RATING RATIONALE

7 Aug 2020

K M Sugar Mills Ltd

Brickwork Ratings reaffirms the ratings for the Bank Loan Facilities of Rs.244.14 Crores of K M Sugar Mills Ltd.

Particulars:

Facility	Amount (Rs. Crs)		Tenure	Rating*	
	Previous	Present		Previous (05 July 2019)	Present
Fund Based	205.95	177.14	Long Term	BWR BBB Stable	BWR BBB Stable (Reaffirmed)
Non Fund Based	7.00	7.00			
Fund Based	40.00	60.00	Short Term	BWR A3+	BWR A3+ (Reaffirmed)
Total	252.95	244.14	Rupees Two Hundred Forty Four cores and Fourteen Lakhs Only		

*Please refer to BWR website www.brickworkratings.com/ for definition of the ratings
Complete details of Bank facilities is provided in Annexure-I

RATING ACTION / OUTLOOK

Reaffirmation in the ratings of K M Sugar Mills Ltd. (KMSL or the company) factors in growth in revenues and an improvement in overall production capacity utilisation and sugar recovery rate. The ratings are, however, constrained by a decline in profit margins and debt coverage indicators during FY20 against the projections for FY20. Decline in operating margins is led by revision in power purchase tariffs by UPERC, whereas decline in net profit margin is led by higher depreciation and borrowing expenses and lower non-operating income. Debt coverage indicators DSCR and ISCR declined during FY20 as compared to past years and also fell short of projections for FY20 due to higher than anticipated borrowing expenses and lower profits.

Due to the essential nature of the commodity, government support by sugar MSP, good monsoons and export incentives by GoI, the company is expected to achieve higher revenues for FY21 along with improvement in net profit margins. With additional borrowings related to COVID 19 emergency credit facilities and accretion of profits to net worth, overall gearing is expected to remain stable during FY21. However, the metric may show sustained improvement from FY22 onwards due to growth in TNW and substantial repayment of long term loans by FY22. The company does not propose any debt funded capex and capital infusion (equity and USL) in the medium term. With improvement in overall operating profits during FY21 along with decline in borrowing expenses, interest coverage is expected to improve.

However, due to bulk of term loan obligations coming up for repayment in FY21 and FY22, DSCR is expected to remain under pressure.

COVID 19 Impact: COVID- 19 outbreak and resultant lockdown imposed by the government caused disruption of supply chain across businesses in India. Since, the company is engaged in manufacturing of essential commodities, directives by the Ministry of Home Affairs and the state government have ensured normal crushing operations and sales of sugar and ethanol in Uttar Pradesh.

Company has not availed moratorium on loan servicing and debt repayments, as per announcement by RBI under COVID 19 regulatory package. However, the company has been sanctioned financial assistance of a total of Rs.16.12 crs under COVID 19 emergency credit line in April 2020 to meet temporary liquidity mismatches.

Outlook: Stable

BWR believes the **K. M. Sugar Mills Ltd.'s** business risk profile will be maintained over the medium term. The 'Stable' outlook indicates a low likelihood of rating change over the medium term. The rating outlook may be revised to 'Positive' in case the revenues and profit show sustained improvement. The rating outlook may be revised to 'Negative' if the revenues go down and profit margins show lower than expected figures.

KEY RATING DRIVERS

Credit Strengths

- **Revenues:** During FY20, operating revenues have grown by 36% to close at Rs.531.35 crs (P.Y Rs.390 crs) primarily on account of 49% growth in revenues from sugar division led by exports through merchant exporters (export support provided by GoI).
- **Improvement in capacity utilisation and sugar recovery rate:** During 2019-20, capacity utilization and recovery rate is 82.74% (P.Y 82.38%) and 11.41% (P.Y 11.12%) respectively. Average sugar recovery rate in U.P was 11.55% (prov. upto 11 March 2020 as per chinimandi.com) during cane season 2019-20 and 11.46% (data from upcane.gov.in) during cane season 2018-19. Improvement in recovery rate and production capacity utilisation results in better profitability.
- **Integrated nature of business operations:** The company operates a 25-MW co-gen power plant that utilises bagasse, a sugar by-product, as fuel and power is sold to UPERC at predetermined tariffs. The company also operates a 50 KLPD distillery plant that utilises molasses, to produce ethanol and industrial alcohol, which are then sold to buyers. These provide alternate sources of revenue and a cushion against cyclicality and volatility in the sugar business. Government support in the form of favorable ethanol production and remunerative pricing are likely to support the earnings. The company has also been permitted to manufacture alcohol based sanitizers, which are likely to attract huge demand due to changed hygiene habits owing to the COVID 19 pandemic.
- **Experienced promoters and management:** L K Jhunjhunwala, aged 78 years is the Chairman of the company with over 58 years experience in Sugar business. Aditya Jhunjhunwala, aged 50 years and MD of the company has over 28 years in this line of business. Currently, Aditya

handles sugar and power businesses. Sanjay Jhunjhunwala, aged 45 years and MBA from UK has business experience of 21 years and is JMD in the company. He looks after commercial operations and distillery business. S C Aggarwala, aged 59 years in an engineering graduate and has over 36 years business experience. He is ED in the company.

Credit Risks:

- **Profit Margins**: Operating profit margin and net profit margin have declined from 9.72% and 6.22% respectively in FY19 to 9.45% and 3.47% respectively in FY20. Decline in operating margin is led by revision in power purchase tariffs by UPERC, whereas decline in net profit margin is led by higher depreciation and borrowing expenses and lower non operating incomes. Cash Accrual declined from Rs. 36.65 Crs in FY19 to Rs. 33.34 Crs in FY20.
- **Gearing and Debt Coverage Indicators:** Gearing (Total Debt/TNW) deteriorated during FY20 to 1.37x due to higher borrowings. Debt coverage (DSCR) deteriorated during FY20 to 1.98x (P.Y 2.56x) due to higher borrowing expenses and lower net profits. Interest coverage ISCR deteriorated during FY20 to 2.81x (P.Y 4.98x) due to higher than anticipated borrowing expenses.
- **Higher Working capital requirements:** Due to seasonal nature of business, the company's working capital requirements remained high due to higher inventory holding levels at the end of each FY.
- **Agro Climatic factors:** Sugarcane is the key input into the business. Sugarcane is a kharif crop, the production of which depends on good monsoons. Any adversity on the timely and adequacy of rainfall, given the highly uneven pattern of rainfall observed in the l\past few years, would drastically affect the availability and price of sugarcane, thereby affecting profitability of the business.
- **Regulatory Risks:** The industry is highly regulated with inability to pass increased costs to buyers and lack of control over input prices. Profitability remains vulnerable to government regulations on input prices, finished goods prices via domestic sale quota, import and export restrictions, pricing of power produced etc. The company is exposed to regulatory risks and commodity price risks due to its nature of operations. Adverse price movement of input raw cane and finished products due to regulatory guidelines without adequate compensation, would impact operating margins of the company and affect its debt servicing capability. Further, payment of cane prices are subject to political guidelines, whereas recovery of sale revenues would be market linked. This is likely to cause liquidity mismatches in the business operations of the company.

ANALYTICAL APPROACH AND APPLICABLE RATING CRITERIA

For arriving at its ratings, BWR has applied its rating methodology on a standalone basis as detailed in the Rating Criteria detailed below (hyperlinks provided at the end of this rationale).

RATING SENSITIVITIES

Positive: The ratings are sensitive to improvement in total operating income, operating and profitability margins, gearing and debt coverage metrics (DSCR and ISCR), amongst other factors which factor an upgrade. Improvement in ISCR to above 3.5x would be considered as a positive factor.

Negative: Deterioration in cash conversion cycle, debt coverage indicator (DSCR), operating profitability may invite adverse rating action.

LIQUIDITY POSITION : Adequate

With actual cash accruals of Rs.33.34 crs during FY20 and projected cash accruals of Rs.41 crs, the company is comfortably placed in servicing term loan repayment obligations of Rs.19.19 crs. The company has been sanctioned financial assistance of a total of Rs.16.12 crs under COVID 19 emergency credit line in April 2020 to meet temporary liquidity mismatches. Cane arrears upto sugar season 2018-19 are fully paid and cane arrears of S.S 2019-20 upto 08th April 2020 are paid. Remaining arrears are expected to be paid by Sept 2020. Cash Conversion cycle has improved to 107 days (P.Y 130 days) during FY20 primarily on account of decline in inventory holding period from 241 days in FY19 to 227 days in FY20. Total non-current investments of Rs.28.33 crs are made in subsidiaries/associate concerns/related entities during FY20 against investments of Rs.11.06 crs during FY19.

COMPANY PROFILE

K M Sugar Mill Ltd (KMSL), incorporated on 17th December 1971 with its current registered office at 11 Moti Bhawan, Collector Ganj, Kanpur, UP, is engaged in production of sugar, distillery products and generation of electricity, with plant located in Faizabad of U.P. L K Jhunjhunwala is the Chairman, and Aditya Jhunjhunwala, Sanjay Jhunjhunwala and S C Aggarwala are directors in the company. Other directors are Hemantpat Singhania, Satish Kumar Gupta, Ram Shanker Shukla, Madhu Mathur and Surendra Bahadur Singh.

KEY FINANCIAL INDICATORS

Key Parameters	Units	2019(Aud)	2020(Aud)
Operating Revenue	Rs. crs	390.06	531.35
EBITDA	Rs. crs	37.93	50.19
PAT	Rs. crs	24.25	18.43
Tangible Net worth (Analysed)	Rs. crs	95.36	99.52
TOL/TNW (Analysed)	Times	4.02	4.02
Current Ratio	Times	1.13	1.19

Note: Unsecured loans have been added to Tangible Net Worth and investments in subsidiaries/associates/related entities have been subtracted from Tangible Net Worth while arriving at the Analysed Tangible Net Worth.

NON-COOPERATION WITH PREVIOUS RATING AGENCY IF ANY : NIL

RATING HISTORY for the past three years (Including withdrawn and suspended)

<table>
<tr><th>Instrument /Facility</th><th colspan="3">Current Year (2020)</th><th colspan="5">Rating History</th></tr>
<tr><td rowspan="4">Bank Loan Facility</td><td colspan="3">Current Rating</td><td colspan="3">05 July 2019</td><td>2018</td><td>2017</td></tr>
<tr><td>FB</td><td>Rs.177.14 crs</td><td rowspan="2">BWR BBB Stable</td><td>FB</td><td>Rs.205.95 crs</td><td rowspan="2">BWR BBB Stable</td><td rowspan="3">N.A</td><td rowspan="3">N.A</td></tr>
<tr><td>NFB</td><td>Rs.7.00crs</td><td>NFB</td><td>Rs.7 crs</td></tr>
<tr><td>FB</td><td>Rs.60 crs</td><td>BWR A3+</td><td>FB</td><td>Rs.40 crs</td><td>BWR A3+</td></tr>
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ANNEXURE I

K M Sugar Mills Ltd
Details of Bank Facilities rated by BWR

Sl. No.	Name of the Bank	Type of Facilities	Long Term {(₹ Cr)	Short Term {(₹ Cr)	Total (₹ Cr)
1	Punjab National Bank, Mid Corporate, Lucknow	Cash Credit	49.00	NIL	49.00
2		Term Loan	4.90	NIL	4.90
3	State Bank of India, Commercial Branch, Gokhale Marg, Lucknow	CC/WCDL/BD	52.25	NIL	52.25
4		WHR	NIL	60.00	60.00
5		Term Loan -1	38.21	NIL	38.21
6		Term Loan - 2	21.56	NIL	21.56
7		Bank Guarantee	7.00	NIL	7.00
8		COVID TL	11.22	NIL	11.22
TOTAL			184.14	60.00	244.14

Total Rupees Two Hundred Forty Four crores and Fourteen Lakhs only.

COMPLEXITY LEVELS OF THE INSTRUMENTS

For more information, visit www.brickworkratings.com/download/ComplexityLevels.pdf

Hyperlink/Reference to applicable Criteria

- [General Criteria]
- [Approach to Financial Ratios]
- [Short Term Debt]
- [Manufacturing Companies]

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