September 21, 2021

Magadh Sugar and Energy Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund Based – Term Loan	146.64	112.50	[ICRA]A-(Stable); Reaffirmed
Fund Based – Working Capital	420.00	460.00	[ICRA]A-(Stable); Reaffirmed
Non-fund based	10.00	2.00	[ICRA]A2+; Reaffirmed
Unallocated limits	0.00	2.14	[ICRA]A-(Stable)/[ICRA]A2+; Reaffirmed
Total	**576.64**	**576.64**	

**Instrument details are provided in Annexure-1*

Rationale

The ratings reaffirmation for the debt programmes of Magadh Sugar and Energy Limited (MSEL) considers the expected reduction in debt levels in the medium term, driven by lower sugar inventory levels following increased higher diversion of cane towards B-heavy based ethanol. Further, MSEL's operating margins are expected to improve going forward from FY2021 levels, supported by the likely increase in minimum selling price (MSP) of sugar, along with rise in distillery volumes with higher proportion of ethanol produced through B-heavy route, despite pressure from growing cane cost.

The ratings continue to factor in MSEL's long operational track record of over 85 years. Moreover, its forward-integrated operations into co-generation and distillery business provides access to alternate revenue streams and acts as a cushion against the cyclicality in sugar business. Although MSEL enhanced its distillery capacity to 80 kilo litre per day (KLPD) in FY2021, the company is in the process of setting up a new ethanol capacity of 75 KLPD, taking the total distillery capacity to 155 KLPD with distilleries being flexible in terms of feedstock (C-heavy molasses/ B-heavy molasses /sugarcane juice). ICRA notes the recently firmed up international sugar prices and sustained favourable Government policy framework such as continuation of MSP (introduced from FY2019), export subsidy, soft loans and interest subvention loans for ethanol expansion. Additionally, ICRA considers the recent advancement of enhanced ethanol-blending timelines that would allow integrated players like MSEL to report lesser volatility in operating profits against the historical levels.

However, the ratings remain constrained by the vulnerability of MSEL'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 agro-climatic risks related to cane production. Further, the profitability of sugar mills, including MSEL, remain vulnerable to the Central Government's policies on sugarcane pricing, sugar trade, sugar and ethanol pricing. Further, high working capital intensity and moderate debt coverage metrics, driven by high inventory holding at fiscal end continue to constrain MSEL's ratings.

The Stable outlook on MSEL's ratings reflects ICRA's opinion that MSEL will continue to benefit from its healthy operational profile. Also, the company's focus on increasing distillery capacity and ethanol production from B-heavy molasses are likely to keep its cash flows comfortable relative to its debt service obligations.

Key rating drivers and their description

Credit strengths

Long track record of operations – MSEL's sugar mills have a long operational track record of over 85 years, which were earlier operating under Upper Ganges Sugar & Industries Ltd. and Oudh Sugar Mills Ltd. Apart from MSEL, the promoters have presence in the sugar industry in Uttar Pradesh with a capacity of 31,800 TCD under Avadh Sugar & Energy Ltd. (ASEL) as on July 31, 2021. ASEL and MSEL (combined) operates seven sugar mills based out of Uttar Pradesh (four mills) and Bihar (three mills), with a combined capacity of 50,800 TCD of sugarcane ensuring scale economies, and are among the large sugar mills in India.

Efficient operations with forward integration into co-gen and distillery – MSEL operates 19,000 tonnes crushed per day (TCD) of sugar capacities in Bihar. The plant's operation is forward integrated into power and alcohol business, with a co-generation capacity of 38 mega-watt (MW) and distillery capacity of 80 KLPD as on July 31, 2021. The company is planning to increase its distillery capacity to 155 KLPD by setting up another distillery of 75 KLPD at Sidhwalia to further strengthen its operational profile. The integrated operation provides alternate revenues and cushions its profitability against the cyclicality in sugar business.

However, MSEL witnessed 22% YoY decline in cane crushing to 188.4 lakh quintals cane in FY2021 from 242.1 lakh quintals in FY2020 owing to floods in Bihar during July-September 2020. Further, the net recovery rate moderated to 10.53% in FY2021 from 11.12% in FY2020 owing to ~46% diversion of cane towards B-heavy molasses (PY: 12%), in addition to slight moderation in gross recovery rates because of agro-climatic conditions. The net recovery rates are expected to further moderate in the medium term with even higher diversion of cane towards B-heavy molasses.

Locational benefit of being in sugar deficit state; sugar companies fix cane prices with state government – MSEL's sugar mills are located in Bihar, which is a sugar deficit state, and thus enjoy higher realisations and limited competition from the nearby sugar factories. Moreover, in Bihar, the sugar factories (in consultation with the state government) fix the cane pricing for the sugar season, which is applicable for all sugar factories in the state. This pricing mechanism provides relief to sugar companies as opposed to the State Advised Price (SAP) mechanism followed in UP, wherein only the state government decides the cane pricing, which is generally higher than the company's cane costs. However, historically, any change in Fair and Remunerative Price (FRP) or SAP in UP led to a change in cane prices in Bihar.

Likely improvement in profitability due to steady sugar realisations and higher volumes from distillery segment – MSEL's overall operating profitability and cash accruals are expected to improve going forward from the current levels, driven by firm sugar realisations both internationally and domestically, along with better distillery performance. The company is anticipated to divert higher cane towards production of ethanol through B-heavy molasses, which would further be supported by upcoming capacity expansion. MSEL's operating margins will be supported by likely continuation of MSP, remunerative prices of ethanol and the industry's focus on diverting of excess cane towards ethanol production, resulting in improved domestic demand supply balance. Further, with increase in sugar sacrifice towards B-heavy/juice-based ethanol, the working capital debt and hence the total debt levels are expected to reduce in FY2023-FY2024.

Credit challenges

High working capital intensity leads to moderate debt coverage indicators – The seasonality in sugarcane crushing results in high inventory of finished goods at each fiscal end. The working capital availed to fund such high inventory, along with soft loans availed for making cane payments, resulted in high debt on the books of domestic sugar companies, including MSEL. However, the debt reduced to Rs. 551 crore as on March 31, 2021 from Rs. 631 crore as on March 31, 2021, leading to an improved gearing of 1.1 times (PY: 1.2 times). However, decrease in operating profits following lower cane crushing and higher cane costs adversely impacted coverage metrics with the total debt to OPBIDTA moderating to 5.4 times (PY: 4.1 times), with an interest cover of 2.1 times (PY: 3.2 times) in FY2021. Nevertheless, going forward, the debt coverage indicators are expected to improve, given the likelihood of better operating margins, along with a decline in debt levels, supported by higher cane diversion towards B-heavy ethanol production.

Risks associated with operating in a regulated industry – MSEL's profitability continues to remain vulnerable to the Government policies and schemes such as creation of buffer stock, export subsidies, mandatory blending of ethanol and its pricing, sugar pricing, etc. Hence, cessation of any subsidies/schemes or any material decrease in sugar or ethanol pricing would have an impact on the company's financials. Nonetheless, recent measures taken by the Central and the state government have supported the financial performance and liquidity of sugar mills.

Sugar mills remain vulnerable to industry cyclicality and agro-climatic risks – Being an agri-commodity, the sugar cane crop is dependent on weather conditions and is vulnerable to pests and diseases that may impact not only the yield per hectare but also the recovery rate. These factors can have a significant impact on the company's profitability. In addition, the cyclicality in sugar production results in significant volatility in sugar prices. However, the sharp downfall in the sugar prices is curtailed after the introduction of MSP by the Central Government in June 2018. Over the long term, higher ethanol production with increased diversion towards B-heavy molasses and direct sugar juice will likely curtail the excess supply of sugar, resulting in lower volatility in sugar prices and hence, cash flows from the sugar business.

Liquidity position: Adequate

MSEL's liquidity is **adequate** with healthy cash flow from operations and average cushion of around Rs. 55 crore in drawing power from August 2020 to July 2021. ICRA expects MSEL to comfortably meet its debt repayment obligations in the medium term. However, the company is in the process of setting up an additional distillery of 75 KLPD that is likely to be operational by the end of December 2021. It plans to incur a capex of around Rs. 130 crore for the same, of which ~Rs. 100 crore is expected to be incurred in FY2022. With respect to the said capex, the company has a sanction of Rs. 101.5-crore term loan, which remained undrawn as on August 26, 2021.

Rating sensitivities

Positive factors – A sustained period of firm sugar prices, driven by favourable demand–supply dynamics and increase in forward integration, leading to reduced volatility in cash flows from the sugar business may warrant a positive rating revision. Additionally, an improvement in the operating profitability and strengthening of debt coverage metrics, on a sustained basis, may trigger a rating upgrade.

Negative factors – The ratings can be downgraded if any sharp decline in sugar prices, cane crushing volumes, recovery rate or an increase in cane costs, or any significant decline in ethanol realisations or material change in Government policies that result in moderation in its profitability and debt coverage metrics on a sustained basis. The specific metrics that could lead to a downgrade include interest cover below 3 times on 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

About the company

MSEL has three sugar mills, namely, New Swadeshi Sugar Mills, Narkatiaganj (District West Chamaparan, Bihar), Bharat Sugar Mills (District Sidhwalia, Bihar), Hasanpur Sugar Mills, Hasanpur (District Samastipur, Bihar) with a combined crushing capacity of 19,000 TCD. It also has one distillery at Narkataiganj with a total capacity of 80 KLPD and a co-gen facility with a total capacity of 38-MW power.

Key financial indicators (audited)

MSEL (Standalone)	FY2020	FY2021
Operating Income (Rs. crore)	918.0	952.9
PAT (Rs. crore)	83.0	27.1
OPBDIT/OI (%)	17.1%	12.2%
PAT/OI (%)	9.0%	2.8%
Total Outside Liabilities/Tangible Net Worth (times)	1.9	1.6
Total Debt/OPBDIT (times)	4.1	5.4
Interest Coverage (times)	3.2	2.1

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation
Source: Company, ICRA Research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2022)					Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Jun 30, 2021 (Rs. crore)	Date & Rating in		Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019
					Sep 21, 2021	Sep 07, 2021	Aug 05, 2020	-	-
1	Fund Based – Term Loan	Long Term	112.50	112.50	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	-	-
2	Fund Based – Working Capital	Long Term	460.00	-	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	-	-
3	Non fund based	Short Term	2.00	-	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+		
4	Unallocated limits	Long Term/ Short Term	2.14	-	[ICRA]A- (Stable)/ [ICRA]A2+				

Complexity level of the rated instruments

Instrument	Complexity Indicator
Fund Based – Term Loan	Simple
Fund Based – Working Capital	Simple
Non fund based	Very Simple
Unallocated limits	Not Applicable

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, is available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN No/Banker Name	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Fund Based – Term Loan*	FY2016	8%-9%	FY2026	112.50	[ICRA]A-(Stable)
NA	Fund Based – Working Capital	-	-	-	460.00	[ICRA]A-(Stable)
NA	Non fund based	-	-	-	2.00	[ICRA]A2+
NA	Unallocated limits	-	-	-	2.14	[ICRA]A-(Stable)/ [ICRA]A2+

Source: *Company, *Includes multiple loans sanctioned at different points of time*

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

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

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