acts as the Group Internal Auditor. The group has expanded the internal audit department by inducting more individuals recently.

Business Risk

Industry Dynamics Pakistan's sugar industry is the country's 2nd largest agro-based industry, comprising 90 mills with an annual crushing capacity estimated ~ 65-70mln MT. The industry has overcome the raw material supply challenges. However, support price of sugarcane, set by considering the cost incurred by farmers, remains a constraint. The Government increased the support price of sugarcane to PKR 250 per maund for mills operating in Sindh (previously, it was increased to PKR 202). Actual realized sugarcane prices at the mill gate were even higher. During MY21, the overall sugar production increased by 15%, YoY, to 5.7mln MT (MY20: 4.9mln MT) due to better crop availability and an increase in area under cultivation. Moreover, in FY21's budget, the Government proposed to levy 17% GST on market retail price instead of PKR 60/kg, after Nov-21. This led to an increase in sugar prices in the local market. To curb this, the Government planned to import 0.8mln MT of sugar. Out of this, 0.3mln MT was imported till Jun-21, whereas, 0.3mln MT was imported till Nov-21. During the current crushing season (MY22), a surge of 10-15% is expected in sugarcane production resulting in an increased total sugar production of ~7mln MT. This along with high sugar prices are expected to remain favorable for the millers.

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 MY21.

Revenues During MY21, sale mix was dominated by sugar (88%), molasses (10%), and bagasse (2%). The Company posted sales worth PKR 5,425mln in comparison to PKR 5,467mln in MY20. The quantity sold was less in comparison to last year (MY21: 61,993MT, MY20: 76,156MT), as the Company withheld inventory. However, the Company benefitted from higher average sugar price (MY21: PKR 77/kg, MY20: PKR 62/kg). Going forward, prices are expected to float in the range of PKR 85 per kg to PKR 90 per kg, benefitting the millers.

Margins Gross margin inclined to 15% in MY21 (MY20: 13%). Average price of cane rose to PKR 260/maund during MY21 (MY20: PKR 220/maund), which was offset by high sugar prices Operating margin inclined to 13% in MY21 (MY20: 11%) on the back of trickledown effect of gross margins. Net profit margin improved to 5% in MY21 (MY20: 2%) owing to finance cost posting a dip (MY21: PKR 374mln, MY20: PKR 528mln) due to low interest rates. Net income improved to PKR 288mln, (MY20: PKR 87mln).

Sustainability Going forward, the management aims to improve business performance through efficient operations with no major expansion activity planned. The overall profitability is expected to improve as sugar and by-products prices are expected to remain high.

Financial Risk

Working Capital The Company witnessed deterioration in working capital requirements during MY21 on the back of higher stocks. During the period, inventory days stood at 61 days as compared to 45 days in MY20. This was the primary reason behind high net working capital days of 57 days (MY20: 41 days). Moreover, sufficient cushion for additional short-term funds is available for the Company. Short term trade leverage and short-term total leverage stood at 13.5% and 13%, respectively in MY21 (MY20: 2.2% and 2%).

Coverages A significant improvement in cashflows helped the Company improve coverage ratios during MY21. Better cashflows resulted in strong coverage ratios (MY21: 2.5x, MY20: 1.8x), owing to reduced finance costs (MY21: PKR 374mln, MY20: PKR 528mln) from dipped interest rates. FCFO during MY21 stood at ~PKR 932mln as compared to ~PKR 951mln during MY20, as a result of stable profitability. Resultantly, core and total coverages remained stable at 1.2x (MY20: 1.3x).

Capitalization The Company has a moderately leveraged capital structure represented by a leveraging ratio of ~48% as at MY21 (MY20: 52%). Total debt is inclined towards short term borrowing (MY21: PKR 894mln, MY20: nil), to fulfill working capital requirements. The Company's long-term debt is worth PKR 2,474mln which was secured in MY18 to pay off debt by the previous sponsors. Additionally, the Company expects to convert Sponsors loan worth PKR 960mln (extended by Mr. Asha Ram) into equity. The figure is currently classified as advance against equity.



The Pakistan Credit Rating Agency Limited

Financial Summary

PKR mln

SGM Sugar Mills Limited Sugar	Sep-21 12M	Sep-20 12M	Sep-19 12M	Sep-18 12M	Sep-17 12M
A BALANCE SHEET					
1 Non-Current Assets	6,691	5,638	5,436	5,681	4,605
2 Investments	-	-	-	-	-
3 Related Party Exposure	-	-	-	-	-
4 Current Assets	1,754	904	1,590	291	847
a Inventories	1,386	414	939	-	589
b Trade Receivables	21	32	0	-	0
5 Total Assets	8,444	6,542	7,026	5,972	5,452
6 Current Liabilities	631	887	844	553	1,551
a Trade Payables	88	63	90	27	69
7 Borrowings	3,369	2,600	3,444	2,800	1,830
8 Related Party Exposure	-	-	-	-	1,208
9 Non-Current Liabilities	836	628	698	775	520
10 Net Assets	3,610	2,426	2,040	1,844	343
11 Shareholders' Equity	3,610	2,426	2,040	1,844	343
B INCOME STATEMENT					
1 Sales	5,425	5,467	3,409	3,483	2,194
a Cost of Good Sold	(4,629)	(4,767)	(2,851)	(3,360)	(2,526)
2 Gross Profit	796	700	559	123	(332)
a Operating Expenses	(116)	(86)	(92)	(219)	(152)
3 Operating Profit	680	615	467	(97)	(484)
a Non Operating Income or (Expense)	(12)	10	79	456	16
4 Profit or (Loss) before Interest and Tax	668	625	545	360	(468)
a Total Finance Cost	(374)	(528)	(497)	(155)	(188)
b Taxation	(6)	(10)	32	(0)	52
6 Net Income Or (Loss)	288	87	81	205	(604)
C CASH FLOW STATEMENT					
a Free Cash Flows from Operations (FCFO)	932	951	888	15	(121)
b Net Cash from Operating Activities before Working Capital	574	336	479	(723)	(166)
c Changes in Working Capital	(1,368)	878	(971)	445	(702)
1 Net Cash provided by Operating Activities	(794)	1,214	(492)	(278)	(867)
2 Net Cash (Used in) or Available From Investing Activities	(141)	(634)	(172)	(7)	(155)
3 Net Cash (Used in) or Available From Financing Activities	583	(544)	759	307	1,029
4 Net Cash generated or (Used) during the period	(351)	36	96	22	7
D RATIO ANALYSIS					
1 Performance					
a Sales Growth (for the period)	-0.8%	60.4%	-2.1%	58.8%	-10.3%
b Gross Profit Margin	14.7%	12.8%	16.4%	3.5%	-15.1%
c Net Profit Margin	5.3%	1.6%	2.4%	5.9%	-27.5%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital / Net Profit Margin)	-8.0%	33.4%	-2.4%	13.2%	-37.5%
e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets / Shareholders' Equity)]	9.5%	3.9%	4.2%	18.8%	-104.6%
2 Working Capital Management					
a Gross Working Capital (Average Days)	62	46	101	62	2
b Net Working Capital (Average Days)	57	41	94	57	-13
c Current Ratio (Current Assets / Current Liabilities)	2.8	1.0	1.9	0.5	0.5
3 Coverages					
a EBITDA / Finance Cost	2.8	1.9	1.9	0.4	-0.5
b FCFO / Finance Cost + CMLTB + Excess STB	1.2	1.3	1.0	0.0	0.0
c Debt Payback (Total Borrowings + Excess STB) / (FCFO - Finance Cost)	4.4	6.1	7.1	-23.1	-12.1
4 Capital Structure					
a Total Borrowings / (Total Borrowings + Shareholders' Equity)	48.3%	51.7%	62.8%	60.3%	89.9%
b Interest or Markup Payable (Days)	78.6	45.3	111.8	157.1	0.0
c Entity Average Borrowing Rate	9.3%	13.4%	13.6%	5.1%	7.4%

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.

Scale	Long-term Rating Definition
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
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.
AA-	
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.
A-	
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.
BBB-	
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.
BB	
BB-	
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.
B-	
CCC	
CC	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.
C	
D	Obligations are currently in default.

Scale	Short-term Rating 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 conditions.
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 surveil 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):

<p>Entities</p> <ul style="list-style-type: none"> a) Broker Entity Rating b) Corporate Rating c) Financial Institution Rating d) Holding Company Rating e) Independent Power Producer Rating f) Microfinance Institution Rating g) Non-Banking Finance Companies (NBFCs) Rating 	<p>Instruments</p> <ul style="list-style-type: none"> a) Basel III Compliant Debt Instrument Rating b) Debt Instrument Rating c) Sukuk Rating
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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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