

March 28, 2022

Avadh Sugar and Energy Limited : Rating reaffirmed and outlook revised to Positive from Stable

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund Based – Term Loan	475.3	475.3	[ICRA]A-(Positive); reaffirmed and outlook revised to Positive from Stable
Fund Based – Working Capital	725.0	725.0	[ICRA]A-(Positive); reaffirmed and outlook revised to Positive from Stable
Non fund based	5.0	5.0	[ICRA]A2+; Reaffirmed
Unallocated	60.3	60.3	[ICRA]A-(Positive)/[ICRA]A2+; reaffirmed and outlook revised to Positive from Stable
Total	1,265.6	1,265.6	

* Instrument details are provided in Annexure-1

Rationale

The revision in the outlook to positive for the debt programmes of Avadh Sugar and Energy Limited (ASEL) factors in the likely improvement in its debt protection metrics in FY2023 and beyond following the reduced debt levels and healthy operating profits due to higher diversion of sucrose towards ethanol (B-heavy molasses as well as juice-based) amid an enhanced capacity. The ratings note that the commercialisation of the enhanced distillery capacity (325 KLPD from 280 KLPD) recently would increase ethanol volumes and improve blended distillery realisations with a favourable change in ethanol mix. ICRA expects the company's revenues in FY2022-FY2023 to remain stable, notwithstanding the higher sugar realisation and increased revenues from the distillery division, offset by lower sugar volumes. Additionally, higher sucrose diversion towards B-heavy molasses/juice-based ethanol would moderate the inventory levels and hence lower its working capital borrowing levels from FY2023.

The ratings continue to factor in ASEL's operational track record of over 85 years with a reasonable scale. Moreover, its forward-integrated operations into co-generation and distillery businesses provide it with alternative revenue streams and act as a cushion against the cyclical nature in the sugar business. ICRA notes the current firm up sugar realisations and 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, ASEL'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 ASEL'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. Further, the profitability of sugar mills, including ASEL, remain vulnerable to the policies of the Government of Uttar Pradesh (GoUP) on cane prices, as well as the central Government's policies on sugar international trade, sugar domestic quota, sugar and ethanol pricing and interest subvention loan for distillery capacity expansion. Further, the high working capital intensity and moderate debt coverage metrics driven by high inventory holding at fiscal-end, which though improved in FY2021, continue to constrain ASEL's ratings

Key rating drivers and their description

Credit strengths

Long track record of operations and reasonable scale—ASEL'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 ASEL, the promoters are present in the sugar industry in Bihar with a capacity of ~19,000 tonnes crushed per day (TCD) under Magadh Sugar & Energy Ltd. (MSEL). 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.

Forward-integrated operations and operational efficiencies—ASEL operates 31,800 TCD of sugar capacities in UP. The plant's operation is forward integrated into the power and alcohol businesses — co-generation capacity of 74 megawatt (MW) and distillery capacity of 325 kilolitres per day (KLPD) as on January 31, 2022. The integrated operation provides an alternative revenue stream and cushions profitability against the cyclicity in the sugar business. Together, these two segments accounted for ~16% of revenues and ~60% of the profit before interest and tax in FY2021. ASEL has recently increased its distillery capacity from to 325 KLPD 240 KLPD, thus strengthening its operational profile. This would also increase the distillery's contribution to revenues going forward and offset the seasonality associated with the sugar business with distillery operating for around 330 days in the year.

While ASEL witnessed a marginal decline in cane crushing and recovery rates in FY2021, these remained healthy. The company crushed 578.3 lakh quintals cane in FY2021 (PY: 600.3 lakh quintals) with a gross recovery rate of 11.73% (PY: 11.88%) and a net recovery rate of 10.7% (PY: 11.44%). Moreover, cane crushing levels and recovery rates are expected to moderate further in FY2022 on account of unfavourable agro-climatic conditions in UP, in line with other UP-based sugar mills. Also, the net recovery is further expected to moderate in light of the higher diversion of cane towards the production of 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 ASEL's operating margin.

Profitability expected to improve going forward owing to steady sugar realisations and higher volumes from distillery segment — ASEL's overall operating profitability and cash accruals are expected to benefit from firm sugar realisations from both the domestic and international markets, healthy export volumes and better distillery performance in the current fiscal. From FY2023, the company is expected to divert higher cane to produce ethanol through B-heavy molasses and/or sugarcane juice with the first full year of expanded capacity becoming operational. ASEL's operating margins are expected to be supported by the likely continuation of MSP while market prices are firm, the remunerative prices of ethanol and the industry's focus on diverting excess cane towards ethanol production, resulting in improved domestic demand-supply balance. Further, with increase in sugar sacrifice towards B-heavy/juice based ethanol, the working capital debt and hence the total debt levels are expected to reduce in going forward.

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 cane payments resulted in high debt on the books of domestic sugar companies, including ASEL. However, the debt reduced to Rs. 1,373 crore as on March 31, 2021 from Rs. 1,596 crore as on March 31, 2020, improving the gearing to 2.1 times (PY: 2.7 times) and total debt to OPBIDTA to 5.2 times (PY: 6.1 times). In 9M FY2022, the company's interest cover improved to 3.2 times compared with 1.7 times in 9M FY2021. Going forward, the debt coverage indicators are likely to improve on expectations of better operating margins and reduced debt levels.

Profitability of UP-based sugar mills depend on state policy on cane prices — ASEL's profitability, along with other UP-based sugar mills, continues to be vulnerable to the GoUP's policy on cane prices. Thus, the company's performance can be impacted

by a disproportionate increase in cane prices in any particular year. Further, the profitability remains vulnerable to the Government’s policies on exports, MSP and remunerative ethanol prices. However, the continuation of Government support in the form of remunerative ethanol prices and interest subvention for debt-funded distillery capex are also likely to prevent the piling up of cane arrears and support the industry. While the recent upward revision in UP-SAP by Rs. 25/quintal could limit the profitability, firmed up domestic prices are likely to offset this risk to some extent.

Sugar mills vulnerable to industry cyclicality and agro-climatic risks –The sugarcane crop, being an agri-commodity, depends on climatic conditions and is vulnerable to pests and diseases that may not only impact the yield per hectare but also the recovery rate. These factors can have a significant impact on the company’s profitability. Further, high dependence on a single crop variety may impact the yields and recovery rate. Nonetheless, ASEL has been exploring other varieties to mitigate this risk to a certain extent. In addition, the cyclicality in sugar production makes sugar prices volatile. However, the sharp contraction 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 and improved realisations. 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 excess supply of sugar, resulting in lower volatility in sugar prices and cash flows from the sugar business.

Liquidity position: Adequate

ASEL’s liquidity is adequate with a healthy cash flow from operations and average cushion of around Rs. 165 crore in drawing power from February 2021 to January 2022. ICRA expects ASEL to comfortably meet its debt repayment obligations in the medium term. However, the company is expanding its crushing capacities and undertaking some maintenance work for which a capex of around Rs. 97 crore has been planned over FY2022-FY2023. Of the said capex, around Rs. 72 crore is expected to be financed through debt and the balance through internal accruals.

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 also trigger a rating upgrade.

Negative factors – Unfavourable rating action can be taken 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 ASEL’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

ASEL has four sugar mills at Hargaon (Sitapur district, Uttar Pradesh), Seohara (Bijnor district, Uttar Pradesh), New India Sugar Mills, Hata (Kushinagar district, Uttar Pradesh), Rosa Sugar Works at Rosa (Shahajahanpur district, Uttar Pradesh) with a combined crushing capacity of 31,800 TCD. It also has two distilleries at Hargaon and at Seohara with a total capacity of 325 KLPD and co-generation facilities of 74 MW power.

Key financial indicators (audited)

Standalone	FY2020	FY2021
Operating Income (Rs. crore)	2559.5	2712.4
PAT (Rs. crore)	88.6	77.6
OPBDIT/OI (%)	10.2%	9.6%
PAT/OI (%)	3.5%	2.9%
Total Outside Liabilities/Tangible Net Worth (times)	3.8	3.0
Total Debt/OPBDIT (times)	6.1	5.2
Interest Coverage (times)	2.3	2.3
DSCR(times)	1.1	1.1

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 07, 2021			
1	Fund Based – Term Loan	Long Term	475.3	NA*	[ICRA]A-(Positive)	[ICRA]A-(Stable)	[ICRA]A-(Stable)	-	-
2	Fund Based – Working Capital	Long Term	725.0	-	[ICRA]A-(Positive)	[ICRA]A-(Stable)	[ICRA]A-(Stable)	-	-
3	Non fund based	Short Term	5.0	-	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+	-	-
4	Unallocated	Long Term/ Short Term	60.3	-	[ICRA]A-(Positive)/ [ICRA]A2+	[ICRA]A-(Stable)/ [ICRA]A2+	-	-	-

*Total term loans outstanding as on December 31, 2021 was Rs 562 crore, break-up of outstanding against rated term loans as on December 31, 2021 is not available

Complexity level of the rated instruments

Instrument	Complexity Indicator
Fund Based – Term Loan	Simple
Fund Based – Working Capital	Very Simple
Non fund based	Very Simple
Unallocated	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	5%-11%	FY2022-FY2028	475.3	[ICRA]A-(Positive)
NA	Fund Based – Working Capital	NA	NA	NA	725.0	[ICRA]A-(Positive)
NA	Non fund based	NA	NA	NA	5.0	[ICRA]A2+
NA	Unallocated	NA	NA	NA	60.3	[ICRA]A-(Positive)/ [ICRA]A2+

Source: Company data

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

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