

# Financing Sugar Mills

Policy and Operational Guidelines For Financing Sugar Mills by the Karnataka State Co-Operative Apex Bank Ltd.

The Bank, in recent years, has been sanctioning term and working capital loans to sugar mills set up under co-operative model and as well as private sectors. However, the loan applications are being processed on ad-hoc basis in the absence of any policy guideline. In this light, the Bank has found it necessary frame policy and operational guidelines to govern the sanctioning of term/working capital loans to sugar mills.

1.Objective: The primary objective of the Bank is to provide short and medium term loans to farmers. However, even after meeting the short and medium financial requirement of the farmers, the bank is left with huge surplus funds, which unless invested prudently will lead to losses. It is therefore imperative to invest the surplus funds in agro-based industries to further help the farmers. Sugar industry is identified as one such sector. So, credit limit can be sanctioned or term loan can be provided to the sugar factories only after meeting crop loan obligations.

2.Clean cash credit limits for pre-seasonal expenses: As sanction of clean limits for pre-seasonal expenses or pre-operative expenses results in dilution of margin requirements on cash credit pledge limits, NABARD in its Circular No. NB.PCD.CMA/H-305/A-75/2001-02, dated 6-8-2001, has advised discontinuation of the same. So, clean limits for pre seasonal expenses or pre-operative expenses shall not be sanctioned.

3.Exposure Norms: While processing the applications for loans, the bank should ensure that exposure norms as prescribed by NABARD in their Circular letters No. NB.PCD.CAS/1193/A-75/1997-98, dated 19.09.97 and NB.PCD/AS/711A-75/1998-99 dated 16-05-1998 for sanction of Cash credit limit is adhered to and shall not be violated. As per NABARD Circulars, the prescribed limit is as follows:

- a)Unit-wise exposure: The total lending by the Bank to a Cooperative/Private sector sugar factory should not exceed 25% of the capital fund of the Bank.
- b)Exposure to Units outside the Co-operative fold: The total exposure by the Bank to Units outside Co-operative fold including individuals should not exceed 25% of the maximum ILR reached by the Bank during the previous year.
- c)Overall exposure to sugar sector: The overall exposure by the Bank to the sugar sector should not exceed 40% of the maximum ILR reached by the Bank during the previous year.

4.a) Capital Fund: The Capital Fund of the Bank includes paid up capital, free reserves (Statutory reserves, ACS fund-Bank contribution, Building Fund, Dividend equalization fund & Provision for standard assets) plus undisbursed profits minus accumulated losses.

b) ILR (Internal Lendable Resources) comprises paid up capital, free reserves, undisbursed profit plus deposits less commitments on internal resources, where commitments mean statutory reserves, advance on deposits, optimum liquid assets (35% of TDL), fixed assets, accumulated losses, investment in share of Co-operative Institutions and loans to staff for housing.

5.Fixation of Margin:

a) As per RBI Circular No. RPCD.NB.Dir.436: D-2: 83-84, dated 7.2.1984, 10% for levy sugar, 15% for free sale sugar and NIL for buffer stock is prescribed for sanction of working capital loan against pledge of sugar.

b) However, Bank may at its discretion prescribe appropriate margin keeping in view the volatility in market price of free sale sugar and other risks being associated with the financing of sugar industry.

6.Fixation of credit limits: Cash credit (Pledge) limits for working capital purpose shall be fixed on the basis of anticipated valuation, realistic peak level stocks likely to be reached by a factory during the relevant crushing season and valued on the basis of levy price fixed by Government of India for levy sugar and at average price realized in the preceding three months (moving average) or the current market price whichever is lower, for free sale sugar (including buffer stocks) in the prescribed proportion as indicated in Sl. No.5(a) above.

7.Co-operative Sugar Mills with negative net worth: As the cooperative sugar mills with negative net worth will not be in a position to provide the stipulated margin out of their own resources on a pledged stock of sugar, sanction or renewal of the limits to such mills having negative net worth shall be considered only if unconditional, irrevocable default guarantee is given by the State Government. Calculation of net worth, net disposable resources and reserve borrowing power is as follows:

a. Net Worth: Paid up capital + Free Reserves+ Undisbursed Profit (-) Accumulated losses.

b. NDR (Net Disposable Resources): Paid up capital + Reserves & Provisions + Deposits + Accumulated Profit, Less: Cash & Bank balance, Investment in fixed assets out of own resources, Investment in shares and Accumulated losses.

c. RBP (Reserve Borrowing power): As per the by-law of the sugar factory

8. Financing under consortium arrangements: Instead of direct financing, consortium finance may be considered so as to minimize the credit risk, easy facilitation of the operation of the account & its monitoring and also to contain over exposure to sugar sector.

9. Cash credit (Hypothecation) limits: Cash credit (Hypothecation) limits for stores and spares (including gunny bags) can be sanctioned or renewed up to 120% of average maximum utilization of the limits during preceding three years or Rs.200.00 lakhs whichever is less. Drawals under the limit would be permitted only against fresh stock of consumables and packaging materials purchased for the sugar season i.e. purchases made after 1st July of the year.

10. Financing of Private Sugar Mills: Private sugar mills, which are having negative net worth or unsound financial health will not be considered for financing. However, sanction of cash credit (Pledge/Hypothecation) limits to private sugar mills will be considered after proper appraisal subject to exposure norms as applicable to units outside the co-operative fold i.e. the aggregate finance to individuals and units outside co-operative fold should not exceed 25% of its maximum level of ILR reached during the previous financial year as advised in NABARD Circular No. NB.PCD (OPR) H-74/A.75/2000-01, dated 19.04.2000 and also subject to obtaining of personal guarantee of the promoters.

a) Block Capital (Term loan): Term loans to sugar mills will be sanctioned within the levels prescribed in NABARD guidelines. In the case of new cooperative sugar mills, the project cost should be as per the normative cost, as may be approved from time to time by the Ministry of Consumer Affairs, Department of Food & Public distribution, Government of India, and debt-equity ratio of 60:40 should be followed. The debt portion sharing by cooperative banks should not be more than 60% and the remaining by Term Lending Institutions/Commercial banks.

The block capital facilities will be sanctioned only if the capacity of the borrower unit is not below the viable operational level of 2500 TCD, and that adequate sugarcane is available in the command area of the proposed unit and supported by the default guarantee of the State Government.

b) Term loan for Co-generation/Distilleries: Term loan for co-generation/Distilleries shall not be sanctioned, unless it is specified in the policy prepared by the Bank and approved by the Board.

c) Repayment or extension of set aside proposals will be considered by the Bank on merits of each case within the exposure limit of the individual unit and with the approval of the competent authority.

#### 11. Appraisal and sanction of working capital limit/Term loan

a) For sanction/renewal of working capital pledge/hypothecation loan proposals, the Bank has to ensure the availability of the following information:

1. Proper application from the Sugar factory.
2. Copy of the Board Resolution by the Sugar Factory requesting the Bank for sanction of loan amount and authorizing the Managing Director/an officer of the Sugar factory to make such request and to sign the necessary documents.
3. Copy of the Audited Balance Sheet and Profit & Loss Account for the previous three years. If audit is not completed on the date of application, the bank at its discretion may accept the tentative financial statements.
4. Cane availability certificate issued by the concerned Government Department.
5. Consortium meeting proceedings, if the loan is under consortium finance.
6. Previous year's operational statement i.e. amount of loan sanctioned, drawals and repayments, present o/s, principal and interest overdue etc.
7. Last 3 years performance report indicating crushing details, sugar produced, recovery percentage, peak level stock etc.
8. Comparative financial position of the sugar factory for the last 3 years.
9. Projected cane crushing (in metric tonnes), Projected sugar production (in quintals), projected recovery % for the ensuing season and projected peak level sugar stocks by the sugar Mill.
10. Cane bill arrears, statutory liabilities, overdue to financing institutions, latest stock position of levy and free sale sugars with its value with insurance details.
11. Copy of the byelaw duly approved by the concerned authority.

b) For scrutiny of term loan proposals, the Bank has to ensure the availability of the following information:

1. Proper application from the sugar factory
2. Copy of the Board Resolution of the Sugar factory requesting the Bank for sanction of loan amount and authorizing The Managing Director/an officer of the Sugar factory to make such request and to sign the necessary documents.
3. Certificate of Incorporation/Memorandum of Association and Articles of Association/Copy of the byelaw duly approved by the concerned authority.
4. Clearance from various Government agencies.
5. Promoters' details and share collection details.
6. Cane availability certificate issued by the concerned Government Department.

7. Project report/appraisal report duly prepared by an approved appraisal agency.

8. Consortium Meeting Proceedings.

12. The operational guidelines

The Accounts Section of the Bank shall ensure to obtain the following documents before allowing Operations in the loan A/c:

a) Working capital pledge/Hypothecation loan:

1. Proper application from the Sugar factory for release of loan with Board Resolution for acceptance of terms and conditions stipulated in the credit limit loan sanction letter.

2. Demand Promissory Note

3. Continuity Agreement

4. Joint documents signed by all the Consortium members.

5. Deed of Hypothecation.

6. Government guarantee in respect of Co-operative Sugar factories having negative net worth.

7. Personal guarantee of all the Promoters/Directors in respect of private sector sugar mills having negative net worth.

8. Age-wise stock statement with its value.

9. Copy of Insurance policies made in the name of Consortium Banks and sugar factory covering all the risks against sugar stock

10. Copy of Income Tax assessment order/returns filed by the sugar mill for the previous year ended.

11. Search Report from a practicing Company Secretary from the Registrar of Companies.

12. Copy of Sanction letter issued by other consortium members.

13. Drawing power calculated by the Lead Bank.

14. Collection of matching share prescribed by the Bank from time to time.Â Â

15. Other terms and conditions stipulated in the sanction letter.

b) Term Loan

1. Proper application from the Sugar factory for release of loan with Board Resolution for acceptance of terms and conditions stipulated in the sanction letter.

2. Demand Promissory Note

3. Joint documents signed by all the Consortium members.

4. Government guarantee in respect of Co-operative Sugar factories having negative net worth.

5. Personal guarantee of all the Promoters/Directors in respect of private sector sugar mills having negative net worth.

6. Charge creation on the Assets of the sugar factory.Â

7. Copies of clearance certificate issued by various Departments for establishment of factory.

8. Copy of insurance policies made in the name of Consortium Banks and sugar factory covering all the risks against plant and machinery.

9. Copy of income tax assessment order/returns filed by the sugar mill for the previous year ended.

10. Search Report from a practicing Company Secretary from the Registrar of Companies.

11.Copy of Sanction letter issued by other consortium members.

12.Drawing power calculated by the Lead Bank.

13.Collection of matching share prescribed by the Bank before enrolling the factory as an associate member of the Bank.

14.Other terms and conditions stipulated in the sanction letter.

C) The Accounts Section of the Bank shall obtain periodical stock statements, insurance copies, search report and periodical review of stock position of sugar pledged to the Bank, recovery of installment and interest, overdue position, filing of disputes in association with legal Cell, invoking of Government guarantee etc.