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
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 is located in Sindh with a crushing capacity of 8000TCD and is recently 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. Given the size of mill and steps taken by new management, a turn around in operations is expected. The financial risk profile is characterized as highly leveraged owing to loans obtained to re-profile the existing debt and 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 level and achieving the 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(Mar-18)
Rating Analysts	Adnan Dilawar | adnan@pacra.com | +92-42-35869504

Profile

Legal Structure SGM Sugar Mills is a public unlisted company.

Background The Company was incorporated in Pakistan 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. In May 18, Essarani Family acquired majority stake from Dhabi Group and Etihad Group.

Operations The primary business of the Company is production and sale of crystalline sugar and byproducts i.e. Molasses and Bagasse. The mill is located in Ghotki, Sindh with a crushing capacity of 8,000 MT. Its Head Office is in Karachi.

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 Post acquisition, Mr. Deoo Mal Essarani and Dr. Tara Chand have been appointed on the Board of Directors and Mr. Asha Ram has been appointed as CEO. Mr. Deo Mal Essarani has assumed the charge of Chairman of the Board. He is also the Chairman of Sindh Abadgar's Sugar Mills Limited (a listed entity) and United Ethanol Industries Limited. He has over 46 years of diversified experience. Further, he is part of the Board in other Group companies.

Board Effectiveness Post acquisition, one Board Meeting was conducted with full attendance for which minutes of meeting were documented. The BoD has no sub-commitees.

Financial Transparency During FY18, M/s Rahman Sarfaraz Rahim Iqbal Rafiq Chartered Accountants, classified in Category 'A' by the SBP having a satisfactory QCR rating by ICAP, have been appointed as the external auditors of the Company. Previously, M/s Grant Thornton Anjum Rahman Chartered Accountants were the external auditors and issued an unqualified opinion the financial statements for FY17.

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 Post-Acquisition, 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 (a listed entity) 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 sugarcane producer, 9th largest by sugar production and 8th largest sugar consuming country in the world. Sugarcane is grown on approximately 1.2 million hectares and provides the raw material for ~90 sugar mills. The industry witnessed surplus sugar production during FY17 which resulted in depressed prices and a significant pile up of sugar stocks at end Sept-17. Sugar production decreased to 6.5mln Tons during FY18 in comparison to 7mln tons in FY17.

Relative Position Due to the high number of players in the industry, companies have relatively low market share. At end Sept-18, SGM Sugar Mills had a market share of ~ 1%.

Revenues The Company has been facing operational issues prior to takeover by new sponsors, who intend to turn around the Company. The topline is constrained and had a declining trend in FY16 and FY17, which reversed in FY18 (PKR 3,524mln) reflecting a 61% increase as compared to FY17. Sales were made entirely locally. The topline is a function of low capacity utilization level which averaged aound 50%-55% and depressed sugar prices.

Margins Despite high recovery rates, the Company has been posting negative margins over the past few years due to inefficient operations. Going forward, improvement in margins under the new management would be critical.

Sustainability The Company is expected to enhance capacity utilization and increase turnover. Performance of the Company would depend on boosting topline, which would largely depend on industry dynamics and concentrated efforts of the new management. The Company is expected not to engage in any further long-term borrowings.

Financial Risk

Working Capital The Company had been managing its working capital by taking advance payments from customers, loans from directors and short term finance. In line with low capacity utilization, the Company has zero stock level at end Sept-18. The Company plans to avail running finance facility of PKR 2bln from different banks to finance its operations.

Coverages The Company maintained weak coverage ratios over the years. At end Sept-18, interest and debt service coverage ratio stood at 0.08x and 0.02x (Sept-17: -0.65x and -0.04x). The coverages are expected to improve in line with higher capacity utilization.

Capitalization SGM Sugar Mills has a highly leveraged capital structure, (74%) in FY18. During the year, the Company has secured long term financing amounting to PKR 2,800mln. The loan carries markup at the rate of 6MK + 1% per annum. Repayment will be done in 14 semi-annual equal installments commencing from December 2019. Going forward, an increase in leverage ratio is expected.

The Pakistan Credit Rating Agency Limited

SGM Sugar Mills Limited

BALANCE SHEET	Sep-18	Sep-17	Sep-16
	FY	FY	FY
	Un-Audited	*Audited*	*Audited*
Non-Current Assets	**5,681**	**4,605**	**4,818**
Investments	-	-	-
Current Assets	**344**	**847**	**239**
Inventory	72	662	82
Trade Receivables	-	0	0
Others	272	185	157
Total Assets	**6,025**	**5,452**	**5,057**
Debt	**2,800**	**1,830**	**1,074**
Short-term	-	1,830	969
Long-term (incl. Current Maturity of Long-Term debt)	2,800	-	105
Other Short-term Liabilities	904	1,551	1,525
Other Long-term Liabilities	792	1,728	1,657
Directors Subordinated loan	545		
Shareholder's Equity	**983**	**343**	**802**
Total Liabilities & Equity	**6,025**	**5,452**	**5,057**
INCOME STATEMENT			
Turnover	**3,524**	**2,194**	**2,447**
Gross Profit	(128)	(332)	(197)
Other Income	32	10	6
Financial Charges	(183)	(188)	(214)
Net Income	**(443)**	**(604)**	**(315)**
Cashflow Statement			
Free Cashflow from Operations (FCFO)	15	(121)	194
Net Cash changes in Working Capital	445	(702)	309
Net Cash from Operating Activities	(278)	(867)	443
Net Cash from InvestingActivities	(7)	(156)	(54)
Net Cash from Financing Activities	307	1,029	(389)
Net Cash generated during the period	22	6	0
Ratio Analysis			
Performance			
Turnover Growth	61%	-10%	-37%
Gross Margin	-4%	-15%	-8%
Net Margin	-13%	-28%	-13%
ROE	-47%	-183%	-38%
Coverages			
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB)	0.02	-0.04	0.1
Interest Coverage (x) (FCFO/Gross Interest)	0.08	-0.65	0.9
Debt Payback (Total LT Debt) / (FCFO)	180.8	0.0	0.5
Liquidity			
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	-39	-106	-119
Capital Structure			
Leveraging (Total Debt/Total Debt+Equity)	74%	84%	57%

Rating Scale

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.

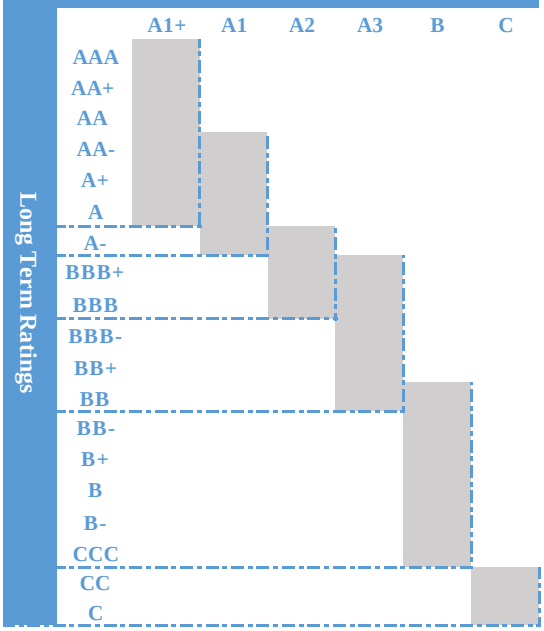
Long Term Ratings

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 Ratings

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.
B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
C	An inadequate capacity to ensure timely repayment.

Short Term Ratings



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 surveill the opinion due to lack of requisite information.

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

Rating Team Statements
(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

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

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.
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest
(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)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(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)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(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)
Proprietary Information