Risk Management and Mitigation

The Company is engaged in multiple businesses and there are unique risks associated with each business. The Company follows a well-structured Enterprise Risk Management (ERM) Policy, which requires the organisation to identify the risks associated with each business and to categorise them based on their impact and probability of occurrence – at the business level and at the entity level. Mitigation plans are laid out for each risk along with designation of an owner thereof. It is the endeavour of the Company to continually improve its systems, processes and controls to improve the overall risk profile of the Company.

The ERM policy defines the risks parameters within which the businesses should operate. It helps to build a discipline within the organisation wherein all business decisions are taken after assessing the attendant risks and formulating effective mitigation plans to contain the impact of such risks. Since the Company is engaged in diversified businesses having completely different risk profiles, Risk Management Framework for each business has been devised considering its complexity and uniqueness. Sugar business (including distillery) of the Company is agro-based and largely dependent on uncontrollable climatic factors and Government regulations and policies, whereas the Engineering business (Power Transmission business and Water business) relates to capital goods and infrastructure sectors, which are dependent on the economic growth of the country.

Risk of Business Disruption due to COVID-19

It remained by and large controlled despite some disruption to the business activities of Water and Power Transmission businesses for a brief period. Presently, the normalcy has been largely restored, including floating of tenders for new projects and finalisation of the earlier tenders.

SUGAR BUSINESS

Sugar business is exposed to significant external risks, which mostly are uncontrollable and thus, it is imperative to optimise the controllable business productivity and efficiencies on a dynamic basis to counteract the impact of such external risks. The internal risks are moderate and are by and large predictable and manageable.

Risks

Some of the key external risks to which the Sugar business is exposed are described herein below:

Risk of adverse Government's policies: it includes sugarcane pricing, export policy, monthly sales quota, prescribing Minimum Sale Price of sugar (MSP) and ethanol pricing. These are mainly uncontrollable risks and may have significant impact on the profitability of the Company.

Risk of excess production and climatic factors: Higher sugar production may lead to depressed sugar prices whereas significantly low production may cause spurt in sugar prices. The fluctuation in production mainly occurs due to climatic factors, such as, monsoon, flood and drought, and diseases to the crop that has the potential of impacting yield and sugar recovery from cane. Lower yields result in lower cane availability to sugar mills whereas lower sugar recovery leads to higher cost of production. The fluctuation in the production is more prominent in the western India where the sugarcane crop is largely dependent on the monsoon.

Risk of arranging working capital funds at competitive cost: In view of seasonal nature of sugar business, it has substantial working capital requirements. Adequate working capital funding is required to make timely cane price payment and to maintain inventories. Further, it is imperative to keep cost of funds in check to rationalise finance costs.

Risk of undertaking capital projects to increase Ethanol capacity: The Government has been promoting increase in ethanol capacity and supplies of ethanol produced from B-heavy molasses, sugarcane juice and damaged foodgrains, maize, rice, etc. and thus, there may be a tendency to undertake capex without ensuring commercial viability of the project.

Mitigation

The mitigation strategy being practiced is described here below:

Government policies

The Company strives to achieve benchmark efficiencies in all areas under its control to offset and absorb the impact of uncontrollable risks arising from the Government policies. However, the Government has been taking rational policy decisions balancing the interests of all the stakeholders, which has substantially helped the sugar industry.

It is the objective of the Company to be amongst the top performers in UP, much above the average, so that it remains less impacted by the Government policies as well as the cyclicality associated with this industry. As large part of SS 2021-22 is already completed, it is expected that the Company may achieve a recovery of 11.70% (after adjustment of B-heavy molasses) and is expected to be higher by ~50 basis points than the average recovery in Uttar Pradesh.

Excess production and climatic factors

Pragmatic export policy of the Government has helped sugar inventories to be at the optimum levels.

All India production in SS 2021-22 is expected at ~35.1 million tonnes, which is ~12% higher than the previous season and against domestic consumption of ~ 27.2 million tonnes. In view of considerable exports of ~ 9.2 million tonnes expected for SS 2021-22, closing inventories are expected at 6.9 million tonnes, the lowest in the last five years.

Further, the Government has been strongly promoting ethanol blending and having achieved 10% EPB, the target is to achieve 20% by 2025. As against estimated diversion of sugar of 3.5 million tonnes in SS 2021-22, the diversion may increase to more than 6 million tonnes by 2025. It will keep surplus production in check.

Lastly, it is important to address the issue of sugarcane pricing as it is one of the highest in major sugar producing countries and without export subsidies, it may be challenging for Indian sugar to compete in the global market based on its cost structure.

With regards to climatic factors, most of the Company's sugar facilities are located in Western UP which is canal-fed and hence less dependent on monsoon. It provides significant mitigation in case of poor monsoons.

Sugar Price

There are various mitigations available against this key risk, internally and externally:

a) The Government announces monthly quota for sale in the domestic market which ensures meeting demand adequately without any excessive supplies. Resultant, the prices remain range bound and excessive volatility is avoided.

b) The Government has prescribed Minimum Selling Price (MSP) of sugar below which sugar mills are not permitted to sell sugar. This mechanism avoids collapse in the sugar prices due to overproduction in the country or temporarily excessive supplies in the market.

c) The Company has been focussing on improvement of recoveries as these lead to low cost of production of sugar and enables the sugar mills to tide over market variation in sugar prices and make the sugar operation profitable. The recoveries of our Company have significantly improved over the last few years.

d) The Company produces premium quality sugar to increase overall realisation prices, such as, refined sugar equivalent to ~40% of its production and pharmaceutical grade sugar which fetch substantial premium over plantation white sugar. The Company has taken steps to improve manufacturing processes to produce better quality sugar and to double the production of pharma grade sugar to increase the overall realisation prices.

e) With increasing quantum of profitable ethanol, the Company has diversified revenue streams and it is in a better position to meet and overcome various risks.

Working capital funding

The Company is rated ICRA A1+ for short term and ICRA AA (with stable outlook) for long term. The Company enjoys good relationship with its bankers and in view of its much improved financials and rating, it is in a position to arrange requisite funds at a competitive price, including through commercial papers. Further, with increasing diversion of sugar towards production of ethanol, the sugar production will progressively reduce resulting in lower working capital requirements.

Ethanol Capacity

The Company has a stringent policy of incurring capex only if the threshold profitability and return parameters are expected to be met. Further, the Company has opted for multi-feed distilleries so that in the event of unsatisfactory contribution level, it should have the flexibility to move to another feedstock to maintain its profitability.

ENGINEERING BUSINESS

The Power Transmission business and Water business are in the capital goods and infrastructure sectors and are largely dependent on the industrial and general economic conditions in the country which regulate demand of the products of our Engineering businesses. These businesses are exposed to the following major risks:

Risks

Risk of economic slowdown: It results in sluggish demand of the products of the user industries, which in turn has adverse effect on investment spend on capital goods required for capacity creation or modernisation.

Scarcity of funds

The sluggish demand puts financial stress on the industrial companies and in view of stressed financials and risk aversion, the lenders generally subject the projects to stringent diligence before arriving at funding decisions. The user industries are forced to defer their expansion plans in view of delay in funding, resulting in poor off-take of capital goods.

Technology risks

It is extremely vital for the Engineering business to offer technology and benchmark efficiencies at par with the competition and in the event of a significant gap in its offerings as compared to its peers, the customers may not prefer the products of the Company.

Project delays and payment risks

On account of financial problems with customers, including non-achievement of financial closure, the project may get delayed, resulting in credit risks, cost overruns and blockage of working capital.

Mitigations

Power Transmission Business (PTB)

PTB has fared well in FY 22, in terms of turnover, profitability and order booking. The business model of Power Transmission Business is robust with main verticals being supply of Gear boxes to OEMs and Aftermarket services, including retrofitting and refurbishment solutions, with a focus to expand export footprints. The Company is working on new areas, such as manufacturing of gear internals to other OEMs under 'Built to Print' and foray into Defence sector with a range of engineered products which are aligned to the Government's 'Make in India' initiative. The diversified business model will enable Power Transmission Business to avoid overdependence on few sectors and withstand sector specific cyclicality.

Water Business (WB)

Water business has done reasonably well during the year, given the challenges posed by the pandemic and the resultant disruption in activities. Having secured a breakthrough order in Maldives, it is exploring potential in other international markets with a view to lessen dependence on the domestic market, predominantly dominated by municipalities and local authorities. The Company has well diversified spread of EPC contracts, HAM projects in PPP and in the private sector, product business and O&M.

The Company has access to almost all technologies which are required to be deployed in various projects within the range and competence of the Company. The Company does proper diligence on its customers prior to accepting any order, which includes evaluating its financials, ensuring financial closure of the project, credit ratings (if any), track record and market feedback, and continues to closely monitor any financial stress which the customer may be subject to during the execution of the project.