April 02, 2020

Dwarikesh Sugar Industries Limited: Ratings reaffirmed; Rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loan	251.36	230.65	[ICRA]A+ (Stable); Reaffirmed
Cash Credit	556.00	770.00	[ICRA]A+ (Stable); Reaffirmed
Long-term -Non-Fund Based Limits	14.00	25.00	[ICRA]A+ (Stable); Reaffirmed
Long-term Unallocated Limits	3.63	4.34	[ICRA]A+ (Stable); Reaffirmed
Total	**824.99**	**1029.99**	
Commercial Paper	300.00	300.00	[ICRA]A1+; Reaffirmed

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

Rationale

The reaffirmation in the ratings factors in Dwarikesh Sugar Industries Limited's (DSIL's) healthy operating performance in its core sugar business, as evidenced by healthy cane crushing volumes and recovery rate in SY2020. DSIL's recovery rate is one of the highest in the state of Uttar Pradesh (UP) which results in low cane cost of production. The ratings take into account DSIL's strong financial flexibility and its healthy debt coverage metrics, with the expected interest coverage at 4x-4.5x and DSCR at 2.5x-2.7x in FY2020. The ratings factor in the continued support from the Government to the sugar industry. ICRA notes that interventions by both the Central Government and the State Government, such as an upward revision in minimum support prices, interest subvention loans for ethanol expansion, soft loans and export subsidy, have supported the sugar industry and benefited integrated sugar producers like DSIL. In FY2020, while the lower power tariff will impact the co-gen division, the overall operating profitability is expected to be supported by the higher domestic sugar realisations and an export subsidy of Rs. 10.44/kg of sugar export for SY2020. Also, while the increase in the molasses reserved quota to 18% in SY2020 from 12.5% in SY2019 for state manufacturers of country-made liquor in UP is likely to reduce the availability of molasses for ethanol manufacture, the distillery segment's performance would be supported by higher sales volumes (backed by higher cane crushing and manufacture of ethanol from B-heavy molasses) and remunerative ethanol realisations in SY2020. However, going forward, given the significant decline in the crude prices, governments continued support to ethanol prices will be critical. Also, in the near term, Covid-19 could have some adverse impact on sugar off-take, which in turn may result in some pressure on sugar prices.

The ratings continue to factor DSIL's forward integration into the cogeneration and the distillery operations, which provide alternate revenue streams and a buffer against cyclicality of the sugar business to a certain extent. DSIL has enhanced the distillery capacity to 130 KLPD in SY2020 from 30 KLPD, further strengthening the company's operating profile.

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

Key rating drivers and their description

Credit strengths

Forward-integrated operations - DSIL operates 21,500 tonne crushed per day (TCD) of sugar capacities in UP. The plant's operation is forward integrated into power and alcohol business—co-generation capacity of 86 mega-watt (MW) and distillery capacity of 130 kilo litre per day (KLPD). DSIL has enhanced the distillery capacity to 130 KLPD in SY2020 from 30 KLPD, further strengthening the operating profile of the company. The integrated operation provides alternate revenues and cushions profitability against cyclicality in sugar business.

Operationally efficient sugar mills with healthy recovery rates – The company's recovery rate for sugar seasons stood at 11.78% in SY2017, 11.88% in SY2018 and 12.29% in SY2019 and continues to be healthy in SY2020. This helped to bring down the company's cost of production substantially. Going forward, over the medium term, though the proportion of high-yielding canes will continue to remain elevated, the higher production of ethanol from B-heavy molasses is likely to moderate the recovery rates to some extent. However, the same is likely to be compensated by higher production in the distillery segment.

Healthy debt coverage metrics and financial flexibility– While the gearing is expected to increase to around 1.7x times as on March 31, 2020 from 1.4x times as on March 31, 2019 primarily owing to higher working capital loans to support the higher sugar stocks (which also includes the buffer stock), the long-term debt to equity is likely to be around 0.45x-0.5x times. Around 72% of the total debt is likely to be accounted by the working capital loans. The debt coverage metrics are likely to be healthy with interest cover of around 4x – 4.5x and DSCR of 2.5x – 2.7x in FY2020. DSIL has sufficient cushion in the drawing power.

Credit challenges

Profitability of UP-based sugar mills continues to depend on GoUP policy on cane prices – DSIL's profitability, along with other Uttar Pradesh-based sugar mills, continues to be vulnerable to the Government of Uttar Pradesh's policy on cane prices. The cane price is determined by the GoUP at the start of the crushing season. Thus, the performance of the company can be impacted by disproportionate increase in cane price. Nonetheless, recent measures taken by the Central Government and the GoUP have supported sugar prices and liquidity of sugar mills.

Sugar mills remain vulnerable to industry cyclicality and agro-climatic risks – Being an agri-commodity, the sugar cane crop is dependent 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. For

SY2020, ICRA expects sugar production to decline to around 26.5 million MT owing to a decline in cane availability in major sugar-producing states, such as Maharashtra and Karnataka. In the near term, Covid-19 could have some adverse impact on sugar off-take, which in turn may result in some pressure on sugar prices. With the distillery capacities of major mills coming into production during SY2019 - SY2020, the diversion of B-heavy molasses and sugarcane juice towards ethanol production is likely to increase, thus resulting in a decline in sugar production to that extent in SY2020. The continuation of government support in the form of buffer stock creation and subsidies for exports is also likely to support the performance of the sugar companies.

Decline in cogeneration tariff and increase in levy molasses quota in UP are likely to adversely impact operating profitability of sugar mills: In July 2019, the Uttar Pradesh Electricity Regulatory Commission revised the tariff for projects commissioned in or prior to FY2006 from Rs. 4.98 in FY2019 to Rs. 2.92 in FY2020. This reduction in tariff would adversely impact the profitability from the co-generation segment going forward. In addition, the GoUP has increased the molasses reserved quota to 18% in SY2020 from 12.5% in SY2019 for the state manufacturers of country made liquor. The state distilleries would purchase the molasses at a subsidised rate of Rs.1200/MT, as against the prevailing molasses price of Rs. 5000/MT. This move would result in a decline in the availability of the molasses for ethanol manufacture, impacting the profitability from the distillery segment to some extent.

Liquidity position: Adequate

DSIL's liquidity position is adequate, with an average cushion of Rs. 115 crore in the working capital facility from February 2019 to January 2020. The debt repayment obligation of Rs. 47.7 crore in FY2021 and Rs. 50.3 crore in FY2022 can be comfortably met from the expected cash flow from operations. Moreover, the company does not have any major capex plans over the next two years.

Rating sensitivities

Positive triggers – The company's ratings can be upgraded if the sugar prices remain firm for a sustained period driven by favourable demand-supply dynamics and/or the pricing of sugarcane is formally linked to sugar realisations, which would lower the volatility of cashflows from the sugar business.

Negative triggers – Negative pressure on DSIL's rating could arise if higher-than-anticipated decline in sugar prices, recovery rate or an increase in cane costs deteriorates the profitability and debt coverage metrics.

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

DSIL, promoted by Mr. Gautam R. Moraraka, was incorporated in 1994. The company set up a 2,500 TCD sugar plant in the sugar-rich belt of UP at the Bundki village in the Bijnor district. DSIL has been increasing its crushing capacity regularly; currently, it is 21,500 TCD. It has three sugar plants, Dwarikesh Nagar, Dwarikesh Puram and Dwarikesh Dham. Besides, DSIL has cogeneration facilities of 17 MW at Dwarikesh Nagar, 33 MW at Dwarikesh Puram and 36 MW at Dwarikesh Dham unit. Of these, DSIL sells 8 MW from Dwarikesh Nagar, 24 MW from Dwarikesh Puram and 24 MW from Dwarikesh Dham unit to the state grid. The company has a distillery of 130,000 litres per day at its Dwarikesh Nagar unit, which is capable of manufacturing industrial alcohol and ethanol.

In 9MFY2020, on a provisional basis, the company reported a net profit of Rs. 29.2 crore on an operating income of Rs. 874.4 crore, as compared to a net profit of Rs. 62.8 crore on an operating income of Rs. 906.1 crore in the previous year. In FY2019, the company reported a net profit of Rs. 95.1 crore on an operating income of Rs. 1112.0 crore, as compared to a net profit of Rs. 101.4 crore on an operating income of Rs. 1446.8 crore in the previous year.

Key financial indicators (audited)

	FY2018	FY2019
Operating Income (Rs. crore)	1446.8	1112.0
PAT (Rs. crore)	101.4	95.1
OPBDIT/OI (%)	11.0%	14.1%
RoCE (%)	16.7%	14.8%
Total Outside Liabilities/Tangible Net Worth (times)	1.6	1.9
Total Debt/OPBDIT (times)	2.1	4.2
Interest Coverage (times)	6.3	7.4
DSCR	1.7	3.6

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				
					2-Apr-2020	2-Apr-2019	22-Oct-2018	28-Jun-2018	15-May-2018	01-Mar-2018	04-Jan-2018	28-Sep-2017	17-Aug-2017	20-Jul-2017
1	Term Loan	Long Term	230.65	230.65	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Negative)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)
2	Cash Credit	Long Term	770.00		[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Negative)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)
3	Long term - Non-Fund Based Limits	Long Term	25.00		[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Negative)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)
4	Long term - Unallocated Limits	Long Term	4.34		[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Negative)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)
5	Commercial Paper	Short Term	300.00		[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-

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 www.icra.in

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan 1	November 2018	5%	June 2024	116.55	[ICRA]A+ (Stable)
	Term Loan 2	January 2019	8.95%	December 2025	114.10	[ICRA]A+ (Stable)
NA	Cash Credit	-	8.75%	-	770.00	[ICRA]A+ (Stable)
NA	Non-fund Based Limits	-	NA	-	25.00	[ICRA]A+ (Stable)
NA	Unallocated Limits	-	NA	-	4.34	[ICRA]A+ (Stable)
NA	Commercial Paper#	-	-	-	300.00	[ICRA]A1+

#carved out of working capital limits, Source: Dwarikesh Sugar Industries Limited

Analyst Contacts

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

Anupama Reddy
+91 40 4067 6516
anupama.reddy@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

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For more information, visit www.icra.in

ICRA Limited

Corporate Office
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300
Email: info@icraindia.com
Website: www.icra.in

Registered Office
1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50

Branches

Mumbai	+ (91 22) 24331046/53/62/74/86/87
Chennai	+ (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
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