

Before Dr. Sajid Qureshi, Executive Director (CL)

In the matter of

M/S Khairpur Sugar Mills Limited

(Under Section 265 Of the Companies Ordinance, 1984)

No. and date of show cause notice	265/251/ISS/CL/93 dated November 28, 1998
Date of final hearing	November 16, 2004
Present:	No one appeared on behalf of Company
Date of Order	December 5, 2005

Order

The case before me pertains to the proceedings initiated in terms of show cause notice issued to M/S Khairpur Sugar Mills Limited (the “Company”) under Section 265 of the Companies Ordinance, 1984 (the “Ordinance”) which deals with investigations into affairs of the companies.

2. The Company was incorporated in Pakistan on August 23, 1989 as a public limited company under the Companies Ordinance, 1984 and its shares are quoted on the Karachi Stock Exchange. The manufacturing facility of the Company is located at Naroo Dhoro Taluka Kot-Diji, Khairpur and the registered office is located at Jumanai Arcade, ST-10-D-14, Main Gulshan-e-Iqbal Road, Karachi. It has authorized and paid up share capital of Rs. 200 million and Rs. 160.175 respectively, as per its audited Balance Sheet for the year ended September 30, 2004. The object for which the Company was established and its powers are contained in its Memorandum and Articles of Association. It is principally engaged in production and sale of sugar. The Company has 235 shareholders comprising individuals, public sector institutions, financial institutions etc. as per pattern of shareholding annexed to the Directors’ Report on the accounts for the year ended on September 30, 2005. Directors and their spouses and children hold around 23 % of the paid up capital and Financial institutions hold 46 %. This indicates that there is a substantial public interest in the shares of this Company.



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3. The Board of Directors of the Company, as per its Financial Statements for the year ended on September 30, 2004 comprises of the following individuals

Mr. Muhammad Mubeen Jumanai, Chief Executive
Mr. Faisal Mubeen Jumani, Director
Mr. Muhammad Bux, Director
Mr. Ghulam Ali, Director
Mr. Ahmed Ali, Director
Mrs Yasmeen, Director
Syed Raza Abbas Jafferri, NIT Nominee

4. In order to dispose of the aforesaid matter, it is necessary to go into the background facts leading to the issue of show cause notice to the Company by the Enforcement Department of the Commission. The latest financial statements of the Company at the time of issue of show cause notice were for the year ended September 30, 1997, which portrayed a dismal financial position of the Company. It appeared that the Company was in a downward spiral and apparently no step had been taken by its management to reverse the trend of losses and put the company back on the recovery path. The accumulated losses of the Company stood at Rs.238.578 million as on September 30, 1997 as compared to its equity of Rs.160.175 millions. The equity has been turned into negative by Rs. 78.403 millions. The Company was highly indebted and the current liabilities were ten times more than its current assets. The Company had not declared any dividend for last many years. The auditors of the Company in their audit report for the year ended on September 30, 1997 raised their doubts regarding the continuation of the Company as going concern. The aforesaid condition of the Company merits proceedings against the Company under Section 265 (b)(iii),(vi)and(vii) which provides that;

- *that the affairs of the company have been so conducted or managed as to deprive the members thereof of a reasonable return; or*
- *that the affairs or the company are not being managed in accordance with sound business principles or prudent commercial practices; or*
- *that the financial position of the company is such as to endanger its solvency:*

5. In reply to the Show cause notice the Company submitted detailed summary of events and circumstances which have caused the incurrence of losses upto September 30, 1997 as stated below;

1) At time of incorporation, the Company had following financing structure

Equity	Rs.160.175 million
Loan	Rs.373.738 millions



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- 2) Pakistan Industrial Credit and Investment Corporation (“PICIC”) cancelled foreign currency loan in 1990 amounting to \$4.512 million, due to non disbursement of project examination fee by Bankers Equity Limited (“BEL”) to PICIC. This loan was released in 1991, however the project cost increased from \$4.512 to \$4.901 millions. The exchange rate of US dollar also rose from Rs.21.17 to Rs.24.13
- 3) BEL withheld the disbursement of its share of equity and Lt-TFC for the period 29-10-1990 to 10-09-1991 as a result civil works and erection came to halt.
- 4) BEL kept on charging markup for the period for which financing was withheld. The total amount of markup was Rs.17.052 millions.
- 5) BEL deducted markup and financial charges at source. Such expenses were not due yet.
- 6) State Bank of Pakistan (“SBP”) imposed penalty of Rs.24.040 million on BEL these penalties were charged to the Company.
- 7) The financing structure before commencement of production became as under

Equity	Rs.160.175 million
Loan	Rs.576.966 millions.
- 8) Amidst these obstacles the Company started its trial season on 17-01-1994. The Turbo Alternator developed serious faults and the entire season was lost.
- 9) Commercial production was started on 01-03-1995. Operations resulted in net loss of Rs.70.652 millions for the year 1995-96, Rs.87.587 millions for the year 1996-97 and Rs.54.305 millions for the year 1997-98.
- 10) Season 1996-97 was a tough season as cane was available on high prices and on cash basis, whereas the Company was declared defaulters by the syndicate members of BEL and the Company was deprived of the working capital loan.

6. The Company has also stated that management has been able to reschedule its liabilities towards BEL and PICIC. It has also been stated that Sugar industry as a whole has been faced with considerable operating constraints. The Company submitted the comparison of operating result of comparable units located in the same geographical regions as on September 30, 1997 which depicts following;

<u>Company Name</u>	<u>Operating Profit/ (Loss)</u>
Al-Noor Sugar Mills Ltd	(Rs.6.852 Millions)
Sakrand Sugar Mills Ltd	(Rs.11.850 Millions)
Habib Sugar Mills Ltd	Rs. 24.912 Millions
Khairpur Sugar Mills Ltd	(Rs. 87.587 Millions)

The Company has also submitted a copy of the summary of Annual Report 1998 of Pakistan Sugar Mills Association, Sindh Zone. The aforesaid annual report discussed the constraints faced by the sugar mills located in Sind Zone. In the end, the Chief Executive submitted that there are no grounds for appointment of inspector under Section 265 of the Ordinance.



7. The reply of the Company was not found satisfactory and the representation of the Company did not tie up with the ground realities. The Company continued to accumulate the losses through its operations and the aforesaid situation required corrective measures on part of management which they failed to exercise. The shareholders remained deprived of any return and the concerns of the Commission in this respect remained unaddressed by the Company. The representations given by the Company, at various occasions do not hold ground and were intended to divert the course of proceedings, which is apparent from the gist of the events given below:

a. *Hearing of the case was fixed many times and was adjourned at the request of the Company. Finally, at the hearing was held on August 09, 1999, wherein the Chief Executive of the Company submitted the revival plan.*

b. *Hearing was again held on September 20, 2000, the Chief Executive of the Company represented the case and took the plea that lack of working capital and shortage of sugar cane are the main causes of heavy losses. He assured that the results will improve in the forth coming season starting from November 2000.*

c. *Thereafter another hearing was held in June 2001 and the Chief Executive of the Company put forward that **none of the shares are held by the general public** and negotiation are underway with the NDFC and EFU for buy back of shares. He was asked to submit a list of shareholders and which was submitted on August 3, 2001 reflecting the following position:*

<i>Shares held by Sponsors and family members</i>	<i>11,297,750</i>	<i>70.53%</i>
<i>NBP</i>	<i>1,601,750</i>	<i>10.00%</i>
<i>EFU</i>	<i>30,000</i>	<i>0.19%</i>
<i>NDFC</i>	<i>3,088,000</i>	<i>19.28%</i>
Total	16,017,500	100.00%

d. *The last hearing in the matter was held on February 11, 2004 and wherein it was submitted that **72,500 shares are with the general public** and the management is ready to buy back the shares from the minority shareholders. The Company was asked to submit a written plan regarding de-listing of the company and buy back of shares, as committed by the Company at the time of hearing.*

e. *The Company submitted vide letter dated June 19, 2004 that in the BOD meeting, held on May 28, 2004, it has been decided to defer the matter till September 30, 2004, so that compliance with Rule 3 and Rule 4 of the Companies Buy Back of shares Rules 1999 can be made in respect of the financial ratios and availability of sufficient cash, as the company does not have sufficient cash flow at present.*

f. *In this regard, the company was advised vide Commission's letter dated August 10, 2004 to settle all the modalities for buy back of shares with the stock exchange and report to the Commission before September 30, 2004.*



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g. The company in its reply has stated that the sugar industry is facing crisis of sugar shortage these days. Therefore, the company cannot buy back the shares from the general public which are 68,500 shares only. It was further stated that the Company will arrange the buy back of shares during the next crushing season (2005-2006).

8. It was against this backdrop that the Commission decided to reinstate the deferred proceedings under Section 265 of the Ordinance and accordingly, a hearing notice dated June 13, 2005 was issued to the Company and its Chief Executive calling upon them to appear in person or through their authorized representatives before the Commission on July 21, 2005 and to explain as to why an inspector, under Clause (b) of Section 265 of the Ordinance should not be appointed to investigate into the affairs of the Company. However, the aforesaid hearing, the hearing fixed for September 22, 2005 and hearing fixed for November 16, 2005 remain unattended by the Company.

9. The financial position of the Company has further worsened and the situation has reached alarming point. The financial cost of the company is one of the lowest in the sugar sector and the reported results of the Company do not reflect any improvement in the financial results due to this advantage. The lowest financial cost is due to the fact that the Company has been able to negotiate loan settlement with BEL, which has resulted in zero mark-up on long term loans. The Company due to the loan settlement is heading toward a quite comfortable situation and it seems that the intentions of the directors are to reap the benefits themselves and do not want to pass the benefits to shareholders representing general public. Financial position of the Company is as follows:

Rupees in million

YEAR	2004	2003	2002	2001	2000	1999	1998	1997
Sales	530.57	652.43	654.26	419.44	330.15	529.67	574.62	353.71
Gross Profit / (loss)	(52.79)	58.53	12.58	27.18	(21.36)	(68.75)	4.83	18.19
Operating profit / (loss)	(79.13)	39.10	(11.53)	4.59	(44.73)	24.24	(24.89)	(0.52)
Financial Charges	5.88	6.41	52.35	95.38	110.35	59.23	44.81	87.07
Net Profit / (loss)	(87.66)	**124.52	(63.88)	(90.78)	(153.27)	(35.78)	*58.67	(89.33)
EPS	(5.47)	**7.77	(3.99)	(5.67)	(9.57)	(2.23)	*3.66	(5.58)
Paid-up Capital	160.17	160.17	160.17	160.17	160.17	160.17	160.17	160.17
Accumulated Losses	(443.05)	(399.10)	(523.63)	(459.75)	(368.96)	(215.69)	(179.91)	(238.58)
Net Equity	(282.88)	238.93	(363.45)	(299.57)	(208.79)	(55.52)	(19.73)	(78.40)
Long Term Loans	547.98	550.85	310.21	346.02	324.74	396.44	440.86	276.94
Gross Profit %	(9.95)	8.97	1.92	6.48	(6.47)	(12.98)	0.84	5.14
Operating Profit %	(14.91)	5.99	(1.76)	1.09	(13.55)	4.58	(4.34)	(0.14)
Net Profit %	(16.52)	**19.35	(9.76)	(21.64)	(46.42)	(6.76)	*10.21	(25.26)
Current Ratio%	0.27:1	0.25:1	0.09:1	0.09:1	0.09:1	0.26:1	0.20:1	0.12:1

* Reported after accounting for unusual item of Rs.127 millions

** Reported after accounting for unusual item of Rs.100 millions



10. The latest audited financial statement for the year ended September 30, 2004 reflected that the financial position of the Company has further deteriorated over the period:

- a) *The Company's accumulated losses are Rs.443.053 million and the equity stands negative amounting to Rs.282.878 million. The losses are reported after adjustment of Rs.100.177 millions and Rs.127.315 millions made on account of settlement with financial institutions and waiver of mark up, excise duty and redeemable capital by the financial institutions respectively. In the absence of these book adjustments the reported accumulated losses would have been much higher and this is the case with operational losses.*
- b) *The Company is under huge debt amounting to Rs.547.980 million against paid up capital of Rs.160.175 million.*
- c) *Current liabilities exceed current assets by Rs.227.559 million.*
- d) *The Company has obtained advances from customers amounting to Rs.168.228 million and whereas the trade debts are Rs.0.489 million only.*
- e) *The auditors have raised their concern regarding the ability of the Company to continue as a going concern and provisioning for current and deferred taxes.*
- f) *The pattern of shareholding reflects that the general public holds 30.682 % shares in the Company, which is similar to that in the previous financial statements*
- g) *Financial institutions shareholding is 45.946 % in the Company, which is similar to that in the previous financial*

11 The Company in its letter dated May 13, 2005 stated that 68,500 shares held by general public whereas in its earlier representation dated June 13, 2001 it was contended that no shares are held by general public. This is total misrepresentation on part of the management of the Company. Moreover, as explained above the latest audit financial statements of September 30, 2004 reflects that Directors, their spouses and children hold around 23 % of the paid up capital. The Company contention that shares held by general public includes a major portion held by the relatives of Directors and do not represent interest of the general public. However these contentions are not correct and these shares do represent the interest of the general public. Moreover this argument does not hold any weight and is put forward to delay the proceedings.

12 The Company is not managed in conformity with the best practices contained in the Code of Corporate Governance (CCG) and cast serious apprehensions on the way the business is conducted. The Statement of Compliance with the CCG to the members, duly reviewed by auditors, disclosed that the powers and decision of the Board has not been exercised since long in respect of following areas;



- a) Annual Business plan, cash flow projections, forecast and long term plans.
- b) Budget including capital, manpower and overhead budget along with variance analysis.
- c) Internal audit report, including cases of fraud or irregularities of material nature.
- d) Status and implications of any lawsuit or proceedings of material nature filed by or against the Company.

13 The Company submitted a revival plan during the hearing held on August 09, 1999. The targets set forth in the plan were never achieved and the financial position of the Company worsened. The comparison of the profitability of company's projections from 1999 with actual results is produced as under;

Year	Projections	Actual	Variance
1999	(72.99)	(35.78)	37.21
2000	1.86	(153.27)	(155.13)
2001	76.40	(90.78)	(167.18)
2002	84.80	(63.88)	(148.68)
2003	91.55	24.35**	(67.21)
2004	103.15	(87.66)	(190.82)

**Excluding Extraordinary Items

14 Substantial interest of the general public, financial institutions and creditors exist in the Company and there remain a strong need of ensuring that no infringement of right of various stakeholders takes place. The Commission raised its concerns with the Company on the dismal performance and deprivation of the return to shareholders, at various points of time. The Directors never paid any heed to the issues raised by the Commission and the representations given by the Company, at various occasions were intended to divert the course of proceedings. The Directors provided representations at one occasion which do not agree with those given at another time.

15. We can safely conclude from the above discussion that the directors have not fulfilled their fiduciary responsibility towards its shareholders. Minority shareholders are the medium, which could genuinely contribute towards economic growth through their savings if those are channelized for productive purposes giving them reasonable returns and assuring the safety of their investments. In this case, the interest of the minority shareholders was seriously jeopardized. In the circumstances, it is the responsibility of the Commission to ascertain factual position through competent inspector(s) whose report can bring to light as to whether the affairs of the Company were managed in conformity with the accepted principles and standards of good



and efficient management. If the inspector holds that the directors were not responsible for the current state of affairs of the Company, the report will be helpful to them rather than detrimental to their interests. The Commission can protect the interest of the investors only through timely initiating of a fact-finding exercise.

16. The apprehensions pointed out in the proceeding paragraphs, the continuous losses, their unresponsive attitude towards the Commission and weakness in the internal controls for the business system reasonably suggest that the affairs of the Company are not being managed in accordance with the sound business principles and prudent commercial practices. The concerns of the Commissions remains to be resolved and the investigations into the affairs of the Company to ascertain fact in respect of the continuing operational losses, shares held by the general public, transactions made with the associates, fair value of the assets and ascertain the future business viability of the project.

17. Securities and Exchange Commission of Pakistan has been established under the Securities and Commission of Pakistan Act, 1997 for the beneficial regulation of the capital markets, superintendence and control of the corporate entities and for matters connected therewith and incidental thereto. It is one of its functions to conduct sue moto investigations into affairs of the companies, through competent inspectors(s) if in its opinion there are circumstances suggesting one or more of the matters given in sub-clauses (i) to (vii) of Clause (b) of Section 265 of the Ordinance. The Commission is further empowered to prosecute a company or persons found guilty as a consequence of such investigations. It would also be pertinent to discuss here the spirit of Section 265 of the Ordinance. It is not possible for the minority shareholders to act jointly to protect their interest. Moreover, they are not able to collect evidence where management is acting prejudicial to their interest to bring the same before the appropriate forums for appropriate action. It was because of this difficulty that the legislators have enacted Section 265 of the Ordinance to prevent the managements of companies from acting in a manner prejudicial to the interest of the minority shareholders. The object of this Section, thus, is to safeguard the interest of the shareholders, creditors and those dealing with the company to provide for investigation into its affairs where the affairs of the company are conducted to jeopardize those interests.



18. In view of aforesaid discussion, I am convinced that the circumstances falls under Sub-clauses (iii), (vi) and (vii) of Clause (b) of Section 265 of the Ordinance and that substantial and worthwhile basis exist to form an opinion warranting investigation into affairs of the Company. The aforesaid discussion also amply demonstrate that such conditions exists, which fulfills the objectives that forms the pre-requisite for the Company, for ordering an investigation. These circumstances reasonably suggest that

Sub-clause (iii) of Clause (b) of Section 265

The affairs of the Company have been conducted or managed as to deprive the members thereof of a reasonable return.

Sub-clause (vi) of Clause (b) of Section 265

The affairs of the Company are not being managed in accordance with sound principles and prudent commercial practices.

Sub-clause (vii) of Clause (b) of Section 265

The financial position of the Company is such as to endanger its solvency.

19 For the forgoing reasons, I, in exercise of the powers conferred on me under Clause (b) of Section 265 of the Ordinance, hereby appoint Fraud Investigation Unit act as inspector to investigate into the affairs of M/S Khairpur Sugar Mills Limited to bring into light the actual state of affairs of the Company.

20. Without limiting the scope of investigation, the inspector shall conduct investigation on all aspects of the operations of the Company and shall, after scrutiny of all the records and books of accounts, furnish a report, *inter alia* covering the period of Four years from the period June 30, 2001 to June 30, 2005 on the following matters:

- a. Risk assessment by doing appraisal of the Control environment, Accounting system and Financial Control procedures.
- b. Reasons of heavy losses sustained by the Company, whether these losses were due to operational inefficiencies, mismanagement and imprudent policies or any other reasons.
- c. Cost Comparison with the industry, specifically mentioning that whether or not the purchase and sales of materials and products respectively are in line with the market.



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- d. Check the material adjustments including fixed assets revaluation, loan settlements, unrecorded employee retirement benefits, Contingent liabilities etc.
- e. Siphoning the funds to the associates/subsidiaries without the shareholders' authority
- f. Detailed investigation of the transactions with the associated undertakings to ascertain that in case of goods and services as to whether the same were "arms length".
- g. Verification of material account balances and ascertaining present net realizable value.
- h. Evaluate internal audit reports and report that how these are disposed of by the Board i.e., whether or not timely actions are taken. Moreover whether or not adequate system of internal controls existed and implemented so as to prevent misappropriation and misapplication of Company's assets and resources.
- i. Verification of shares held by Directors, General Public and others
- j. Determination of any false and incorrect statement in the Directors' Report.
- k. Report any lapses or other delinquency detected during the course of investigation.
- l. Review the business plan and management's representation in respect of the future viability of the company.
- m. Report on the maintenance of Statutory books including minutes books of the Board and general body meetings.
- n. To suggest future course of action in the interest of the shareholders of the Company.
- o. To report violations made by the Company under various provisions of the Ordinance

21. The inspector shall submit his report along with supporting documents to the Commission within sixty days from the date of this order. The Commission expects that the report shall be made specifically on each terms of reference along with the names of persons responsible for any irregularities and mismanagement in the affairs of the Company.

22 The inspector, for the purpose of his investigation, shall have the same powers as are vested in a Court under the Code of Civil procedure, 1908 while trying a suit in respect of the matters enumerated under Section 266 of the Ordinance and every proceeding before the inspector shall be deemed to be judicial proceeding within the meaning of Section 193 and 228 of the Pakistan Penal Code, 1860. Any contravention or non-compliance with any orders, direction or requirement of the inspectors shall entail the consequences under the Code of Civil Procedure, 1908 and Pakistan Penal Code, 1860.



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23 It shall be the duty of all the officers, employees and agents and other persons having dealing with the Company to provide all assistance to the inspector in connection with the investigation, and any default whereof shall be punishable under Section 268 of the Ordinance.

Dr. Sajid Qureshi
Executive Director (CLD)