Avadh Sugar & Energy Limited

July 05, 2019

Ratings

Facilities	Amount (Rs. crore)	Ratings1	Rating Action
Long-term Bank Facilities	957.23 (reduced from 968.80)	**CARE BBB+; Stable (Triple B Plus; Outlook: Stable)**	**Reaffirmed**
Short-term Bank Facilities	39.80	**CARE A2 (A Two)**	**Reaffirmed**
Total	**997.03 (Rupees Nine Hundred and ninety seven crore and three lakh Only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of Avadh Sugar & Energy Limited (ASEL) continues to derive strength from experienced promoters with long track record of operations, integrated business model resulting in diversified revenue streams and performance in FY19 (refers to the period April 1 to March 31) supported by forward integrated units of ethanol and co-generation and various measures announced by the government to support the sugar industry.

The ratings also factor in the working capital intensive nature of business leading to leveraged capital structure, elevated operating cycle, vulnerability of operations to agro climatic conditions and cyclical, seasonal and regulated nature of the industry.

Going forward demand supply dynamics and price movements of sugar and sugarcane in domestic and international markets, government regulations pertaining to the sugar industry and ability of the company to manage its working capital and improve its capital structure are the key rating sensitivities.

Detailed description of the key rating drivers

Key Rating Strengths

Experienced promoters and long track record of operations

ASEL belongs to Mrs. Nandini Nopany and Mr C.S. Nopany faction of the erstwhile KK Birla group of companies. The group is an established business house having interest in sugar, textiles and fertilizers. Sutlej Textiles and Industries Limited (rated CARE A+; Stable/CARE A1+) belonging to the promoters is among India's leading producers of dyed spun yarn and value added/speciality yarn. Chambal Fertilizers and Chemicals Limited, where the Nandini Nopany faction is one of the three promoter groups, is engaged in the manufacture of urea and trading of complex fertilizers and pesticides. The sugar units of ASEL have an operational track record of over eight decades which were earlier operating under Upper Ganges Sugar & Industries Limited (UGSIL) and Oudh Sugar Mills Limited (OSML). The combined sugar capacity of the group (49,200 TCD) is one of the largest in the Indian sugar industry.

Integrated business model resulting in diversified revenue streams

All of ASEL's sugar manufacturing units located in Uttar Pradesh are integrated with co-generation power plant. Further, of the above units, the sugar units located in Hargaon and Seohara are forward integrated with a distillery unit. Integrated business model provides alternate revenue stream and cushion against cyclicality of the sugar business, to some extent. During FY19, the distillery and the cogeneration segment, collectively contributed to 16.39% of the gross revenue (as against 11.67% in FY18) and 78.29% of the PBIT (as against 42.51% in FY18).

Performance in FY19 supported by forward integrated units of ethanol and co-generation and various measures announced by the government to support the sugar industry

Despite subdued operating income during FY19 owing to declined sugar prices (ASP of Rs.30.03/kg in FY19 as against Rs.35.51/kg in FY18) as a result of over-supply pursuant to record production in SS18 and SS19; the company was able to post improved profitability (PBILDT margin up from 11.29% in FY18 to 13.78% in FY19) led by improved performance of the cogeneration and the distillery segments (as a result of higher production of molasses and bagasse upon 10% higher quantum of sugar cane crushed in SS19), inventory gains and support in the form of various government incentives. Various government initiatives like introduction of minimum support price of sugar at Rs.29/kg in June 2018 and its increase to Rs.31/kg in February 2019, resulting in inventory gains, quota based supply controls minimising price impact, diversion of sugarcane for alternate usage by increasing ethanol blending standards and thereby reducing sugar supply, increased export incentives to reach Minimum Indicative Export Quantity (increased from 2 million to 5 million), introduction buffer stock & state subsidies had a positive impact on the company's financial health.

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

Segment wise performance analysis is hereunder:

Sugar segment: 10% higher sugarcane crushing in FY19 coupled with higher recovery (11.80% vis-à-vis 11.26% in FY18) led to increased sugar production; however, realisations fell drastically to Rs.30.03/kg in FY19 from Rs.35.51/kg in FY18 owing to supply glut in the industry in spite of government measures for controlling supply and thereby, supporting prices. The decline in segment PBIT from Rs.142.55 crore in FY18 to Rs.68.01 crore in FY19 was starker owing to lower transfer pricing of molasses in FY19 (@ Rs.74.27/quintal in FY19 vis-à-vis Rs.266.36/quintal in FY18).
Distillery Segment: ASEL's distillery segment posted stupendous improvement in profitability (PBIT of Rs.142.14 crore in FY19, up from Rs.57.16 crore in FY18) as a result of lower transfer pricing of molasses as mentioned above as also for higher molasses availability upon increased crushing.
Power Segment: Increased bagasse production as mentioned above had a corresponding effect on power division's performance (PBIT of Rs.54.60 crore on a total revenue of Rs.194.86 crore in FY19 as against Rs.39.98 crore PBIT on Rs.160 crore of revenue in FY18)

Key Rating Weaknesses
Working capital intensive nature of operations leading to leveraged capital structure:
Since sugar is an agro-based commodity (with sugarcane crushed mainly during November to April), sugarcane has to be crushed within a day or two of its arrival in the mills. Hence, the sugar inventory is piled up during the crushing season and gradually released till the commencement of the next crushing season, resulting into high inventory carrying cost and requirement of high working capital. Gradually, the inventory declines and reaches a minimum by the end of September or October. In addition, various government measures to control supply of sugar amidst record production such as maintenance of buffer stock, monthly sales quota also resulted in an increase in inventory, thus necessitating a high level of bank borrowing to finance the same. In line with the level of inventory, the overall gearing of ASEL stood high at 3.11x as in March 31, 2019 (as against 3.46x as on March 31, 2018) which was at relatively lower levels in at 2.22x as on September 30, 2018 (as against 1.87x as on September 30, 2017). In addition, around 33% of the total debt outstanding as on March 31, 2019 comprised soft loans under financial assistance schemes where interest rates ranged between 0%-5%. Further, the company is undertaking expansion of its distillery capacity and would avail soft loan funding to part finance the same.

Elevated Operating Cycle
The company's inventory period increased from 182 days in FY18 to 248 days (in view of buffer stock as well as high production) in FY19. The creditor days also increased in FY19 due to increase in cane arrears. However, of the total cane purchases for SS19, the company had cleared 83% of the cane dues as on June 17, 2019, partly out of the soft loan (@2.6% for one year) taken in April 2019. Increase in inventory period led to elongation of the operating cycle which increased from 147 days in FY18 to 186 days in FY19.

Vulnerability of operations to agro climatic conditions
Being an agro-based industry, performance of ASEL is dependent on the availability of sugarcane for crushing which may get adversely affected due to adverse weather conditions resulting into lower availability and diversion of cultivable lands to alternate crops.

Cyclical and seasonal nature of the industry
The production of sugarcane is on an uptrend for two years and then declines over the next two years, before trending up again. It is a typical cycle which is affected more by cane and sugar supply than by sugar demand. Further, depending on the variety of the cane, the sugar cane takes around 12-18 months to be harvested from the time it is sown. The crushing of cane typically begins from the month of November and goes up to April while sugar sales happen throughout the year.

Regulated nature of the industry
The industry is cyclical by nature and is vulnerable to the government policies for various reasons like its importance in the Wholesale Price Index (WPI) as it classifies as an essential commodity. The government on its part resorts to various regulations like fixing the raw material prices in the form of State Advised Prices (SAP) and Fair & Remunerative Prices (FRP), Minimum Sale Price of Sugar, mandatory ethanol blending etc. All these factors impact the cultivation patterns of sugarcane in the country and thus affect the profitability of the sugar companies. Further, the government has also announced various other incentives like export quotas and subsidies, financial assistance for carrying of buffer stock and in the form of soft loans to clear cane dues, introduction of monthly sales quota, etc. to support the industry.

Prospects
For the entire sugar year 2018-19, Indian Sugar Mills Association (ISMA) estimates sugar output to increase from 32.5 million tonnes in SS18 (refers to period from October to September) to 33.0 mn tonnes in SS19. Considering these

estimates India will have a closing stock of 14.7 million tonnes of sugar which is sufficient to fulfill the requirement of about 5-6 months of country's sugar consumption. This is much more than the normative requirement of 2 months stock that India keeps to avoid any disturbance in sugar supply. However, due to various government regulations, such as increase in minimum sale price of sugar at Rs.31 per kg in Feb 2019 from Rs. 29/kg, the prices are expected to have a support. Other government initiatives such as increase in the ethanol prices to support sugar mills and providing financial assistance to mills to help them clear payment to farmers are also expected to augur well for the industry. Sugar production, though expected to be lower in SS2019-20, is expected to be more than domestic requirement (ISMA). Government policy in respect of SAP, MSP, buffer stock, subsidies, etc., shall be critical.

Adequate Liquidity:
The company earned GCA of Rs.163.53 crore in FY19 against a term debt repayment obligation of Rs.70.76 crore in the year. In FY20, the company has a debt repayment obligation of around Rs.120 crore. For sugar companies, the utilization of bank limit (& drawing power) follows a certain cycle. It peaks at the end of sugar crushing season due to build-up of inventory and gradually becomes low before start of next sugar season. While the average fund based working capital utilisation of the company remained low at around 61% and 43% (excluding buffer stock) during the last 12 months ending May 2019, the peak utilization stood at 87% and 70% (excluding buffer stock) in April 2019.

Analytical approach*:* Standalone Approach.

Applicable Criteria
Criteria on assigning Outlook to Credit Ratings
CARE's Policy on Default Recognition
Criteria for Short Term Instruments
Rating Methodology-Manufacturing Companies
Financial ratios – Non-Financial Sector

About the Company
Avadh Sugar & Energy Limited (ASEL') was incorporated on March 19, 2015 with the purpose of transferring sugar units in Uttar Pradesh (UP) of Oudh Sugar Mills Limited (OSML) and Upper Ganges Sugar & Industries Limited (UGSIL) to a separate entity. UGSIL and OSML were incorporated in 1932 by the erstwhile KK Birla group. Ms. Nandini Nopany and Mr. Chandra Shekhar Nopany, eldest daughter and grandson of the late Mr. K. K. Birla, inherited UGSIL and OSML after the demise of Mr. K. K. Birla on August 30, 2008. Through a Composite Scheme of Arrangement, the business undertakings located at Seohara, UP of UGSIL and business undertakings located at Hargaon, Hata, and Rosa, UP of OSML have been transferred to ASEL at their respective fair values on a going concern basis (appointed date April 1, 2015). ASEL is primarily engaged in manufacture and sale of sugar and its by-products (molasses and bagasse), spirits including Ethanol and co-generated power in the state of UP.
ASEL is currently operating four sugar mills with an aggregate crushing capacity of 31,700 TCD, co-generation power plants of 74 MW and distillery units of 200 KLPD.

Brief Financials (Rs. crore)	FY18 (Audited)	FY19 (Abridged)
Total operating income	2404.90	2132.29
PBILDT	271.62	293.85
PAT	88.16	119.87
Overall gearing (times)	3.46	3.11
Interest coverage (times)	2.40	3.07

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	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT-Cash Credit	-	-	-	614.30	CARE BBB+; Stable
Fund-based - LT-Term Loan	-	-	October 2025	342.93	CARE BBB+; Stable
Non-fund-based - ST-Bank Guarantees	-	-	-	39.80	CARE A2

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 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
1.	Fund-based - LT-Cash Credit	LT	614.30	CARE BBB+; Stable	-	1)CARE BBB+; Stable (31-Mar-19) 2)CARE A-; Stable (06-Apr-18)	1)CARE A-; Stable (03-Aug-17)	-
2.	Fund-based - LT-Term Loan	LT	342.93	CARE BBB+; Stable	-	1)CARE BBB+; Stable (31-Mar-19) 2)CARE A-; Stable (06-Apr-18)	1)CARE A-; Stable (03-Aug-17)	-
3.	Non-fund-based - ST-Letter of credit	ST	4.80	CARE A2	-	1)CARE A2 (31-Mar-19) 2)CARE A2+ (06-Apr-18)	1)CARE A2+ (03-Aug-17)	-
4.	Non-fund-based - ST-Bank Guarantees	ST	39.80	CARE A2	-	1)CARE A2 (31-Mar-19) 2)CARE A2+ (06-Apr-18)	1)CARE A2+ (03-Aug-17)	-
5.	Fund-based - ST-Working Capital Demand loan	ST	-	-	-	1)Withdrawn (31-Mar-19) 2)CARE A2+ (06-Apr-18)	-	-

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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