RATING REPORT

Faran Sugar Mills Limited

REPORT DATE:
February 26, 2019

RATING ANALYSTS:
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Rating Category	Previous Rating	
	Long-term	**Short-term**
Entity	A-	A-2
Rating Date	*February 15,2019*	
Rating Outlook	Stable	
Outlook Date	*February 15,2019*	

COMPANY INFORMATION	
Incorporated in 1981	**External auditors:** M/s Rahman Sarfaraz Rahim Iqbal Rafiq Chartered Accountants
Public Listed Company	**Chairman:** Muhammad Omar Amin Bawany
Key Shareholders :	**Chief Executive Officer:** Ahmed Ali Bawany
Ahmed Ali Bawany - 16.10%	
Rukhsana Omar - 8.52%	
National Investment Unit Trust - 8.48%	
Shahdia Amin - 8.15%	
Ayesha Amin - 7.02%	
Gulshanara Amin - 5.94%	
Roshan Ara Mohd Amin - 5.50%	

APPLICABLE METHODOLOGY(IES)
JCR-VIS Entity Rating Criteria *Industrial Corporates (May 2016)* ***http://www.jcrvis.com.pk/images/IndustrialCorp.pdf***

Faran Sugar Mills Limited

OVERVIEW OF THE INSTITUTION

Incorporated in 1981, Faran Sugar Mills Limited (FSML) is a public limited company and is listed on Pakistan Stock Exchange (PSX).

The company operates under the umbrella of Amin Bawany Group.

RATING RATIONALE

Assigned ratings of Faran Sugar Mills Limited (FSML) derive strength from its sponsor, Amin Bawany Group, an experienced business group of the country. While FSML is primarily engaged in the business of manufacturing and selling of sugar, group entities are present in ethanol, energy and confectionary sectors. Production facilities of FSML are located at Shaikh Bhirkio, District Tando M. Khan, in the province of Sindh.

Current ratings are constrained by inherent business risk present with volatility in sugar prices in particular and commodity prices in general. Depressed sugar prices in last few years have put pressure on sugar segment margins in the backdrop of regulated cane prices. The ratings remain dependent on maintenance of margins and low leveraged capital structure, incremental cash flow generation from recent capital expenditure coupled with evolution of sector dynamics.

Key Rating Drivers

Sugar Industry Dynamics

Local demand supply dynamics projected to depict some improvement in MY19; slight upward pressure expected in local prices

Over the last two years excess supply of sugar has prevailed on the back of sugar production outpacing the overall consumption. Significant increase in production and lower allowable export quota set by the Government resulted in a sizeable increase in ending inventory at end-FY17. While production continued to outpace supply, higher export quota of 1.5m tons (with subsidy benefit by federal government and an additional subsidy by Sindh government for sugar mills in Sindh) has facilitated in reducing inventory levels which continued to remain at elevated levels at end-MY18. Decline in production for MY19 (expected to be significantly lower at around 6m tons but still higher than domestic consumption for MY19) along with export quota of 1.1m tons allowed is expected to improve local demand supply dynamics (resulting in lower ending inventory) and result in some upward pressure on prices. However, profitability of sugar mills will remain dependent on quantum of increase in domestic prices of sugar along with quantity of sugar exported. Subsidy allowed by Punjab Government is significantly lower vis-à-vis overall subsidy of prior year while no subsidy has been announced by the Federal and Sindh Government.

Mn Tons	MY16	MY17	MY18
Opening Inventory	0.849	0.777	2.326
Sugar Production	5.1	7.048	6.5
Sugar Available	5.949	7.825	8.826
Domestic Consumption	4.9	5.1	5.4
Exports	0.272	0.399	1.5
Ending Inventory	0.777	2.326	1.926

Global oversupply situation to persist; prices expected to remain under pressure in MY19

Baring two years (MY16 & MY17), global production of sugar has outpaced consumption over the last decade resulting in sizeable global sugar ending inventory. Resultantly, ending inventory has stood at over 50% of the total consumption over the last 5 years. The demand-supply dynamics have kept international sugar prices on the lower side during MY18 (Average sugar prices were

$357.5/tonne in MY18 vis-à-vis $477.4/tonne in MY17). Going forward, global stock levels are projected to rise as higher production from India is expected to offset decline in production in Brazil and European Union. Resultantly, international prices are expected to remain bearish during MY19 with exports for local producers being only profitable with subsidy support from government. India is forecasted to become the largest sugar producer (due to enhanced yields and increase in area under cultivation) in the world in MY19 overtaking Brazil for the first time in the last fifteen years. Other major sugar producers include Brazil, Thailand, China, USA, Mexico, and Pakistan.

Mn Tons	MY16	MY17	MY18
Opening Inventory	96.40	91.21	88.06
Sugar Production	164.20	168.30	179.44
Sugar Available	260.60	259.51	267.50
Consumption	169.09	171.40	174.40
Import Demand	66.00	60.04	57.40
Exports	66.30	60.10	61.09
Ending Inventory	91.21	88.06	89.41

Existing pricing dynamics are a drag on the profitability of the sector. Based on current international prices and existing exchange rate, international prices are still at a discount to local prices

Local retail prices which are driven by market forces have remained depressed on account of surplus supply of sugar. Higher fixed sugarcane prices (including the impact of quality premium which is estimated to range between Rs. 5 to Rs. 12 per mound for mills in Sindh) set by the government to facilitate growers and farmers coupled with depressed retail prices have compressed margins for the industry. Based on current sugar cane prices announced by the government and assuming average recovery ratio for the industry, cost of production of sugar is slightly higher vis-à-vis local prices. Given the expected increase in sugar prices, this trend is expected to reverse in MY19 with retail prices expected to be higher vis-à-vis cost of production. However, margins and profitability are expected to remain depressed. On the export front, current international prices (assuming exchange rate of 140) translate into a 10% discount vis-à-vis local prices. Break even international prices accounting for freight and sales tax advantage at existing exchange rate are $370 vis-à-vis existing prices of $339.

Per Kg Prices	MY14	MY15	MY16	MY17	MY18
Average Local Prices (Rs)	54.8	58.91	63.77	61.43	53.57
Average International Prices (USD)	0.459	0.377	0.461	0.474	0.358

Operating & Financial Performance

The company operates at a total crushing capacity of 1.62m tonnes while maintaining its recovery rate at 11% on a timeline basis. FSML crushed 959,378 tonnes of cane producing 105,633 tonnes of sugar. As a result, the plants operated at a capacity utilization of 59% in MY18.

Improved profitability of FSML's associate, belonging to the ethanol sector, offsets loss from sugar division in the previous year translating into significant jump in overall profitability. Trend in overall profitability is expected to persist during MY19 on the back of improved revenues from the ethanol segment along with better sugar dynamics

Similar to other players in the market, revenue base of the company is highly dependent on the sector dynamics being directly proportional to volumes of cane procurement and retail sugar prices in the local market. Sales of the company stood at Rs. 6.2b in MY18, out of which a large chunk of sales is contributed by exports; exports contributed a share of 65% vis-à-vis an average of 20% over the past 5 years (MY13-MY18). Gross margin of the company is highly dependent on the cost of cane and retail price. It remained in the range of (8.7%-11.7%) and was reported at 8.7% in MY18 (MY17:-2.2%). Along with its primary business, FSML's bottom line is supported by strong cash flow coming from its investment in Unicol Limited. Unicol manufactures ENA Grade ethanol which is exported to Far East Asia, Europe & Africa. Profitability of ethanol exports is dependent on international prices of ethanol, efficiency in operations and availability of molasses at competitive rates. Having significant environmental advantages, ethanol is considered one of the cheapest sources of octanes. However, these have been susceptible to some downfall in global price trend due to higher global supply which is expected to persist going forward. Distilleries in Pakistan have enjoyed superior margins as high availability of molasses had pulled down cost of producing ethanol while global ethanol prices witnessed a mild descent in MY18. The expected decline in sugar production in MY19 has limited the availability of molasses driving up prices significantly and hence increasing cost of producing ethanol. This is however expected to be partly offset by benefit of rupee depreciation that industry players will enjoy.

Liquidity profile has witnessed improvement due to enhanced cash flow coverage and increase in debt servicing ability

On account of significant increase in export sales, Funds Flow from Operations improved (MY18: 143m; MY17: -355m; MY16: 518m) translating into FFO to total debt of 0.06x (MY17: -0.16x; MY16: 2.05x). This has resulted in improved ability of the company to retire debt as Debt Service Coverage Ratio increased to 1.31x (MY17: -1.39x; MY16: 6.32x) in MY18.

Leverage indicators remained within adequate levels on a timeline basis. Leverage indicators are projected to remain range bound going forward

Leverage indicators of the company are considered adequate. Debt profile of the company largely comprises short term borrowing utilized to finance its working capital. Given that management has no plans for capital expenditure in the near future, leverage indicators are projected to remain within manageable limits.

Composition of Board along with IT infrastructure

Similar to the structure of private limited companies, majority of the directors belong to the sponsoring family. These directors are experienced personnel having long association with the company. Nonetheless, both Board composition and IT infrastructure of the company depict room for improvement.

Faran Sugar Mills Limited **Appendix I**

FINANCIAL SUMMARY				*amounts in Rs. millions*
BALANCE SHEET	**30-Sep-15**	**30-Sep-16**	**30-Sep-17**	**30-Sep-18**
Property, Plant & Equipment	1,257.20	1,530.30	1,570.40	1,730.40
Long Term Investments	659.5	773.9	968.4	1,177.40
Capital Expenditure	293.6	347.1	127.7	248.6
Stock in Trade	2,051.50	677	2,003.70	1,295.30
Trade Debts	26.49	3.61	81.98	190.4
Loans, advances and deposits	444.2	381.4	346.5	1,078.70
Cash and Bank Balances	59.93	443.9	70.3	94.9
Total Assets	4,594.80	3,898.00	5,153.60	5,773.60
Trade and other payable	1,968.30	1,258.90	840.2	941
Long Term Debt (*incl. current maturity)	119.5	179.1	126.9	224
Short Term Debt	500	-	2,089.00	1,933.30
Total Equity	1,545.50	1,904.30	1,595.30	2,037.50
INCOME STATEMENT	**30-Sep-15**	**30-Sep-16**	**30-Sep-17**	**30-Sep-18**
Sales Revenue	2,938.40	6,529.70	4,435.70	6,291.20
Cost of Sales	2,615.20	5,842.40	4,532.70	5,742.90
Gross Profit	323.4	687.3	-97.1	548.2
Selling Expenses	11.7	10.3	35.3	210.2
Administrative Expenses	101.4	124.4	119.7	137.6
Financing Cost	104.6	38.09	140.8	156.1
(Loss)/Profit After Tax	309.7	482.6	-184.1	442.4
RATIO ANALYSIS	**30-Sep-15**	**30-Sep-16**	**30-Sep-17**	**30-Sep-18**
Gross Margin (%)	11	10.5	-2.2	8.7
Net Margin (%)	10.5	7.4	-4.1	7
FFO	299.7	518.1	-355.6	142.6
FFO/Total Debt (x)	0.45	2.05	-0.16	0.06
Gearing (x)	0.43	0.13	1.44	1.1
Debt Leverage (x)	1.97	1.05	2.23	1.83
Debt Servicing Coverage (x)	3.55	6.32	-1.39	1.31
ROAA (%)	8	11	-4	8
ROAE (%)	22	28	-11	24

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.vis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details. www.vis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES					Appendix III
Name of Rated Entity	Faran Sugar Mills Limited				
Sector	Sugar				
Type of Relationship	Solicited				
Purpose of Rating	Entity Rating				
Rating History	**Rating Date**	**Medium to Long Term**	**Short Term**	**Rating Outlook**	**Rating Action**
			RATING TYPE: ENTITY		
	02/15/2019	A-	A-2	Stable	Initial
Instrument Structure	N/A				
Statement by the Rating Team	VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.				
Probability of Default	VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.				
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