



The Pakistan Credit Rating Agency Limited

Rating Report

SGM Sugar Mills Limited

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Rating History

| Dissemination Date | Long Term Rating | Short Term Rating | Outlook | Action | Rating Watch |
|--------------------|------------------|-------------------|---------|----------|--------------|
| 07-May-2019 | BBB- | A3 | Stable | Maintain | - |
| 31-Dec-2018 | BBB- | A3 | Stable | Initial | - |

Rating Rationale and Key Rating Drivers

The ratings draw comfort from strong acumen and support of new sponsors and management in the sugar industry. SGM Sugar has its mill located in Sindh with a crushing capacity of 8000TCD. The Company has recently been acquired by 'United Group' of Essarani family. The family 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 operations is expected. The Company did not engage in sales during 1QMY19 in expectation of better prices in the near future. The financial risk profile is characterized by highly leveraging, owing to loans obtained for debt re-profiling of the existing structure, with a thin equity base. The Company's coverages are in a distressed situation for the period. However, planned activity for current crushing season and Sponsors' commitment to provide financial support provides cushion for the Company.

The ratings are dependent upon increasing capacity utilization and achieving operational efficiency envisaged by the management. Any further 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 Ratings(Jun-18),Methodology Criteria Rating Modifier(Jun-18),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-18) |
| Related Research | Sector Study Sugar(Apr-19) |
| Rating Analysts | Adnan Dilawar adnan@pacra.com +92-42-35869504 |

Profile

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

Background The Company was incorporated on September 11, 2007, as a public limited company under the Companies Ordinance, 1984. It started operations on December 6, 2009. The Company was formerly owned by Dhabi Group, Etihad Group and Mehar Family. However, during May, 2018, Essarani Family acquired the majority stake from Dhabi Group and Etihad Group.

Operations The primary business of the Company involves the sale and manufacture of crystalline sugar along with ensuing byproducts (Molasses and Bagasse). The Company has a crushing capacity of 8,000 TCD with its mill located in Ghotki, Sindh, whereas the head office is located in Karachi. During MY19, the Company was able to produce ~72,926 MT of sugar while achieving a recovery rate of 10%, with no opening stock available.

Ownership

Ownership Structure Majority shareholding (66%) lies with the Essarani Family through individuals while remaining (34%) is held by the Mehar Family through individuals.

Stability Ownership is seen as 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 as 'United Group'. The Group's entities include a listed entity in sugar industry; Sindh Abadgar's Sugar Mills Limited, United Ethanol Industries Limited (engaged in ethanol manufacturing), Agro Trade Private Limited (engaged in coal trading) and United Agro Chemicals (fertilizer and sugar trading).

Financial Strength SGM Sugar Mills derives its financial strength from United Group. Collectively, the United Group's asset base is ~ PKR 19,356mln supported by an equity base of ~ PKR 9,510mln as at Nov' 18.

Governance

Board Structure The Company's BoD comprises three members all of whom are Essarani family members, including the CEO. Limited size of the board, dominance of sponsoring family and absence of independent oversight indicates room for improvement exists in the overall governance framework.

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.

Board Effectiveness Lack of board meetings and low frequency of board meetings reflects negatively on board effectiveness.

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 of the Company.

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 and electrical at mill location that report to the Resident Director. All functions at head office pertaining to finance and purchases 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 is using an in-house web based Information System having four integrated modules; GL, sales and receivable, store and cane procurement.

Control Environment Internal audit department exists at the Group level. The Group is in the phase of extending the same services on shared basis to the Company.

Business Risk

Industry Dynamics Pakistan is the 6th largest country in the world in terms of area under sugarcane cultivation. The sugar industry in Pakistan is the 2nd largest agro based industry comprising ~90 sugar mills with annual crushing capacity estimated between 65 – 70 million tons. During MY19, sugar production is estimated around 5.5mln MT, coming down from 6.5mln MT in the preceding year.

Relative Position Owing to the high amount of players in the industry, players relatively have low market share. During MY18, the Company has ~1% share in total sugar production.

Revenues The Company has been facing operational issues prior to takeover by new sponsors, who intend to turn around the Company. Under new management, the Company held on to sugar produced during 1QMY19 in expectation of better prices in the near future. During the current season, total production amounted to ~72,926 MT of sugar.

Margins Inefficient operations in recent years has led the Company to post losses over successive years. Turnaround in profitability from new management is yet to be seen. Insignificant amount of sales during 1QMY19 led to the Company incurring overheads, resulting in a gross loss of ~PKR 58mln. Similarly, after factoring in operating expenses, operating loss during the quarter stood at ~PKR 77mln. All factors considered, the Company posted a net loss of ~PKR 178mln in 1QMY19.

Sustainability Going forward, the Company is expected to engage in sales as prices in the domestic market recovery. Additionally, management aims to improve business performance through efficient operations.

Financial Risk

Working Capital The Company has built up inventory levels during the current crushing season resulting in high working capital requirements. The Company had been managing its working capital by taking advance payments from customers, loans from directors and short term finance. Sponsors have injected money in-line with expanding operations. Going forward, the Company plans to avail a running finance facility to support operations.

Coverages Owing to negative cash flows arising from a loss incurred during the quarter, the company posted negative coverage ratios. During 1QMY19, interest coverage stood at -0.5x (MY18: 0.1x), whereas, total coverage stood at -0.2x (MY18: 0.0x). Coverages are expected to improve as the Company starts to generate sales revenue.

Capitalization The Company has a highly leveraged capital structure represented by a debt-to-equity ratio of ~63% (MY18: ~60%). Leveraging witnessed a slight increase during 1QMY19 as the Company engaged in short-term borrowings. Going forward, an increase in short-term borrowings is expected in-line with higher plant utilization.



**SGM Sugar Mills
Private Limited**

BALANCE SHEET

| | Dec-18 3M | Sep-18 12M | Sep-17 12M | Sep-16 12M |
|--|--------------|---------------|---------------|---------------|
| a Non-Current Assets | 5,642 | 5,681 | 4,605 | 4,818 |
| b Investments (Incl. Associates) | - | - | - | - |
| Equity Instruments | - | - | - | - |
| Debt Instruments | - | - | - | - |
| c Current Assets | 1,077 | 291 | 847 | 239 |
| Inventory | 692 | - | 589 | 5 |
| Trade Receivables | - | - | 0 | 0 |
| Others | 385 | 291 | 257 | 234 |
| d Total Assets | 6,719 | 5,972 | 5,452 | 5,057 |
| e Debt/Borrowings | 3,090 | 2,800 | 1,830 | 1,074 |
| Short-Term | 290 | - | 1,830 | 969 |
| Long-Term (Incl. Current Maturity of Long-Term Debt) | 2,800 | 2,800 | - | 105 |
| Other Short-Term Liabilities | 581 | 553 | 1,551 | 1,525 |
| Other Long-Term Liabilities | 759 | 775 | 520 | 712 |
| f Shareholder's Equity | 2,289 | 1,844 | 1,551 | 1,747 |
| g Total Liabilities & Equity | 6,719 | 5,972 | 5,452 | 5,057 |

INCOME STATEMENT

| | | | | |
|----------------------------|--------------|--------------|--------------|--------------|
| a Turnover | 0 | 3,483 | 2,194 | 2,447 |
| b Gross Profit | (58) | 123 | (332) | (197) |
| c Net Other Income | 0 | 429 | 8 | 181 |
| d Financial Charges | (51) | (155) | (188) | (214) |
| e Net Income | (118) | 205 | (604) | (315) |

CASH FLOW STATEMENT

| | | | | |
|--|-------|-------|-------|-------|
| a Free Cash Flow from Operations (FCFO) | (24) | 15 | (121) | 194 |
| b Total Cashflows (TCF) | (24) | 15 | (121) | 194 |
| c Net Cash changes in Working Capital | (172) | 445 | (702) | 309 |
| d Net Cash from Operating Activities | (309) | (278) | (867) | 443 |
| e Net Cash from Investing Activities | (13) | (7) | (156) | (54) |
| f Net Cash from Financing Activities | 405 | 307 | 1,029 | (389) |
| g Net Cash generated during the period | 82 | 22 | 6 | 0 |

RATIO ANALYSIS

| | | | | |
|--|-------|-------|-------|--------|
| a Performance | | | | |
| Turnover Growth | -100% | 59% | -10% | -37% |
| Gross Margin | N/A | 4% | -15% | -8% |
| Net Margin | N/A | 6% | -28% | -13% |
| ROE | -26% | 19% | -105% | -30% |
| b Coverages | | | | |
| Debt Service Coverage (X) (FCFO/Gross Interest+CMLTD+Uncovered STB) | -0.2 | 0.0 | 0.0 | 0.1 |
| Interest Coverage (X) (FCFO/Gross Interest) | -0.5 | 0.1 | -0.6 | 0.9 |
| Debt Payback (Years) (Total Debt (excluding Covered Short Term Borrowings) / FCFO) | -9.4 | -22.6 | -12.1 | -180.6 |
| c Capital Structure (Total Debt/Total Debt+Equity) | | | | |
| Net Cash Cycle (Inventory Days + Receivable Days - Payable Days) | N/A | 57 | 83 | -7 |
| d Capital Structure (Total Debt/Total Debt+Equity) | 63% | 60% | 90% | 71% |

SGM Sugar Mills

Apr-19

Credit Rating Scale & Definitions

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 Ratings | | Short Term Ratings | |
|--|---|--------------------|--|
| AAA | Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments | A1+ | The highest capacity for timely repayment. |
| 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. | A1 | A strong capacity for timely repayment. |
| 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. | A2 | A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial 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. | A3 | An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions. |
| 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 | The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. |
| 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. | C | An inadequate capacity to ensure timely repayment. |
| 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. | | |



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, a) some material identifiable event and/or b) deviation from expected trend. 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 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) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults, or/and f) 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.

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- 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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- (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.
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- (15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
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- (19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
- (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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