

RATING REPORT

Fatima Sugar Mills Limited (FSML)

REPORT DATE:

December 22, 2023

RATING ANALYSTS:

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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 Date	December 22, 2023		October 25, 2022	
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 (May 2023)
<https://docs.vis.com.pk/docs/CorporateMethodology.pdf>
VIS Rating scale (2023)
<https://docs.vis.com.pk/docs/VISRatingScales.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 of sugar and its byproducts.

Chairman Profile:

Mr. Fawad Ahmed Mukhtar holds extensive experience in manufacturing & industrial management.

He is also the chairman of five other group companies & CEO of four group companies.

CEO's Profile:

Faisal Ahmed Mukhtar is a law graduate and has more than 25 years of experience in the textile, sugar, and fertilizer businesses. He serves on the board of FSML and other group companies, and is active in various regional development and finance committees.

Financial Snapshot
Tier-1 Equity: end-9M'MY23: Rs. 6.8b; end-MY22: Rs. 5.9b; end-MY21: Rs. 5.5b.

Assets: end-9M'MY23: Rs. 20.2b; end-MY22: Rs. 13.2b; end-MY21: Rs. 9.9b.

Net Profit:
 9M'MY23: Rs. 861.7m; MY22: Rs. 407.6m, MY21: Rs. 711.8m

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.

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.

Key Rating Drivers

Business Risk & Sector Update: Pakistan is the seventh-largest producer and the fifth-largest consumer of sugar. According to the Economic Survey of Pakistan, sugar industry is the country's second-largest agro based business after the textile industry. In terms of sugarcane production, Punjab produces 67% of the sugarcane, followed by Sindh (25%), Khyber Pakhtunkhwa (KPK) (8%), and Baluchistan (less than 1%). Its production contributes 0.8% to GDP and 3.7% to agriculture's value addition. The country has the capacity to raise production by 4.0 million tons and export USD 2.0b worth of sugar and USD 500m worth of ethanol by using the same land by raising yields by 40 to 50 percent. According to the data collected by Ministry of Food Security, through September 30, 2022, at least 5.3 million metric tons (MT) of sugar has been removed from inventories or has been consumed. The volume of sugar consumed each day is around 15,980 tons. More than 1.7m MT surplus sugar was available at the start of crushing season MY23. Additionally, exporting this surplus sugar would have generated USD 1.0b in foreign currency. During CY22, almost 33% of the 22 million hectares of total cultivable land were inundated by flood while damage to the sugarcane crops resulted in a loss of USD 273m. On aggregate, direct losses from rice, cotton, and sugarcane were USD 1.30b (rice: USD 543m, cotton: USD 485m, and sugarcane: USD 273m).

The inherent cyclicity in crop yields and raw material prices is believed to have a substantial impact on the business risk profile of the sugar sector. Furthermore, there is a noticeable difference in pricing mechanisms, with the price of the end product, granulated sugar, being set by market forces whereas sugarcane cost being regulated by the government. A typical sugarcane crop has a 3 to 5-year production cycle, with government assistance to farmers and crop productivity playing a major role. In 2022-23 season, the crushing season took off a bit late owing to disagreement between Pakistan Sugar Mills Association (PSMA), which represents the sugar mill owners, and Government of Pakistan, to allow export of sugar, to cover up for the higher costs associated with producing sugar and pulling the industry out of crisis.

According to the most recent USDA sugar report published on April 12, 2023, sugarcane production is expected at 83.5m MT during 2023-24, three percent above 2022-23 production, on account of expected recovery in yield in areas which were previously impacted by the floods. For the season 2023-24, the estimated harvesting area is also expected to increase to 1.25 million hectares (2022-23: 1.23 million hectares). Sugar output for the forthcoming season is expected to clock at 7.05 million MT, a marginal increase from that in 2022-23. Moreover, due to population growth and demand from the developing food processing industry, sugar consumption is projected to rise by around 3% to 6.3

million MT. In view of accumulating sugar stocks, the Govt. allowed 250,000 tons of sugar export in MY22. Sugar prices remained relatively low throughout the 2022-23 crushing season. However, following the season's conclusion, sugar prices experienced a noticeable increase in line with inflationary pressures. While this uptick may have positively impacted the gross profitability of companies, those with a heavily leveraged capital structure are likely to face challenges due to elevated interest rates, potentially affecting their bottom line.

Regulatory matter (Update on CCP penalty): Ratings have incorporated the developments with regards to penalties imposed by Competition Commission of Pakistan (CCP) on certain sugar mills and legal proceedings for interim relief initiated by the subject company. The CCP penalty imposed on FSML stands at Rs. 862.0m. The Company has filed Constitutional Petition before the Honorable Lahore High Court against legality, correctness, propriety and legitimacy of the Casting Vote of Chairperson of CCP along with application seeking stay of demand against the impugned order. The Honorable Lahore High Court vide its order dated October 18, 2021, has restrained the Competition Commission of Pakistan from recovering the impugned demand, till the next date of hearing and restrained the authorities from recovering any amounts from the Company till the next date of hearing. The case is pending adjudication.

Long-term equity investments of the company amounted to Rs. 1.8b (MY22: Rs. 1.8b; MY21: Rs. 106.8m), details of which are given below:

Fatima Energy Limited (FEL): The amount invested in FEL stood at Rs. 1.7b (MY22: Rs. 1.7b) by end-9thMY23. FEL is part of the Fatima Group, and operates a co-generation power plant in Sanawan, Kot Addu, Punjab, Pakistan. The project involves a 120 MW power generation plant, leveraging both bagasse—a byproduct from Fatima Sugar Mills—and coal as fuels, to address the energy crisis in the region. The plant switches from bagasse to coal in off-season. During MY22, pursuant to the approval of shareholders of FEL on 9th Feb 2022, FEL offered preference share to the Company at the subscription price of Rs. 10 per share, against balance of loan outstanding as at 31st Dec 2021. The offer was accepted by FSML vide its letter dated 10 March 2022 and preference shares were issued to the Company on 21st Mar, 2022. Accordingly, the whole amount of loan outstanding as at 31st Dec, 2021 amounting to Rs. 1.53b stands converted into preference shares. As of 9thMY23, the company holds 1.79% of ordinary shares and 14.38% of preference shares of FEL.

Fatima Transmission Company (Ltd.) (FTCL): FSML has also invested Rs. 52.1m (MY22: Rs. 52.1m) in FTCL, operating in the power transmission sector in Pakistan. The company's primary operation involves constructing and owning a 37-kilometer-long double circuit transmission line, which includes over 150 towers.

Operations Update: In MY23, FSML regularized its crushing capacity at 20,000 tpd under section 11 of the Punjab industries (Control on Establishment and Enlargement) (Amendment) Act, 2022 against a requital fee of Rs. 180.0m. During the outgoing season 2022-23, the mill remained operational for 105 days as compared to 136 days in the preceding year, on account of lower cane availability due to the inundation caused by floods. The cane crushing during the season was lower by ~15% while average sucrose recovery ratio improved to 10.82% (2021-22: 10.07%) primarily due to better quality of crop procured. As a result, the Company managed to produce 162.3K MT of sugar (2021-22: 178.1K MT) in the outgoing season. Similarly, due to lower crushing, molasses production decreased by 14.2% with recovery rate of 4.36% (2021-22: 4.31%). During the period under review, the company incurred capital expenditure including the upgradation and replacement of various machinery parts including refine centrifugal, cane carriers and boiler tubes among others to enhance operational efficiency and increase bagasse savings. The production statistics for three years are tabulated below:

Particulars	2020-21	2021-22	2022-23
Crushing Capacity	11,500	11,500	20,000
Sugarcane Crushed (MT)	1,257,201	1,769,587	1,499,571
Crushing Days	111	136	105

Sugar Recovery (%)	9.56	10.07	10.82
Sugar Produced (MT)	120,155	178,115	162,326
Molasses Production (MT)	54,814	76,181	65,349
Molasses Recovery (%)	4.36	4.31	4.36

Sales and Profitability: During 9M'MY23, net sales of FSML augmented to Rs. 12.2b as compared to Rs. 9.2b in SPLY (MY22: 13.8b), out of which sugar sales amounted to 70.6% (9M'MY22: 58.3%) of the total net sales, while molasses sales accounted for 21% (9M'MY22: 30.1%). The substantial growth in revenue was primarily due to a significant ~34% rise in the quantity of sugar sold, coupled with nearly 20% increase in the average selling prices vis-à-vis SPLY. During the same period the company exported 5,045 MT of sugar at an average price of Rs. 131,823/MT. Molasses on the other hand, are exported entirely to the UK and Ireland. The revenue from molasses remained largely unchanged at Rs. 2.6b (9M'22: Rs. 2.76b; MY22: 3.83b) on account of increase in average selling prices, despite nearly 34% decrease in quantity sold. The selling prices of molasses are supported by favorable demand dynamics of ethanol exports amidst massive local currency devaluation.

(In Metric Tons.)	MY22		9M'22		9M'23	
	Volume	Avg. S. Price*	Volume	Avg. S. Price*	Volume	Avg. S. Price*
Sugar (Local)	131,855	67,350	78,012	68,585	99,510	79,447
Sugar (Export)	-	-	-	-	5,045	131,823
Molasses Local	36,031	25,143	12,554	25,182	2,048	26,000
Molasses Export	95,150	30,742	81,500	30,000	60,000	42,511
Bagasse	267,266	3,961	267,266	3,961	228,633	4,263

The average rate of procurement of sugarcane for the season 2022-23 was Rs. 312/maund (2021-22: Rs. 242/maund) vis-à-vis the support price of Rs. 300/maund. The company generated Rs. 3.1b (9M'22: 2.1b; MY22: 2.56b) in gross profits during 9M'MY22. The gross margins improved to 25.3% (9M'MY22: 22.9%; MY22:18.6%), mainly due to inventory gains on sale of carryover sugar stock. Distribution cost was recorded lower at Rs. 448.6m (9M'MY22: Rs. 611.2m; MY22: Rs. 666.8m) respectively, due to decrease in handling and freight charges coupled with lower regulatory duty on export of molasses. Administrative expenses stood higher at Rs. 363.5m (9M'MY22: Rs. 284.4m; MY22: Rs. 384.6m) mainly due to increase in salaries and benefits coupled with other miscellaneous expenses. Other expenses amounted to Rs. 84.1m (9M'MY22: Rs. 68.7m; MY22: Rs. 109.4m), which included charity and donation and net exchange fluctuation loss. During 9M'MY23, finance cost augmented to Rs. 1.2b (9M'MY22: Rs.627.8m; MY22: Rs. 954.0m), due to higher average markup rates and financing requirement to meet working capital needs. Other income decreased to Rs. 67.6m (9M'MY22: Rs. 148.6m; MY22: Rs. 281.5m) during the same period due to lower markup income from associates. In 9M'MY23, the company witnessed an increase in net profitability to Rs. 861.7m (9M'MY22: Rs. 552.2m; MY22: Rs. 407.6m), driven by growth in its top line and a subsequent rise in gross profits despite rise in finance costs. Consequently, there was also an improvement in the company's net margins to 7.1% (9M'MY22: 6.0%; MY22: 3.0%).

Sugar prices were consistently under pressure throughout the outgoing crushing season. However, there was a significant surge after the season's conclusion, primarily in line with inflationary trends. The crushing season 2023-24 officially started in the last week of November. Retail sugar prices, while remaining relatively elevated, have recently exhibited a downward trend due to government initiatives aimed at reducing smuggling across the Afghan border. Meanwhile, given higher indicative support prices (i.e., Rs. 400/maund) of sugarcane for the ongoing crushing season and lower available sugar stocks in the country, it is expected that sugar prices will increase. Going forward, the management projects that the carryover sugar stock at end-Sept'23 will bolster topline, coupled with higher average selling prices of sugar, while sugar production is expected to clock in at around similar levels in the ongoing year.

Liquidity Profile: The company's liquidity position is underpinned by adequate cash flow coverages maintained on a timeline basis. Funds from operations (FFO) were recorded higher at Rs. 1.3b (MY22: Rs. 882.6m) during 9M^{MY23}, mainly on the back of higher profitability and positive difference between finance cost incurred and paid. Resultantly, FFO to long-term debt improved to 1.06x (MY22: 0.58x), while FFO to total-debt decreased marginally to 0.16x (MY22: 0.18x) due to higher outstanding short-term borrowings by end-9M^{MY23}. Debt service coverage ratio (DSCR) remained adequate at 1.41x (MY22: 1.37x).

The company held stock in trade worth Rs. 7.3b (MY22: Rs. 2.6b) as of Jun'23, which largely included 104,798 MT of sugar stock. Stores, spares and loose tools were recorded higher at Rs. 373.5m (MY22: Rs. 577.6m). Trade receivables were recorded higher at Rs. 1.3b (MY22: Rs. 37.2m) by end-9M^{MY23}, mainly consisting of secured export bills amounting to Rs. 1.28b. Loans, advances, and other prepayments increased to Rs. 1.6b (MY22: Rs. 1.3b) primarily on the back of dues from associated undertakings (*interest bearing*) amounting to Rs. 847.5m (MY22: Rs. 764.8m). Trade deposits, prepayments and other receivables increased to Rs. 329.6m (MY22: Rs. 18.4m), mainly due to increase in deposits amounting to Rs. 299.5m (MY22: 12.1m) which largely consisted of requital fee paid for the enhancement of crushing capacity. Short-term investments remained at Rs. 115.3m (MY22: Rs. 115.3m), comprising investment made in Multan Real estate company Ltd.

Trade and other payables (including contract liabilities) were recorded lower at Rs. 974.8m (MY22: Rs. 1.2b). Current ratio improved slightly to 0.99x (MY22: 0.94x). The coverage of short-term borrowings via stock in trade and trade debts increased to 0.95x (MY22: 0.78x). Improvement in cash flow coverages and overall strengthening of working capital management is considered imperative from rating purview.

Capitalization Profile: The core equity has augmented to Rs. 6.8b (MY22: Rs. 5.9b) on the back of internal capital generation during 9M^{MY23}. The debt profile of the company largely includes short-term borrowings to meet working capital requirements. The long-term loans inclusive of current maturity amounted to Rs. 1.66b (MY22: Rs. 1.1b) as of Jun 30, 2023. The company mobilized long-term loan amounting to Rs. 400.0m during 9M^{MY23}, to fund Balancing, Modernization and Replacement (BMR), having a grace period of one year. Short term borrowings augmented to Rs. 9.13b (MY22: Rs. 3.38b) by end-9M^{MY23}.

As a result of considerable increase in short-term borrowings, gearing and debt leverage have increased to 1.59x (MY22: 0.83x) and 1.96x (MY22: 1.21x) by end-9M^{MY23}. However, with subsequent lifting of majority of the sugar stock, leverage indicators have receded by end-Sep'23. Looking ahead, despite reliance on working capital financing, leverage indicators are projected to improve largely in line with growth in equity base on the back of internal capital generation.

FINANCIAL SUMMARY <i>(amounts in PKR millions)</i>			
<u>BALANCE SHEET</u>	MY21	MY22	9M'MY23
Property, Plant & Equipment	5,344.9	5,869.6	6,282.6
Long-term Investment	106.8	1,787.6	1,787.6
Stock in Trade	72.7	2,604.4	7,293.8
Stores, Spares. And Loose Tools	329.6	577.6	373.5
Trade Receivables (Debtors)	552.9	37.2	1,347.7
Loans and Advances	816.5	1,343.3	1,558.6
Cash and Bank Balances	447.4	12.7	63.5
Other Assets	2,240.6	962.7	1478.1
Total Assets	9,911.4	13,195.1	20,185.5
Long-Term Financing <i>(Inc. current maturity)</i>	1,348.1	1,074.9	1,656.2
Loans From Related Parties	0.0	434.3	19.3
Trade and Other Payables (including contract Liabilities)	797.6	1,229.8	974.8
Short-term Borrowings	1,431.4	3,378.0	9,125.9
Other Liabilities	794.7	1,087.6	1,557.0
Total Liabilities	4,371.9	7,204.7	13,333.3
Paid-Up Capital	2,101.7	2,101.7	2,101.7
Tier-1 Equity	5,523.2	5,930.8	6,792.5
Total Equity	5,539.5	5,990.4	6,852.2
<u>INCOME STATEMENT</u>	MY21	MY22	9M'MY23
Net Sales	11,877.7	13,770.3	12,176.6
Gross Profit	1,844.6	2,558.4	3,081.2
Finance Cost	561.5	954.0	1,264.1
Other Income	231.8	281.5	67.6
Profit Before Tax	1,069.1	725.1	988.6
Profit After Tax	711.8	407.6	861.7
FFO	1,093.5	882.6	1,332.1
<u>RATIO ANALYSIS</u>	MY21	MY22	9M'MY23
Gross Margin (%)	15.5%	18.6%	25.3%
Net Margin (%)	6.0%	3.0%	7.1%
Current Ratio (x)	0.89	0.94	0.99
Net Working Capital	(337.20)	(309.13)	(169.05)
FFO to Long-Term Debt	0.81	0.58	1.06*
FFO to Total Debt	0.39	0.18	0.16*
Debt Servicing Coverage Ratio (x)	2.81	1.37	1.41
ROAA (%)	7.7%	3.5%	6.9%*
ROAE (%)	13.8%	7.1%	18.0%*
Gearing (x)	0.50	0.82	1.59
Debt Leverage (x)	0.79	1.21	1.96

*Annualized

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					
	22/12/2023	A-	A-2	Stable	Reaffirmed	
	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.					
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Due Diligence Meetings Conducted		Name	Designation	Date		
	1	Hamza Rizwan	DGM Finance	17-Nov-2023		