March 28, 2022

Magadh Sugar and Energy Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund Based – Term Loan	112.50	112.50	[ICRA]A-(Stable); reaffirmed
Fund Based – Working Capital	460.00	460.00	[ICRA]A-(Stable); reaffirmed
Non-fund based	2.00	2.00	[ICRA]A2+; reaffirmed
Unallocated limits	2.14	2.14	[ICRA]A-(Stable)/[ICRA]A2+; reaffirmed
Total	**576.64**	**576.64**	

* *Instrument details are provided in Annexure-1*

Rationale

The rating reaffirmation for the debt programmes of Magadh Sugar and Energy Limited (MSEL) continue to factor in MSEL's operational track record of over 85 years and its association with the KK Birla Group. Moreover, its forward-integrated operations into co-generation and distillery business provide it with alternative revenue streams and act as a cushion against the cyclicality in the sugar business. Further, MSEL has expanded its distillery capacity to 150 KLPD recently that would increase ethanol volumes and improve blended distillery realisations with a favourable change in the ethanol mix. The expanded distillery capacity will also reduce the inventory levels and the working capital debt, going forward. Further, no major debt-funded capex is planned over medium term.

ICRA takes note of the current firmed up sugar realisations and a sustained favourable Government policy framework such as continuation of MSP (introduced from FY2019), export subsidy, soft loans and interest subvention loans for ethanol expansion. Over the medium term, MSEL's operating profits are likely to be less volatile than the historical levels, driven by the industry's focus on diverting excess cane towards ethanol production.

However, the ratings remain constrained by the vulnerability of MSEL's profitability to the cyclical nature of the sugar industry (though the sharp fall in sugar prices has been curtailed after the introduction of MSP) and the agro-climatic risks related to cane production. Also, MSEL witnessed a 22% YoY decline in cane crushing at 188.4 lakh quintals cane in FY2021 and a further moderation of 22% YoY to 62.45 lakh quintals in 9M FY2022 owing to the unfavourable climatic conditions, including the floods at Bihar. Further, the profitability of sugar mills, including MSEL, remain vulnerable to the Central Government's policies on international sugar trade, domestic quota for the sweetener, pricing and interest subvention loan for distillery capacity expansion. Further, a high working capital intensity and moderate debt coverage metrics, driven by high inventory holding at fiscal-end continue to constrain MSEL's ratings.

The Stable outlook on MSEL's ratings reflects ICRA's opinion that MSEL will continue to benefit from its healthy operational profile. Also, the company's focus on increasing ethanol production from B-heavy molasses are likely to keep its cash flows comfortable relative to its debt service obligations.

Key rating drivers and their description

Credit strengths

Long track record of operations –MSEL's sugar mills have an operational track record of over 85 years, which were earlier operating under Upper Ganges Sugar & Industries Ltd. and Oudh Sugar Mills Ltd. Apart from MSEL, the promoters are present in the sugar industry in Uttar Pradesh with a capacity of 31,800 tonnes crushed per day (TCD) under Avadh Sugar & Energy Ltd. ASEL and MSEL together account for seven sugar mills based out of Uttar Pradesh (four mills) and Bihar (three mills) with a combined capacity of 50,800 TCD of sugarcane, which provide it with economies of scale and are among the large sugar mills in India.

Efficient operations with forward integration into co-generation and distillery – MSEL operates 19,000 TCD of sugar capacities in Bihar. The plant's operation is forward integrated into the power and alcohol businesses — co-generation capacity of 38 megawatt (MW) and distillery capacity of 150 kilolitres per day (KLPD) as on February 01, 2022. The integrated operation provides an alternative revenue stream and cushions profitability against the cyclicality in the sugar business. Together, these two segments accounted for ~15% of the revenues and ~71% of the profit before interest and tax in FY2021. MSEL has recently increased its distillery capacity to 150 KLPD from 80 KLPD, strengthening its operational profile. This would also increase the distillery's contribution to the revenues going forward and offset the seasonality associated with the sugar business with distillery operating for around 330 days in the year.

However, MSEL witnessed a 22% YoY decline in cane crushing at 188.4 lakh quintals cane in FY2021 and a further moderation of 22% YoY to 62.45 lakh quintals in 9M FY2022 owing to the unfavourable climatic conditions in Bihar. Moreover, the net recovery rate moderated to 10.53% in FY2021 from 11.12% in FY2020 owing to a ~46% diversion of cane towards B-heavy molasses (PY: 12%) in addition to a slight moderation in gross recovery rates because of the agro-climatic conditions. The net recovery rates are expected to further moderate in the medium term with higher diversion of cane towards B-heavy molasses. However, increased contribution from the distillery division with a higher proportion of ethanol production from B-heavy molasses would offset the impact of the moderated recovery rate on MSEL's operating margin.

Locational benefit of being in a sugar-deficit state; cane pricing decided by sugar companies in consultation with state government – MSEL's sugar mills are located in Bihar, which is a sugar-deficit state, and thus enjoy higher realisations and limited competition from 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 the sugar factories in the state. This pricing mechanism provides relief to sugar companies as opposed to the state-advised price (SAP) mechanism followed in UP, wherein only the state government decides the cane pricing. However, historically it has been noted that any change in the fair and remunerative price (FRP) or SAP in UP had led to a change in the cane prices in Bihar. The recent hike in UP-SAP and FRP increased cane costs by Rs. 13-20/quintal for SY2022 in Bihar for all sugarcane varieties compared to the last season.

Profitability seen to improve owing to steady sugar realisations and higher volumes from distillery segment – MSEL's overall operating profitability and cash accruals are expected to improve going forward from the current levels, driven by firm sugar realisations both in the domestic and international markets, along with better distillery performance. The company is expected to divert higher cane towards the production of ethanol through B-heavy molasses, supported by the recent capacity expansion. MSEL's operating margins are expected to be supported by the likely continuation of MSP, remunerative prices for ethanol and the industry's focus on diverting excess cane towards ethanol production, resulting in improved domestic demand-supply balance. Further, with the increase in sugar sacrifice towards B-heavy ethanol, the working capital debt and hence the total debt levels are expected to reduce in FY2023-FY2024.

Credit Challenges

High working capital intensity leads to moderate debt coverage indicators – The seasonality involved in sugarcane crushing results in high inventory of finished goods at the end of March. The working capital availed to fund such high inventory along with the soft loans taken to make the cane payments resulted in high debt on the books of domestic sugar companies, including

MSEL. However, the debt reduced to Rs. 551 crore as on March 31, 2021 from Rs. 631 crore as on March 31, 2021, improving the gearing to 1.1 times (PY: 1.2 times). Nevertheless, the total debt to OPBIDTA moderated to 5.4 times (PY: 4.1 times) and the interest cover moderated to 2.1 times (PY: 3.2 times) on account of a contraction in operating profits with lower cane crushing, higher cane prices along with a marginal reduction in sugar realisation in FY2021. Further, the interest cover slightly improved to 2.13 times in 9M FY2022 (PY:1.51 times). ICRA expects the debt coverage indicators to improve given the likelihood of better operating margins along with the reduction in debt levels, supported by higher cane diversion towards ethanol production in the medium term.

Risks associated with a regulated industry – MSEL's profitability, along with that of sugar mills, continues to remain vulnerable to Government 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, recent measures taken by the Central and the state government have supported the financial performance and liquidity of sugar mills.

Sugar mills vulnerable to industry cyclicality and agro-climatic risks –The sugarcane crop, being an agri-commodity, depends on weather conditions and is vulnerable to pests and diseases that may impact not only the yield per hectare but also the recovery rate. These factors can have a significant impact on the company's profitability. In addition, the cyclicality in sugar production results in significant volatility in sugar prices. However, the sharp downfall in sugar prices has been curtailed after the introduction of MSP by the Central Government in June 2018. Further, healthy exports and higher diversion of sucrose towards ethanol in recent years resulted in a favourable demand-supply dynamics in the country, improving realisations at present. Over the long term, higher ethanol production with increased diversion towards B-heavy molasses and direct sugar juice by the industry is expected to help curtail the excess supply of sugar, resulting in lower volatility in sugar prices and cash flows from the sugar business.

Liquidity position: Adequate

MSEL's liquidity is adequate with healthy cash flow from operations and average cushion of around Rs. 40 crore in drawing power from February 2021 to January 2022. ICRA expects MSEL to comfortably meet its debt repayment obligations in the medium term. Further, the company does not have any major planned capex in the medium term.

Rating sensitivities

Positive factors – A sustained period of firm sugar prices, driven by favourable demand-supply dynamics and increase in forward integration, leading to reduced volatility in cash flows from the sugar business may warrant a positive rating revision. An improvement in the operating profitability and strengthening of the debt coverage metrics, on a sustained basis, may trigger a rating upgrade.

Negative factors – The ratings can be downgraded if there is any sharp decline in sugar prices, or cane crushing volumes, or the recovery rate, affecting the company's profitability and coverage indicators on a sustained basis. An increase in cane costs, or any significant decline in ethanol realisations, or any material change in Government policies might also moderate MSEL's profitability and prompt a rating downgrade. A specific metric that could lead to a downgrade includes an interest cover below 3.5 times on sustained basis.

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

About the company

MSEL has three sugar mills at New Swadeshi Sugar Mills, Narkatiaganj (West Chamaparan district, Bihar), Bharat Sugar Mills (Sidhwalia district, Bihar), Hasanpur Sugar Mills, Hasanpur (Samastipur district, Bihar) with a combined crushing capacity of 19,000 TCD. It also has one distillery at Narkataiganj with a total capacity of 150 KLPD and co-generation facilities to produce 38 MW power.

Key financial indicators (audited)

Standalone	FY2020	FY2021
Operating Income (Rs. crore)	918.0	952.9
PAT (Rs. crore)	83.0	27.1
OPBDIT/OI (%)	17.1%	12.2%
PAT/OI (%)	9.0%	2.8%
Total Outside Liabilities/Tangible Net Worth (times)	1.9	1.6
Total Debt/OPBDIT (times)	4.1	5.4
Interest Coverage (times)	3.2	2.1
DSCR(times)	1.7	1.3

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

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 on Dec 31, 2021 (Rs. crore)	Date & Rating on			Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019
					Mar 28, 2022	Sep 21, 2021	Sep 07, 2021	Aug 05, 2020	-	-
1	Fund Based – Term Loan	Long Term	112.50	93	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	-	-
2	Fund Based – Working Capital	Long Term	460.00	-	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	-	-
3	Non fund based	Short Term	2.00	-	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+	-	-
4	Unallocated limits	Long Term/ Short Term	2.14		[ICRA]A- (Stable)/ [ICRA]A2+	[ICRA]A- (Stable)/ [ICRA]A2+				

Complexity level of the rated instruments

Instrument	Complexity Indicator
Fund Based – Term Loan	Simple
Fund Based – Working Capital	Simple
Non fund based	Very Simple
Unallocated limits	Not Applicable

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 Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Fund Based – Term Loan*	FY2016-FY2022	8%-9%	FY2024-FY2027	112.50	[ICRA]A-(Stable)
NA	Fund Based – Working Capital	NA	NA	NA	460.00	[ICRA]A-(Stable)
NA	Non fund based	NA	NA	NA	2.00	[ICRA]A2+
NA	Unallocated limits	NA	NA	NA	2.14	[ICRA]A-(Stable)/ [ICRA]A2+

Source: *Company data*Includes multiple loans sanctioned at different points of time*

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

ANALYST CONTACTS

Sabyasachi Majumdar
+91 124 4545 304
sabyasachi@icraindia.com

Girishkumar Kashiram Kadam
+91 22 6114 3441
girishkumar@icraindia.com

Anupama Arora
+ 91 124 4545 303
anupama@icraindia.com

Suksham Arora
+91-124-4545 300
suksham.arora@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee
+91 80 4332 6401
jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

ICRA Limited

Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

Branches