

December 17, 2021

Harinagar Sugar Mills Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loans	147.32	120.86	[ICRA]A- (Stable); reaffirmed
Cash Credit	338.80	302.00	[ICRA]A- (Stable); reaffirmed
Non-fund Based Limits	20.00	15.00	[ICRA]A2+; reaffirmed
Unallocated Limits	36.91	105.17	[ICRA]A- (Stable)/ [ICRA]A2+; reaffirmed
Total	543.03	543.03	

*Instrument details are provided in Annexure-1

Rationale

The rating reaffirmation factors in Harinagar Sugar Mills Limited's (HSML) long operational track record of over eight decades, and its forward integration into co-generation and distillery operations, which provide alternate revenue streams and reduce the impact of the cyclical nature associated with the sugar business to some extent. ICRA notes the recently firmed up international sugar prices and sustained favourable Government policy framework such as introduction of the minimum selling price (MSP), interest subvention loans for ethanol capacity creation/ expansion, export subsidy to address the demand-supply situation in the domestic market, which supports the company's profitability metrics. Moreover, the ratings positively factor in the benefits of being located in eastern India, a sugar-deficit zone, and thus enjoy limited competition from the nearby sugar factories. The cane pricing in Bihar is decided by sugar companies in consultation with the state government, resulting in the cane prices to remain below the state advised price (SAP) in Uttar Pradesh.

HSML's ratings are constrained by the inherent cyclical nature and agro-climatic risks in sugar operations and vulnerability to Government regulations. The sharp 25% reduction in cane crushing in SY2021 due to floods in Bihar resulted in 34% contraction in sugar production volume. Lower sugar production in SY2021 and continued moderate crushing levels in SY2022 owing to lower crop in the current season, amid absence of exports subsidy, would result in a decline in revenues by over 20% in FY2022, despite higher sugar realisations and diversion towards remunerative ethanol production. The ratings factor in HSML's moderate debt coverage indicators and its high working capital intensity of operations (NWC/OI of 52% in FY2021), albeit reduced from the previous year. Nevertheless, going forward, the debt coverage indicators are expected to improve, driven by stable operating profits, along with a decline in debt levels with reduced inventory holding, supported by higher cane diversion towards B-heavy ethanol production.

The Stable outlook on the rating reflects ICRA's expectation that sugar realisation will remain stable in the near term, aided by the ongoing structural changes in the industry, the balanced global demand-supply position and beneficial policies. The favourable ethanol pricing regime, and the higher expected production of ethanol from B-heavy molasses having better realisations, is likely to support the company's operating profitability, going forward.

Key rating drivers and their description

Credit strengths

Long track record of operations; forward integration cushions sugar cyclicality to some extent – HSML has a long operational track record of over 85 years in sugar manufacturing with a 11,500-tonne crushed per day (TCD) facility in Bihar. The plant's operations are forward integrated into power and alcohol business, with a co-generation capacity of 14.5 mega-watt (MW) and distillery capacity of 120 KLPD. The company has invested for increasing its distillery capacity to 140 KLPD and is likely to achieve commercialisation of the expanded facility soon. The integrated operations provide alternate revenues and cushions its profitability against the cyclicality in sugar business.

Locational benefit of being in sugar-deficit state; sugar companies fix cane prices with state government – HSML's sugar mills are in Bihar, a sugar deficit state, and thus enjoy limited competition from the nearby sugar factories. Moreover, in Bihar, the sugar factories (in consultation with the state government) fix the cane pricing for the sugar season, which is applicable for all sugar factories in the state. This pricing mechanism provides relief to sugar companies as opposed to the SAP mechanism followed in UP, wherein only the state government decides the cane pricing, which is generally higher than the company's cane costs. However, historically, any change in the fair and remunerative price (FRP) or SAP in UP led to a revision in cane prices in Bihar.

Favourable policy framework supports profits and cash accruals – The Government of India (GoI) has supported the sugar industry in the past through various measures such as introduction of the MSP, interest subvention loans for ethanol capacity creation and expansion, soft loans for clearing cane dues, export subsidy and creation of sugar buffer stock to address the demand-supply situation in the domestic market. Additionally, the GoI preponed the ethanol blending programme timeline to 2025 from 2030 for 20% mandatory blending of ethanol with petrol. Over the years, the GoI has supported the blending programme by fixing the prices of ethanol manufactured through varied sugarcane-based feedstocks at the beginning of each ethanol supply year and has also announced annual hikes. Favourable pricing, coupled with relatively shorter credit period for ethanol supplies, has supported the profits and cash accruals of various medium to large-sized sugar mills.

Credit challenges

High working capital intensity leads to moderate debt coverage indicators – The seasonality in sugarcane crushing results in high inventory of finished goods at each fiscal end leading to high working capital intensity of operations (NWC/OI of 52% in FY2021). The company's debt reduced to Rs. 378.7 crore as on March 31, 2021 from Rs. 426.8 crore as on March 31, 2020, resulted in an improved gearing of 1.2 times as of March 2021 (PY: 1.4 times). The company's debt coverage indicators remained in line with the previous fiscal and was moderate with interest coverage of 2.7 times, TD/OPBDITA of 4.6 times and TOL/TNW of 1.5 times as on March 31, 2021, as a large part of its debt reduction came towards end of the year with lower crushing levels and resultant moderation in inventory levels. Nevertheless, going forward, the debt coverage indicators are expected to improve, driven by better operating margins, a decline in debt and inventory levels, supported by higher cane diversion towards B-heavy ethanol production.

Risks associated with operating in a regulated industry – HSML's profitability is vulnerable to the Government's policies and schemes such as creation of buffer stock, export subsidies, mandatory blending of ethanol and its pricing, sugar pricing, etc. Hence, cessation of any subsidies/schemes or any material decrease in sugar or ethanol pricing would have an impact on the company's financials. Nonetheless, the recent measures taken by the Central and the state government supported the financial performance and liquidity of sugar mills.

Sugar mills remain vulnerable to industry cyclicality and agro-climatic risks – Being an agri-commodity, sugarcane is dependent on weather conditions and is vulnerable to pests and diseases that may affect the yield per hectare and recovery rate. These factors can have a significant impact on the company's profitability. HSML recorded a sharp 25% reduction in cane crushing in SY2021 pursuant to floods in Bihar that resulted in 34% contraction in sugar production volume. The company's

revenue and OPBITDA growth in FY2021 was supported by higher liquidation of stocks from SY2020 and receipt of exports subsidy. Lower sugar production in SY2021 and continued moderate crushing levels expected in SY2022 due to lower crop, coupled with absence of exports subsidy, would result in a decline in revenues by over 20% in FY2022, despite higher sugar realisations and diversion towards B-heavy ethanol production. Additionally, the cyclical nature in sugar production results in significant volatility in their prices. Over the long term, higher ethanol production with increased diversion towards B-heavy molasses and direct sugar juice will likely curtail the excess supply of sugar, resulting in lower volatility in sugar prices and in turn, cash flows from the sugar business.

Liquidity position: Adequate

HSML's liquidity is adequate, with an expectation of healthy cash flow from operations due to favourable sugar realisations, increased diversion towards ethanol from B-heavy molasses, along with cash and cash equivalents of Rs. 5.80 crore as on March 31, 2021. The company does not have any major capex plans. Its debt repayments (Rs. 21.29 crore in FY2022 and Rs. 33.26 crore in FY2023) are likely to be comfortably met from the expected cash accruals. Further, HSML's liquidity position is likely to be supported by various subsidies of Rs. 8.37 crore as on September 30, 2021, which is anticipated to be received by January-February 2022.

Rating sensitivities

Positive factors – Higher-than-anticipated cane crushing levels and recovery rate, along with a sustained period of firm sugar prices, driven by favourable demand-supply dynamics and the consequent improvement in profitability and debt coverage metrics, on a sustained basis, may trigger an upgrade. Interest coverage ratio above 5 times, on a consistent basis, may also lead to a rating upgrade.

Negative factors – Negative pressure on HSML's ratings could arise in case of a significant decline in sugar prices or recovery rate. Increase in cane costs, resulting in deterioration of its profitability and debt coverage metrics, or interest coverage ratio falling below 3 times, on a sustained basis, may also trigger a negative rating action.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Sugar Industry
Parent/Group Support	Not applicable
Consolidation/Standalone	The ratings are based on the standalone financial statement

About the company

HSML, incorporated in 1933 by the Late Narayanlal B. Pittie, is a closely-held company with most of the shareholding remaining with the Pittie family. The manufacturing facility is in the West Champaran region of Bihar. HSML started with an initial crushing capacity of 600 TCD and gradually increased it to 11,500 TCD. The company operates a 120-KLPD (increased from 50 KLPD in December 2018) distillery unit, and a 14.5-MW co-generation unit. Further, the capacity of its distillery unit increased to 140 KLPD in SY2022. HSML has a wholly-owned subsidiary – Shangrila Food Products Ltd., earlier involved in biscuit manufacturing on a job work basis for Britannia Industries Limited. However, the contract with Britannia stands terminated from November 2019.

In FY2021, the company reported a net profit of Rs. 9.8 crore on an operating income (OI) of Rs. 789.9 crore compared with a net profit of Rs. 14.7 crore on an OI of Rs. 748.1 crore in the previous year.

Key financial indicators

	FY2020	FY2021
Operating Income (Rs. crore)	748.1	789.9
PAT (Rs. crore)	14.7	9.8
OPBDIT/OI (%)	10.5%	10.4%
PAT/OI (%)	2.0%	1.2%
Total Outside Liabilities/Tangible Net Worth (times)	2.2	1.5
Total Debt/OPBDIT (times)	5.4	4.6
Interest Coverage (times)	3.1	2.7

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

Status of non-cooperation with previous CRA: Not Applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2022)			Chronology of Rating History for the Past 3 Years				
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Nov 30, 2021 (Rs. crore)	Date & Rating in Dec 17, 2021	Date & Rating in FY2021 Dec 07, 2020	Date & Rating in FY2020 Aug 13, 2019	Date & Rating in FY2019	
								Feb 21, 2019	May 24, 2018
1	Term Loans	Long Term	120.86	118.46	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A (Stable)	[ICRA]A (Negative)
2	Cash Credit	Long Term	302.00	-	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A (Stable)	[ICRA]A (Negative)
3	Non-fund Based Limits	Short Term	15.00	-	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+	[ICRA]A1	[ICRA]A1
4	Unallocated Limits	Long Term/Short Term	105.17	-	[ICRA]A- (Stable)/[ICRA]A2+	[ICRA]A- (Stable)/[ICRA]A2+	-	-	-

Complexity level of the rated instrument

Instrument	Complexity Indicator
Term Loans	Simple
Cash Credit	Simple
Non-fund Based Limits	Very Simple
Unallocated Limits	NA

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or

complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments, is available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN No/Banker Name	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan-1	FY2020	NA	FY2025	45.68	[ICRA]A- (Stable)
NA	Term Loan-2	FY2021	NA	FY2026	75.18	[ICRA]A- (Stable)
NA	Cash Credit	NA	NA	NA	302.00	[ICRA]A- (Stable)
NA	Non-fund Based Limits	NA	NA	NA	15.00	[ICRA]A2+
NA	Unallocated Limits	NA	NA	NA	105.17	[ICRA]A- (Stable)/ [ICRA]A2+

Source: Company

Annexure-2: List of entities considered for consolidated analysis

Not Applicable

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