RATING REPORT

Fatima Sugar Mills Limited (FSML)

REPORT DATE:
October 25, 2022

RATING ANALYSTS:
Asfia Aziz
asfia.aziz@vis.com.pk

Muhammad Taha
m.taha@vis.com.pk

RATING DETAILS				
	Latest Rating		Previous Rating	
Rating Category	Long -term	Short -term	Long -term	Short -term
Entity	A-	A-2	A-	A-2
Rating Outlook	Stable		Stable	
Rating Date	*October 25, 2022*		*November 05, 2021*	
Rating Action	Reaffirmed		Reaffirmed	

COMPANY INFORMATION	
Incorporated in 1988	**External auditors:** Shinewing Hameed Choudhry & Co. Chartered Accountants
Public Limited – Unquoted	**Chairman:** Mr. Fawad Ahmed Mukhtar **CEO:** Mr. Faisal Ahmed Mukhtar
Key Shareholders (with stake 5% or more):	
Fatima Trading Company (Pvt.) Limited – 33%	
Fatima Management Company Limited – 33%	
Farrukh Trading Limited – 33%	

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

Fatima Sugar Mills Limited (FSML)

OVERVIEW OF THE INSTITUTION

Fatima Sugar Mills Limited (FSML) was incorporated in 2006 as an unquoted public limited under the Companies Ordinance, 1984. The principal business activity of the company is manufacturing and sale sugar and its byproducts.

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.

Profile of CEO

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 installed sugarcane crushing capacity of 16,000 MT 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. During the ongoing year, long-term loan provided to FEL was converted into equity investment as the associate company issued preference shares. Long-term investment portfolio of FSML increased to Rs. 1.8b at end-June'22 contributing 11% of the total asset base.

While short-term outlook of sugar sector remains favorable due to greater availability of sugarcane and higher sucrose recovery rates, the ratings are constrained by inherent cyclicality and price vulnerability in sector dynamics.

Shareholding structure is 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.

Operational Performance

Available sugarcane crushing capacity increased to 13,500 MTPD in MY22 attributable to greater availability of sugarcane in the season. The higher availability of sugarcane, coupled with an extended crushing period during the year (25 days more than last year), resulted in a rise in production of sugar by around 50%. The recovery rate was also recorded higher at 10.07% in MY22 as compared to 9.56% in the preceding year. With higher output in sugar, a noticeable increase was also observed in the production of molasses and bagasse. Going forward, the company plans to incur BMR related capital expenditure amounting Rs. 800m (60-70% to be financed through debt), which will help to enhance the efficiency of installed machinery.

	MY20	MY21	MY22
Available Sugarcane Crushing Capacity MTPD	11,500	11,500	**13,500**
No. of Operational Days	115	111	**136**
Capacity based on Operating Days	1,322,500	1,276,500	1,836,000
Sugarcane Crushed	1,053,403	1,257,201	1,769,587

Capacity Utilization	79.65%	98.49%	96.38%
Sugar Produced	106,408	120,155	**178,115**
Sucrose Recovery Rate	10.10%	9.56%	**10.07%**
Molasses Production	46,186	54,814	**76,181**
Molasses Recovery Rate	4.38%	4.36%	4.31%
Bagasse Production	305,369	352,241	**507,518**
Bagasse Recovery Rate	28.99%	28.02%	28.68%

Key Rating Drivers:

Business Risk profile of the sector to remain on the higher side given inherent cyclicality in the crop levels and raw material prices. Efficient management of current surplus supply situation is considered important.

Pakistan is the world's fifth largest producer of sugarcane, the sixth largest producer of cane sugar and the eighth largest consumer of sugar. Sugarcane production accounts for 3.7% in agriculture's value addition and 0.8% in the country's GDP in FY22. The business 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 since raw material prices are regulated and output prices are determinants of market demand and supply. Typically, sugarcane production depicts volatility every three years driven largely by government support for farmers and crop yield.

Sector performance for the outgoing season (MY22) improved due to greater sugarcane availability with production levels increasing by 9.4% to 89m MT (MY21: 81m MT) on account of increase in area under cultivation, favorable weather conditions, improvement in crop yield, and timely availability of quality inputs. The minimum support price for sugarcane in FY22 was raised and set at Rs. 225/40kg bag in Punjab and KPK, but the industry still had to procure it at much higher prices as the growers were not willing to sell at these support prices. It is also pertinent to note that the sugarcane industry was impacted minimally by the current flood situation. In fact, since sugarcane is a water intensive crop; the yield is expected to go up by 10-15% in the next crushing season due to excessive rainfall during the recent monsoon season.

Based on an average recovery rate of around 10%, the sector produced 8m MT (MY21: 5.6m MT) of sugar in MY22 with annual sugar demand hovering around 6.8m MT leading to a production surplus of 1.2m MT. As per management, surplus output is expected to be utilized in the next season as the government has imposed a ban on the export of sugar. Weighing the impact of high level of domestic stocks, average selling prices of sugar witnessed a downward trend in MY22.

According to United States Department of Agriculture (USDA) annual report of March 15, 2022, sugar production in MY23 is forecasted at 7.2m MT, a slight decrease from MY22 crop due to surplus sugar available in the outgoing season. Sugar consumption on the other hand is forecasted at 6.1m MT in MY23.

Business risk profile of the sector draws comfort from inelastic demand of sugar which is an integral part in essential food items. However, major risks affecting the sugar sector include inconsistent pricing mechanism and policies for the farmer community, and stock hoarding and artificial shortage issues. The 'Sugar Sector Reforms Committee report' has recommended that the "government would no longer regulate the indicative sugarcane prices and ex-factory sugar prices would be deregulated with effect from crushing season MY23". Decreased political intervention is expected to result in more competitive quality and pricing in the country.

Regulatory Matter involving penalty imposed by Competition Commission of Pakistan (CCP)

The ratings have incorporated the developments with regards to penalties imposed by CCP on certain sugar mills and legal proceedings for interim relief initiated by the subject company. However, in the meanwhile, uncertainty of the outcome would persist on the sector. The material impact of penalty imposed, amounting to Rs. 860m on FSML will be significant and hence VIS will continue to monitor further development in this matter.

Profitability levels of the company remained at similar level in 9MMY22, as the benefit of higher sales volumes of by-products was offset by an increase in operational expenses.

Revenue of the company increased by 17% during 9MFY22 vis-à-vis the corresponding period last year and was reported at Rs 9.2b (9MMY21: Rs. 7.8b, FY21: Rs.11.9b, FY20: Rs. 10.3b). This was mainly attributable to a volumetric growth in the sales of by-products (bagasse and molasses) and benefit of dollar devaluation on exports of molasses to the tune of 81,500 MT. With sugar surplus in the ongoing year, quantity sold and average selling price for sugar was recorded on the lower side in 9MMY22. Hence, a change in the sales mix was noted with sugar sales accounting for only 58% (MY21: 85%) of total revenue. As per management, FSML's sugar inventory is expected to be largely sold by the end Dec'22. Materialization of the same is considered important.

	MY21				9MMY22			
	Quantity (MT)	**Avg. Price/MT**	**Value (Rs.)**	**%**	**Quantity (MT)**	**Avg. Price/MT**	**Value (Rs.)**	**%**
Sugar - Local	129,747	78,256	10,153,481,232	85%	78,012	68,585	5,350,453,020	58%
Sugar - Export				0%				0%
Molasses - Local	54,816	17,052	934,722,432	8%	12,554	25,182	316,134,828	3%
Molasses - Export				0%	81,500	30,000	2,445,000,000	27%
Bagasse	218,575	3,612	789,492,900	7%	267,266	3,961	1,058,640,626	12%
			11,877,696,564				**9,170,228,474**	

Gross margins improved to 22.9% in 9MFY22 (MY21: 15.55, MY20: 22.8%), owing to lower cost of procurement of sugarcane along with higher selling prices for molasses and bagasse. Overall profitability remained at similar level due to a significant rise in distribution expenses to the tune of Rs. 611m, as the company incurred regulatory duty and freight charges on the export of molasses. Further, with elevated debt levels to finance working capital needs, finance cost also went up to Rs. 628m in 9MMY22. Consequently, net margin of the entity was reported at 6.0% (MY21: 6.0%, MY20: 11.8% in 9MMY22). Future profitability will be contingent on selling of available inventory at lucrative prices in the market.

Cash flow coverages of outstanding obligations remain at manageable levels; however the same are expected to further improve after sales of the sugar inventory on books. Asset liability mismatch evident from current ratio being less than 1.00x.

In line with higher profitability, Funds from Operations (FFO) was reported higher in absolute terms during 9MMY22. However, due to a sizeable increase in the quantum of short-term debt and the associated finance cost, cash flow coverages reduced during the review period. At end-June'22, FFO to Total Debt and Debt Servicing Coverage were reported at 13.8% (MY21: 38.6%, MY20: 57.7%) and 1.8x (MY21: 2.8x, MY20: 2.3x), respectively. Current ratio also remained under pressure and stood at 0.9x (FY21: 0.9x, FY20: 1.5x) at end-June'22. Due to the seasonal nature of production and an overall surplus in the industry, the stock level on company's books at the end of the period was quite high, which helped to provide a reasonable coverage against short-term debt. A significant proportion of inventory is expected to be sold before the start of the next crushing season, which will ease the pressure on the liquidity profile. The company also has loans and advances due from associates to the tune of Rs. 896m at end-June'22 which are regular in nature, as per management. Planned reduction in sugar inventory and manageable levels of loans and advances from associates will be key rating sensitivities.

Capitalization indicators have gone up due to a significant increase in short-term borrowings.

Equity base of the company expanded during 9MMY22 in line with profit retention. However, over the same period, short-term borrowings were elevated due to extended working capital requirements for the season. Consequently, gearing and leverage ratios were reported higher at 1.5x (MY21: 0.51x) and 1.8x (MY21: 0.8x), respectively at end-June'22. Improvement in relevant indicators is expected by the end of the ongoing year as sugar inventory is released to the market. Going forward, the management plans to raise long-term debt to the tune of Rs. 400-500m for buying machinery, but the projected retention of profit is likely to keep leverage indicators within manageable levels.

Fatima Sugar Mills Limited (FSML) Appendix I

FINANCIAL SUMMARY- Year end September (amounts in PKR millions)				
BALANCE SHEET	**FY19**	**FY20**	**FY21**	**9MFY22**
Fixed Assets	3,824	4,448	5,345	6,052
Stock-in-Trade	2,045	621	73	6,338
Trade Debts	367	83	553	68
Cash & Bank Balances	77	172	447	33
Trade and Other Payables	443	892	774	752
Long Term Debt	965	1,208	1,404	1,252
Short Term Debt	2,876	1,074	1,431	7,603
Total Debt	3,841	2,282	2,835	8,855
Total Equity	3,594	4,811	5,539	6,092
Total Liabilities	4,696	3,730	4,372	10,747
Paid Up Capital	2,102	2,102	2,102	2,102
INCOME STATEMENT	**FY19**	**FY20**	**FY21**	**9MFY22**
Net Sales	6,767	10,319	11,878	9,170
Gross Profit	1,266	2,351	1,845	2,104
Operating Profit	1,057	2,034	1,631	1,289
Profit Before Tax	408	1,391	1,069	661
Profit After Tax	370	1,217	712	552
RATIO ANALYSIS	**FY19**	**FY20**	**FY21**	**9MFY22**
Gross Margin (%)	18.7%	22.8%	15.5%	22.9%
Net Margin (%)	5.5%	11.8%	6.0%	6.0%
Net Working Capital	652	1,341	(337)	(947)
FFO	374	1,317	1,093	917
FFO to Total Debt (%)	9.7%	57.7%	38.6%	13.8%
FFO to Long Term Debt (%)	38.8%	109.0%	77.9%	97.4%
Debt Servicing Coverage Ratio (x)		2.31	2.78	1.78
Current Ratio (x)	1.18	1.54	0.89	0.90
Stock+Trade Debts/STD	83.9%	65.6%	43.7%	84.3%
Gearing (x)	1.07	0.47	0.51	1.45
Leverage (x)	1.31	0.78	0.79	1.76
ROAA (%)		14.5%	7.7%	5.5%
ROAE (%)		29.0%	13.8%	1.3%

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix 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					Appendix III
Name of Rated Entity	Fatima 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				
	25/10/2022	A-	A-2	Stable	Reaffirmed
	05/11/2021	A-	A-2	Stable	Reaffirmed
	17/11/2020	A-	A-2	Stable	Reaffirmed
	12/02/2020	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.				
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. VIS is not an NRSRO and its ratings are not NRSRO credit ratings. Copyright 2022 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.				
Due Diligence Meetings Conducted		**Name**	**Designation**	**Date**	
	1	Mr. Jawad Ahmed	DGM Finance	01-Sep-2022	