

Sitara Chemical Industries Limited

Chief Executive Officer: Mian Muhammad Adrees

December 11, 2013

Rating Rationale

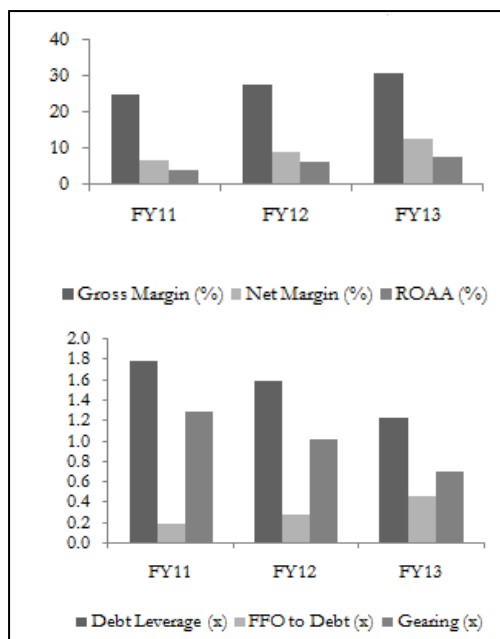
Analysts: Maimoon Rasheed
Usman Ali Khan

| Category | Latest | Previous |
|-------------------|-----------------------|-----------------------|
| Entity | A+/A-1 Mar 7, '13 | A+/A-1 Feb 22, '12 |
| PTC Rs. 1,000M | AA- Jun 20, '13 | AA- Nil |
| Outlook | Stable Jun 20, '13 | Stable Feb 22, '12 |

Sitara Chemicals Industries Limited (SCIL) is a leading manufacturer of caustic soda in Pakistan having a share of around 39% in sales of caustic soda. SCIL is majority owned by sponsoring family who are also represented on the Board. In line with the revised Code of Corporate Governance, changes in the Board composition have been made resulting in improvement of overall governance structure.

Industry-wide capacity utilization improved during FY13 (except for SCIL) primarily on account of better availability of gas. Although increase in cost of production has been witnessed owing to upward trend in the prices of gas & electricity, margins of the sector improved mainly on account of considerably higher average prices of caustic soda during FY13. The industry has also benefited from initiation of export of caustic soda liquid mainly to India. In this regard, SCIL has been the largest exporter among the local manufacturers. In order to address vulnerability in power and gas availability, the industry has taken different initiatives. To reduce cost in times of non-availability of gas, coal based boiler for steam generation has been installed that has augured well for the industry. Market participants including SCIL are also considering alternative energy sources to ensure smooth supply of electricity, materialization of which is expected to improve capacity utilization.

Key Financial Trends



In spite of decline in volumetric sales of chemical division, net sales revenue increased to Rs. 8.10b (FY12: Rs. 7.46b) on account of favorable prices of caustic soda along with higher yarn related sales of textile division during FY13. Resultantly, gross margins increased to 31% (FY12: 28%). Financial charges decreased to Rs. 486.8m (FY12: Rs. 682.9m) on account of reduction in average borrowings amount as well as average cost of funds during FY13 vis-à-vis prior year. Despite higher administrative expenses, mainly an outcome of advances written off related to an abandoned project, bottom line of the company augmented to Rs. 1.04b (FY12: Rs. 688m; FY11: Rs. 428m) in FY13.

Total debt of the company amounted to Rs. 3.7b (FY12: Rs. 4.5b) at end-FY13. While long-term borrowing witnessed a decline during FY13, average utilization of short-term borrowing remained largely at previous year levels. The company has sizeable property investment, which has been partially financed with short-term debt. In view of this, current ratio remains under 1x albeit having improved on a timeline basis. Overall liquidity position and debt service coverage has strengthened on the back of higher funds from operations (FFO), which amounted to Rs. 1.68b (FY12: Rs. 1.22b). With higher FFO along with reduced debt levels, FFO as a proportion of total debt improved to 0.45x (FY12: 0.27x) in FY13. Debt service coverage ratio of 1.5x (FY12: 1.2x; FY11: 1.0x) denotes enhancement in the company's ability to timely honor its financial obligations from internal sources.

To rationalize long-term debt levels of the company, the board has approved issuance of Sitara Islamic Participation Term Certificates (PTCs) of Rs. 1.0b with a Green Shoe Option of Rs. 500m for a tenor of 5 years. The PTCs have a mandatory yearly conversion into 'Class-B' non-voting ordinary shares of SCIL at a pre-determined price to the extent of 94.3% of the value of the issue price while the remaining proportion will be redeemed in cash to the PTC holders. The return will be based on a profit and loss sharing arrangement. The profit before tax, depreciation and financial charges attributable to the PTCs will be the basis for determining return to PTC holders.

| (Rs. million) | FY11 | FY12 | FY13 |
|--------------------|-------|-------|-------|
| Net Sales | 6,216 | 7,464 | 8,099 |
| Net Profit | 428 | 688 | 1,036 |
| Equity (Tier-1) | 3,777 | 4,386 | 5,313 |
| Total Debt | 4,888 | 4,464 | 3,737 |
| Gearing (x) | 1.29 | 1.02 | 0.70 |
| FFO | 864 | 1,219 | 1,680 |
| FFO/Total Debt (x) | 0.18 | 0.27 | 0.45 |
| ROAE | 12% | 17% | 21% |
| ROAA | 4% | 6% | 8% |

Overview of the Institution

SCIL was incorporated as a public limited company in 1981 and commenced production of caustic soda in 1985. The company is listed on all three stock exchanges of the country. Operationally, the company is structured into two divisions, namely; Chemical and Textile. The chemical division is engaged in the production of caustic soda & other auxiliary products while textile division is involved in production of different types of yarn. The annual accounts of SCIL for FY13 were audited by M. Yousuf Adil Saleem & Co. – Chartered Accountants **JCR-VIS**