

RATING METHODOLOGY - AGROCHEMICALS

June 2024


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This rating methodology updates and supersedes ICRA's earlier methodology document on this subject, published in June 2022. While this revised version incorporates a few editorial changes to provide further clarity on some points, ICRA's overall approach to rating agrochemical companies remains materially similar.

Overview

An agrochemical is any substance, or a mixture of substances intended for preventing, exterminating, or repelling the pests that attack crops. Agrochemicals are classified according to the type of pest they control and primarily include (i) insecticides (ii) fungicides (iii) herbicides/weedicides (iv) pesticides and (v) others, such as plant growth regulators, rodenticides, etc. The manufacturing of agrochemicals involves production of a basic ingredient called 'technical' – a material containing the active ingredient, which is combined with solvents/additives (known as formulants) to develop the finished pesticide, known as 'formulation', in a form that optimises biological efficiency and convenience at the same time, while minimising environmental hazards. Agrochemicals can also be classified into (i) generic (non-patented) and (ii) specialty (patented) products. ICRA considers the entities in this industry as those whose primary business activity involves manufacturing and marketing of agrochemical products and/or providing contract synthesis & manufacturing (CSM) services¹ to global agro-chemical entities². The entities are categorised into: (i) technical manufacturers (ii) formulation manufacturers /marketers (iii) integrated manufacturers (involved in manufacturing of technical as well as formulations) (iv) intermediate manufacturers³ (v) those providing CSM services.

The domestic agrochemicals industry is highly fragmented with a large number of manufacturers, involved in manufacturing of a sizeable number of technical-grade pesticides. Nevertheless, the top-10 players control a large portion of the market share.

Indian agrochemical players primarily comprise generic formulations and off-patented product manufacturers, while multinational agrochemicals entities are focused on development of new molecules, which culminate into development of high-end specialty products. While the formulations business is not capital and technically intensive, the profitability of the entities depends on their ability to develop a strong brand and distribution network, which may entail significant time and cost and act as key competitive strengths. Technical and capital intensity is higher in case of production of technicals. The industry is also heavily regulated, given the fact that agrochemical products can have an adverse effect on the environment. Further, for development of the export markets, it may take several years to get requisite approvals from the respective countries' regulatory authorities and market the products in those countries.

¹ CSM services include providing customised research and manufacturing to innovator companies, who define the quality of molecule which is then synthesised by CSM companies

² The rating methodology primarily focuses on agrochemical manufacturers and many factors will not be applicable to entities engaged in only the trading of agrochemicals

³ Manufactures chemicals used as raw material for manufacturing of technical

This document provides an overall perspective on the considerations that are usually the most important from a credit standpoint while assessing companies in the agrochemicals industry, even as it may not include an exhaustive discussion of all the rating factors that our analysis considers. For analytical convenience, this document explains ICRA's methodology for rating agrochemical sector entities under four sections viz., Industry Risk Assessment, Business Risk Assessment, Financial Risk Assessment and other factors including an assessment of Environment, Social and Governance (ESG) risks.

Industry Risk Assessment

- Agro-climatic risks
- Commodity price risk

Business Risk Assessment

- Business profile
 - Extent of integration across business segments
 - Extent of diversification in product portfolio, number of product registrations and brand strength
 - Regulatory risk management
 - Manufacturing infrastructure and compliances
 - R&D strength and product pipeline
- Market position
 - Scale of operations
 - Geographical diversification
 - Customer diversification
 - Strength of distribution network
- Procurement
 - Raw material/feedstock linkages

Financial Risk Assessment

- Revenue growth
- Operating profitability and return indicators
- Leverage, cash flows and debt coverage indicators
- Working capital intensity and liquidity profile
- Foreign currency risk management
- Tenure mismatches and risks relating to interest rates and refinancing
- Debt-servicing track record
- Contingent liabilities/off-balance sheet exposures

Assessment of Environmental, Social and Governance (ESG) Risks

- Environmental (E) and Social (S) Risks
- Governance practices

Other Elements of Credit Risk Assessment

- Parentage/ group support
- Financial flexibility
- Event risk

Management Quality

Industry Risk Assessment

With a significant proportion of India's population dependent on agriculture and the need for increasing the farm output, the agrochemical industry has grown at a rapid pace. Besides, India has the advantages of being a low-cost manufacturing hub with technical competence and manpower availability for producing quality agrochemical products, which has led to a substantial increase in exports over the past few years, primarily to the US, Europe and Africa.

Agro-climatic risks

As the share of irrigated (by dams/canals/wells) area is low in India, most regions are dependent on the monsoons. Even the irrigated areas are indirectly dependent on it. Poor monsoons translate into slower agrochemicals offtake and, therefore, affect the performance of the agrochemical entities. While weak rainfalls are a risk, heavier-than-normal rainfall resulting in floods also affect the pesticide consumption. However, the risk can be mitigated to some extent if the rated entity has a diversified geographic presence spread across several states as the possibility of adverse climatic conditions simultaneously afflicting several states would be lower. Similarly, the frequency of pest attacks is another determinant of pesticide consumption. The risk is partly mitigated by a product portfolio diversified across plants, pests and application i.e., insecticide, fungicide, herbicide, etc.

Commodity price risks

Prices of most chemicals are exposed to input price cyclicalities, which renders the profitability of the end-product vulnerable to these fluctuations. Given that many of the technicals are produced from derivatives of crude oil, prices of the raw materials have fluctuated over the years as crude oil prices have remained volatile. China has been a major supplier of technicals for formulation players. As China plays a major role in the supply chain of raw materials for agrochemicals, developments in the Chinese market result in fluctuation of prices for raw materials. This is also an indicator of the volatility that players might face due to realignment of the global supply chain. ICRA examines the impact of fluctuations in raw material prices on the contribution margin and the overall profitability of the industry participants.

Business Risk Assessment

Product Profile

- **Extent of diversification/integration across business segments:** Business segment diversity enables entities to better withstand segment-specific risks by shielding them from revenue volatility pertaining to high dependence on the performance of any one segment.

Integrated players are viewed favourably, given the benefits of backward integration which ensures quality and availability of the technicals for the formulation business. Additionally, integrated players have showcased capabilities to move up the value chain e.g., manufacturing specialty chemicals and Custom Synthesis Manufacturing (CSM). Nevertheless, integrated entities are also exposed to risks arising from the demand slowdown or price correction in view of their higher fixed-cost structure and greater reliance on operating leverage.

- **Portfolio strength and diversity:** The risks which the entities face are also related to the products in their portfolio. Generics are commodity products and hence, competition is intense with a large number of players present in the segment. Margins remain low in generics manufacturing and brand strength plays an important part in protecting the profitability in this segment. On the other hand, few Indian entities also manufacture specialty products in-licensed from larger MNCs wherein the entities sign exclusive manufacturing and marketing arrangements with the MNCs in-lieu for royalty paid to the MNC. As a result, these entities face lesser competitive intensity and hence, profitability is protected to that extent. Besides, entities having a higher number of product registrations domestically or in the overseas markets

have sustainable growth prospects due to lesser dependence on individual products or markets. ICRA also assesses the product diversification across applications – insecticides, pesticides, fungicides, etc.

ICRA analyses an entity's research and development (R&D) capabilities through past track record of successful product launches, pipeline of upcoming products and successful patents filed. A pipeline of products and healthy quantum of products launched in the last 2-3 years is a credit positive as it reflects the growth potential. Being a regulated industry, it takes almost 10 years for an entity to bring a new molecule into the market and almost five years to get a generic product registered. No product is allowed to be produced, exported and imported without registration. As a result, entities with larger number of products registered remain in an advantageous position. Also, due to environmental regulations, there are possibilities of a ban on the sale of certain products by the regulator. As a result, it is imperative for an entity to have a number of products in various stages of product development and registration process.

Many products being sold in the agrochemical market are patented and remain exclusive to certain entities for a specified period. However, post the patent expiry, these products can be produced and sold by any entity which can get approvals for these products from the regulatory authority. ICRA notes that any tie-ups by an entity with large MNCs for contract manufacturing of any new molecule could act as an added advantage. ICRA also analyses the number of product launches done by the company and the contribution of 9(3)⁴ products to the revenue to gauge the sustainability of the revenues and profitability. A higher proportion of 9(3) products in the revenue indicates superior product profile.

- **Regulatory risk management:** The Indian agrochemical industry is highly regulated by two Central Ministries: a) The Department of Chemicals and Petrochemicals under the Ministry of Chemicals and Fertilisers, and b) the Ministry of Agriculture. The Department of Chemicals and Petrochemicals is responsible for planning, development and regulations of the agrochemical industry. The Ministry of Agriculture regulates the registration, manufacture, sale, transport, export/import, distribution and use of pesticides through the Insecticides Act, 1968 and Insecticides Rules, 1971. All pesticides manufactured by the Indian entities have to necessarily undergo the registration process with the Central Insecticides Board & Registration Committee (CIB & RC) before they can be made available in the market for end use. Besides, the agrochemical industry is highly regulated globally with entities being governed on the basis of patents, product toxicity and quality. Indian agrochemical entities need to comply with these regulations for selling their products in the domestic and export markets where they have a presence. By virtue of operating in a dynamic regulatory environment with respect to product approvals and patent expiry, the management's ability to tailor the entity's strategies to mitigate the risks associated with changes in regulations is critical. The companies are also exposed to regulatory risks associated with handling of hazardous chemicals and thus, have to meet strict compliance norms in terms of effluent discharge, etc. ICRA assesses the capability of the company in meeting the norms related to environmental and pollution norms.

Some of these pesticides fall under the hazardous category. Indiscriminate and injudicious use of chemical pesticides have resulted in adverse effects such as environmental pollution, ecological imbalances, pesticide residues in food, fruits and vegetables, human and animal health hazards, development of resistance in pests, etc. Agrochemical products are classified into four groups based on their toxicity levels: (i) Red triangle - Extremely hazardous (ii) Yellow triangle - Highly hazardous (iii) Blue triangle - Moderately hazardous (iv) Green triangle - Low risk. Some of these products have been banned in India and in various developed markets, which implies that entities highly dependent on red and yellow triangle chemicals run the risk of losing their source of revenue from products falling under these categories facing ban. ICRA analyses the product portfolio of the entity to understand the associated regulatory risks. ICRA further analyses the impact of any possible ban by the regulatory authorities on the production of these products and subsequently on the overall revenues and liquidity profile of the entity.

⁴ These are products which are being introduced for the first time in India. These get registered under the section 9(3) of the Insecticides Act

Market Position

The market position of an entity, as determined by its scale of operations, strength of distribution network and geographical and customer diversification, is one of the critical factors of success for agrochemical entities.

- **Scale of operations:** Large scale typically leads to greater bargaining power with suppliers and dealers, besides enabling superior competitive position on the back of cost and manufacturing process efficiencies. Combined with a wide portfolio of products, the large scale of operations has the potential to enable better marketing reach and bargaining power with distribution channel for agrochemical entities. Besides, it is easier for a larger entity with established cash flows to diversify into other geographies, thereby generating better avenues for growth, as also enhancing capabilities to make R&D investments for maintaining a healthy product pipeline.

Various chemicals are used as raw materials for the manufacturing of technicals, which is a highly capital and technologically-intensive business. Further, economies of scale play a big role in reducing cost of production and hence, domestically produced technicals have faced tough competition from imported technicals, as manufacturers in countries like China operate on a very large scale giving them an advantage over domestic producers.

- **Geographical & customer diversification:** Better geographical diversification enables an entity to mitigate demand risks associated with a particular geography. India has the advantages of being a low-cost manufacturing hub with technical competence and manpower availability for producing quality agrochemical products, which has led to a substantial increase in exports over the past few years, primarily to the US, Europe and the African countries. ICRA analyses the presence of the entity in key export destinations, marketing set-up in the region and any strategic alliance and partnership with local players.

Most Indian agrochemical entities manufacture and market generic and off-patent agrochemicals, which comprise ~80% of the Indian market, while the MNCs generally focus on high-end specialty products. Given the low value-added nature of the generic products, strong distribution network, appropriate pricing and brand image act as differentiating factors. A meaningful presence across a large number of states within India is also seen as a credit positive as it gives an additional benefit of providing a hedge against the exposure to agro-climatic risks.

Supplier Concentration

A major portion of the demand for technicals for domestic formulation manufacturing entities is met through imports from international players. However, some of the large agrochemical entities are backward integrated into technical manufacturing, providing them a degree of self-sufficiency and control on quality. ICRA evaluates the entity's sources of raw material supply and supplier concentration risk to assess supply disruption risks, which may impact the operations.

Summary of salient business risk factors

	Strongest	Weakest
Segment Diversification	Presence in R&D, Technicals, Formulation and CSM business	Presence in single segment
Number of product launches in last 3 years	>10	<=2
Product Diversification		
Formulation business	9(3) products revenue contribution >40% and No. of products > 40	9(3) products revenue contribution <=5% and No. of products <=15
Non formulation business	No. of products > 35	No. of products <=10
Regulatory Risk		
Revenue proportion from red and yellow triangle products	<=5%	>50%
Formulation business		
Geographical diversification		
Exports market	Export revenue proportion >=40%	Export revenue proportion = 0%
Domestic market	Presence in more than 12 states	Presence in less than 3 states
Non formulation business		
Geographical and customer diversification		
Geographical diversification	Export revenue proportion >=40%	Export revenue proportion = 0%
Customer diversification	Revenue share of top 5 customers <=25%	Revenue share of top 5 customers >70%
Scale of operations	Revenues > Rs. 1500 crore	Revenues <= Rs. 300 crore
Raw material sourcing	Share of top 5 suppliers <=50% of the total raw material costs	Share of top 5 suppliers > 80% of the total raw material costs

Financial Risk Assessment

ICRA analyses the long period of past financial performance trends and estimates the future financial performance to assess the financial risk exposure of an entity, i.e., to evaluate the sustainability and adequacy of cash flows against its debt servicing obligations. The financial metrics provide a useful reference not only to evaluate the performance trends of an entity over a given period, but also to enable a comparison with its peers. The various financial metrics assessed by ICRA could be divided into five categories viz., Profitability, Leverage, Coverage, Liquidity and Cash Flows. Given the uncertainty around how the various credit drivers could evolve in the future, ICRA also carries out a sensitivity analysis to assess the impact of the key variables on various financial metrics of the entity to evaluate its ability to withstand stress events. This is especially critical to evaluate the earnings movement over the course of the industry cycle so that the ratings are through the cycle, and not influenced purely by the stage of the industry cycle at a particular point of time.

Profitability

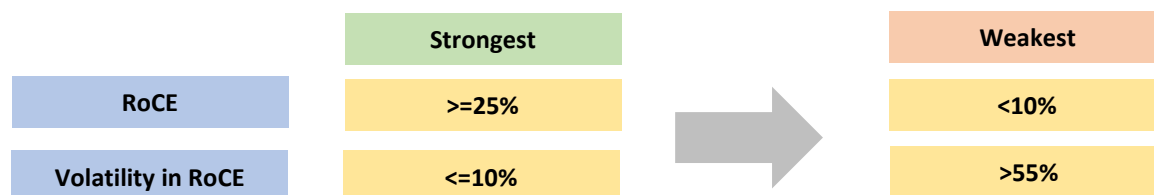
Profitability is a measure of the earnings generated by an entity in a given period in relation to the resources deployed. From a rating perspective, both the level as well as the stability in profitability metrics matter. A consistent track record of higher profitability shown by an entity compared with its peers reflects a superior competitive position arising from one or more factors, including greater brand strength, better distribution reach, attractive product profile, technological superiority or higher cost efficiency (operating or capital). Entities with higher profitability than its peers are likely to show stronger resilience against economic downturns and are more likely to generate relatively higher internal resources for reinvestment and debt servicing and attract fresh capital. Moreover, as the company’s cash flow generation is likely to fall short of the levels needed to support capital expenditure and the debt-servicing needs during periods of downturns, the sustained profits generated during other periods would help build a cushion to surpass the downcycles.

The profitability of the agrochemical entity depends on the value-additive nature of the products, brand premium, geographical market and competitive position. Agrochemical players with a large number of exclusive products (more commonly known as Section-9(3) products) in its portfolio will be able to post higher profitability against players with major share of revenue being derived from the sale of generic products more commonly known as Section-9(4) products. The trends

in the operating margin and return on capital employed are also analysed to establish the stability of cash flow generation and the sufficiency of the same vis-à-vis the entity’s future debt service obligations.

Validation of Business Risk through Profitability Metrics

[Indicative Metrics⁵]



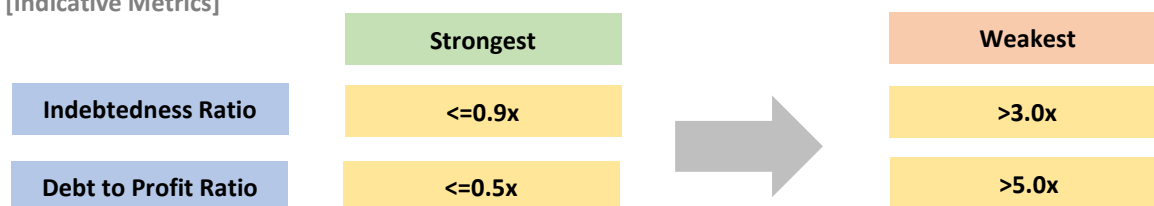
Leverage and Coverage indicators

Leverage indicators: Financial leverage is a measure of an entity’s dependence on borrowed funds. Lower the dependence on borrowings, the lower (better) the leverage. When an entity borrows, it is obliged to pay both interest as well as principal to the lenders as per a defined schedule. This increases the fixed cost burden on the borrowing entity and in the limiting case, increases the default risk. While high leverage may mean high risk from a credit perspective, it is an often-adopted course by shareholder-oriented managements, given that high leverage, in good times, leads to high returns on equity capital. An entity’s financial leverage could, thus, be a function of its management’s financial policy and risk tolerance, besides being a point-in-time reflection of an entity’s business and financial choices. An entity with lower leverage is better equipped to withstand volatility in cash flow generation in situations of economic downturn, competitive challenges, unexpected costs, changing consumer preferences, or regulatory changes.

While working capital requirements in the agrochemicals industry remain on the higher side owing to elevated inventory and receivables, as the end customer is the farmer, the overall capital structure for most of the established entities has remained fairly comfortable.

Assessment of Leverage

[Indicative Metrics]



Coverage Indicators: Coverage is a measure of an entity’s debt-servicing ability and is calculated as the ratio of profits to the debt servicing obligations in a given time. Higher the ratio, higher the cushion available with an entity to withstand the variability in profits for meeting its financial obligations. Coverage is a function of an entity’s profits, leverage and debt characteristics (in terms of cost of debt and repayment schedule). The interest coverage indicator reflects the company’s ability to fund the cost of external borrowings after meeting all the operating expenditure requirements. The debt service coverage ratio (DSCR) is a measure of an entity’s debt servicing ability and is calculated as the ratio of profits to the debt servicing

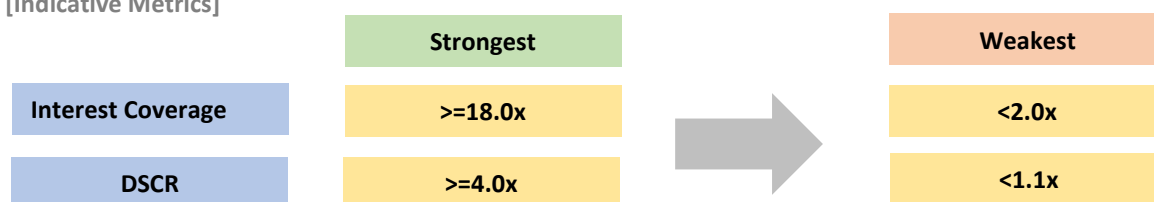
⁵ The indicative financial metrics mentioned here and elsewhere in the document are intended to provide a broad overview to the readers regarding what ICRA generally considers as ‘relatively strong’ or ‘relatively weak’ metrics. It is, however, possible that an entity has relatively weaker metrics on one or more financial parameters, but its credit risk is assessed to be low because of other mitigating factors, including (but not limited to) stronger metrics on other financial parameters, a healthy business risk profile, strong financial flexibility or a strong promoter group that is willing to extend distress support to it.

obligations in a given time. Entities with higher profitability and lower leverage will generally have better coverage ratios and thereby healthier financial risk profiles.

Typically, working capital borrowings constitute a larger share of the borrowings for majority of agrochemical entities which tends to be rolling in nature. As a result, the interest coverage ratio remains a key metric to assess the debt-servicing capability of an entity. For companies with long-term debt on their books, the ability to meet the debt repayments through the debt service coverage ratio, its trend as well as the expected drivers of operating profit are analysed to arrive at a holistic view on debt servicing.

Assessment of Coverage

[Indicative Metrics]



Working capital indicators

The working capital intensity of agrochemical players tends to remain moderately high owing to the long operating cycle as production and placement of products happens throughout the year, while the sales of the product happen majorly during the cropping season. As a result, the working capital intensity remains high. The trends in an entity’s key working capital indicators like receivables, inventory and creditors are analysed with respect to industry peers and the reasons for higher or lower indicators are assessed. A relatively higher receivables could be on account of an entity pushing sales through distributors without commensurate end-user demand. A relatively higher payables could be on account of an entity’s bargaining power with its suppliers or due to its weak liquidity profile.

Liquidity

Liquidity is the measure of an entity’s ability to meet its short-term cash obligations from various internal or external resources. Internal resources include cash flows from operations, unencumbered cash and cash equivalents on the balance sheet and cash inflows expected from the monetisation of physical and financial assets. External resources include undrawn lines of credit or equity capital. The short-term obligations include both the committed as well as the contingent claims on an entity’s cash, including the debt servicing obligations, working capital requirements, capital expenditure and other investment outlays, dividend and share buyback-related outflows, besides the sudden demand arising from the crystallisation of discrete events such as unfavourable outcome of an ongoing litigation. The higher the cushion available between the resources available (especially internal resources) and the obligations, better the liquidity profile of an entity.

Liquidity is generally assessed in conjunction with the vulnerability of an entity to timely refinance/renewal of short-term sources of funding. Depending on the circumstances, an entity that has a relatively modest liquidity profile, but a strong refinancing ability may not be viewed too unfavourably. ICRA also notes that the liquidity available with an entity may be for a temporary period and, hence, an entity’s overall policy towards maintaining adequate liquidity (given the trade-off between returns and liquidity) is accorded due importance in the analytical approach.

Other aspects which are analysed include the following:

- **Cash flow analysis:** Cash flows reflect the sources from which cash is generated and its deployment for debt servicing as well as other cash outflows. ICRA analyses the drivers of the entity’s funds flow from operations (FFO) after adjusting for working capital changes, the retained cash flows, and the free cash flows after meeting the debt

repayment obligations and capital expenditure needs. The cash flow analysis also helps in understanding the external funding requirement that an entity has to meet its maturing obligations.

- **Foreign currency-related risks:** Such risks arise if an entity's major costs and revenues are denominated in different currencies. Agrochemical players are largely dependent on imported chemicals for manufacturing of the end products and, thus, face foreign currency risks in terms of increased cost of imports in case of steep INR depreciation against the US dollar. The foreign currency risk can also arise from the unhedged liabilities like foreign currency debt both working capital and term debt, especially for companies earning most of their revenues in local currency. ICRA analyses the hedging policy of the entity concerned in the context of the tenure and nature of its contracts with clients (short term/long term, fixed price/variable price).
- **Tenure mismatches, and risks relating to interest rates and refinancing:** Large dependence on short-term borrowings to fund long-term investments can expose an entity to significant refinancing risks, especially during periods of tight liquidity. The existence of adequate buffers of liquid assets / bank lines to meet short-term obligations is viewed positively. Similarly, the extent to which an entity would be impacted by movements in interest rates is also evaluated.
- **Accounting quality:** Here, the Accounting Policies, Notes to Accounts, and Auditor's Comments are reviewed. Any deviation from the Generally Accepted Accounting Practices is noted and the financial statements of the entity are adjusted to reflect the impact of such deviations.
- **Contingent liabilities/Off-balance sheet exposures:** The likelihood of devolvement of contingent liabilities/off-balance sheet exposures and the financial implications of the same are evaluated.

Other Elements of Credit Risk Assessment

Parentage/Group Support

Apart from standalone credit considerations, the likelihood of extraordinary support coming in from the parent to an entity or the support that an entity is likely to extend to the other group companies is factored in while assessing the entity's credit profile. This process involves an assessment of the ability and willingness of the parent to extend support to the entity (and vice-versa), in addition to evaluating the entity's own fundamental credit strength⁶.

Financial Flexibility

As the agrochemical business is working capital intensive, ability to raise resources from the capital or loan market at competitive rates is a key rating strength. The entity's financial flexibility is assessed from the nature of its relationship with banks, financial institutions and other intermediaries, strategic importance of the entity to the Group to which it belongs, along with the financial strength of the Group entities, if any.

Debt-Servicing Track Record

The debt-servicing track record of the company forms an important rating consideration. Any history of past delays or defaults in meeting interest and principal repayment obligations reduces the comfort level with respect to the company's future debt-servicing capability and willingness. Nevertheless, the reason behind past defaults is also analysed, which could also be due to adverse demand situations in the underlying industry. The company's ability to honour its debt obligations during the period of cyclical stress is also factored in.

Event Risk

ICRA recognises the possibility of events, such as unrelated diversification, mergers and acquisitions, business restructuring, asset sales and spin offs, capital restructuring and litigations, which could have a material impact on the credit profile of a company. Incorporating the impact of such discrete events in the credit rating, from the beginning, is often difficult. Depending on whether and when such events occur, the rating opinion could be different. To take rating decisions in such cases, ICRA applies its analytical judgement based on the rated entity's track record, the credibility of the management and the experience of having seen similar situations play out in other entities. However, given the nature of such events, it is possible that the rating may undergo a material change later, upon the occurrence of the event.

⁶ For more details, please refer to ICRA's methodology, "Rating Approach—Implicit Parent or Group Support" available on ICRA's website www.icra.in.

Management Quality

In addition to the business and financial risk analysis, all debt ratings incorporate an assessment of the quality of the entity's management and financial policies.

In addition, the likely cash flow impact on the rated entity, from the possible need to support other Group entities are of importance, in case the rated entity is among the stronger ones within the Group. Usually, a detailed discussion is held with the management of the rated entity to understand its business objectives, plans and strategies, and views on past performance, besides the outlook on the rated entity's industry.

Some of the points assessed are:

- Experience of the promoter/ management in the industry
- Commitment of the promoter/ management to the concerned line of business
- Risk appetite of the promoter/ management and risk mitigation plans
- The rated entity's plans regarding new projects, acquisitions, and investment in non-core business segments
- The rated entity's policies on leveraging, interest and currency risks

Periodic interactions with the management also help to estimate the possibility of the management's tendency to deviate from its core philosophy in times of stress.

Assessment of Environmental, Social and Governance (ESG) Risks

Environmental (E) and Social (S) Risks

As this methodology highlights, while undertaking credit assessment of entities, ICRA seeks to incorporate all relevant credit considerations into its rating decisions while taking a forward-looking view on the risks and the mitigations. The relevant credit considerations include the E&S factors that could affect the rated entity. While ICRA's analytical approach does not explicitly disaggregate these risks to assess their impact on the rating, these risks are often assessed broadly. Further, it is not always feasible to fully or precisely disaggregate the sub-components of E&S risks in credit analysis as these considerations often tend to overlap.

That said, the materiality of the E&S risks and the time over which they are expected to crystallise differs widely across sectors and entities. In some cases, while the E&S risks could be material, their effect on the credit profile may be muted because of other fundamental strengths of the entity. In other cases, the adverse impact of the E&S risks is expected to play out in the distant future, and, hence, these considerations do not necessarily weigh on the rating today—with the expectation that when these risks manifest in the distant future, the rated entity by then would possibly adapt itself by realigning its business model.

While evaluating E&S risks, ICRA's objective is only to assess the direct and indirect risks that an entity faces and how it already is or is intending to mitigate the impact of such risks on its credit profile. As an example, ICRA only assesses whether an entity is exposed to physical climate risks, or carbon-transition risks such as those arising from changes in regulations or other environmental and social risks; and seeks to understand the various mitigation and adaptation approaches that the entity is implementing to mollify these risks. Global efforts towards reducing the use of pesticides on crops have been gaining ground as several chemicals have shown adverse effects on humans as well as the surrounding ecosystem. Periodic reviews have led to banning of several pesticides, albeit their substitutes were already available to allow continued use of pesticides. Going forward, the risks emanating from the harmful effects of these chemicals on the environment which are essentially poisonous in nature, in the form of fines, penalties, loss of business, etc, will remain a key risk for industry participants to mitigate. Additionally, the domestic as well as export markets for agrochemicals remain vulnerable to agro-climatic risks. Changing climate patterns, frequent flooding, droughts etc., can hamper agricultural activity across the globe in multiple geographies including India, thus impacting the consumption of agrochemicals.

While the agrochemical sector remains a socially important sector, given its role in ensuring food security by warding off pests, weeds etc., there have been rising concerns related to the excessive usage of agrochemicals and its impact on health. Changing

consumer preference towards use of organically grown products wherein no agrochemicals are used poses a social risk for agrochemical demand. While ICRA does not expect the risk to fructify in the near term, the innovations in the organic farming techniques, which could lead to increase in yields and lowering of the pricing premium for organically grown products, in the long term could weigh on the agrochemicals demand.

Governance Practices

A sound corporate governance structure attempts to make clear the distinction of power and responsibilities between the board of directors and the management. The constitution of an entity's board and the board of directors' participation in strategy formulation, besides the entity's adherence to legal and statutory compliance requirements are factored in during credit assessments. ICRA seeks to gain a qualitative understanding of an entity's commitment to following transparent and credible practices by the way its financial statements are reported, their level of disclosures, consistency in communication and the openness about sharing information during the credit rating exercise. Besides, the corporate group structure (whether simple or complex), the rated entity's related party transactions and instances of supporting Group entities at the expense of debt holders are assessed.

Summing Up

ICRA's credit ratings are a symbolic representation of its opinion on the relative credit risk associated with the instrument being rated. This opinion is arrived at following a detailed evaluation of the entity's business and financial risks, its competitive strengths, its likely cash flows over the life of the instrument being rated, and the adequacy of such cash flows vis-a-vis its debt-servicing obligations. As highlighted in the note, ICRA evaluates the product and segmental profiles, R&D and manufacturing capabilities, geographical diversification, agro-climatic risk, regulatory risks and distribution network of the entity in the agrochemical industry and the entity's capability to generate cash over the lifetime of the instrument being rated, to arrive at an opinion on the credit risk.

ANNEXURE

Summary of rating factors and an example to illustrate the key building blocks of a credit rating for agrochemical players

		Strong			Comfortable			Adequate			Moderate			Weak							
Industry Risk	Regulatory Risk																				
	Segment diversification																				
Business Risk	Product Portfolio																				
	Regulatory Risk																				
	Geographical Diversification																				
	Scale of Operations																				
	Raw Material Sourcing																				
Financial Risk	Leverage																				
	Coverage																				
		Enhance						Support/ Neutral						Hinder							
Do these factors enhance or hinder the credit profile?	Diversification																				
	Refinancing Dependence, Liquidity and Financial Flexibility																				
	Currency Risk																				
	Financial Policy																				
	Management, Governance & Reporting																				
		Very High						High						Moderate				Low			
Parent Support	Likelihood of Parent Support	NA																			
	Rating of Parent	AAA	AA+	AA	AA-	A+	A	A-	BBB+	BBB	BBB-	BB+	BB	BB-	B/ C category						
	Final Rating	AAA	AA+	AA	AA-	A+	A	A-	BBB+	BBB	BBB-	BB+	BB	BB-	B/ C category						

The above graphic is only for illustration purpose and does not represent a rating output from a formulaic model. The ratings assigned by ICRA are determined by Rating Committees based on both quantitative and qualitative considerations.

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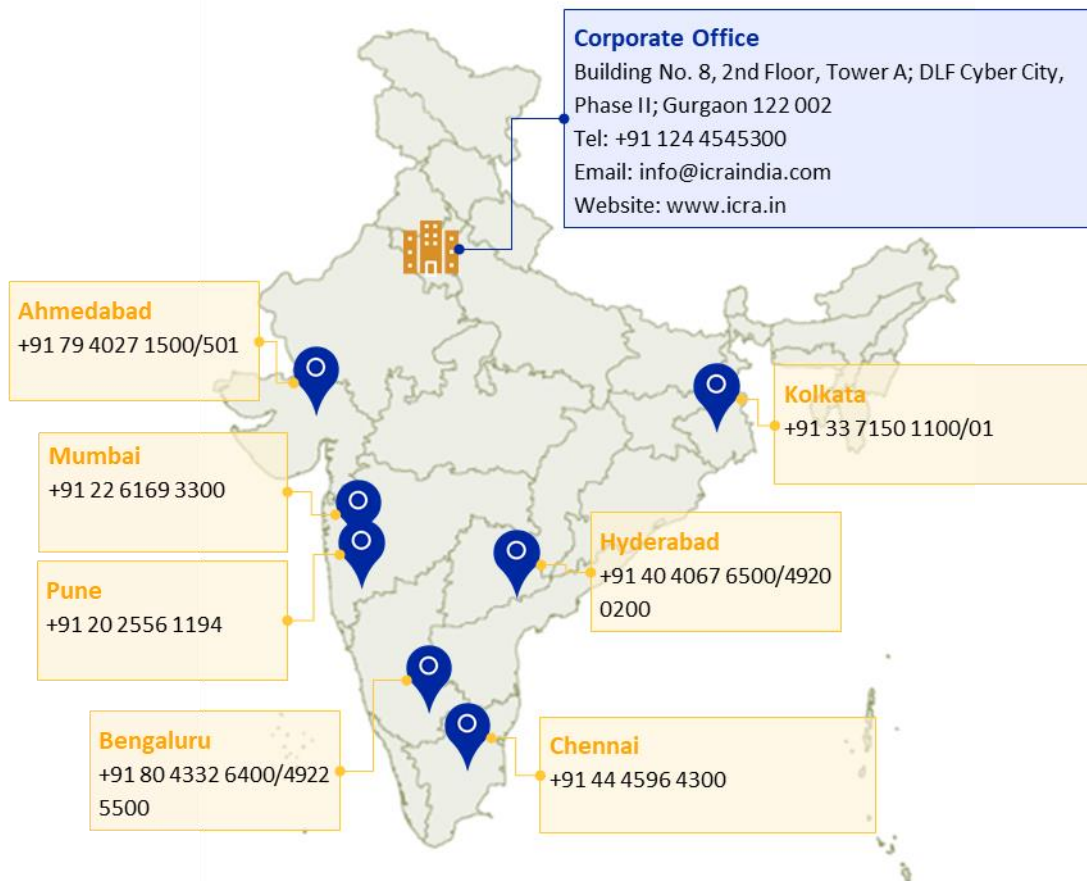
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