Dwarikesh Sugar: Structural story at play with ethanol focus

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Highlights:

- *Well-integrated business model*
- *Better sugar recovery and uptick in sugar prices expected*
- *Sugar production to drop as more cane is diverted to ethanol*
- *Alcohol sales volume continuously trending up, to boost margins*

Dwarikesh Sugars (Dwarikesh; CMP: Rs 82; Market cap: Rs 1,530 crore) is seeing a paradigm shift in its business model with an aggressive capacity build-up in distillery. It is well-positioned to benefit from the government’s push for ethanol blending.
The company is focusing on sweating existing ethanol assets and better sugar recovery.

On the earnings front, the coming quarter and the next fiscal will be supported by the distillery segment and better recovery as the plant sugarcane starts getting crushed.

Why this sugar stock tastes sweeter than others small-caps?

Dwarikesh is a well-integrated player in the sugar-ethanol industry, and will benefit hugely from the doubling of ethanol volume (from 5.6 crore litres in FY22 to 11 crore litres in FY23), a strategic move towards sustainability and profitability.

Efficient crushing operations

The recovery rate reported by the company is among the best in North India (gross recovery was 12 percent during SS21-22), thereby reducing the cost of production and improving margins (higher yield, better quality juice).

Moreover, the company plans to change the cane variety mix, with optimal recovery expected from the next sugar season (SS23-24) and full benefits to be realised by FY25.

Ethanol is the way forward

Ethanol is going to be a focus area for Dwarikesh as it plans to cut sugar production by 30 percent. This, we believe, is a strategic move and is in line with the changing global trends.

Ethanol is not only reducing the inherent cyclicality and seasonality in the sugar business model but it is also helping in ramping up revenues with higher margins. Better cash conversion cycle also reduces working capital debt substantially.

We believe, even if crude prices correct, there will be unhindered demand for ethanol, aided by the government's push for self-reliance in order to curtail import dependency (over 85 percent).

Also, the steady Co-gen segment offers healthy margins and takes care of the captive power requirement of the plants.

As the cane crushing season comes to an end for most sugar mills (mid-Oct to mid-Apr), the current inventory levels offer reasonable upside potential for domestic sugar prices amid a rising global price scenario.

The stock had corrected by around 21 percent in the past three months, and we see upside potential for the stock from the current level.

Multi-fold increase in distillery capacity

Encouraged by the huge demand created by the government to meet the blending targets of 20 percent by 2025, the company successfully commissioned the second distillery at Dwarikesh Dham unit with 175 KLPD (kilo litres per day) capacity in Jun-22. The current capacity is 337.5 KLPD (10 times jump from FY07 level of 30 KLPD).

The shift towards ethanol production is driven by the attractive pricing for ethanol in comparison to sugar, which has been struggling with low prices in recent years. The management is also exploring opportunities to increase ethanol exports, which could bring significant revenue.

	1995	2002	2004	2005	2007	2019	2020	2021	2022
Sugar (TCD)	2500	6500	6500	14000	21500	21500	21500	21500	21500
Power (MW)	6	6	17	26	86	91	91	91	96
Distillery (LPD)	Nil	Nil	Nil	30000	30000	100000	130000	162500	337500

Source: Company

Capacity	Dwarikesh Nagar	Dwarikesh Puram	Dwarikesh Dham	Aggregate
Sugar (TCD)	6,500	7,500	7,500	21,500
Cogeneration (MW)	22	33	41	96 (Surplus: c. 56)
Distillery (LPD)	1,62,500	-	1,75,000	3,37,500

Source: Company

Weak quarterly performance; Ethanol to improve margins

In the nine-month performance ended December 2022, margins dropped sharply YoY (down 380 bps), hit both by the sugar and the distillery segments (lower sugar recovery and high cost).

Although, lower yield (unseasonal rains) at the start of the current sugar season (Oct-22 to Sep-23) impacted sugar recoveries of most UP-based sugar mills, it is expected to improve as the season advances and the plant sugarcane starts getting crushed.

Ethanol will be the mainstay for Dwarikesh. The combined margin share (B-heavy molasses that produces ethanol provides better margin versus sugarcane juice) for ethanol is around 20 percent, and the management is confident that the margins will improve once juice-based ethanol is properly remunerated by the government.

During the coming quarter (Q4FY23 is a seasonally better quarter), the company expects to sell 1.6 crore litres of ethanol, and is optimistic about its ability to sell higher levels in the next fiscal year.

Going forward, margins will also get support from increased sugar prices as domestic inventory is likely to remain tight.

SEGMENTS

Segments (Rs. Cr.)	9MFY22	9MFY23	YoY
Sugar Revenue	1432	1500	5%
Sugar EBITDA margin	3.00%	0.40%	(300 bps)
Distillery Revenue	228	339	49%
Distillery EBITDA margin	39.80%	21.90%	(1800 bps)
Cogen Revenue	176	182	3%
Cogen EBTDA margin	33.00%	33.10%	(10 bps)
EPS (Rs)	4.41	-9.8%	-33.1%

Source: Company

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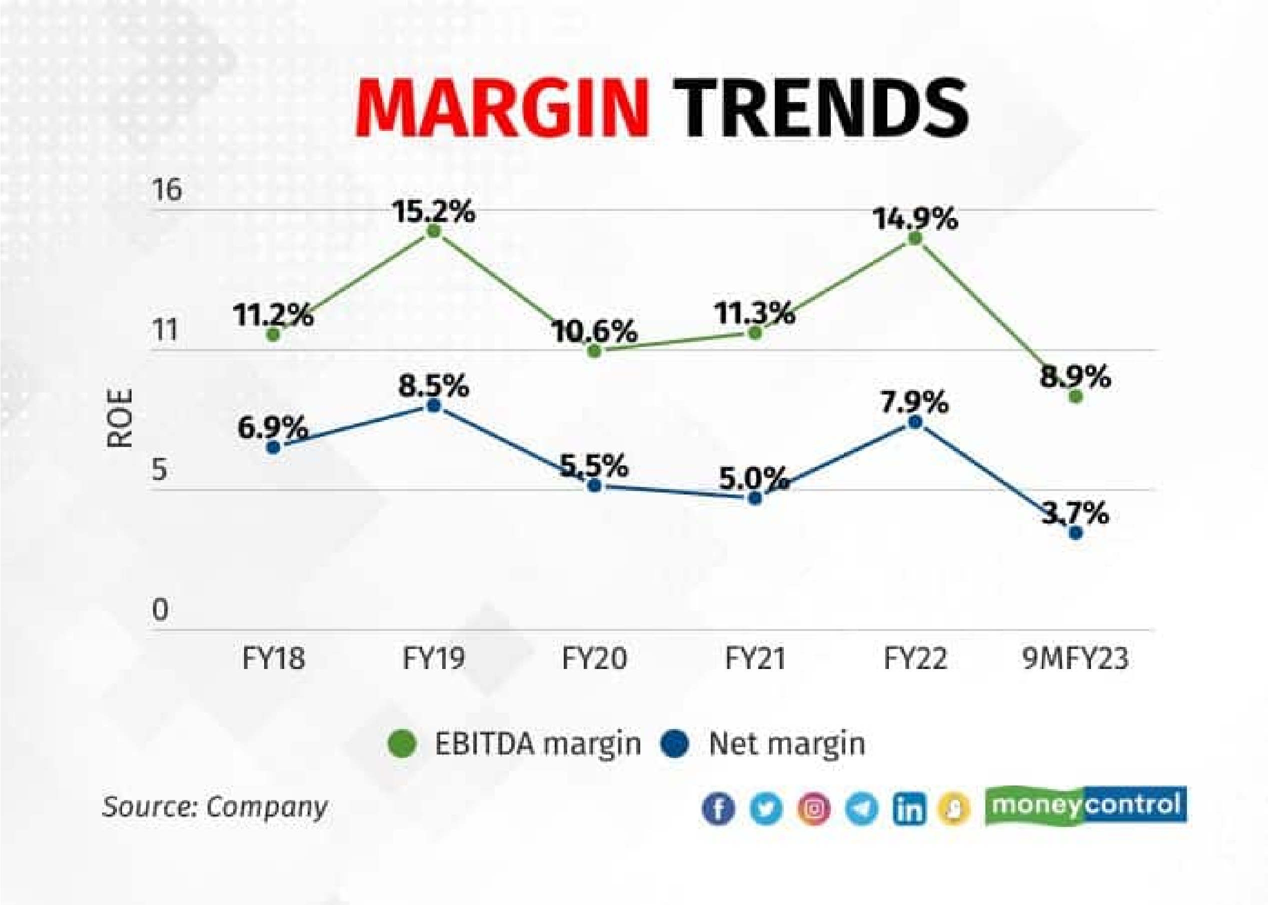
KEY DRIVERS

Key drivers	FY21	FY22
Sugar Production (LMT)	4.59	3.96
Recovery (%)	11.5	10.6
Domestic relaisation (per kg)	31	34.6
Distillery Sales (LL)	317	557
Distillery: avg. realisation (Rs. Per Lt)	50	58
Cogen sold (LU)	1709	1595
Avg realisation	3.1	3.2

TCD: Tons cane per day; KLPD: Kilo litre per day; MW: Mega Watt; GW: Giga watt; LMT: Lakh Metric Tonnes; LU: Lakh unit; LL: Lakh Litre
Source: Company



Outlook and valuation

After major sugar producing states reported a decline in sugar production, the Indian Sugar Mill Association lowered its production estimate to 34 million tonnes for SS22-23 (earlier 36.5 million tonnes) in Jan-23.

The management plans to increase cane crushing capacity for the next crushing season, with a 500-600 TCD improvement from the current capacity of 21,500 TCD (tons canes per day).

Dwarikesh Sugar has been operating both its distillery plants at full capacity. Post distillery capacity expansion, ethanol production run rate is 1 crore litres per month and more than 20 percent of sugarcane juice is diverted towards ethanol production.

As per the management, there is sufficient feed stock available to produce over 7 crore litres for FY23 and 11 crore litres for FY24, by which time the revenue share is expected to increase to over 30 percent.

Working capital debt has come down substantially and we see sustainable improvement in profitability margins riding on the higher share of distillery segment for the coming fiscal.

At 11.0x FY24e P/E and 7.2x FY24e EV/EBITDA, the stock appears to be reasonably priced on account of strengthening operational profile and improving revenue diversification. Moreover, the debt metrics are expected to remain healthy driven by strong cash flow generation.

Investors can add the stock at current levels with a long-term view.

VALUATION SNAPSHOT

(Rs. Cr.)	FY20	FY21	FY22	FY23e	FY24e
Net operating revenue	1,336	1,839	1,974	1,984	2,196
% growth y-o-y	23%	38%	7%	1%	11%
EBITDA	141	208	294	236	283
EBITDA margin (%)	10.6%	11.3%	14.9%	11.9%	12.9%
Net Profit	73	92	155	112	140
Net Profit margin (%)	5.5%	5.0%	7.9%	5.6%	6.4%
Current Market capitalisation			1,530		
Price- to-earnings ratio (x)				13.7	11.0
EV/EBITDA (x)				8.3	7.2
ROE	16%	17%	25%	16%	18%

Source: Company & Moneycontrol Research

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PEER COMPARISON

Peer Group	FY22						
	Market cap (Rs. Cr.)	FY22 Sales (Rs. Cr.)	EBITDA margin	Net margin	D/E (X)	ROE	ROCE
Dwarikesh Sugars	1,530	1,974	15%	8%	0.4	25%	21%
Balrampur Chini Mills	7,360	4,773	15%	9%	0.1	19%	21%
EID Parry	7,990	16,653	11%	7%	0.2	11%	13%

Source: Company & Moneycontrol Research

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RELATIVE VALUATION

Peer Group	FY24	
	P/E (x)	EV/EBITDA (x)
Dwarikesh Sugars	11.0	7.2
Balrampur Chini Mills	19.2	11.9
EID Parry	6.1	6.8

Source: Company & Moneycontrol Research

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Risks

Highly regulated. Any interruption in monsoon and resultant water scarcity can affect performance.

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