Dwarikesh Sugar Industries Limited

May 15, 2018

Summary of rated instrument

Instrument	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loan	57.44	54.05	[ICRA]A+ reaffirmed; outlook revised to negative from stable
Cash Credit	565.0	565.00	[ICRA]A+ reaffirmed; outlook revised to negative from stable
Non-Fund Based Limits	5.00	5.00	[ICRA]A+ reaffirmed; outlook revised to negative from stable
Unallocated Limits	22.55	25.94	[ICRA]A+ reaffirmed; outlook revised to negative from stable
Commercial Paper	300.00	300.00	[ICRA]A1+ reaffirmed

Material event

Dwarikesh Sugar Industries Limited (DSIL) has announced its quarterly/yearly result (Q4 FY2018/FY2018) on May 7, 2018. The company reported operating income (OI) of Rs. 354.0 crore with losses at operative level of Rs. 7.7 crore and net loss of Rs. 9.2 crore in Q4 FY2018 against OI of Rs. 440.8 crore with operating profit (OPBITDA) of Rs. 119.5 crore and net profit of Rs. 46.8 crore in Q4 FY2017. In FY2018, the company reported OI of Rs. 1,429.9 crore with OPBITDA of Rs. 142.5 crore and net profit of Rs. 101.4 crore against OI of Rs. 1,190.4 crore with OPBITDA of Rs. 273.4 crore and net profit of Rs. 156.1 crore in FY2017.

Impact of material event

The long-term rating has been reaffirmed at [ICRA]A+ (pronounced ICRA A plus) and the short-term rating has been reaffirmed at [ICRA]A1+ (pronounced ICRA A one plus). The outlook on the long-term rating has been revised to Negative from Stable.

Rationale

The outlook revision factors in the oversupply scenario in the domestic market owing to record sugar production in SY2018 resulting in a sharp decline in domestic sugar prices. This has led to lower-than-anticipated profitability indicators (losses at operating and net level) in Q4 FY2018 for sugar mills, including DSIL. Further, even if the exports under Minimum Indicative Export Quota (MIEQ) is implemented successfully, ICRA expects the sugar prices to remain subdued in the near term, which is likely to have an adverse impact on the profitability metrics in the coming quarters. However, DSIL has repaid a significant portion of the long-term debt in FY2017 and FY2018 and hence the cash flows would remain comfortable relative to the debt servicing even under an adverse operating environment for the sugar division, particularly given the healthy recovery rates. Further, healthy cane crushing levels and DSIL’s forward integration into cogeneration and distillery businesses continue to provide cushion against cyclicality in the sugar business. Also, DSIL’s liquidity profile remains comfortable with sufficient cushion in its working capital limits.

DSIL's ratings are constrained by the risks associated with the inherent cyclicality in the sugar business, agro-climactic risks related to cane production and Government policies on import duties, co-generation power and ethanol pricing and offtake, and counterparty credit risk associated with the sale of power to the utilities in Uttar Pradesh (UP). ICRA also notes that profitability of the UP-based sugar mills will continue to be vulnerable to the Government of UP's (GoUP) policy on cane prices.

Outlook: Negative

The outlook may be revised to Stable in case any incremental Government support leads to improvement in sugar prices/reduction in cane costs, resulting in higher-than-expected profitability and debt coverage metrics.

Key rating drivers:

Credit strengths

Significant size of forward-integrated and operationally-efficient sugar operations - DSIL operates 21,500 tonne crushed per day (TCD) of sugar capacities in UP, which are forward integrated into power and alcohol business with co-generation capacity of 86 mega-watt (MW) and distillery capacity of 30 kilo litre per day (KLPD). This provides alternate revenues and some cushion to profitability against cyclicality in sugar business.

Healthy cane crushing and recovery rates - The company is likely to report a substantial increase in cane crushing to an all-time high of 36.1 lakh (MT) in SY2018 from 28.3 lakh MT in SY2017. DSIL has reported cane crushing of 35.6 lakh MT as on May 10, 2018 with two out of its three plants still crushing. The healthy crushing levels would support the forward-integrated operations in FY2019. Further, DSIL's recovery rate is healthy at 11.88% in SY2018, an increase from 11.78% in SY2017, supporting its cost of production.

Comfortable capital structure and debt coverage metrics – The capital structure of the company is comfortable at 0.94 times as on March 31, 2018. Almost 80% of the debt was on account of working capital loans implying a long term debt to equity of 0.19 times. The company had used its cashflows in FY2017 and FY2018 to prepay significant portion of its long-term liabilities. This resulted in a decline in the outstanding long-term debt as on March 31, 2018 to Rs. 79.0 crore from Rs. 176.6 crore as on March 31, 2017. Given the lower interest burden and the limited long-term debt repayments going forward, the interest coverage and debt service coverage ratio are likely to remain comfortable despite moderation in the profitability metrics.

Comfortable liquidity position - Sufficient cushion available in working capital limits ranging between Rs. 50 crore and Rs. 150 crore during April, 2017 – April, 2018.

Credit challenges

Sugar industry outlook remains weak in the near term – The outlook on the domestic demand-supply scenario and the prices remains weak in the near term given the oversupply situation. Domestic sugar production is expected to cross 31.0 million MT in SY2018 and even after meeting the target of exporting 2 million MT, the domestic market would still have around 2.5 – 3.0 million MT of excess sugar stocks than the normative sugar stock for the next season. Hence, while the sugar prices are likely to improve with the successful implementation of MIEQ, any significant increase from the current levels can be ruled out, given the continued oversupply scenario in the domestic market.

Geographical-concentration risk as all three units are located in UP - DSIL has three sugar plants, viz. Dwarikesh Nagar, Dwarikesh Puram and Dwarikesh Dhamt in UP. DN and DP are located in the Bijnor district, while DD is located in the Bareilly district. As a result, DSIL's operations remain exposed to geographic concentration risk.

Profitability remains vulnerable to the state government's policy on cane prices - The cane price 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 price in any particular year.

Vulnerability of profitability to agro-climatic risk and regulatory risk - The profitability of sugar mills remain exposed to the cyclical nature of the sugar industry, agro-climatic risks related to cane production, government policies related to sugar trade and counterparty credit risk associated with the sale of power to the utility.

The previous detailed rating rationale is available on the following link: Click here

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