Davangere Sugar Company Limited

March 09, 2021

Ratings

Facilities/Instruments	Amount (Rs. crore)	Ratings[1]	Rating Action
Long Term Bank Facilities	100.35 (Reduced from 106.70)	CARE BB-; Stable (Double B Minus; Outlook: Stable)	Revised from CARE B; Stable (Single B; Outlook: Stable)
Short Term Bank Facilities	13.22	CARE A4 (A Four)	Reaffirmed
Total Bank Facilities	113.57 (Rs. One Hundred Thirteen Crore and Fifty-Seven Lakhs Only)		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The revision in the rating of Davangere Sugar Company Limited (DSCL) is on account of the improved operational performance in 10MFY21 backed by a higher recovery rate and expectation of higher margins on the back of exports in FY21 and improvement in capital structure. CARE also takes into account the long track record and experience of the promoters and significant fall in inventory levels leading to improved working capital cycle and satisfactory debt repayment track record since February 2020.

The strengths are partially offset by the cyclical and regulated nature of the sugar industry, lower crushing days and high operating cycle which is inherent to the industry.

Rating Sensitivities

Positive Factors *– Factors that could lead to positive rating action/upgrade*

- Improvement in profitability and reduction in TDGCA on sustained basis.
- Improvement in liquidity position.

Negative Factors *– Factors that could lead to negative rating action/downgrade*

- Further stretching of WC cycle impacting liquidity
- Any large debt funded capex

Detailed description of the key rating drivers

Key Rating Strengths

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.

Expectation of improved margin in FY21 with higher exports and improvement in capital structure

During FY20, the company's sales improved on the back of higher realization and higher sales volume when compared to FY19. However, the margins were affected due to the late start of the season and lower recovery rate. During FY21, the company is expected to export 5176 MT of sugar as per Maximum Admissible Export Quota and with the export subsidy announced by Govt. in Dec '20 and assistance of Rs. 5.8/kg is assured. The company is expected to garner Rs. 18 Cr in export revenue in FY21. As on March 31, 2020 the overall gearing of the company was at 2.12x as against 2.43x the previous period. During FY21, the company converted Rs. 40 Cr working capital limit to Working Capital Term Loan (WCTL) repayable in quarterly instalments over a period of 7 years and reduced the working capital limit from Rs.99 Cr to Rs.59 Cr.

[1]*Complete definitions of the ratings assigned are available at www.careratings.com and in other CARE publications.*

As on December 31, 2020 the company had working capital borrowing of Rs. 126.33 Cr (as on March 31, 2020 – Rs. 167.41 Cr) and term loan of Rs. 69.18 Cr (as on March 31, 2020 – Rs. 32.18 Cr).

Satisfactory debt repayment track record since February 2020

The company has maintained a delay free track record since Feb 2020, after reporting delay in repayments in 2 term loans of Syndicate Bank and the same was pre-closed in FY21. The bankers have confirmed the servicing of interest and installment towards its loans are regular without any delays.

Improved operational performance in 10MFY21 with higher recovery rate, however crushing days remain low

The heavy rainfall in Karnataka during the months of September and October 2019 had led to delay in the start of crushing season and the factories lost close to 30 crushing days. As a result, the crushing days reduced to 117 days (SS18-19: 146 days). The recovery rate fell to 9% from the previous season's 9.5%. As on March 31, 2020 the company had cleared all the cane arrears. PAT margin fell from 2.83% to 0.52% due to lower crushing days and increased interest expense. The lower crushing days in SS19-20 had affected the power production of the co-gen plant due to reduced supply of the raw material, bagasse. In 10MFY21, the recovery rate of sugar improved to 9.48% due to favourable climatic conditions, however the crushing days fell during the period as the catchment area was diversified for cultivation of paddy and areca nut. Till February '21, the company crushed for 132 days.

Significant fall in inventory levels, however working capital cycle continues to remain stretched due to the inherent nature of the industry

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. During FY18 & 19, operating cycle of the company stood high at 404 days and 403 days respectively on account of holding inventory in expectation to realize at higher prices and high short term advances given for farmers and harvesting gangs. During FY20, the company offloaded a huge amount of finished inventory at higher realization compared to FY19. The inventory days fell from 370 days in FY19 to 155 days in FY20. In addition to this, as on March 31, 2020 the company has cleared all the cane arrears with the farmers and thus creditor period fell by 11 days from 19 days to 8 days. All this led to a contraction of working capital cycle from 403 days to 200 days.

Key Rating Weaknesses

Cyclical and regulated nature of the industry

Cyclical nature of the sugar industry significantly impacts the operating performance and cash flow generation of the sugar companies. The raw material prices are regulated by the government. In addition to this, sale and distribution of by-products (molasses and power) are also regulated at different levels in different States. Integrated players are in a better position to counter cyclicality of the sugar business.

Liquidity : Stretched

The Company's liquidity position is stretched with average 12-month Dec '20 utilisation of the working capital borrowing at 96%. As on March 31, 2020 the company's current ratio was 0.81x against 0.92x the previous year. During FY21, the company availed moratorium under RBI's COVID 19 package and deferred the interest obligation towards cash credit and the interest capitalized Rs. 2.46 Cr has to be repaid by March 31, 2021. Moreover, the company availed COVID19 relief term loan of Rs. 5.1 Cr to fund temporary liquidity mismatches. The debt repayment obligations during FY21 is Rs. 12.62 Cr and out of which the company has already made repayment of Rs. 9.32 Cr as on February 28, 2021. As on December 31, 2020 the company had free cash and bank balance of Rs. 3.15 Cr.

Analytical approach: Standalone

Applicable Criteria

Criteria on assigning 'outlook' and 'credit watch' to Credit Ratings
CARE's Policy on Default Recognition
Rating Methodology- Manufacturing Companies
Financial ratios - Non-Financial sector
Criteria for Short Term Instruments
Rating Methodology - Sugar Sector
Liquidity Analysis of Non-Financial Sector Entities

About the Company
Davangere Sugar Company Limited 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 Board of Industrial and Financial Reconstruction 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. As on March 31, 2019, the promoters hold 59.54% stake in DSCL. The company has an installed sugar crushing capacity of 4750 TCD and a multi fuel co-generation unit of 24.5MW.

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

Brief Financials (Rs. crore)	FY19 (A)	FY20(A)
Total operating income	113.96	203.29
PBILDT	31.51	33.59
PAT	3.22	2.07
Overall gearing (times)	2.43	2.12
Interest coverage (times)	1.76	1.54

A: Audited
Status of non-cooperation with previous CRA:
Not Applicable
Any other information:
Not Applicable
Rating History for last three years: Please refer Annexure-2

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. 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	-	-	-	July, 2027	41.35	CARE BB-; Stable

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018
1.	Fund-based - LT-Cash Credit	LT	59.00	CARE BB-; Stable	1)CARE B; Stable (02-Jul-20) 2)CARE C; Stable; ISSUER NOT COOPERATING* (06-May-20)	1)CARE C; Stable (28-Jan-20)	1)CARE BB+; Stable (11-Jan-19)	1)CARE BB+; Stable (05-Jan-18) 2)CARE BBB-; Negative (05-Apr-17)
2.	Non-fund-based - ST-Letter of credit	ST	13.22	CARE A4	1)CARE A4 (02-Jul-20) 2)CARE A4; ISSUER NOT COOPERATING* (06-May-20)	1)CARE A4 (28-Jan-20)	1)CARE A4+ (11-Jan-19)	1)CARE A4+ (05-Jan-18) 2)CARE A3 (05-Apr-17)
3.	Term Loan-Long Term	LT	41.35	CARE BB-; Stable	1)CARE B; Stable (02-Jul-20) 2)CARE D; ISSUER NOT COOPERATING* (06-May-20)	1)CARE D (28-Jan-20)	1)CARE BB+; Stable (11-Jan-19)	1)CARE BB+; Stable (05-Jan-18) 2)CARE BBB-; Negative (05-Apr-17)

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

Cash Credit and Working Capital Demand Loan	Detailed explanation
A. Financial covenants	
I. Total outside liabilities/ Total Networth	Total outside liabilities/ Total Networth <= 5x

Annexure 4: Complexity level of various instruments rated for this Company

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

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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