

August 5, 2020 *Revised*

Avadh Sugar and Energy Limited: [ICRA]A-(Stable)/A2+ assigned

Summary of rating action

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Fund Based – Term Loan	552.6	[ICRA]A-(Stable); Assigned
Fund Based – Working Capital	693.0	[ICRA]A-(Stable); Assigned
Non fund based	20.0	[ICRA]A2+; Assigned
Total	1265.6	

*Instrument details are provided in Annexure-1

Rationale

The rating assignment takes into consideration the long track record Avadh Sugar & Energy Limited (ASEL or the company), experience of the promoters in the sugar industry and strong operational profile of the company with healthy sugar recovery rates along with forward integration into distillery and cogeneration facilities. The company's forward integration into cogeneration and distillery segments provide alternative revenue streams and cushion it from the cyclicity of the sugar business to a certain extent. While lower power tariff is expected to impact the profitability of the cogeneration segment going forward, ASEL's overall profitability is likely to improve, driven by firm sugar realisations and higher profits from the distillery division. The company is in the process of increasing its distillery capacity along with its policy to produce entire ethanol from B-heavy molasses only.

The long-term rating, however, continues to be constrained by the cyclical nature of the sugar industry, and the agro-climatic risks related to cane availability. The ratings also consider the regulatory risks associated with the sugar industry as it is susceptible to sudden changes in Government policies. However, ICRA notes that recent interventions by both the Central Government and the state government, which included revision in minimum support prices, interest subvention loans for setting up of ethanol manufacturing facilities, soft loans and export subsidy, have supported the sugar industry and benefited integrated sugar producers. The debt on the books of ASEL has increased over the last two fiscals on account of an increase in the working capital debt, including interest-free debt to fund the buffer stock as well as soft loans availed at low interest rates under various Central/state Government schemes to fund the ongoing distillery capex as well as to make payment of cane arrears. Consequently, the gearing stood at ~2.7 times as on March 31, 2020 and debt coverage indicators were moderate with an interest cover of ~2.3 times and TD/OPBITDA of ~6.1 times in FY2020. However, the debt metrics are likely to improve going forward, with an improvement in profitability.

The Stable outlook on the rating reflects ICRA's opinion that ASEL will continue to benefit from its healthy operational profile. Besides, its with focus on increasing distillery capacity and 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

Experienced promoters and long track record of operations – ASEL is a part of the erstwhile KK Birla Group, currently managed by Mrs. Nandini Nopany and her son C. S. Nopany. MSEL's sugar mills have a long operational track record of over 85 years, which were earlier operating under Upper Ganges Sugar & Industries Ltd. (UGSIL) and Oudh Sugar Mills Ltd. (OSML). Apart from ASEL, the promoters also have presence in the sugar industry in Bihar with a capacity of ~17500 TCD under Magadh Sugar & Energy Ltd.

Efficient operations with forward integration into cogen and distillery – The volumes of cane crushed, and sugar recovery rates have been steadily increasing over the years due to cane developmental activities undertaken by the company, leading to a lower cost of production. The cane crushed increased to ~600 lakh quintal in FY2020 from ~421 lakh quintal in FY2017, while the sugar recovery rates have improved to ~11.8% in FY2019 from 11.1% in FY2017. The recovery rate was slightly lower in FY2020 at 11.4% due to diversion of a part of the canes to B-heavy molasses for ethanol production. Going forward, the volumes of cane crushed are expected to remain stagnant at FY2020 levels, and the recovery rate is also likely to moderate as the company will be producing 100% ethanol via B-heavy molasses.

Additionally, ASEL has a co-generation capacity of 74 mega watt (MW) and a distillery capacity of 200 kilo litres per day (KLPD), which provide additional revenue streams and provide a buffer against cyclicity in the sugar industry. ASEL is in the process of enhancing the distillery capacity to 220 KLPD from SY2021, resulting in higher levels of forward integration, strengthening the operating profile of the company. In the current year, 100% of ethanol is expected to be produced via B-heavy molasses, resulting in higher profitability from the distillery segment. However, revision in power tariff in Uttar Pradesh in FY2020 will continue to impact the profitability of the cogeneration segment.

Profitability expected to improve going forward owing to steady sugar realisations and higher volumes from distillery segment – The Government support has provided stability to sugar prices and benefitted sugar mills. While lower power tariff is expected to impact the profitability of the cogeneration segment going forward, ASEL's overall profitability is expected to improve, driven by firm sugar realisations and higher profits from the distillery division. ASEL's cash accruals are expected to improve with the addition distillery volumes in SY2021 along with its policy to produce entire ethanol from B-heavy molasses only.

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, including buffer stock, along with soft loans availed for making cane payments resulted in an increase in debt on the books of domestic sugar companies, including ASEL, over the last two fiscals. As at end of FY2020, the total debt on the books of ASEL stood at ~ Rs 1596 crore. Notwithstanding the steady accretion to reserves, ASEL's gearing stood at ~2.7 times as on March 31, 2020. The debt coverage indicators also remain moderate with an interest cover of 2.3 times and Total Debt/OPBITDA of ~6.1 times in FY2020. Although the debt levels are high, it is primarily working capital, which limits debt repayment obligation. Moreover, the company has adequate headroom in terms of drawing power vis-a-vis the working capital debt outstanding. Going forward, the debt coverage indicators are expected to improve given the likelihood of higher profitability on account of firm sugar prices and higher volumes of B-heavy ethanol sales and repayment of debt.

Risks associated with operating in a regulated industry – ASEL's profitability, along with other Uttar Pradesh-based sugar mills, continues to remain vulnerable to the Government of Uttar Pradesh's (GoUP) policy on cane prices. The cane prices and subsidies (if any) are determined by the GoUP at the start of the crushing season. Thus, the performance of the company can be impacted by a disproportionate increase in cane prices in any particular year. Also, discontinuation of any subsidies/schemes such as export subsidy, subsidy on buffer stock borrowing, etc. or any material decrease in ethanol pricing would impact the profits. Nonetheless, recent measures taken by the Central Government and the GoUP have supported the financial performance and liquidity of sugar mills.

Sugar mills remain vulnerable to industry cyclicity and agro-climatic risks - Being an agricultural product, the sugarcane crop is dependent upon weather conditions and is vulnerable to pests and diseases that may impact the yield per hectare and the recovery rate. These factors can have a significant impact on the company's profitability. In SY2020, ICRA expects sugar consumption to be lower by ~4%. So, the closing stock will continue to remain high at ~11-11.5 million MT at the end of SY2020, however, the same would be lower compared to ~14.5 million MT in the previous year. In the next season, large players are expected to increase ethanol production from B-heavy molasses, so any significant increase in sugar production is expected to be checked. However, the trend in domestic demand and export policies would determine the supply-balance scenario in SY2021.

Liquidity position: Adequate

ASEL's liquidity is **adequate** with healthy cash flow from operations, low capex commitments in the near term and moderate average working capital utilisation levels of ~55% (adjusted for buffer stock borrowing) of the total sanctioned limits over the last one year. Overall, ICRA expects ASEL to be able to meet its near-term commitments through internal as well as external sources of funds.

Rating sensitivities

Positive triggers – The rating may be upgraded if the company is able to maintain an interest cover of ~4 times or higher on a sustained basis.

Negative triggers – The rating may be downgraded if the interest cover is less than 3 times and/or TD/OPBITDA (adjusted for buffer stock borrowing) is more than 3.5 times on a 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 financials have been considered

About the company

ASEL has four sugar mills at Hargaon (Sitapur district, Uttar Pradesh), Seohara (Bijnor district, Uttar Pradesh), Hata (Kushinagar district, Uttar Pradesh), and Rosa (Shahajahanpur district, Uttar Pradesh) with a combined crushing capacity of 31,800 TCD. It also has two distilleries at Hargaon and Seohara with a total capacity of 200 KLPD and a cogen facility, which can produce 74 MW power.

In FY2020, the company reported a net profit of Rs. 88.6 crore on an operating income of Rs. 2,559.5 crore compared to a net profit of Rs. 119.9 crore on an operating income of Rs. 2,130.3 crore in the previous year.

Key financial indicators (audited)

	FY2019	FY2020
Operating Income (Rs. crore)	2130.3	2559.5
PAT (Rs. crore)	119.9	88.6
OPBDIT/OI (%)	13.7%	10.2%
PAT/OI (%)	5.6%	3.5%
Total Outside Liabilities/Tangible Net Worth (times)	4.1	3.8
Total Debt/OPBDIT (times)	5.3	6.1
Interest Coverage (times)	3.0	2.3

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)				Rating History for the Past 3 Years		
		Type	Amount Rated	Amount Outstanding	Rating	FY2020	FY2019	FY2018
					5-Aug-2020			
1	Term Loan	Long Term	552.6	552.6	[ICRA]A- (Stable) assigned	-	-	-
2	Fund based – working capital	Long Term	693.0		[ICRA]A- (Stable) assigned	-	-	-
3	Non fund based	Short Term	20.0		[ICRA]A2+ assigned	-	-	-

Amount in Rs. crore

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website [click here](#)

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
	Term Loan*	FY2016	5%-11.05%	FY2026	552.6	[ICRA]A-/Stable
	Fund based – working capital				693.0	[ICRA]A-/Stable
	Non fund based				20.0	[ICRA]A2+

*Includes multiple loans availed at different points of time

Source: Avadh Sugar & Energy Limited

Corrigendum:

Rationale dated August 5, 2020 has been corrected with revisions as detailed below:

- The expected enhancement in distillery capacity in the “Credit Strengths” section on Page 2 has been revised to 220 KLPD instead of 275 KLPD.
- The total combined sugar crushing capacity in the “About the Company” section on Page 3 has been revised to ~31,800 TCD instead of ~31,200 TCD.

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