Davangere Sugar Company Limited

February 03, 2023

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long Term Bank Facilities	182.85 (Enhanced from 164.35)	CARE BB+; Stable	Revised from CARE BB-; Stable (Double B Minus; Outlook: Stable)
Short Term Bank Facilities	13.22	CARE A4+	Revised from CARE A4 (A Four)

Details of instruments/facilities in Annexure-1.

Rationale and key rating drivers

The revision in the rating assigned to the bank facilities of Davangere Sugar Company Limited (DSCL) factors in the commencement of commercial operations of ethanol plant during Q1FY23 which would improve scale of operations and profitability of the company. With operationalization of distillery unit, company would have reduced dependence over sugar segment wherein the prices are more volatile. Entry into distillery segment would ensure regular offtake, assured pricing and timely receipt of receivables.

The ratings also continue to positively factors in long operational track record of company, experienced promoters and consistent improvement in sugarcane availability. These rating strengths are partially offset by moderate scale of operations which has reduced in FY22 when compared to FY21 along with leveraged capital structure and debt coverage indicators and elongation in the operating cycle along with its presence in cyclical and regulated nature of the sugar industry and is inherent to agro climatic risk.

Rating sensitivities: Factors likely to lead to rating actions

Positive factors

- Sustainable improvement in the scale of operations above Rs.280 Cr with PBILDT margins above 19% and PAT Margins above 2.50%
- Overall gearing below 1.75x with TD/GCA below 8x and ICR of more than 2.25x

Negative factors

- Sustainable Deterioration in overall gearing beyond 2.50x with TD/GCA above 10x and ICR below 1.50x

Analytical approach: Standalone

Key weaknesses

Moderate scale of operations albeit improvement in H1FY23: DSCL's total operating income came down to Rs. 124.2 Cr in FY22 when compared to Rs.147.8 Cr in FY21 as the company held onto sugar inventory due to lower sugar prices. With sale of sugar stock and commencement of ethanol plant in Q1FY23, the company was able to achieve income of Rs.98.82 Cr for H1FY23. Company's ability to operate distillery unit at higher utilization levels on sustained basis would be key to its prospects.

Elongation in operating cycle: The sugar industry is characterized by high levels of inventory holding (due to seasonality associated with sugarcane), coupled with low credit on sugarcane purchase, makes the operations of the company working capital intensive. Sugar industry being seasonal in nature has high working capital requirements during the peak season which is from November to April. The companies have high working capital requirements during the peak season to procure their primary raw material, i.e., sugarcane and manufacture sugar during this period. Further DSCL's average working capital utilization remains high at 95.10% for the trailing twelve months ended December 31, 2022. Operating cycle of the company stood elongated at 423 days in FY22 when compared to 212 days in FY21. Deterioration in operating cycle is on account of increased inventory levels on account of increased finished goods stock along with increase in storage of molasses in order to maintain adequate stock for ethanol production in FY23, however collection period has seen a deterioration and stood at 110 days in FY22 when compared to 78 days in FY21 on account of higher credit period offered to its customers on account of covid-19 and due to lower demand for sugar. Further the credit period stood at 8 days in FY22 when compared to 5 days in FY21 as mostly are sugarcane payables to the farmers.

Cyclical and regulated nature of the industry: The industry is cyclical by nature and is vulnerable to the government policies for various factors like its importance in the Wholesale Price Index (WPI), as sugar is classified as an essential commodity. The

[1]Complete definition of the ratings assigned are available at www.careedge.in and other CARE Ratings Ltd.'s publications

governments (both Union and State) resort to various regulations such as fixing the raw material (sugarcane) prices in the form of Fair & Remunerative Prices (FRP) and State Advised Prices (SAP). All these factors impact the cultivation patterns of sugarcane in the country and thus affect the profitability of the sugar companies. India also continues to carry high levels of sugar inventory largely due to the controlled release mechanism followed by the Government. Thus, the company's performance can be impacted by disproportionate increase in cane price in any particular year. Furthermore, the profitability remains vulnerable to the Government's policies on exports, MSP and remunerative ethanol prices. In addition, the cyclicality in sugar production results in volatility in sugar prices. However, the sharp contraction in the sugar prices is curtailed after the introduction of MSP by the Central Government in June 2018. Furthermore, healthy exports and higher diversion of sucrose towards ethanol in the recent years resulted in favourable demand-supply dynamics in the country, thus resulting in improved realisations currently. 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 in curtailing the excess supply of sugar, resulting in lower volatility in sugar prices and cash flows from the sugar business.

Inherent to Agro-climactic risk: The sugar industry, being directly dependent on the sugarcane crop and its yield, is susceptible to agro climatic risks including pest & diseases. Climatic conditions, more specifically, the monsoons influence various operational parameters for a sugar entity, such as the crushing period and sugar recovery levels.

Key strengths

Operationalization of Distillery unit: DSCL's 63 KLPD distillery unit which was setup with a total cost of Rs.99.31 Cr has commenced its commercial operations in Q1FY23 which was within the envisaged timelines. With operationalization of distillery unit, company would have reduced dependence over sugar segment wherein the prices are more volatile and would provide stability to PBDIT margins which were otherwise fluctuating for company. Entry into distillery segment would ensure regular offtake, assured pricing and timely receipt of receivables.

Long track record and experienced promoters: DSCL has more than five decades of track record in the present line of business. DSCL enjoys established relationship with farmers having operated in the same region over the decades. The day to day operations of the company are looked after by Mr S S Ganesh (MD), who is adequately supported by a group of professionals having rich business experience in the operative industry.

Liquidity: Stretched

DSCL's liquidity position remained stretched due to working capital intensive nature of operations which has resulted in higher working capital utilisation of 95% during the 12 months ended December 31,2022. Further the cash flow from operations for the company remained negative for FY22.The current ratio of the company stood satisfactory at 1.53x as on March 31, 2022.The company had unencumbered Cash and bank balance of Rs.4.02 Cr as on September 30, 2022.

Applicable criteria

Policy on default recognition
Financial Ratios – Non financial Sector
Liquidity Analysis of Non-financial sector entities
Rating Outlook and Credit Watch
Short Term Instruments
Manufacturing Companies
Policy on Withdrawal

About the company

Davangere Sugar Company Limited (DSCL) was incorporated in 1970 as a joint sector undertaking between Karnataka Agro Industries Corporation (KIAC), Karnataka State Industrial Investment and Development Corporation (KSIIDC) and Farmers. DSCL commenced commercial operations in October 1974. However, owing to continuous losses from operation, it was declared a sick unit in FY87. Subsequently, with the debt restructuring and support from financial institutions, DSCL came out of BIFR in 1996. The present promoters acquired the shares owned by KIAC and KSIIDC and took over the management of DSCL in 1995. Shri. S S Ganesh takes care of the day to day functioning of the company.

Initially, the company commenced operation with an installed capacity of 1250TCD [Sugar], subsequently, the sugar crushing capacity was enhanced to 4750TCD. DSCL also operates a multi fuel co-generation unit of 24.45MW. The company has commenced its distillery unit of 63 KLPD capacity in Q1FY23.

Brief Financials (₹ crore)	March 31, 2021 (A)	March 31, 2022 (A)	H1FY23(UA)
Total operating income	147.47	124.23	98.82
PBILDT	28.27	34.40	22.04
PAT	2.50	5.68	2.34
Overall gearing (times)	1.96	3.25	NA
Interest coverage (times)	1.71	1.80	1.53

A: Audited; UA: Un Audited; NA: Not Available

Status of non-cooperation with previous CRA: Nil

Any other information: Not Applicable

Rating history for the last three years: Please refer Annexure-2

Covenants of the rated instruments/facilities: Detailed explanation of the covenants of the rated instruments/facilities is given in Annexure-3

Complexity level of the various instruments rated: Annexure-4

Lender details: Annexure-5

Annexure-1: Details of instruments/facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Fund-based - LT-Cash Credit	-	-	-	-	59.00	CARE BB+; Stable
Non-fund-based - ST-Letter of credit	-	-	-	-	13.22	CARE A4+
Term Loan-Long Term	-	-	-	March 2028	123.85	CARE BB+; Stable

Annexure-2: Rating history for the last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2022-2023	Date(s) and Rating(s) assigned in 2021-2022	Date(s) and Rating(s) assigned in 2020-2021	Date(s) and Rating(s) assigned in 2019-2020
1	Fund-based - LT-Cash Credit	LT	59.00	CARE BB+; Stable	-	1)CARE BB-; Stable (31-Mar-22)	1)CARE BB-; Stable (09-Mar-21) 2)CARE B; Stable (02-Jul-20) 3)CARE C; Stable; ISSUER NOT COOPERATING* (06-May-20)	1)CARE C; Stable (28-Jan-20)
2	Non-fund-based - ST-Letter of credit	ST	13.22	CARE A4+	-	1)CARE A4 (31-Mar-22)	1)CARE A4 (09-Mar-21) 2)CARE A4 (02-Jul-20)	1)CARE A4 (28-Jan-20)

							3)CARE A4; ISSUER NOT COOPERATING* (06-May-20)	
3	Term Loan-Long Term	LT	123.85	CARE BB+; Stable	-	1)CARE BB-; Stable (31-Mar-22)	1)CARE BB-; Stable (09-Mar-21) 2)CARE B; Stable (02-Jul-20) 3)CARE D; ISSUER NOT COOPERATING* (06-May-20)	1)CARE D (28-Jan-20)

*Long term/Short term.

Annexure-3: Detailed explanation of the covenants of the rated instruments/facilities

Name of the Instrument	Detailed Explanation
A. Financial covenants	Unsecured loans from the promoters shall not be repaid without banks consent
B. Non-financial covenants	Not Stipulated

Annexure-4: Complexity level of the various instruments rated

Sr. No.	Name of the Instrument	Complexity Level
1	Fund-based - LT-Cash Credit	Simple
2	Non-fund-based - ST-Letter of credit	Simple
3	Term Loan-Long Term	Simple

Annexure-5: Lender details

To view the lender wise details of bank facilities please click here

Note on the complexity levels of the rated instruments: CARE Ratings has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careedge.in for any clarifications.

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