Magadh Sugar & Energy Ltd

October 06, 2020

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long Term Bank Facilities	460.38 (reduced from 494.56)	CARE A-; Stable (Single A Minus; Outlook: Stable)	Revised from CARE BBB+; Positive (Triple B Plus; Outlook:Positive)
Short Term Bank Facilities	30.00 (reduced from 39.55)	CARE A2+ (A Two Plus)	Revised from CARE A2 (A Two)
Total	**490.38 (Rupees four hundred ninety crore and thirty eight lakh only)**		

Details of facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The revision in the ratings assigned to the bank facilities of Magadh Sugar & Energy Ltd (MSEL) factors in the improvement in the operational and financial performance in FY20 (refers to period April 1 to March 30) as evidenced by improved sugar recovery rates, increased volumes of sugar sales and increased domestic sugar realisations.

Further it is expected that the expansion at Narkatiaganj (distillery) from the upcoming ethanol supply year (refers to period December 1 to November 30), would enable the company to produce higher proportion of B heavy molasses which was limited in the current season owing to capacity bottleneck and the expansion projects at Sidhwalia (distillery) and Hasanpur (additional crushing) in the subsequent ethanol supply year would help the company derive benefits of higher levels of integration.

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 MSEL.

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 Q1FY21 had moderated on account of lower sugar prices amidst lower bulk demand during lockdown however, sugar prices have stabilized currently with gradual unlocking.

The ratings are however tempered by the working capital intensive nature of business aggravated by consecutive seasons of record sugar production, albeit same was supported through soft loans for buffer stock inventory and to clear cane dues, project risk, vulnerability of operations to agro climatic conditions and cyclical, seasonal and regulated nature of the industry.

Key Rating Sensitivities

<u>Positive Factors</u>

- Improvement in capital structure with overall gearing (<0.6x), TD/GCA (<3x) and interest coverage (>5x) on a sustained basis.
- Increase in scale of operations (>Rs.1600 crore) while sustaining the profitability and maintaining capital structure.

<u>Negative Factors</u>

- 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 (>1.7x), 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

MSEL 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 pesticides. The group also operates sugar mills in Uttar Pradesh through another group company Avadh Sugar & Energy Ltd (ASEL; rated CARE A-; Stable/CARE A2+). The sugar units of ASEL and MSEL have an operational track record of over

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

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 significant in the Indian sugar industry.

Integrated business model resulting in diversified revenue streams

All of MSEL's sugar manufacturing units located in Bihar are integrated with co-generation power plant. Further, of the above units, the sugar unit located in Narkatiaganj is 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 15% of the total segment revenue (as against 20% in FY19) and 42% of the PBIT (as against 82% in FY19). With upcoming projects of distillery expansion, MSEL is expected to benefit from better level of integration.

Higher sugar realizations and volumes drive financial performance in FY20, albeit, Q1FY21 realizations impacted due to lower prices.

In FY20 the total operating income (TOI) increased by 23% y-o-y driven by higher sugar sales volumes and higher realizations. Although the increase in cane price (due to removal of cane price subsidy) resulted in increase in raw material costs, same was compensated by higher sugar recovery. Sugar recovery improved despite diversion of B Heavy molasses for ethanol production. While the slower off-take by Oil Marketing Companies (OMCs) in the ethanol segment, impacted the distillery segment, higher sugar realizations, drove overall PBILDT margins which improved from 14.24% in FY19 to 17.13% in FY20. The profits in the year, were also supported by various subsidies and government initiatives like increase of minimum support price of sugar 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.

The TOI in Q1FY21 increased by 7% y-o-y primarily due to increase in sales volume of sugar in the quarter even when there was a drop in realizations by around due to lower demand from bulk consumers such as restaurants, bakery, etc. following COVID induced lockdown. The decreased realization impacted profit margins which deteriorated from 14.93% in Q1FY20 to 8.90% in Q1FY21. Distillery segment however supported the performance in Q1FY21 driven by higher sales of B Heavy ethanol. However, on account of early start of crushing during Sugar Season 2019-20, revenue and profit from the power segment was also lower.

Segment wise performance analysis is hereunder:

Sugar segment: Although, sugar cane crushed in FY20, was similar to that in FY19, sugar produced was slightly higher on account of improvement in recovery in Narkatiaganj and Sidhwalia units**.** The revenue from the sugar division increased by 29% y-o-y, driven by higher sugar sales volumes and higher realizations. Higher sugar realizations and volumes, better recovery and higher realizations from direct sale of by product molasses during the period resulted in significant increase in sugar segment PBIT in FY20. In Q1FY21, the segment revenue increased due to increase in sales volume despite a drop in realizations due to COVID. However, decreased realizations impacted the profits of the segment.

Distillery Segment: The revenue from the distillery segment decreased by 15% y-o-y in FY20, due to lower sale of ethanol as off-takes from OMCs started getting impacted from March 2020. Sales volume had declined y-o-y by 16%.

In Q1FY21, the ethanol sales had increased y-o-y with higher production and sale of B heavy molasses as against last year, also leading to increase in realizations. However, profits did not increase as much due to increase cost of molasses consumed.

Power Segment: The performance of the power division was stable as the slight decrease in electricity generated and sold was offset by increase in tariff rates.

Satisfactory 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 higher working capital. 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 increase in inventory. However, the same declines with reducing stock and reaches a minimum by the end of September or October. the overall gearing of MSEL stood at 1.20x as on March 31, 2020 (as against 1.18x as on March 31, 2019) which was at relatively lower levels at 1.07x as on September 30, 2019 and at 0.84x as on September 30, 2018. As on March 31, 2020, around 60% of the total debt was working capital borrowing. Further, around 30% of the term loans were under financial assistance schemes of State/Central Government. Notwithstanding the higher working capital borrowing, the overall gearing of MSEL was satisfactory at 1.2x as on March 31, 2020 as against 1.18x as on March 31, 2019. Despite, the increase in term loan to clear cane arrears, the term debt/GCA improved from 2.08x as on March 31, 2019 to 1.44x as on March 31, 2020. Further, on the back of higher GCA, the total debt/GCA also improved from 8.92x as on March 31, 2019 to 6.02x as on March 31, 2020. The interest coverage continued to be comfortable at above 3x in FY20.

Key Rating Weaknesses

Working capital intensive nature of operations aggravated due to consecutive years of record sugar production

Along with record production, government measures such as selling quota to control supply led to MSEL's operating cycle being marked by high inventory days which increased from 318 days in FY19 to 343 days in FY20. Around 15% of the inventory as on March 31, 2020 included buffer stock where carrying and storage cost was being finance by the government for a year (August 2019 to July 2020). MSEL's creditor days were also high and increased from 146 days in FY19 to 156 days in FY20. High creditors of Rs.313 crore o/s as on March 31, 2020 was on account of cane arrears which had reduced to Rs.62 crore as on September 1, 2020. Primarily due to increase in inventory, the working capital cycle increased from 182 days in FY19 to 192 days in FY20. Increase in inventory also resulted in negative cash flow from operations in FY20.

Project Risk

MSEL is expanding existing distillery capacity at Narkatiaganj from 60 KLPD to 80 KLPD which would enable it to produce the entire range of ethanol in the unit through the B heavy route if needed. It is also undertaking a project to increase in crushing capacity at Hasanpur from 5000 TCD to 6500 TCD to better utilize the higher cane production in the region. The above projects have a combined cost of around Rs.22 crore and are expected to be financed through internal accruals.

Further, it is setting up a distillery of 75 KLPD at Sidhwalia, project cost of Rs.140 crore financed through a mix of internal accruals and soft loan of Rs.102 crore, where it would be using the molasses being produced at Sidhwalia and Hasanpur for production of ethanol.

Given the complete integration plans of the company to produce ethanol, project execution risk, in particular for the Sidhwalia project, along with timely completion of all the projects is of significance.

Vulnerability of operations to agro climatic conditions

Being an agro-based industry, performance of MSEL 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.

Liquidity: Adequate

MSEL has scheduled term debt obligations of Rs.31 crore in FY21 of which it has met repayment of Rs.6 crore till August 31, 2020. MSEL has not availed any moratorium or emergency credit lines 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. MSEL's liquidity is also supported by unutilised lines of fund based limits where average utilization stood at 80% (limits Rs.400 crore) for the last 12 months ended July 2020.

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

MSEL was incorporated on March 19, 2015 as a subsidiary of Upper Ganges Sugar & Industries Limited (UGSIL). UGSIL and Oudh Sugar Mills Limited (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 Sidhwalia and Hasanpur, Bihar of UGSIL have been demerged to MSEL at book value from appointed date i.e. April 1, 2015. Also, the business undertaking located at Narkatiaganj, Bihar of OSML has been first transferred to Vaishali Sugar and Energy Limited (VSEL) via slump sale and is subsequently merged with MSEL from the appointed date i.e. April 1, 2015. MSEL 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 Bihar. MSEL is operating sugar mills of capacity 17,500 TCD, TCD, co-generation power plants of 38 MW and distillery units of 60 KLPD

Brief Financials (Rs. crore)	FY19 (A)	FY20 (A)
Total operating income	743.79	918.70
PBILDT	105.89	157.34
PAT	34.22	83.04
Overall gearing (times)	1.18	1.20
Interest coverage (times)	3.03	3.30

Status of non-cooperation with other CRA: Not applicable

Any other information: Not Applicable

Rating History for last three years: Please refer Annexure-2

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

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

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	-	-	-	384.55	CARE A-; Stable
Fund-based - LT-Term Loan	-	-	June 2025	75.83	CARE A-; Stable
Non-fund-based - ST-Bank Guarantees	-	-	-	10.00	CARE A2+
Fund-based - ST-Working Capital Demand loan	-	-	-	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	384.55	CARE A-; Stable	-	1)CARE BBB+; Positive (02-Jan-20) 2)CARE BBB+; Stable (05-Jul-19)	1)CARE BBB+; Stable (31-Mar-19) 2)CARE A-; Negative (25-Jul-18) 3)CARE A-; Negative (06-Apr-18)	1)CARE A-; Stable (03-Aug-17)
2.	Fund-based - LT-Term Loan	LT	75.83	CARE A-; Stable	-	1)CARE BBB+; Positive (02-Jan-20) 2)CARE BBB+; Stable (05-Jul-19)	1)CARE BBB+; Stable (31-Mar-19) 2)CARE A-; Negative (25-Jul-18) 3)CARE A-; Negative (06-Apr-18)	1)CARE A-; Stable (03-Aug-17)
3.	Non-fund-based - ST-Bank Guarantees	ST	10.00	CARE A2+	-	1)CARE A2 (02-Jan-20) 2)CARE A2 (05-Jul-19)	1)CARE A2 (31-Mar-19) 2)CARE A2+ (25-Jul-18) 3)CARE A2+ (06-Apr-18)	1)CARE A2+ (03-Aug-17)
4.	Non-fund-based - ST-Letter of credit	ST	-	-	-	-	1)Withdrawn (31-Mar-19) 2)CARE A2+ (25-Jul-18) 3)CARE A2+ (06-Apr-18)	1)CARE A2+ (03-Aug-17)
5.	Fund-based - ST-Working Capital Demand loan	ST	20.00	CARE A2+	-	1)CARE A2 (02-Jan-20) 2)CARE A2 (05-Jul-19)	1)CARE A2 (31-Mar-19) 2)CARE A2+ (25-Jul-18) 3)CARE A2+ (06-Apr-18)	-

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

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.	Fund-based - ST-Working Capital Demand loan	Simple
4.	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. 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**