Davangere Sugar Company Limited

March 14, 2024

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long-term bank facilities	182.85	CARE BB+; Stable	Reaffirmed
Short-term bank facilities	13.22	CARE A4+	Reaffirmed

Details of instruments/facilities in Annexure-1.

Rationale and key rating drivers

Ratings assigned to bank facilities of Davangere Sugar Company Limited (DSCL) factor in the expectation of lower crushing in SS24 (sugar season; refers to October 1, 2023, to September 30, 2024), which would impact sugar production. While this may impact sugar sales, it is likely to be cushioned by better realisation of sugar and adequate inventory of B-Heavy molasses and maize for ethanol production. Overall, CARE Ratings Limited (CARE Ratings) estimates the company to maintain its FY24 sales in line with FY23. Ratings are constrained by moderate capital structure though improving, the company's presence in the cyclical and regulated sugar industry, and inherent agro-climatic risk.

Ratings' weaknesses are partially offset by stabilising the company's multi-feed ethanol plant, which can operate on grains in the off-season. Ratings also positively factor in the company's long operational track record, experienced promoters, and improving operating cycle.

Rating sensitivities: Factors likely to lead to rating actions

Positive factors

- Improving scale of operations above ₹300 crore with term debt (TD) /profit before depreciation, interest, and tax (PBDIT) less than 1.5x and interest coverage ratio (ICR) above 2.5x.

Negative factors

- Deteriorating overall gearing beyond 2.50x with TD/gross cash accruals (GCA) above 10x and ICR below 1.50x.

Analytical approach: Standalone

Outlook: Stable

'Stable' outlook reflects CARE Ratings' expectation that the company can maintain its stable business profile aided by distillery operations, while maintaining profitability margins.

Detailed description of the key rating drivers:

Key weaknesses

Moderate capital structure with satisfactory debt coverage indicators

The company's capital structure, marked by overall gearing, though improved, to 1.75x as on March 31,2023 when compared to 3.05x as on March 31, 2022, remaining moderate. The improvement was considering unsecured loans from promoters into equity, though working capital utilisation remained high to fund purchase of sugarcane in the crop season. Interest coverage stood at 2.06x in FY23 as compared to 1.80x in FY22 from improved profit before depreciation, interest, and taxes (PBDIT) in the year. With no major debt-funded capex plans, CARE Ratings expects the capital structure would improve gradually over the years.

Moderation in profitability margins; recovery seen in 9MFY24 aided by distillery business

Profitability has normalised to previous level with PBILDT at 19.93% in FY23 when compared to 27.69% in FY22. Correction in margin was from export ban on sugar and increase in raw material costs backed by increase in sugarcane prices. The profit after taxes (PAT) margins remained stable at 4.72% in FY23 as compared to 4.57% in FY22. The PBILDT margin in 9MFY24 remains in line with FY23, slightly improved to 24.90% mainly aided by better margins from distillery business. In a normalised scenario, company is likely to maintain PBILDT margin of 20-22% against 16-18% earned earlier primarily due to ethanol production.

Cyclical and regulated industry

The industry is cyclical and vulnerable to government policies for factors such as importance in Wholesale Price Index (WPI), as sugar is classified as an essential commodity. Governments (both Union and State) resort to regulations such as fixing raw material (sugarcane) prices under Fair & Remunerative Prices (FRP) and State Advised Prices (SAP). All these factors impact sugarcane

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

cultivation patterns in the country, affecting profitability for sugar companies. India also continues to carry high levels of sugar inventory, largely due to controlled release mechanism followed by the Government. The company's performance can be impacted by disproportionate increase in cane price in a particular year. Furthermore, profitability remains vulnerable to Government's policies on exports, MSP, and remunerative ethanol prices. In addition, cyclicality in sugar production results in volatile sugar prices. Sharp contraction in sugar prices is curtailed after the Central Government introducing MSP in June 2018.

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

Key strengths

Improving scale of operations driven by commencing of the distillery business
In Q1FY23, the company started its multi-feed distillery unit to produce ethanol, which is sold to oil manufacturing companies. The company's operations are partially integrated in the form of 24.45 MW co-generation unit. Income from sale of power ESCOM's contributes around 5-10% of the total income.
The total operating income of the company improved to ₹279.94 crore in FY23 as compared to ₹124.23 crore in FY22, which was majorly driven by improved prices for sugar and diversification into ethanol. Commencing ethanol production led to decrease in share from sugar segment from 73% in FY22 to 46% in FY23. In 9MFY24, the company achieved a total revenue of ₹157.52 crore. Increase in sugar prices and availability of maize and B-Heavy molasses stock would help in maintaining sales levels in FY24 similar to FY23, despite expectation of lower crushing in the current sugar season.

Improvement in operating cycle.
The sugar industry is characterised by high levels of inventory holding (due to seasonality associated with sugarcane), coupled with low credit on sugarcane purchase, making the company's operations working capital intensive. Sugar industry being seasonal has high working capital requirements in peak season, which is from November to April.
The average working capital utilisation slightly improved, though remaining high, at 88.07% for 12-months ended December 31, 2023. However, the company's operating cycle improved significantly and normalised to previous level at 195 days in FY23 as compared to 419 days in FY22. Elongating operating cycle in FY22 was due to increased inventory levels from increased storage of molasses and sugar syrup to maintain adequate stock for ethanol production in FY23. The collection period has also seen an improvement and stood at 37 days as compared to 99 days previous year due to reduction in credit period offered to customers, which was stretched earlier owing to COVID-19 and lower demand for sugar. The company's credit period stood at 16 days in FY23 as compared to 8 days in FY22, as mostly sugarcane payables to the farmer.

Long track record and experienced promoters
DSCL has more than five decades of track record in its present line of business. DSCL enjoys established relationship with farmers operating in the same region over the decades. The company's day-to-day operations are managed by SS Ganesh (MD), who is adequately supported by a group of professionals having rich business experience in the operative industry.

Liquidity: Adequate

The company's liquidity is adequate marked by improving operating cycle to 195 days in FY23 as compared to 419 days in FY22, which was mainly due to stock maintained for ethanol production. Working capital utilisation slightly improved though remained high at 88.07% in 12-months ended December 31,2023, as the company's operations are working capital intensive due to inventory stocking.4
The company is expected to generate sufficient cash accruals against future repayment obligation. The company's current ratio stood satisfactory at 1.29x as on March 31, 2023. The company had unencumbered cash and bank balance of ₹ 7.78 crore as on December 31, 2023.

Applicable criteria

Definition of Default
Liquidity Analysis of Non-financial sector entities
Rating Outlook and Rating Watch
Manufacturing Companies
Sugar
Financial Ratios – Non financial Sector
Short Term Instruments

About the company and industry

Industry classification

Macro-economic indicator	Sector	Industry	Basic industry
Fast-moving consumer goods	Fast-moving consumer goods	agricultural food and other products	Sugar

DSCL was incorporated in 1970 and acquired by current promoters in 1995. SS Ganesh takes care of the day-to-day functioning of the company.

The company commenced operation with an installed capacity of 1250TCD sugar, subsequently, its sugar crushing capacity was enhanced to 4750TCD. DSCL also operates a multi fuel co-generation unit of 24.45 MW. The company commenced operations of its distillery unit of 65 KLPD capacity in Q1FY23.

Brief Financials (₹ crore)	March 31, 2022 (A)	March 31, 2023 (A)	December 31, 2023 (UA)
Total operating income	124.23	279.94	157.52
PBILDT	34.40	55.81	39.23
PAT	5.68	13.22	7.68
Overall gearing (times)	3.05	1.75	NA
Interest coverage (times)	1.80	2.06	1.90

A: Audited UA: Unaudited NA: Not Available; Note: 'these are latest available financial results'

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

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

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

Complexity level of 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	-	-	-	-	80.02	CARE BB+; Stable
Non-fund-based - ST-Letter of credit	-	-	-	-	13.22	CARE A4+
Term Loan-Long Term	-	-	-	March 2028	102.83	CARE BB+; Stable

Annexure-2: Rating history for 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 2023-2024	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
1	Fund-based - LT-Cash Credit	LT	80.02	CARE BB+; Stable	-	1)CARE BB+; Stable (03-Feb-23)	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)
2	Non-fund-based - ST-Letter of credit	ST	13.22	CARE A4+	-	1)CARE A4+ (03-Feb-23)	1)CARE A4 (31-Mar-22)	1)CARE A4 (09-Mar-21) 2)CARE A4 (02-Jul-20) 3)CARE A4; ISSUER NOT COOPERATING* (06-May-20)
3	Term Loan-Long Term	LT	102.83	CARE BB+; Stable	-	1)CARE BB+; Stable (03-Feb-23)	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)

*Issuer did not cooperate; based on best available information.
^LT: Long term; ST: Short term

Annexure-3: Detailed explanation of covenants of rated instruments/facilities: Not applicable

Annexure-4: Complexity level of 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 complexity levels of rated instruments: CARE Ratings has classified instruments rated by it based on complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careedge.in for clarifications.

Contact us

Media Contact	Analytical Contacts
Mradul Mishra Director **CARE Ratings Limited** Phone: +91-22-6754 3596 E-mail: mradul.mishra@careedge.in	Karthik Raj K Director **CARE Ratings Limited** Phone: +91-80-46625555 E-mail: karthik.raj@careedge.in
Relationship Contact Saikat Roy Senior Director **CARE Ratings Limited** Phone: +91-22-6754 3404 E-mail: saikat.roy@careedge.in	Himanshu Jain Associate Director **CARE Ratings Limited** Phone: +91-80-46625555 E-mail: himanshu.jain@careedge.in Rajat Verma Analyst **CARE Ratings Limited** E-mail: Rajat.Verma@careedge.in

About us:

Established in 1993, CARE Ratings is one of the leading credit rating agencies in India. Registered under the Securities and Exchange Board of India, it has been acknowledged as an External Credit Assessment Institution by the RBI. With an equitable position in the Indian capital market, CARE Ratings provides a wide array of credit rating services that help corporates raise capital and enable investors to make informed decisions. With an established track record of rating companies over almost three decades, CARE Ratings follows a robust and transparent rating process that leverages its domain and analytical expertise, backed by the methodologies congruent with the international best practices. CARE Ratings has played a pivotal role in developing bank debt and capital market instruments, including commercial papers, corporate bonds and debentures, and structured credit.

For the detailed Rationale Report and subscription information, please visit www.careedge.in