Avadh Sugar & Energy Ltd

September 29, 2020

Ratings

Facilities	**Amount (Rs. crore)**	**Rating[1]**	**Rating Action**
Long Term Bank Facilities	870.42 (reduced from 957.23)	CARE A-; Stable (Single A Minus; Outlook: Stable)	Revised from CARE BBB+; Stable (Triple B Plus; Outlook: Stable)
Short Term Bank Facilities	20.00 (reduced from 39.80)	CARE A2+ (A Two Plus)	Revised from CARE A2 (A Two)
Total	**890.42 (Rupees eight hundred ninety crore and forty two lakh only)**		

Details of facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The revision in the ratings assigned to the bank facilities of Avadh Sugar & Energy Ltd (ASEL) factors in improvement in cash flows from operations in FY20 (refers to period April 1 to March 30) as evidenced by healthy volumes in sugar sales supported by the higher exports and increased domestic sugar realisations. Further the revision also factors in the expectation of improvement going forward with receipt of subsidies booked in FY20 and with commencement of the expanded distillery facilities, enabling the company to produce higher proportion of B heavy molasses which was limited in the current season owing to capacity bottleneck. Consequently, profitability is likely to improve and is expected to have a positive bearing on the capital structure going forward. The revision in ratings also factor in the continued support from the Government to the sugar industry viz. upward revision in minimum support prices, interest subvention loans for ethanol expansion, soft loans and export subsidy, which has benefited integrated sugar producers like ASEL.

The ratings also derive strength from experienced promoters with long track record of operations, integrated business model resulting in diversified revenue streams. The profitability in FY20 had shown some moderation due to reduction in power tariff, while moderation in profits in Q1FY21, was on account of lower sugar prices amidst lower bulk demand and slow off-take of ethanol during COVID induced lockdown. However, ethanol off-take by Oil Marketing Companies (OMCs) and sugar prices have stabilized currently and company is likely to benefit from the cane diversion towards its enhanced distillery capacities with more ethanol production and lower sugar production. In the scenario of high sugar inventory, while sugar sales in India are currently governed by a selling quota, there is thrust of increasing ethanol blending to move towards government’s target as per the Ethanol Blended Petrol Programme.

The ratings also factor in the working capital intensive nature of business aggravated by consecutive seasons of record sugar production leading to elevated operating cycle and leveraged capital structure, albeit a significant proportion of debt comprised of soft loans, project risk, vulnerability of operations to agro climatic conditions and cyclical, seasonal and regulated nature of the industry.

Key Rating Sensitivities

Positive Factors

- Improvement in capital structure with overall gearing (<1.5x), TD/GCA (<6x) and interest coverage (>5x) on a sustained basis.

Negative Factors

- Significant decline in sugar prices affecting profitability of the company with deterioration in PBILDT margin (<10%) and PAT margin (<3%) on a sustained basis.
- Deterioration in capital structure with overall gearing (>2.7x), TDGCA (>10x) and interest coverage (<2x) on a sustained basis.
- Any regulatory change having the potential to materially impact the company’s performance negatively on a sustained basis.

Detailed description of the key rating drivers

Key Rating Strengths

Experienced promoters and long track record of operations

ASEL belongs to the 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

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

pesticides. The group also operates sugar mills in Bihar through another group company Magadh Sugar & Energy Ltd (MSEL). The sugar units of ASEL and MSEL have an operational track record of over eight decades and 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 FY20, the distillery and the cogeneration segment, collectively contributed to 14% of the total segment revenue (as against 19% in FY19) and 50% of the PBIT (as against 74% in FY19). The decrease in power tariff by UPERC resulted in lower contribution from the electricity segment y-o-y in FY20. With commencement of increased distillery capacity, ASEL is expected to benefit from better level of integration.

Even with higher sugar sales, profits impacted in FY20 and in Q1FY21, however, future profits to be supported by higher proportion of ethanol sales post distillery expansion
The total operating income (TOI) increased by 20% y-o-y primarily due to higher sugar sales in the year driven by increase in exports volumes and higher sugar realizations (including export subsidy). This also aided the company in improving its cash flow from operations on a y-o-y basis. The TOI was however negatively impacted by lower power tariff in FY20 as against last year which also resulted in lower PBILDT levels in FY20 vis-à-vis that in FY19. Lower recovery of sugar (on account of diversion of more cane towards production of ethanol through the B Heavy molasses route) didn't immediately translate into profit on account of lower off-take from OMCs, due to slowdown from March 2020 which continued in Q1FY21. Further, in Q1FY21, the sugar prices had decreased due to decline in demand from bulk consumers, consequent to the lockdown. Currently, the off-take from OMCs and sugar prices have both increased and stabilized. Moreover, going ahead cash flows are likely to increase with higher ethanol sales and increased proportion of B heavy molasses and receipt of subsidies booked in FY20.
Various government initiatives like increase of minimum support price of sugar from Rs.29/kg to Rs.31/kg in February 2019, quota based supply controls minimising price impact, diversion of sugarcane for alternate usage by increasing ethanol blending standards and increase in prices of ethanol, increase in quantum of assistance based export of sugar from 5 mn to 6 mn ton, increase in buffer stock & state subsidies had a positive impact on the company's financial health.

Segment wise performance analysis is hereunder:
Sugar segment: Sugar production increased only marginally even with higher sugar cane crushed due to decline in recovery rate from 11.80% in FY19 to 11.44% in FY20. This was primarily due to the production of ethanol through the B heavy molasses route. The sugar sales volumes had increased by 22% y-o-y to 6.80 lakh tonnes in FY20 on account of exports and the average realizations of sugar sold increased from Rs.30.03/kg in FY19 to Rs.31.40/kg (including export subsidy) in FY20. The increase in PBIT from the sugar segment from Rs.68 crore to Rs.121 crore in FY20 was also due to increase in transfer prices of molasses. During Q1FY21, even with a y-o-y increase in sugar sales volumes the profits were impacted due to decline in sugar realizations.

Distillery Segment: ASEL's distillery division's revenue moderated by 7% to Rs.236 crore in FY20. This was due to lower sales volumes of ethanol during Q4FY20, even when production remained at similar levels. Lower sales were due to lower off take from OMCs on the back of slowdown witnessed from March 2020. Although off-take in Q1FY21 continued to be lower than the contracted levels, there was a y-o-y increase in sales in distillery segment. However, PBIT in FY20 and Q1FY21 was impacted due to higher transfer price of molasses from the sugar segment.

Power Segment: The major reason for the decrease in revenue and PBIT from the power segment was the decrease in tariff rates by Uttar Pradesh Electricity Regulatory Commission (UPERC) by around Rs.2/KwH in FY20. Further, even with higher crushing and higher production of bagasse the electricity generated reduced as ASEL, preferred to sell bagasse directly in some instances instead of consuming the same to produce power.

Liquidity: Adequate
ASEL has not availed any moratorium or any emergency credit line from its banks. It has repaid Rs.37cr till July 31, 2020 out of scheduled debt repayment obligation of Rs.122cr for FY21 and it is expected that cash accruals in the remaining part of the year would be adequate to meet the balance repayment obligations. Further, receipt of subsidies booked in FY20 is also expected to support liquidity in FY21. ASEL's liquidity is also supported by unutilised lines of fund based limits where average utilization stood at 80% (sanctioned limits Rs.1075 crore) for the last 12 months ended July 2020. For sugar companies, the utilization of bank limit (& drawing power) follows a certain cycle. It peaks at the end of sugar crushing season (Mar/Apr) due to build-up of inventory and gradually becomes low before start of sugar season (Sep/Oct).

Key Rating Weaknesses

Working capital intensive nature of operations leading to leveraged capital structure, albeit a significant proportion of debt comprised of interest free working capital loans for maintenance of buffer stock and soft loans with interest subventions

Although, sugar inventory usually decreases at the start of the crushing season (Sep/Oct) and piles up at the end of the sugarcane crushing cycle (March/April), ASEL's sugar inventory has been consistently high since March 2019, owing to high production in the last few sugar seasons. This has also resulted in higher level working capital borrowing to finance the same. Around 55% of the outstanding borrowings on March 31, 2020 (60% on March 31, 2019) comprised working capital borrowing. Further, around 45% (33% as on March 31, 2019) of the total debt outstanding as on March 31, 2020 comprised soft loans under financial assistance schemes where interest rates ranged between 0%-5%.

In line with the level of inventory, the overall gearing of ASEL stood high but improved from at 3.11x as in March 31, 2019 to 2.74x as on March 31, 2020 and further to 2.65x as on June 30, 2020. Interest coverage and TD/GCA however, saw some moderation due to increase in debt levels and interest costs and lower operational profit and GCA due to the impact of power segment. Further, the company has also taken complete drawdown of loan with interest subvention for expansion of distillery project in Q2FY21. However, going ahead with increased production of ethanol by more diversion of cane towards the ethanol segment, the profits and cash flows in the future are expected to have a positive bearing on the capital structure.

Elevated Operating Cycle

The company's inventory period continued to be high at 236 days in FY20 (248 days in FY19) due to high sugar inventory. However, around 25% of the sugar inventory (in terms of volumes) was buffer stock where carrying costs was being borne by the government. With second year of record sugar production and government regulations to control supply, there was inventory buildup for most parts of FY20, however, ASEL sold higher sugar during the latter part of the year supported by exports and closing stock was at similar levels on March 31, 2020 when compared to that on March 31, 2019. The creditor days of the company were also high at 84 days in FY20 (79 days in FY19) on account of outstanding cane arrears of Rs.599 crore as on Mar'20. Cane arrears have reduced to Rs.179 crore as on August 31, 2020. The operating cycle was primarily marked by the high inventory and improved from 186 days in FY19 to 169 days in FY20.

Project Risk

ASEL is undertaking a distillery expansion by 20 KLPD and also increasing the no. of working days by changing boilers that can also operate during off-season of monsoon. The project cost is Rs.145 crore expected to be financed through Rs.95 crore soft loan and balance internal accruals. The project is in the advanced stage of implementation and company expects to commission the same in the upcoming sugar season. Timely execution and off take from the projects have the potential to impact profits and cash flows going forward.

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 (MSP) 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 had 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.

Analytical approach: Standalone

Applicable Criteria

Criteria on assigning Outlook and credit watch to Credit Ratings
CARE's Policy on Default Recognition

Criteria for Short Term Instruments
Rating Methodology-Manufacturing Companies
Rating Methodology- Sugar Sector
Financial ratios – Non-Financial Sector
Liquidity Analysis of Non-Financial Sector Entities
Consolidation & Factoring Linkages in Rating

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. Mrs. 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)- Standalone	FY19 (A)	FY20 (A)
Total operating income	2132.29	2560.87
PBILDT	293.85	263.33
PAT	119.87	88.62
Overall gearing (times)	3.11	2.74
Interest coverage (times)	3.07	2.27

Status of non-cooperation with other 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	-	-	-	634.10	CARE A-; Stable
Fund-based - LT-Term Loan	-	-	October 2025	236.32	CARE A-; Stable
Non-fund-based - ST-Bank Guarantees	-	-	-	20.00	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 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	634.10	CARE A-; Stable	-	1)CARE BBB+; Stable (05-Jul-19)	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	236.32	CARE A-; Stable	-	1)CARE BBB+; Stable (05-Jul-19)	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	0.00	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	20.00	CARE A2+	-	1)CARE A2 (05-Jul-19)	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)	-

Annexure-3: Detailed explanation of covenants of the rated instrument / facilities: Not Applicable

Annexure 4- Complexity of various instruments rated for this Company

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

Contact Us

Media Contact
Name: Mradul Mishra
Contact no. – +91-22-6837 4424
Email ID – mradul.mishra@careratings.com

Analyst Contact
Name: Mr Anil More
Tel: 033-4018 1623
Cell: +91 8444 867144
Email: anil.more@careratings.com

Relationship Contact
Name: Mr Lalit Sikaria
Tel: 033-4018 1607
Cell: +91 98303 86869
Email ID : lalit.sikaria@careratings.com

About CARE Ratings:
CARE Ratings commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). CARE Ratings is proud of its rightful place in the Indian capital market built around investor confidence. CARE Ratings provides the entire spectrum of credit rating that helps the corporates to raise capital for their various requirements and assists the investors to form an informed investment decision based on the credit risk and their own risk-return expectations. Our rating and grading service offerings leverage our domain and analytical expertise backed by the methodologies congruent with the international best practices.

****For detailed Rationale Report and subscription information, please contact us at www.careratings.com**