Ponni Sugars (Erode) Limited

July 02, 2020

Rating

Facilities	**Amount (Rs. crore)**	**Rating[1]**	**Rating Action**
Long Term Bank Facilities –Term Loan	-	-	Withdrawn*
Long Term Bank Facilities – Fund Based working capital facilities	40.00	CARE BBB+; Stable [Triple B Plus; Outlook: Stable]	Revised from CARE BBB; Negative [Triple B; Outlook: Negative]
Long- term/Short-term Fund Based/Non-Fund based bank facilities	10.00	CARE BBB+; Stable/CARE A2 [Triple B Plus; Outlook: Stable/ A Two]	Revised from CARE BBB; Negative/CARE A3+ [Triple B; Outlook: Negative/A Three Plus]
Short-term bank facilities (Non-Fund Based)	1.00	CARE A2	Revised from CARE A3+ [A Three Plus]
Total Facilities	**51.00 (Rupees Fifty One Crore only)**		

*****based on written communication from the Bank that term loan has been fully repaid and there is no outstanding liability*

Details of facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The revision in ratings assigned to the bank facilities of Ponni Sugars (Erode) Limited (or PSEL) factors in a robust operating performance during FY20, achieved by increase in cane crushing volume, increase in sugar sales, rise in by-product prices and peak power production. The profitability margins of the company also improved on account of higher recovery of cane, which was achieved by prudent agricultural practises adopted by the company. CARE, earlier had assigned a 'Negative' outlook while reaffirming the rating at 'CARE BBB'. This was on account of long pending receivables from sale of power to Tamil Nadu Generation and Distribution Corporation Limited (TANGEDCO), thus impacting the liquidity position of the company. Collection of substantial portion of long pending receivables from TANGEDCO, eased the erstwhile stretched liquidity position of PSEL. The ratings continue to derive strength from the experience of promoters in sugar industry, its partially integrated operations, comfortable capital structure and various measures undertaken by government to support the sugar industry. CARE has also withdrawn the rating assigned to the term loan facility of PSEL upon receipt of written confirmation from the bank that the term loan has been fully repaid and there is no outstanding liability against the same.

The ratings are partially tempered by vulnerability of operations to agro climatic conditions, cyclical, seasonal and regulated nature of the industry. The ratings also factor in subdued macroeconomic conditions triggered by the onset of the coronavirus pandemic which has caused disruptions in the sugar industry as well as the business operations of PSEL. CARE believes the impact of the pandemic on the sugar industry to be limited considering the essential nature of the commodity. CARE also draws comfort from low debt levels, strong liquidity of PSEL currently along with continued steps taken by the Government to support the sugar industry.

Key Rating Sensitivities

Positive factors

- Prompt recovery of pending receivables, ability to sustain growth in operations and profitability in a challenging macro-environmental scenario
- Forward integration into ethanol production can enable PSEL to handle volatility of the sector and act as a positive trigger, on account of government's emphasis on ethanol blending programme.

Negative factors

- Any debt funded capex, without commensurate equity infusion, resulting in Overall Gearing> 0.50x
- Decline in scale of operations < Rs. 200 crore and PBILDT margin falling below 10%

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

Detailed description of key rating drivers

Key Rating Strengths

Experienced promoters & management

The flagship company of the group to which PSEL belongs is Seshasayee Paper & Boards Limited [SPBL, rated CARE A+; Positive/ CARE A1+]. The promoters of the group have over five decades of experience in industries such as paper & paper products, sugar, chemicals, project consultancy etc. The group has also been operational in the sugar industry for more than three decades and has, over the time, acquired significant experience in managing the cyclicality of sugar industry and various other industry challenges.

Partially integrated operations

PSEL operations are partially integrated with a 19 MW co-generation plant. Additionally, the company derives income from sale of bagasse (to paper manufacturing companies) and molasses (to animal feed companies). However, the company presently does not have a distillery unit to produce ethanol.

Robust growth in operations; ability to maintain it in challenging environment remains critical

After a stagnant performance from FY18 to FY19, the Total operating income (TOI) of PSEL has grown y-o-y by 67% from FY19 to FY20 along with an improvement in profitability margins. PSEL's command area i.e. Erode, Namakkal and Salem had been facing consistent drought upto FY18, after which it has received sufficient rainfall for the past 2 years. Steady water flow in the river Cauvery due to better rainfall in the catchment area and inflow of water to the nearby Mettur dam from Karnataka Reservoirs helped PSEL to go for improved cane planting. Cane recovery rates have also improved to 9.80% as compared to 8.50% two seasons ago. Increase in cane crushing volume, increase in sugar sales, rise in by-product prices and peak power production were the contributory factors. PSEL fetches better realization by selling molasses to cattle feed companies which are located in the vicinity in comparison to selling to distilleries. However, considering the challenging macro environment exacerbated by the coronavirus pandemic, PSEL's ability to sustain stable operations remains critical. PSEL has also been constantly focussing on prudent agricultural practises like improved and scientific cane planting methods, installation of drip irrigation assets which has ensured improved yield for the farmer. They have roped in prominent consulting agencies to advise them on areas such as improved irrigation techniques, improvement of crop quality, soil quality etc. Going forward, PSEL is expected to continue to derive the benefits from these practises adopted. CARE also draws comfort from low debt levels and strong liquidity of PSEL. Further, the government has also continued to support the sugar industry through various 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.

Comfortable capital structure

PSEL has repaid its outstanding term loans in May 2020 and utilises only working capital borrowings for its operations. The dependency on the same has also been coming down, as the liquidity position of PSEL has improved subsequent to collection of long pending receivables from TANGEDCO. Overall Gearing as on March 31, 2020 was 0.08x (P.Y. 0.12x). Capital structure is expected to remain comfortable going forward with no significant capex planned in near future. As on date the utilisation of working capital bank lines is negligible and for the next few months, the company's surplus cash from collection is expected to be utilised to fund its operations in the upcoming crushing season. From Q3FY21 onwards, with the ramping up of cane crushing and sugar manufacturing operations, its operating profits are expected to remain adequate to fund its working capital, thereby resulting in minimal reliance on bank finance for the remainder of the year as well. This is one of the key reasons leading CARE Ratings to upgrade the ratings with 'Stable' outlook from 'Negative' outlook earlier.

Key Rating Weaknesses

Regulated nature of the industry

The industry is regulated 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), besides setting quotas for export of sugar. All these factors impact the cultivation patterns of sugarcane in the country and thus affect the profitability of the sugar companies.

Agro-climatic risk and seasonality

The sugar industry, being directly dependent on the sugarcane crop and its yield, is susceptible to agro climatic risks. Climatic conditions, more specifically, the monsoons influence various operational parameters for a sugar entity, such as the crushing period and sugar recovery levels. Also, the degree of dispersion of monsoon precipitation across the sugar-growing areas also leads to fluctuating trends in sugar production in different regions. This is more critical for PSEL which operates in Erode which has historically received below par rainfall. This risk is however partly offset by the fact that its command area for sourcing sugarcane also covers the Cauvery river banks, where water availability is generally not a serious concern.

Impact of coronavirus pandemic on the sugar industry and PSEL's operations

Since the onset of the pandemic, global sugar prices have fallen by 30%. The key reason that led to the drop in prices is the rapid spread of the virus across the globe that has resulted in partial and complete lockdown in many countries. This, in turn, has affected the global sugar demand that comes from bulk consumers like restaurants, eateries among others. Due to the pandemic, Indian sugar industry has also been consequently impacted by sluggish demand, slowdown in sugar exports, disruption in supply chain, decline in ethanol off-take, cumulatively leading to downward price correction in sugar in India. Further supply glut in the country bound to keep sugar prices in check at lower bands. Bans on weddings, social gatherings etc. continue to remain. People are also avoiding cold drinks & ice-creams to avoid falling sick. The FMCG & beverage companies are also working on reduced capacities. Restaurants have opened up, but however catering only to home delivery. All this is likely to have an impact on the annual sugar consumption. PSEL's operations also got interrupted in late March'20 and for most of the part of April'20 due to the imposition of national lockdown to control the spread of coronavirus. The lockdown led to instant disruption in harvest labour and logistical challenges. With phased relaxation in lockdown conditions, production was resumed from April 23, 2020 however at below par capacity. Temporary closure and reopening has pushed the tail end crushing to summer months where cane recovery is depressed due to warmer climate. PSEL incurred higher compliance cost to conform to standard operating procedures under extant Covid guidelines. The company management also expects a fall in cane volume and pressure on sugar prices which could affect the business prospects for FY21.

Prospects

As per the ISMA, sugar sales were higher by about 1 million tonne during the first five months (October 2019-February 2020) of the current sugar season. However, sugar sales were affected in the month of March 2020 and April 2020 as the sales were lower by 1 million tonne during these 2 months due to lockdown situation in India thus offsetting higher sales of sugar during the initial period of sugar season.

The lockdown restrictions nevertheless were eased in the third and fourth phase of lockdown. The fourth phase allows restaurants to operate kitchens for delivery of food items which is expected to increase consumption of sugar by these bulk consumers. However, the consumption of sugar is expected to remain disturbed for some months now as bans on celebrations and social gatherings continue.

Liquidity Analysis: Adequate

PSEL's liquidity was previously stretched on account of long pending receivables (since May 2018) from sale of power to TANGEDCO, which is currently in a financial crisis and has not paid to suppliers for many months and its debt levels have also been mounting. Hence there was pressure on PSEL's working capital limits which were utilized upto 90%. The outstanding trade receivables from TANGEDCO increased from Rs. 38.06 crore as on March 31, 2019 to Rs. 69.45 crore as on March 31, 2020. However, after persistent follow-up with government authorities by PSEL's officials, TANGEDCO cleared Rs. 45.18 crore on May 27, 2020 which are dues for the period May 2018 to July 2019. This has significantly eased the liquidity position of the company. Coupled with strong net accruals, the working capital utilization levels have also been coming down to an average maximum of 57% for 12 months ended May 2020. PSEL has prepaid the term loans from the proceeds and has parked the remaining surplus amount of Rs 35 crore in short term deposits with the banks and proposes to utilize the same for its operations which will commence from July 2020. This is expected to further reduce dependency on working capital borrowings and save interest cost, thereby improving profitability. The balance dues (from August 2019) are expected to be cleared in a phased manner by TANGEDCO. Total outstanding receivables amount as on May 31, 2020 is Rs. 28 crore.

Analytical approach: Standalone

Applicable criteria –

CARE's Policy on Default Recognition
CARE's methodology for Short-term Instruments
Rating Outlook and Credit watch
Liquidity Analysis of Non-Financial Sector Entities
Financial ratios – Non-Financial Sector
Rating Methodology - Sugar Sector
Policy on withdrawal of ratings

About the Company

Incorporated in 1996, Ponni Sugars (Erode) Ltd. (PSEL) is engaged into sugar manufacturing and operates a sugar mill at Erode, Tamil Nadu with capacity of 3500 TCD. The mill was originally established in 1984 under another group company Ponni Sugars & Chemicals Ltd and was later demerged to PSEL in 2001.

PSEL is a part of the ESVIN group. Its flagship company - Seshasayee Paper & Board Ltd (SPBL; rated CARE A+:Positive /CARE A1+) is one of the leading integrated pulp and paper manufacturer. The group also has interests in engineering consultancy, battery manufacturing and technology research through various group entities.

Brief Financials (Rs. crore)	FY19 (A)	FY20 (Abr.)
Total operating income	187.72	314.18
PBILDT	22.49	45.14
PAT	8.43	30.94
Overall gearing (times)	0.12	0.08
Interest coverage (times)	6.48	16.84

A: Audited; Abr: Abridged

Status of non-cooperation with previous CRA: None

Any other information: Not Applicable

Rating History: 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-Term Loan	-	-	-	0.00	Withdrawn
Fund-based - LT-Cash Credit	-	-	-	40.00	CARE BBB+; Stable
Fund-based/Non-fund-based-LT/ST	-	-	-	10.00	CARE BBB+; Stable / CARE A2
Non-fund-based - ST-BG/LC	-	-	-	1.00	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-Term Loan	LT	-	-	-	1)CARE BBB; Negative (03-Oct-19)	1)CARE BBB; Stable (06-Nov-18)	1)CARE BBB; Stable (24-Nov-17)
2.	Fund-based - LT-Cash Credit	LT	40.00	CARE BBB+; Stable	-	1)CARE BBB; Negative (03-Oct-19)	1)CARE BBB; Stable (06-Nov-18)	1)CARE BBB; Stable (24-Nov-17)
3.	Fund-based/Non-fund-based-LT/ST	LT/ST	10.00	CARE BBB+; Stable / CARE A2	-	1)CARE BBB; Negative / CARE A3+ (03-Oct-19)	1)CARE BBB; Stable / CARE A3+ (06-Nov-18)	1)CARE BBB; Stable / CARE A3+ (24-Nov-17)
4.	Non-fund-based - ST-BG/LC	ST	1.00	CARE A2	-	1)CARE A3+ (03-Oct-19)	1)CARE A3+ (06-Nov-18)	1)CARE A3+ (24-Nov-17)

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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