February 07, 2023 (Revised)

Dwarikesh Sugar Industries Limited: Long-term ratings upgraded; Outlook revised to Stable from Positive and short-term rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term loans	333.78	296.07	[ICRA]AA-; upgraded from [ICRA]A+ and Outlook revised to Stable from Positive
Fund-based limits	735.00	450.00	[ICRA]AA-; upgraded from [ICRA]A+ and Outlook revised to Stable from Positive
Non-fund based facilities	10.00	30.00	[ICRA]AA-; upgraded from [ICRA]A+ and Outlook revised to Stable from Positive
Unallocatedlimits	21.21	23.93	[ICRA]AA-; upgraded from [ICRA]A+ and Outlook revised to Stable from Positive
Total	**1,099.99**	**800.00**	
Commercial paper^	**300.00**	**300.00**	[ICRA]A1+; reaffirmed

**Instrument details are provided in Annexure-1; ^ carved out of working capital limits*

Rationale

The rating upgrade of the debt programmes of Dwarikesh Sugar and Industries Limited (DSIL) factors in the expected improvement in the company's coverage metrics, benefitting from the reduced working capital borrowings with increased diversion of sugar towards ethanol and favourable exports prospects. The distillery segment's increasing contribution to the operating income lends more stability to the cash flows, besides contraction in inventory days, improving the working capital cycle. DSIL's exports have remained healthy during 9M FY2023 at ~94,000 MT, which has supported its low inventory levels (0.47 lakh MT as on December 31, 2022).

The ratings continue to draw comfort from DSIL's efficient operations with one of the highest recovery rates in Uttar Pradesh (UP) that has supported its comfortable credit profile. Moreover, being forward-integrated into co-generation and distillery operations, the company benefits from access to alternative revenue streams, which act as a cushion against the cyclicality of the sugar business. Additionally, the revenue diversification is expected to increase in FY2023 with distillery and co-generation contributing to over 25% of the total revenues (~19% in FY2022), which is expected to improve further FY2024 onwards.

The commercialisation of the distillery of 175 kilolitres per day (KLPD) has strengthened DSIL's operational profile and improved the revenue diversification. The inventory levels and thus the total borrowings (despite higher term debt for distillery) are expected to moderate from FY2022 levels, going forward, with higher sucrose getting diverted towards ethanol, ensuring stronger coverage metrics. Notwithstanding expected moderation in operating profits in FY2023 following higher cane costs, impact of retrospective wage revision, initial teething issues with new distillery as well as increased levy molasses proportion, the company's borrowings would decline and total debt/ OPBITDA expected to be largely stable. DSIL also benefits from continued favourable Government support measures such as interest subvention on term debt for distillery-related capital expenditure, procurement of ethanol at remunerative prices by OMCs, among others, besides comfortable inventory position in the country, lending stability to prices.

In 9M FY2023, both domestic and export sugar prices have remained largely stable, with average domestic realisation at Rs ~34.8 per kg and average export realisation at Rs ~35.5 per kg (excluding logistics cost of ~Rs 1.5 per kg). With increasing diversion of cane towards ethanol production and lower estimated domestic production for SY2023 (34 million MT sugar production post diversion of 4.5 million MT), resulting in stable or slightly lower domestic sugar stock levels, domestic prices

are expected to remain stable. While the international prices remain firm, higher production from Brazil may weigh on the global demand-supply position, thereby keeping prices under check and remains a key monitorable.

ICRA expects the company's revenues in FY2023 to grow by 4-8% YoY in FY2023, backed by higher revenues from the distillery division on account of enhanced capacities and improved sugar and ethanol realisations, despite the reduction in sugar volumes. Over the medium term, DSIL's operating profits are likely to be less volatile than the historical levels, driven by the expected continuation of MSP and the industry's focus on diverting excess cane towards ethanol production that may reduce the volatility in sugar prices.

However, the ratings are constrained by the vulnerability of DSIL's profitability to the cyclical nature of the sugar industry (though the sharp fall in sugar prices is curtailed after the introduction of MSP) and the agro-climatic risks related to cane production. Further, the profitability of sugar mills, including DSIL, remains vulnerable to the policies of the Government of UP (GoUP), international sugar trade, domestic quota, sugar and ethanol pricing and interest subvention loan for distillery capacity expansion. With DSIL's scale of operations being moderate compared to its peers, the proportion of the revenue diversification through forward-integrated operations, which allows stability in cash flows, remains key to withstand the sugar cycle downturns. However, with distillery revenues scaling up, the operational cash flows are likely to be more stable than the historic levels.

Key rating drivers and their description

Credit strengths

Forward-integrated operations - DSIL operates sugar capacities of 21,500 tonnes crushed per day (TCD) at its three mills in UP. The operations are forward-integrated into the power and alcohol businesses — co-generation capacity of 96 megawatt (surplus – 56 MW) and distillery capacity of 337.5 kilolitres per day (KLPD) as on December 31, 2022. The integrated operation provides alternative revenues and cushions the profitability against the cyclicality in the sugar business. In 9M FY2023, the sugar business accounted for around 74% of the company's revenue, followed by distillery at ~17% (increased from 13% in FY2022) and the balance from the co-generation business (~9%). With the new 175-KLPD distillery commencing operations in early July 2022, the revenue contribution is expected to increase to over 25% for FY2023 and further to over ~35% FY2024 onwards. It would also moderate the seasonality associated with sugar business, as distilleries operate for 320-330 days a year.

Operationally-efficient sugar mills with healthy recovery rates - The company's gross recovery rate for the sugar season slightly moderated to 12.01% in SY2022 from 12.32% in SY2021 owing to agro-climatic conditions but remained healthy. However, the net recovery rates moderated to 10.46% in SY2022 (PY: 11.36%) owing to the higher diversion of cane towards B-heavy molasses-based ethanol. Healthy recovery rates over the years aided in reducing the company's cost of production. Over the medium term, the higher production of ethanol from B-heavy molasses and sugarcane juice is likely to moderate the net recovery rates to some extent amid the continued high share of better-yielding cane variety.

The gross recovery in SY2023 is also expected to be largely similar or moderate slightly via-a-vis SY2022 levels, to ~11.8-12.0%. Further, the net recovery is expected to decline to ~8.8% (PY: ~10.46%) due to the higher diversion of cane towards ethanol through the sugarcane juice route, with the new distillery becoming operational in July 2022.

Profitability likely to remain healthy owing to steady sugar realisations and higher volumes from distillery segment – DSIL's overall operating profitability and cash accruals are expected to benefit from firm sugar realisations, both internationally and domestically, along with better distillery performance, partially offset by lower total sugar sales. Going forward, the company is likely to divert higher cane towards the production of ethanol through B-heavy molasses and/or sugarcane juice with the expanded capacity becoming operational. DSIL's operating margins will be supported by the likely continuation of MSP, remunerative prices of ethanol, and the industry's focus on diverting excess cane towards ethanol production, improving the domestic demand-supply balance. Further, the working capital debt and hence the total debt levels (despite increase in debt for distillery capex) are anticipated to reduce going forward with the increase in sugar sacrifice towards ethanol.

Strong capital structure and healthy debt coverage metrics – The company has a comfortable capital structure with a gearing of 0.8 times as on March 31, 2022 (PY: 1.1 times). Reduced borrowings and higher profits resulted in better coverage indicators in FY2022 with total debt/OPBIDTA of 1.8 times (PY: 3.0 times) and NCA/total debt of 31.1% (P.Y.: 22.9%). The DSCR and

interest cover also improved to 3.1 times and 9.2 times, respectively (PY: 0.8 times and 4.2 times, respectively). Going forward, the debt metrics are expected to remain healthy over the medium term, driven by lower total debt levels (despite higher term debt for distillery capex which is under interest subvention), healthy operating profits and cash accruals.

In FY2023, reduced debt levels in addition to improved net worth is expected to result in healthier capital structure with the expected total debt/TNW at ~0.5 times as on Mar 31, 2023 (FY2022: 0.8 times). However, due to lower expected OPBTIDA in FY2023, the coverage indicators are likely to be largely stable, with interest cover of ~8.9 times (PY: ~9.2 times) and total debt/ OPBIDTA of 1.6 times (PY: 1.8 times). DSCR for FY2023 is estimated to be comfortable at 2.35 times in FY2023, despite moderation from 3.07 times in FY2022, and is expected to be around similar level of ~2.2-2.4 times for FY2024-FY2025 as well.

Credit challenges

Profitability of UP-based sugar mills continues to depend on GoUP policy on cane prices – DSIL's profitability, along with other UP-based sugar mills, continues to be vulnerable to the GoUP's policy on cane prices. The cane price is determined by the GoUP at the start of the crushing season. Thus, the company's performance can be impacted by a disproportionate increase in cane prices. Further, its profitability remains vulnerable to the Government's policies on exports, MSP and remunerative ethanol prices. However, the recent measures taken by the Central Government and the GoUP supported sugar prices and the liquidity of sugar mills. The continuation of Government support in the form of remunerative ethanol prices and interest subvention for the debt-funded distillery capex are likely to prevent the piling up of cane arrears.

DSIL's profitability in FY2023 impacted by certain one-offs, and it remains vulnerable to risks associated with a regulated industry - DSIL's operating profitability deteriorated to ~8.2% in 9M FY2023 from 12.6% in 9M FY2022 (9.6% in 9MFY2021). Sugar profitability was impacted by the higher cost of goods sold (combination of higher cane price or SAP & lower recovery at the beginning of season) without a commensurate increase in the selling price of sugar. It was also impacted by an additional cost of Rs 9.77 crore due to retrospective revision of wages payable to employees covered under the wage board from October 18. Ethanol profitability was impacted by a retrospective increase in levy sale obligation of molasses from 18% to 20% for SY2022, resulting in a loss of opportunity to produce and sell ethanol from ~3,400 MT of molasses, and lower operating leverage due to some initial teething issues and higher expenses at the newly commissioned distillery plant. Further, DSIL remains vulnerable to regulatory risks like revision of ethanol prices approved by CCEA, sugarcane price (UP-SAP), employee wages rate, GOI's export policy, etc.

The operating income (OI) of the company witnessed a moderate growth of 4.8% YoY in 9M FY2023 at Rs. 1,570 crore, supported largely by improved ethanol volumes, partially offset by lower total sugar production and sales due to higher diversion towards ethanol. Further, the OI was also supported by increase in realisations for both sugar and ethanol sold.

Profitability of sugar mills vulnerable to industry cyclicality and agro-climatic risks – Being an agri-commodity, the sugarcane crop depends on climatic conditions and is vulnerable to pests and diseases, which may influence the yield per hectare and the recovery rate. These factors can have a significant impact on the company's profitability. Further, high dependence on a single crop variety may affect the yield and recovery rate. Nonetheless, DSIL has been exploring other varieties to mitigate this risk to a certain extent. The process of shifting to other varieties could be slow. In addition, the cyclicality in sugar production results in volatility in sugar prices. However, the sharp contraction in sugar prices has been curtailed after the introduction of MSP by the Central Government.

Over the long term, higher ethanol production with increased diversion towards B-heavy molasses and direct sugar juice are expected to help in curtailing the excess supply of sugar, resulting in lower volatility in sugar prices and in turn, the cash flows from the sugar business. With DSIL's scale of operations being moderate compared to its peers, the proportion of revenue diversification through forward-integrated operations, which would allow stability in cash flows, remains key to withstand the sugar downturns. However, with the new distillery becoming operational in the near term, the operational cash flows are likely to be more stable than the historic levels.

Environmental and social risks

DSIL is exposed to the risks arising from tightening regulations on environment and safety. These have necessitated DSIL to increase its investments to meet evolving and tighter regulatory standards. As per the disclosures made by DSIL, the emissions /waste generated by the company are within the permissible limits prescribed by CPCB/SPCB. Also, there were no pending show cause/legal notices from CPCB/SPCB at the end of FY2022. This indicates that DSIL has been able to mitigate the regulatory risks by demonstrating a sound operational track record and ensuring regulatory compliance.

The worldwide societal trends towards a shift to less sugar-intensive food products considering the health issues related to high sugar consumption could structurally reduce the demand for sugar products. However, such change in consumer behaviour or any other driver of change is expected to be relatively slow-paced. Therefore, while DSIL remains exposed to the aforementioned social risk, it does not materially affect its credit profile over the medium term. Further, as per the disclosures made by the company, it deals with around 1.51 lakh farmers and interacts with them to give various information to update their knowledge, educate them about the best farming practices and provide seeds for planting sugarcane and pesticides at competitive rates. This engagement has led to mutually beneficial relationship of DSIL with farmers, wherein farmers are able to achieve better yields on their crops and there is lower diversion of cane within DSIL's allocated command area. DSIL also benefits from higher recovery as well as higher cane crushed, which supports its operating income as well as profitability.

Liquidity position: Adequate

DSIL's liquidity position is adequate with likely healthy cash flow from operations over the next 12 months. Also, the company had an average cushion of around Rs. 257 crore in drawing power (DP) for the 12 months ended December 2022. ICRA expects adequate cushion to be available over the near term despite reduction in working capital limits to Rs. 450 crore from Rs. 735 crore earlier on account of moderation in working capital intensity resulting in release of cash. ICRA expects DSIL to comfortably meet its annual debt repayment obligations of Rs. ~67-70 crore during FY2024-FY2025. Moreover, the company is likely to incur a capex of Rs. ~100 crore over the next two years to enhance the crushing capacity by ~2,500 TCD and set up a refinery before SY2024 which are also expected to be funded from internal accruals.

Rating sensitivities

Positive factors – An upgrade will be backed by a continued period of firm sugar prices, driven by favourable demand-supply dynamics and benefits from investments in forward integration, which will lower the volatility in cash flows from the sugar business and improve the operating profitability and debt coverage metrics on a sustained basis. Additionally, an improvement in the scale of business coupled with the diversity in revenues would be critical for a rating upgrade.

Negative factors – ICRA could revise the ratings downwards if there is any sharp decline in sugar prices, cane crushing volumes, recovery rate or an increase in cane costs. Any significant decline in ethanol realisations or any material change in Government policies that will moderate the profitability and debt coverage metrics on a sustained basis may also prompt a revision. A specific metric that may drive an unfavourable rating action could be an interest cover of below 7 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Sugar Industry
Parent/Group Support	Not applicable
Consolidation/Standalone	Standalone financial statements

About the company

DSIL, promoted by Mr. Gautam R. Moraraka, was incorporated in 1994 through the establishment of a 2,500-TCD sugar plant in the sugar-rich belt of UP at the Bundki village in the Bijnor district. It has been raising the crushing capacity regularly and the capacity has since been increased to 21,500 TCD. It has three sugar plants, viz. Dwarikesh Nagar (DN), Dwarikesh Puram (DP) and Dwarikesh Dham (DD), at present. DN and DP are located in the Bijnor district and DD is located in the Bareilly district. Besides, DSIL has co-generation facilities of 17 MW at DN, 33 MW at DP and 36 MW at DD unit. Of these, DSIL exports 8 MW from DN, 24 MW from DP and 24 MW from DD unit to the state grid. The company has two distilleries - 162.5 KLPD at its DN unit and 175 KLPD at its DD unit, both of which are capable of manufacturing industrial alcohol and ethanol. The company employed 771 permanent non-seasonal employees as on March 31, 2022 across its manufacturing facilities and offices.

Key financial indicators

DSIL Standalone	Audited	Audited
	FY2021	FY2022
Operating income (Rs. crore)	1838.8	1974.1
PAT (Rs. crore)	91.5	155.2
OPBDIT/OI (%)	11.0%	14.7%
PAT/OI (%)	5.0%	7.9%
Total outside liabilities/Tangible net worth (times)	1.4	1.1
Total debt/OPBDIT (times)	3.0	1.8
Interest coverage (times)	4.2	9.2

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)					Chronology of Rating History for the past 3 years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Mar 31, 2022) (Rs. crore)	Date and Rating on		Date and Rating in FY2022		Date and Rating in FY2021	Date and Rating in FY2020
					Feb 07, 2023	Jun 14, 2022	Dec 29, 2021	Apr 7, 2021	Apr 2, 2020	Apr 2, 2019
1	**Term loans**	Long Term	296.07	251.19	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)
2	**Working capital facilities**	Long Term	450.00	-	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)
3	**Non-fund based-Working capital facilities**	Long term	30.00	-	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)
4	**Unallocated limits**	Long term	23.93	-	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)
5	**Commercial paper^**	Short term	300.00	100.00	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

Amount in Crores; Source: Company; ^ carved out of working capital limits

Complexity level of the rated instrument

Instrument	Complexity Indicator
Term loans	Simple
Working capital facilities	Simple
Non-fund based - Working capital facilities	Very Simple
Unallocated limits	NA
Commercial paper	Very Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA’s website: www.icra.in

Annexure-1: Instrument details

ISIN No	Instrument Name	Date of Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term loans	Nov 2018 – Aug 2021	5%-8%	Jun 2024 – Sep 2028	296.07	[ICRA]AA- (Stable)
NA	Working capital facilities	-	NA	-	450.00	[ICRA]AA- (Stable)
NA	Non-fund based - Working capital facilities	-	NA	-	30.00	[ICRA]AA- (Stable)
NA	Unallocated limits	-	NA	-	23.93	[ICRA]AA- (Stable)
INE366A14119	Commercial paper^	Jan 27, 2022	4.75%	Apr 28, 2022	50.00	[ICRA]A1+
INE366A14127	Commercial paper^	Mar 17, 2022	5.00%	Jun 17, 2022	50.00	[ICRA]A1+
Yet to be placed	Commercial paper^	-	-	-	200.00	[ICRA]A1+

Source: *Company; ^ carved out of working capital limits*

Please click here to view details of lender-wise facilities rated by ICRA

Annexure-2: List of entities considered for consolidated analysis – Not Applicable

Corrigendum

Document dated February 07, 2023 has been corrected with revisions as detailed below:

- Statement regarding estimated DSCR for FY2023 has been corrected due to inadvertent error.
- Credit challenge point pertaining to FY2023 profitability has been updated to reflect a more forward-looking view.
- Environmental and social risks have been updated to reflect their credit implications on the company.

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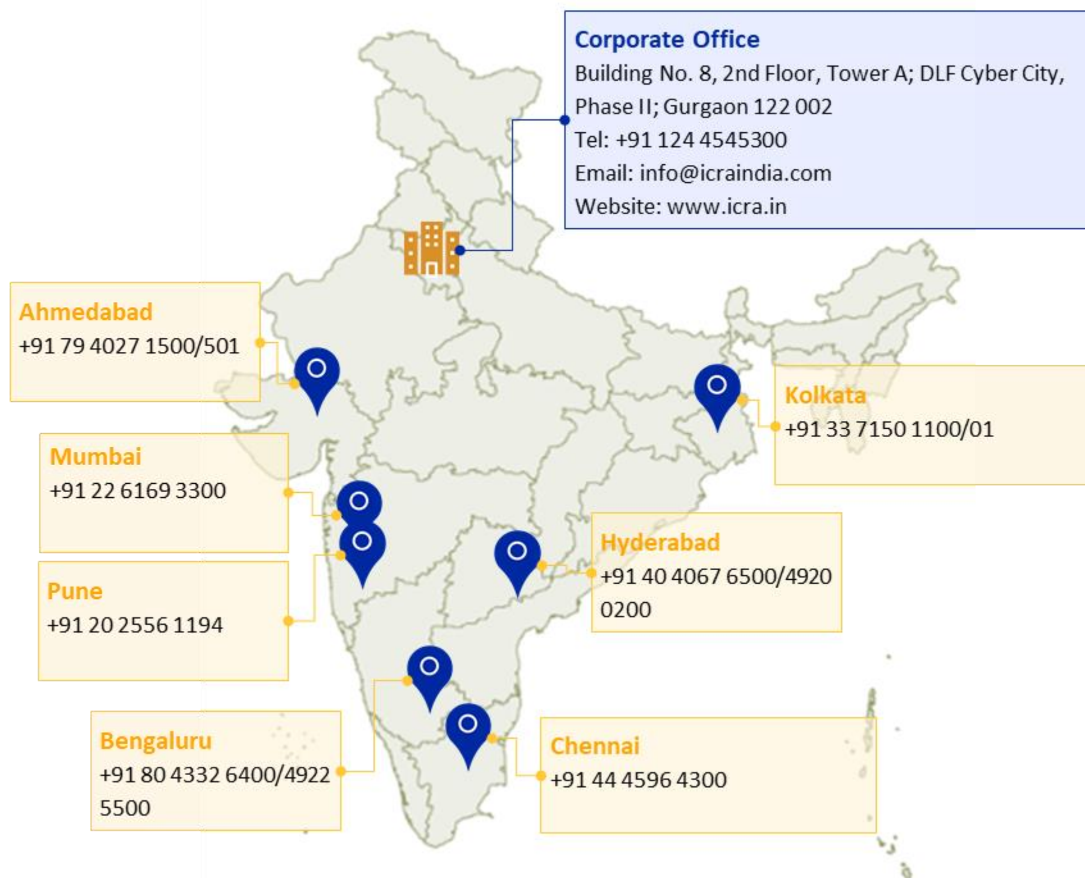

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