

June 14, 2022

Dwarikesh Sugar Industries Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loans	354.43	333.78	[ICRA]A+ (Positive); reaffirmed
Fund-Based Limits	735.00	735.00	[ICRA]A+ (Positive); reaffirmed
Non-Fund-Based Facilities	10.00	10.00	[ICRA]A+ (Positive); reaffirmed
Unallocated Limits	0.56	21.21	[ICRA]A+ (Positive); reaffirmed
Total	1,099.99	1,099.99	
Commercial Paper^	300.00	300.00	[ICRA]A1+; reaffirmed

*Instrument details are provided in Annexure-1; ^ carved out of working capital limits

Rationale

The rating reaffirmation of the debt programmes of Dwarikesh Sugar and Industries Limited (DSIL) continue to factor in DSIL's efficient operations with one of the highest recovery rates in Uttar Pradesh (UP) that has supported its comfortable credit profile. Moreover, being forward-integrated into co-generation and distillery operations, the company benefits from access to alternative revenue streams, which act as a cushion against the cyclicity of the sugar business. Further, the revenue diversification has increased in FY2022 with distillery and co-generation contributing to ~25% of the total revenues. DSIL is in an advanced stage of setting up a new distillery of 175 kilo litres per day (KLPD), which is expected to be operational by June-July 2022 and would strengthen its operational profile further and improve the revenue diversification. The inventory levels and thus the total borrowings (despite higher term debt for distillery) are expected to moderate going forward with the new distillery getting commercialised and higher sucrose getting diverted towards ethanol, ensuring stronger coverage metrics.

ICRA expects the company's revenues in FY2023 to grow by 4-8% over the previous year, backed by higher revenues from the distillery division on account of enhanced capacities and improved realisations, despite the likely reduction in sugar volumes. Over the medium term, DSIL's operating profits are likely to be less volatile than the historical levels, driven by the expected continuation of MSP and the industry's focus on diverting excess cane towards ethanol production.

However, the ratings are constrained by the vulnerability of DSIL's profitability to the cyclical nature of the sugar industry (though the sharp fall in sugar prices is curtailed after the introduction of MSP) and the agro-climatic risks related to cane production. Further, the profitability of sugar mills, including DSIL, remains vulnerable to the policies of the Government of UP (GoUP), international sugar trade, domestic quota, sugar and ethanol pricing and interest subvention loan for distillery capacity expansion. With DSIL's scale of operations being moderate compared to its peer, the proportion of the revenue diversification through forward-integrated operations, which would allow stability in cash flows, remains key to withstand the sugar downturns. However, with the new distillery becoming operational in the near term, the operational cash flows are likely to be more stable than the historic levels.

Key rating drivers and their description

Credit strengths

Forward-integrated operations - DSIL operates sugar capacities of 21,500 tonnes crushed per day (TCD) at its three mills in UP. The operations are forward-integrated into the power and alcohol businesses — co-generation capacity of 91 megawatt (MW) (surplus – 56 MW) and distillery capacity of 162.5 kilo litres per day (KLPD) as on March 31, 2022. DSIL plans to further increase its distillery capacity by 175 KLPD, expected to be operational by June-July 2022, which will strengthen the company's operational profile. The integrated operation provides alternative revenues and cushions the profitability against the cyclicity

in the sugar business. In FY2022, the sugar business accounted for around 75% of the company's revenue, followed by distillery at ~13% (increased from 7% in FY2021) and the balance from the co-generation business (~12%). The expansion plans of the distillery would increase the contribution of the segment to revenues going forward and moderate the seasonality associated with the sugar business, as distilleries operate for around 325 days a year.

Operationally-efficient sugar mills with healthy recovery rates - The company's gross recovery rate for the sugar season slightly moderated to 12.01% in SY2022 from 12.32% in SY2021 owing to agro-climatic conditions but remained healthy. However, the net recovery rates moderated to 10.46% in SY2022 (PY: 11.36%) owing to the higher diversion of cane towards B-heavy molasses-based ethanol. Healthy recovery rates over the years aided in reducing the company's cost of production. Over the medium term, the higher production of ethanol from B-heavy molasses and sugarcane juice is likely to moderate the net recovery rates to some extent amid the continued high share of better-yielding cane variety.

Profitability likely to remain healthy owing to steady sugar realisations and higher volumes from distillery segment – DSIL's overall operating profitability and cash accruals are expected to benefit from firm sugar realisations, both internationally and domestically, along with better distillery performance, partially offset by lower domestic sugar sales. Going forward, the company is likely to divert higher cane towards the production of ethanol through B-heavy molasses and/or sugarcane juice with the expanded capacity becoming operational. DSIL's operating margins will be supported by the likely continuation of MSP, remunerative prices of ethanol, healthy exports for SY2022 and the industry's focus on diverting excess cane towards ethanol production, improving the domestic demand-supply balance. Further, the working capital debt and hence the total debt levels (despite increase in debt for distillery capex) are anticipated to reduce going forward with the increase in sugar sacrifice towards ethanol.

Strong capital structure and healthy debt coverage metrics – The company has a comfortable capital structure with a gearing of 0.8 times as on March 31, 2022 (PY: 1.1 times). Reduced borrowings and higher profits resulted in better coverage indicators in FY2022 with total debt/OPBIDTA of 1.8 times (PY: 3.0 times) and NCA/total debt of 31.1% (P.Y.: 22.9%). The DSCR and interest cover also improved to 3.1 times and 9.2 times, respectively (PY: 0.8 times and 4.2 times, respectively). Going forward, the debt metrics are expected to remain healthy over the medium term, driven by lower total debt levels (despite higher term debt for distillery capex which is under interest subvention), healthy operating profits and cash accruals.

Credit challenges

Profitability of UP-based sugar mills continues to depend on GoUP policy on cane prices – DSIL's profitability, along with other UP-based sugar mills, continues to be vulnerable to the GoUP's policy on cane prices. The cane price is determined by the GoUP at the start of the crushing season. Thus, the company's performance can be impacted by a disproportionate increase in cane prices. Further, its profitability remains vulnerable to the Government's policies on exports, MSP and remunerative ethanol prices. However, the recent measures taken by the Central Government and the GoUP supported sugar prices and the liquidity of sugar mills. The continuation of Government support in the form of remunerative ethanol prices and interest subvention for the debt-funded distillery capex are likely to prevent the piling up of cane arrears. Even as UP-SAP increased by Rs. 25/quintal for the current season, firm realisations as well as enhanced ethanol volumes support profits.

Profitability of sugar mills vulnerable to industry cyclicality and agro-climatic risks – Being an agri-commodity, the sugarcane crop depends on climatic conditions and is vulnerable to pests and diseases, which may influence the yield per hectare and the recovery rate. These factors can have a significant impact on the company's profitability. Further, high dependence on a single crop variety may affect the yields and recovery rate. Nonetheless, DSIL has been exploring other varieties to mitigate this risk to a certain extent. The process of shifting to other varieties could be slow. In addition, the cyclicality in sugar production results in volatility in sugar prices. However, the sharp contraction in sugar prices has been curtailed after the introduction of MSP by the Central Government.

Over the long term, higher ethanol production with increased diversion towards B-heavy molasses and direct sugar juice are expected to help in curtailing the excess supply of sugar, resulting in lower volatility in sugar prices and in turn, the cash flows from the sugar business. With DSIL's scale of operations being moderate compared to its peer, the proportion of revenue diversification through forward-integrated operations, which would allow stability in cash flows, remains key to withstand the sugar downturns. However, with the new distillery becoming operational in the near term, the operational cash flows are likely to be more stable than the historic levels.

Liquidity position: Adequate

DSIL's liquidity position is adequate with likely healthy cash flow from operations and an average cushion of around Rs. 360 crore in drawing power for the 12 months ended April 2022. ICRA expects DSIL to comfortably meet its debt repayment obligations of Rs. 50-70 crore during FY2023-FY2024. Moreover, the company is likely to incur a capex of Rs. 90-110 crore per annum over the next two years to set up distillery capacity, enhance the crushing capacity by ~2,500 TCD and set up a refinery before SY2024. With respect to distillery capex, DSIL has a sanction of Rs. 185.6 crore (Rs 104.5 crore availed till March 31, 2022), which also has a moratorium of two years and a comfortable repayment tenure of five years.

Rating sensitivities

Positive factors – An upgrade will be backed by continued period of firm sugar prices, driven by favourable demand-supply dynamics and benefits from the investments in forward integration, which will lower the volatility in cash flows from the sugar business and improve the operating profitability and debt coverage metrics on a sustained basis. Additionally, a healthy ramp-up in revenues from ethanol post the commencement of the commercial operations of the new distillery will provide a meaningful revenue diversity and would be critical for a rating upgrade. A specific metric that may drive a favourable rating action could be an interest cover of 7 times on a sustained basis.

Negative factors – The outlook can be revised to Stable if there is any sharp decline in sugar prices, cane crushing volumes, recovery rate or an increase in cane costs. Any significant decline in ethanol realisations or any material change in Government policies that will moderate the profitability and debt coverage metrics on a sustained basis may also prompt a revision.

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	Standalone financial statements

About the company

DSIL, promoted by Mr. Gautam R. Moraraka, was incorporated in 1994 through the establishment of a 2,500-TCD sugar plant in the sugar-rich belt of UP at the Bundki village in the Bijnor district. It has been raising the crushing capacity regularly and the capacity has since been increased to 21,500 TCD. It has three sugar plants, viz. Dwarikesh Nagar (DN), Dwarikesh Puram (DP) and Dwarikesh Dham (DD), at present. DN and DP are located in the Bijnor district and DD is located in the Bareilly district. Besides, DSIL has co-generation facilities of 17 MW at DN, 33 MW at DP and 36 MW at DD unit. Of these, DSIL exports 8 MW from DN, 24 MW from DP and 24 MW from DD unit to the state grid. The company also has a distillery of 162.5 KLPD at its DN unit, which is capable of manufacturing industrial alcohol and ethanol. Further, DSIL has embarked upon a project to set up a 175-KLPD distillery in DD in July 2021, which is expected to be operational by June-July 2022. This would increase the total distillery capacity to 337.5 KLPD.

Key financial indicators

DSIL Standalone	Audited	Audited
	FY2021	FY2022
Operating Income (Rs. crore)	1838.8	1974.1
PAT (Rs. crore)	91.5	155.2
OPBDIT/OI (%)	11.0%	14.7%
PAT/OI (%)	5.0%	7.9%
Total Outside Liabilities/Tangible Net Worth (times)	1.4	1.1
Total Debt/OPBDIT (times)	3.0	1.8

Interest Coverage (times)	4.2	9.2
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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	Type	Current Rating (FY2023)			Chronology of Rating History for the past 3 years				
		Amount Rated (Rs. crore)	Amount Outstanding (Mar 31, 2022) (Rs. crore)	Date and Rating on Jun 14 2022	Date and Rating in FY2022		Date and Rating in FY2021		Date and Rating in FY2020
					Dec 29, 2021	Apr 7, 2021	Apr 2, 2020	Apr 2, 2019	
1 Term Loans	Long Term	333.78	251.19	[ICRA]A+ (Positive)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	
2 Working Capital Facilities	Long Term	735.00	-	[ICRA]A+ (Positive)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	
3 Non-fund based- Working Capital Facilities	Long term	10.00	-	[ICRA]A+ (Positive)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	
4 Unallocated Limits	Long term	21.21	-	[ICRA]A+ (Positive)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	
5 Commercial Paper [^]	Short term	300.00	100.00	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	

Amount in Crores; Source: Company; [^] carved out of working capital limits

Complexity level of the rated instrument

Instrument	Complexity Indicator
Term Loans	Simple
Working Capital Facilities	Simple
Non-fund based-Working Capital Facilities	Very Simple
Unallocated Limits	NA
Commercial Paper	Very Simple

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	Instrument Name	Date of Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loans	Nov 2018 – Aug 2021	5%-8%	Jun 2024 – Sep 2028	333.78	[ICRA]A+ (Positive)
NA	Working Capital Facilities	-	NA	-	735.00	[ICRA]A+ (Positive)
NA	Non-fund based-Working Capital Facilities	-	NA	-	10.00	[ICRA]A+ (Positive)
NA	Unallocated Limits	-	NA	-	21.21	[ICRA]A+ (Positive)
INE366A14119	Commercial Paper^	Jan 27, 2022	4.75%	Apr 28, 2022	50.00	[ICRA]A1+
INE366A14127	Commercial Paper^	Mar 17, 2022	5.00%	Jun 17, 2022	50.00	[ICRA]A1+
Yet to be placed	Commercial Paper^	-	-	-	200.00	[ICRA]A1+

Source: Company; ^ carved out of working capital limits

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Annexure-2: List of entities considered for consolidated analysis – Not Applicable

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