# RATING REPORT

# Fatima Sugar Mills Limited

**REPORT DATE:**
November 05, 2021

**RATING ANALYSTS:**
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| RATING DETAILS | | | | |
|---|---|---|---|---|
| Rating Category | Latest Rating | | Previous Rating | |
| | Long-term | Short-term | Long-term | Short-term |
| **Entity** | A- | A-2 | A- | A-2 |
| **Rating Outlook** | *Stable* | | *Stable* | |
| **Rating Action** | Reaffirmed | | Reaffirmed | |
| **Rating Date** | *5th Nov'21* | | *17th Nov'20* | |

| COMPANY INFORMATION | |
|---|---|
| Incorporated in 1988 | External auditors: EY Ford Rhodes, Chartered Accountants |
| Public Listed Company (Unquoted) | Chairman: Mr. Fawad Ahmed Mukhtar<br>CEO: Mr. Faisal Ahmed Mukhtar |
| **Key Shareholders (with stake 5% or more):** | |
| Fatima Trading Company (Pvt.) Limited – 33%<br>Fatima Management Company Limited – 33%<br>Farrukh Trading Limited – 33% | |

| APPLICABLE METHODOLOGY(IES) |
|---|
| **VIS Entity Rating Criteria:** Corporates (August 2021)<br>***https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf*** |

# Fatima Sugar Mills Limited

## OVERVIEW OF THE INSTITUTION

Fatima Sugar Mills Limited was incorporated as a public limited company in 1988 under the Companies Ordinance 1984 (now Companies Act, 2017). The company is primarily engaged in the manufacturing & sales of refined sugar and allied products.

**Chairman Profile:** Mr. Fawad Ahmed Mukhtar is the chairman of the company. He has extensive experience in manufacturing & industrial management. He is also the chairman of five other group companies & CEO of four group companies.

**CEO Profile:** Mr. Faisal Ahmed Mukhtar is the CEO of the company. He is also CEO of Fatima Holding Limited and director at eleven other group companies. He has also served as Mayor and District Nazim of Multan.

## RATING RATIONALE

Fatima Sugar Mills Limited (FSML) is a part of 'Fatima Group' which has business interests in fertilizer, textile, energy, sugar and commodities trading sectors. Apart from FSML, the group companies include Pakarab Fertilizers Limited, Fatima Fertilizer Company Limited, Reliance Weaving Mills Limited, Reliance Commodities (Pvt.) Limited, Fatima Energy Limited (FEL), Fatima Packaging Limited, and Fatima Holding Limited. FSML utilizes sugarcane as a raw material for the production of refined sugar and allied products. FSML currently has sugarcane crushing capacity of 11,500 tons per day. Crushing activity normally takes place between November and April to produce sugar, molasses and bagasse. The company has total electricity requirement of 14.5 MW which is met either through in-house bagasse-based power unit or sourced from FEL to whom the company also sells bagasse. While short-term outlook of sugar sector remains favorable, the ratings are constrained by inherent cyclicality and price vulnerability in sector dynamics.

**Rating Drivers**

**Shareholding mainly vested with sponsoring family having experience in sugar & other manufacturing sectors.**

Previously, FSML was a wholly owned subsidiary of Fatima Holding Limited (FHL), which acts as the holding company of the group. The shareholding of FHL is owned by sponsoring family with three brothers and their families, each having one-third shareholding in the company. Subsequent to regulatory approval, shareholding structure has been changed and is now equally split between three group-companies i.e. Fatima Trading Company (Pvt.) Limited (33%), Fatima Management Company Limited (33%), and Farrukh Trading Limited (formerly Fatima Trade Company Limited) (33%). Board of Directors of FSML comprises seven members, including six non-executive directors, all being representatives of the sponsoring family. Board also exercises oversight through Board Audit Committee and Board Human Resource & Remuneration Committee.

**Business Risk**

Risk profile of sugar sector is considered high given inherent cyclicality in the crop levels and raw material prices. Moreover, distortion in pricing mechanism of raw material prices and refined sugar also creates challenge for sugar mills. Typically, sugarcane crop has production cycle of 3-to-5 years, driven largely by government support for farmers and crop yield. During MY21, sugarcane production has increased by 22% to 81m MT on account of increase in area under cultivation and improvement in crop yield. Based on around 78% crushing and an average recovery rate of 10.2%, the sector has produced 5.62m MT of sugar during MY21. Meanwhile, sugar demand is projected at 5.9m MT for the period. While narrow demand and supply dynamics may lead to high sugar prices, government may intervene by importing sugar in order to control prices. Meanwhile, margins may also be curtailed by increasing trend in sugarcane prices. During MY21, sugarcane procurement prices have been recorded as high as Rs. 350 per mound in Punjab and Rs. 275 per mound in Sindh against the minimum support price of Rs. 200 per mound and Rs. 202 per mound in respective provinces. However, sector's risk profile draws support from diversification into distillery, power and steel segments.

**Revenue increase led by higher sugar production and prices despite decrease in sucrose recovery, margins impacted by higher sugarcane prices.**

FSML plant was operational for 111 days (MY20: 115 days) during MY21; however, efficiency gains in crushing process emanating from the balancing, modernization, and replacement (BMR) and improvement in crop produce in the country led to higher sugarcane crushed amounting to 1.26m MT (MY20: 1.05m MT). Sugar production increased at a slightly lower pace to 120,155 MT (MY20: 106,408 MT) as the impact of higher quantum crushed was partially offset by decrease in sucrose recovery rate to 9.56% (MY20: 10.10%) due to early start of crushing activity. Meanwhile, molasses production was recorded higher at 54,812 MT (MY20: 46,186 MT) with largely stable recovery rate of 4.36% (MY20: 4.38%). The company also produced 352,241 MT (MY20: 305,369 MT) of bagasse during the crushing season.

During 9MFY21, net revenue of the company increased by 35% over corresponding period last year to Rs. 7.8b (FY20: Rs. 10.3b; FY19: Rs. 6.8b), driven mainly by increase in sugar dispatches at higher selling prices and incremental revenue from sale of entire bagasse produce to FEL in exchange for purchase of electricity and steam. Previously, the company used to produce electricity from in-house bagasse-based power plant. As per the management, this arrangement where the company sells bagasse to FEL and in turn receives electricity and steam does not impact the profitability. Sugar remains the key revenue contributor followed by molasses and bagasse.

Revenue from sugar sales increased by 28% over the corresponding period of last year to Rs. 6.2b (FY20: Rs. 9.3b; FY19: Rs. 5.8b) as the company sold 82,096 MT (FY20: 140,607 MT; FY19: 105,105 MT) of sugar at an average selling price (ex-factory) of Rs. 75/kg (FY20: Rs. 66/kg; FY19: Rs. 55/kg) during 9MFY21. No sugar exports were made during the period due to tight demand and supply dynamics within the local market and restriction imposed by the government. Revenue from molasses sales was recorded at Rs. 879m (FY20: Rs. 881m; FY19: Rs. 588m) as the impact of increase in volumes to 51,074 MT (FY20: 46,390 MT; FY19: 60,438 MT) was more than offset by lower average selling price of Rs. 17,203/MT (FY20: Rs. 19,143/MT; FY19: 10,221/MT) because of price disparity between the local and international markets and lack of export opportunities during 9MFY21. Meanwhile, revenue from bagasse sales increased by multifold to Rs. 790m (FY20: Rs. 146m; FY19: Rs. 290m) as the company sold entire bagasse produce to FEL.

During 9MFY21, cost of sales increased by 44% over the corresponding period last year to Rs. 6.7b (FY20: Rs. 8.0b; FY19: Rs. 5.5b) mainly on account of increase in sugarcane procurement price to Rs. 256 per 40kg (FY20: Rs. 218 per 40kg; FY19: 188 per 40kg), decline in sucrose recovery rate, and increase in fuel & power cost due to purchase of electricity and steam from FEL vis-à-vis indigenous production in the prior years. Gross profit was recorded at Rs. 1.2b (FY20: Rs. 2.4b; FY19: Rs. 1.3b) which led to lower gross margin of 15.1% (FY20: 22.8%; FY19: 18.7%). Going forward, the company is expecting some improvement in gross margin on account of increase in average selling price during fourth quarter of FY21.

Distribution expenses decreased to Rs. 16m (FY20: Rs. 98m; FY19: Rs. 124m) due to considerably lower loading, handling & freight charges in the absence of any exports during 9MFY21. Administrative expenses, however, increased by 25% over the corresponding period of last year to Rs. 204m (FY20: Rs. 247m; FY19: Rs. 194m) on account of higher staff related expenses during the period. Other expenses amounted to Rs. 41m (FY20: Rs. 158m; FY19: Rs. 75m) which mainly represented workers' profit participation fund. Other income was recorded at Rs. 119m (FY20: Rs. 185m; FY19: Rs. 184m) which mainly represented markup on loan to associates of Rs. 90m (FY20: Rs. 149m) and scrap sale of Rs. 24m (FY20: Rs. 4m). Financial charges decreased to Rs. 339m (FY20: Rs. 642m; FY19: Rs. 649m) on account of lower interest rates during 9MFY21. Accounting for taxation, the company reported net profit of Rs. 582m (FY20: Rs. 1.2b; FY19: Rs. 370m) with a net margin of 7.4% (FY20: 11.8%; FY19: 5.5%) during 9MFY21.

**Asset base growth led by higher inventory levels, amount due from associated companies, and capex.** Increase in total assets to Rs. 12.2b (FY20: Rs. 8.5b; FY19: Rs. 8.3b) by end-9MFY21 was primarily driven largely by higher inventory levels, increase in amount due from associated companies, and capex. Property, plant and equipment augmented to Rs. 5.0b (FY20: Rs. 4.5b; FY19: Rs. 3.8b) due to capex of Rs. 666m (FY20: Rs. 805m; FY19: Rs. 586m) related to ongoing balancing, modernization and replacement (BMR) of existing plant. The BMR is scheduled to be completed by end-December'2021 for a capex of Rs. 1.2b. The replacement of old crushing machineries and spare parts will contribute towards production efficiencies.

Investment in freehold land and FEL remained unchanged at Rs. 99m and Rs. 88m, respectively. Stock in trade was recorded at Rs. 3.2b (FY20: Rs. 621m; FY19: Rs. 2.0b), which mainly represented sugar inventory of 48,417 MT at end-9MFY21. Trade receivables stood at Rs. 322m (FY20: Rs. 83m; FY19: Rs. 367m) out of which Rs. 143m (FY20: Rs. 65m) pertained to third-party sugar customers and Rs. 179m (FY20: Rs. 19m) were due from FEL against bagasse sale. Increase in loans and advances to Rs. 2.2b (FY20: Rs. 1.9b; FY19: Rs. 1.2b) was mainly led by higher markup-bearing amount due from associated companies amounting to Rs. 1.9b (FY20: Rs. 1.7b; FY19: Rs. 871m)), higher advances to contractors related to BMR amounting to Rs. 272m (FY20: Rs. 42m; FY19: Rs. 104m) and advances to sugarcane growers of Rs. 106m (FY20: Rs. 100m; FY19: Rs. 76m). Interest receivables against these loans to associated undertakings amounted to Rs. 407m (FY20: Rs. 318m; FY19: Rs. 191m) at end-9MFY21; the management is actively working with the related parties to recover the same. Tax receivable was recorded at Rs. 243m (FY20: Rs. 305m; FY19: Rs. 260m) while cash and bank balance at Rs. 174m (FY20: Rs. 172m; FY19: Rs. 77m).

**Improved cash flows generation and manageable coverage ratios, though liquidity is impacted by increasing loans to associated undertakings.**

The company generated funds from operations (FFO) of Rs. 848m (FY20: Rs. 1.3b; FY19: Rs. 374m) during 9MFY21, which along with the lower interest payment resulted in improved debt service coverage ratio of 3.43x (FY20: 2.44x; FY19: 1.53x). Meanwhile, FFO-to-total debt ratio was recorded at 0.21x (FY20: 0.56x; FY 19: 0.10x) primarily due to higher short-term borrowings for working capital requirements and mobilization of new long-term loan for capex. The current ratio also decreased to 1.25x (FY20: 1.54x; FY19: 1.18x) due to disproportionately higher short-term borrowings at end-9MFY21. Inventory plus inventory to short-term borrowing ratio stood at 0.87x (FY20: 0.66x; FY19: 0.84x) as short-term borrowings are also being utilized to make loans to associated concerns, which continue to impact the overall liquidity profile of the company.

**Manageable leverage indicators**
Paid up capital remained unchanged at Rs. 2.1b. Total equity increased to Rs. 5.4b (FY20: Rs. 4.8b; FY19: Rs. 3.6b) with the retention of profits. The debt matrix of the company comprises short-term and long-term debt. Long-term borrowings increased to Rs. 1.4b (FY20: Rs. 1.2b; FY19: Rs. 969m) by end-9MFY21 on account of new long-term loan mobilization of Rs. 166m (FY20: Rs. 291m). The company availed principal deferment of Rs. 154m (FY20: Rs. 58m) under the SBP's COVID-19 relief program; major portion of the same has already been repaid. Short term borrowings stood higher at 4.1b (FY20: Rs. 1.1b; FY19: Rs. 2.9b) in line with higher working capital requirement at end-9MFY21. Resultantly, gearing and debt leverage ratios were recorded at 1.0x (FY20: 0.47x; FY19: 1.07x) and 1.25x (FY20: 0.78x; FY19: 1.31x) respectively at end-9MFY21. While the company is mobilizing new long-term loan facility of Rs. 1.0b for the ongoing BMR requirements, the leverage indicators are expected to remain manageable on account of internal capital generation.

## Fatima Sugar Mills Limited Annexure I

| FINANCIAL SUMMARY *(amounts in PKR millions)* | | | | |
|---|---|---|---|---|
| **BALANCE SHEET** | **FY18** | **FY19** | **FY20** | **9MFY21** |
| Property, Plant & Equipment | 3,341 | 3,824 | 4,501 | 5,009 |
| Investment Property | 99 | 99 | 99 | 99 |
| Long-term Investment | - | - | 88 | 88 |
| Stock-in-Trade | 2,140 | 2,045 | 284 | 3,227 |
| Stores, spares & loose tools | 242 | 264 | 621 | 241 |
| Trade Debts | 724 | 367 | 83 | 322 |
| Loans & Advances | 1,350 | 1,189 | 2,219 | 2,697 |
| Other receivables | 570 | 150 | 117 | 1 |
| Tax Receivables from Government | 242 | 260 | 305 | 243 |
| Other Assets | 17 | 16 | 53 | 53 |
| Cash & Bank Balances | 8 | 77 | 172 | 174 |
| Total Assets | **8,733** | **8,291** | **8,542** | **12,154** |
| Trade and Other Payables | 284 | 443 | 1,023 | 832 |
| Accrued Mark Up | 49 | 135 | 54 | 154 |
| Short Term Borrowings | 4,531 | 2,876 | 1,074 | 4,096 |
| Long-Term Borrowings *(Inc. current maturity)* | 344 | 965 | 1,208 | 1,358 |
| Total Bank Borrowing | 4,875 | 3,841 | 2,282 | 5,454 |
| Other Liabilities | 300 | 278 | 371 | 320 |
| Total Liabilities | **5,508** | **4,697** | **3,730** | **6,760** |
| Total Equity | **3,225** | **3,594** | **4,811** | **5,394** |
| Paid up Capital | 2,102 | 2,102 | 2,102 | 2,102 |
| | | | | |
| **INCOME STATEMENT** | **FY18** | **FY19** | **FY20** | **9MFY21** |
| Net Sales | 8,551 | 6,767 | 10,319 | 7,848 |
| Gross Profit | 745 | 1,266 | 2,351 | 1,182 |
| Finance Cost | 317 | 649 | 642 | 339 |
| Profit Before Tax | 94 | 408 | 1,391 | 700 |
| Profit After Tax | 54 | 370 | 1,217 | 582 |
| FFO | 80 | 374 | 1,281 | 848 |
| | | | | |
| **RATIO ANALYSIS** | **FY18** | **FY19** | **FY20** | **9MFY21** |
| Gross Margin (%) | 8.7 | 18.7 | 22.8 | 15.1 |
| Net Profit Margin (%) | 0.6 | 5.5 | 11.8 | 7.4 |
| Current Ratio | 1.06 | 1.18 | 1.54 | 1.25 |
| Net Working Capital | 287 | 652 | 1,341 | 1,394 |
| FFO to Total Debt (x) | 0.02 | 0.10 | 0.56 | 0.21* |
| FFO to Long Term Debt (x) | 0.23 | 0.39 | 1.06 | 0.83* |
| Debt Servicing Coverage Ratio (x) | 0.92 | 1.53 | 2.44 | 3.43 |
| (Inventory + Receivables)/Short Term Debt | 0.63 | 0.84 | 0.66 | 0.87 |
| Debt Leverage (x) | 1.71 | 1.31 | 0.78 | 1.25 |
| Gearing (x) | 1.51 | 1.07 | 0.47 | 1.01 |

**Annualized*

## ISSUE/ISSUER RATING SCALE & DEFINITIONS — Annexure II

**VIS** Credit Rating Company Limited

### 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 | Annexure III |
|---|---|
| **Name of Rated Entity** | Fatima Sugar Mills Limited |
| **Sector** | Sugar |
| **Type of Relationship** | Solicited |
| **Purpose of Rating** | Entity Ratings |
| **Rating History** | see table below |
| **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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| **Due Diligence Meetings Conducted** | see table below |

**Rating History**

| Rating Date | Medium to Long Term | Short Term | Rating Outlook | Rating Action |
|---|---|---|---|---|
| **RATING TYPE: ENTITY** | | | | |
| 05/11/2021 | A- | A-2 | Stable | Reaffirmed |
| 17/11/2020 | A- | A-2 | Stable | Reaffirmed |
| 12/02/2020 | A- | A-2 | Stable | Initial |

**Due Diligence Meetings Conducted**

| Name | Designation | Date |
|---|---|---|
| Mr. Jawad Ahmad | Deputy GM Finance | October 10, 2021 |