**July 16, 2021**

# Paradeep Phosphates Limited: Ratings continue to be on watch with negative implications

## Summary of rating action

| Instrument* | Previous Rated Amount (Rs. crore) | Current Rated Amount (Rs. crore) | Rating Action |
|---|---|---|---|
| Term Loans | 824.0 | 824.0 | [ICRA]A @; Rating continues to be on watch with negative implications |
| Fund based-Long Term facilities | 1,365.0 | 1,365.0 | [ICRA]A @; Rating continues to be on watch with negative implications |
| Non-fund based short term facilities | 2,570.0 | 2,570.0 | [ICRA]A1 @; Rating continues to be on watch with negative implications |
| Commercial Paper programme | 250.0 | 250.0 | [ICRA]A1 @; Rating continues to be on watch with negative implications |
| Total | **5,009.00** | **5,009.0** | |

**Instrument details are provided in Annexure-1*

## Rationale

The ratings continue to remain under watch with negative implications following the impending asset sale transaction between Paradeep Phosphates Limited (PPL) and Zuari Agro Chemicals Limited (ZACL, rated [ICRA]B &/[ICRA]A4&) for a total consideration of $280 million on a slump sale basis, which is expected to moderate PPL's return metrics. ZACL and PPL had signed a Business Transfer Agreement (BTA) in March 2021 outlining the transaction details. The aforesaid transaction has been approved by the board of directors and shareholders of ZACL and recently the Competition Commission of India (CCI) also accorded its approval to the transaction. ICRA expects PPL to fund the asset purchase primarily by equity with only the working capital portion being funded by working capital debt. While PPL is in process of filing for an Initial Public Offering (IPO) to raise funds for the transaction, ICRA will closely monitor the developments and resolve the watch following the conclusion of the transaction.

The ratings factor in the expectations continued healthy cash generation from operations by Paradeep Phosphates Limited (PPL), stable credit profile going forward post clearance of the subsidy backlog by the GoI in FY2021 and expected operational improvements which will enable improved cost efficiencies. PPL's cash generation is expected to be supported by completion of the debottlenecking of its manufacturing capacity which now stands at 1.5 MMTPA from 1.3 MMTPA earlier. With the contribution margin on sale of phosphatic fertilisers expected to moderate in FY2022 driven by the steep rise in the raw material prices partially alleviated by the increase in the subsidy rates, the cash flow is expected to remain stable with expected rise in the sales volume. Further, with normal monsoon forecast for the current kharif season, the volume offtake is expected to remain healthy, although the monsoon rainfall has been lagging the normal levels in various parts of the country. PPL's credit profile will continue to benefit from the clearance of the subsidy backlog by the GoI at the end of FY2021 leading to a steep decline in the working capital borrowings. As a result of the expected timely release of the subsidy by the GoI and healthy collections from the market, the overall working capital requirements are expected to remain low. As a result, reliance on working capital borrowings will remain low leading to lower interest outgo.

The ratings continue to factor in the company's established position as one of the largest manufacturers of phosphatic and complex fertilisers in India and its leading market position in its marketing territories, which is expected to strengthen further post the ZACL's asset acquisition. The ratings also factor in the substantial gap between domestic production and consumption leading to limited demand-related risks and the company's moderate cost position due to high operating efficiency and part backward integration into the manufacture of phosphoric acid. The company's established relations with overseas raw materials' suppliers due to the latter belonging to the promoter group generally results in smooth availability of raw materials.

The ratings are constrained by the vulnerability of the company's profitability to agro-climatic and regulatory risks, with the former being reflected by muted demand in some past years and the latter being reflected by substantial delays in subsidy receipts from the GoI in recent years leading to high short-term borrowings. The ratings also continue to factor in the company's relatively high segmental concentration towards phosphatic/complex fertilisers, significant exposure to forex fluctuation risks being a major importer and high working capital intensity of its fertiliser business. The performance of P&K fertiliser manufacturers is relatively more vulnerable to regulatory aspects e.g. fixed subsidy levels as well as economic variables (such as supply-demand, commodity prices and currency movements). Further, substantial increase in the prices of P&K fertilisers post the implementation of NBS have adversely impacted demand due to significant price differential with urea.

ICRA also takes note of PPL's ~Rs. 500 crore debt-funded capex program for debottlenecking of its DAP/NPK capacity, capacity expansion for its phosphoric acid plant and installation of a phosphoric acid evaporator. While PPL has completed debottlenecking of two trains leading to the increase in the capacity to 1.5 MMTPA from 1.3 MMTPA, the remaining debottlenecking is expected to complete in H1 CY2023. The evaporator capex is expected to be completed by end of FY2022 while phosphoric acid expansion is expected to be completed by the mid of FY2023.

## Key rating drivers and their description

### Credit strengths

**Established position as one of the largest manufacturers of DAP and complex fertilisers in India -** PPL is one of the largest manufacturers of DAP/NPK fertilisers in India with a total installed capacity of 1.5MMTPA post debottlenecking of two trains in FY2021. The capacity will increase further to 1.7 MMTPA in FY2023 post debottlenecking of the remaining two lines. Post the acquisition of ZACL's assets the company will have around 2.5 MMTPA of annual manufacturing capacity of phosphatic fertilisers making it the third largest P&K manufacturer in the country.

**Leading market position in DAP and NPK complexes in most of its marketing territories-** PPL enjoys leading market share in most of its territories like Orissa, West Bengal, Bihar and Uttar Pradesh. With acquisition of ZACL's assets, PPL will enhance its market reach to the Southern and Western markets. PPL has a network of 2540 dealers and around 25,000-30,000 retailers.

**Favourable domestic demand outlook for phosphatic fertilisers due to deficient soil and substantial gap between domestic production and consumption-**The ideal N:P: K nutrient balance for Indian soil is 4:2:1 while the actual ratio was 7.1:2.7:1 at the end of FY2019. The nutrient imbalance is a result of overuse of urea and low use of NPK which makes the soil acidic. With schemes like soil health cards being implemented by GoI to determine the soil health and advice to farmers on the right fertilisers to use the demand outlook for P&K fertilisers remains positive. The domestic demand for P&K fertilisers stands at around 25-28 MMT whereas the domestic capacity for P&K fertilisers is about 15.8 MMT resulting in significant portion being met through imports. Thus, the offtake risk remains low.

**Efficient cost structure with part backward integration; to improve with increase in phosphoric acid manufacturing capacity-** PPL is partially backward integrated into production of phosphoric acid by using rock phosphate and sulphuric acid which provides cost advantage to PPL as phosphoric acid produced is cheaper than imported phosphoric acid. PPL had commissioned a 1.32 MMTPA sulphuric acid plant in FY2016 which has improved the cost structure of the company owing to lower cost of power (produced from steam generated from the sulphuric acid plant) and sulphuric acid. Additionally, with the company in midst of installing an evaporator to increase the inhouse production of strong phosphoric acid and increase in the phosphoric acid production capacity to 1500 TPD (currently 1100 TPD) the extent of backward integration will further improve leading to improvement in the contribution margins.

**Favourable relations with overseas suppliers due to same being from the promoter group results in smooth availability of raw materials-** One of the promoters of PPL is Office Cherifien des Phosphates (OCP), Morocco which is one of the largest producers of phosphoric acid globally. PPL procures part of its phosphoric acid requirement from OCP. Since OCP is one of its promoters, PPL does not face any challenges in procurement of its key raw material.

**Significant improvement in the credit profile post subsidy clearance by the GoI in FY2021-** PPL's credit profile underwent significant improvement post the clearance of the subsidy backlog by the GoI through additional allocation towards fertiliser subsidy in FY2021. With the clearance in the subsidy backlog and timely receipt of the subsidy from the GoI under the direct Benefit Transfer (DBT) scheme, the financial leverage (Gross Debt/OPBDITA) moderated to 2.3x at the end of FY2021 vis-à-vis 4.4x at the end of FY2020. The interest coverage also improved to 4.9x in FY2021 as against 2.7x at the end of FY2020. While the working capital requirement is expected to rise in FY2022 driven by significant finished goods and raw material price inflation, the capital structure is not expected to moderate significantly.

### Credit challenges

**Acquisition of ZACL's goa plant to result in moderation of return profile**- With the equity funded acquisition of the assets of ZACL, the return metrics of PPL are expected to moderate going forward given that the expected returns from the assets are expected to be lower than PPL's existing assets. The Return on Capital Employed (RoCE) is expected to moderate going forward.

**Segmental concentration towards phosphatic fertilisers though acquisition of urea asset from ZACL will provide segmental diversification –** Currently, PPL's entire product profile comprises of phosphatic fertilisers. The phosphatic segment remains less subsidy intensive given that only 30% of the realisation comprises of the subsidy. The segment however remains exposed to the movement in the international prices of raw material as well as finished products since the subsidy for the products remains fixed. Thus even in a scenario of volatility in the raw material prices, the industry may have to undertake retail price revisions which may impact demand for the products.

**Vulnerability of profitability to agro-climatic conditions as majority of Indian agriculture depends on monsoon rains -** Agriculture sector in India remains vulnerable to the vagaries of monsoon as the area under irrigation remains low. The sector being highly regulated also remains vulnerable to changes in the regulations by GoI.

**Significant price differential of phosphatic fertilisers vis-à-vis urea impacting demand for phosphatic fertilisers-** Post implementation of Nutrient Based Subsidy (NBS) for P&K fertilisers, the price differential between urea and P&K fertilisers has widened which has adversely impacted demand for P&K fertilisers. The profitability of the company depends on the movement of international prices of raw material as majority of the raw materials are imported. The ability of the company to pass on any increase in raw material prices to end-consumers through revision of retail prices also plays a crucial role in protecting the profitability of the company. However, the industry has passed on the impact of change in raw material prices as well currency fluctuations albeit with a bit of lag. Thus, at some points the industry may witness erosion of margins for short span of time in a scenario of rising raw material prices which is corrected after a lag.

**Being a substantial importer, exposed to risk of currency fluctuations -** PPL imports majority of its raw material requirements including rock phosphate, ammonia, Muriate of Potash (MOP) and part of phosphoric acid for production of DAP/NPK fertiliser which exposes it to foreign exchange risks. The risk is however partly mitigated by the nearly complete hedging of the foreign exchange exposure the company undertakes.

## Liquidity position: Adequate

The liquidity position of the company remains adequate to meet its capex and working capital requirements given adequate cash accruals and access to sanctioned fund based working capital limits and term loans for the ongoing capex programs. The company had nearly Rs. 214 crore of free cash at the end of FY2021 which provides support to the liquidity position of the company. The acquisition of ZACL's assets is expected to be funded entirely through the equity raised through the Initial Public Offering (IPO) and hence should not impact the liquidity profile.

## Rating sensitivities

**Positive factors –** The rating upgrade looks unlikely in the near term given the impending acquisition of the assets of Zuari Agro Chemicals Limited. Post the completion of the acquisition, the integration and ramp up of ZACL's operations, along with steady improvement in the credit profile characterised by Net Debt to OPBDITA remaining below 1.3x and RoCE of more than 15% on a sustained basis could lead to a rating upgrade.

**Negative factors –** a) Significant leveraging of the balance sheet to acquire ZACL's assets against expectations of equity funded acquisition b) Any larger than expected fund outflow to support its related parties leading to weakening of the credit profile of the company would lead to a rating downgrade c) Deterioration of the receivable days to greater than 150 days on a sustained basis resulting in increased reliance on working capital borrowings will lead to downward pressure on the ratings.

## Analytical approach

| Analytical Approach | Comments |
|---|---|
| **Applicable Rating Methodologies** | Corporate Credit Rating Methodology<br>Rating Methodology for entities in the fertiliser industry |
| **Parent/Group Support** | NA |
| **Consolidation/Standalone** | The ratings are based on standalone financials of the company |

## About the company

Paradeep Phosphates Limited (PPL) was incorporated in 1981 as a joint venture between the Government of India (GoI) and the Republic of Nauru to set up facilities for the manufacture of di-ammonium phosphate (DAP) at Paradeep, Orissa. In 1993, the Republic of Nauru disinvested its equity stake to the GoI and PPL became a public sector enterprise wholly owned by the GoI. In February 2002, GoI disinvested 74% of PPL's equity in favour of Zuari Maroc Phosphates Private Limited (ZMPPL), a 50:50 joint venture between Zuari Industries Limited (ZIL, a K.K. Birla Group company) and Maroc Phosphores, Morocco (part of OCP Group, Morocco). ZIL was demerged into Zuari Agro Chemicals Limited (ZACL, rated [ICRA]B(RWD) / [ICRA]A4, earlier Zuari Holdings Limited) and Zuari Global Limited w.e.f. July 1, 2012. Currently, ZMPPL holds 80.45% stake in PPL, while the remaining 19.55% is held by the GoI.

PPL is currently among the top few integrated DAP plants in India with an installed effective annual capacity of 1.4 million metric tonnes per annum (MMTPA) (increased from 1.2 MMTPA post debottlenecking in FY2021 and name plate capacity of 0.72 MMTPA) of DAP / NPK complex fertilisers, 0.30 MMTPA of phosphoric acid and 1.32 MMTPA of sulphuric acid. The company has also scaled up trading operations of various P&K fertilisers, pesticides and agro-chemicals, etc. in recent years. The company is almost fully reliant on imported raw materials (rock phosphate, ammonia, sulphur, potash, partly for phos acid etc.) for its operations and has a dedicated jetty at the Paradeep Port for these imports.

## Key financial indicators (audited)

| PPL Standalone | FY2020 | FY2021 |
|---|---|---|
| Operating Income (Rs. crore) | 4,192.9 | 5,164.7 |
| PAT (Rs. crore) | 194.0 | 223.5 |
| OPBDIT/OI (%) | 12.4% | 10.6% |
| PAT/OI (%) | 4.6% | 4.3% |
| Total Outside Liabilities/Tangible Net Worth (times) | 2.1 | 1.4 |
| Total Debt/OPBDIT (times) | 4.4 | 2.3 |
| Interest Coverage (times) | 2.7 | 4.9 |

*PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation*

## 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 March 31, 2021 (Rs. crore) | Date & Rating in | Date & Rating in FY2021 | | Date & Rating in FY2020 | Date & Rating in FY2019 | |
| | | | | | 16 July 2021 | 6 Nov 2020 | 20 July 2020 | 30 Aug 2019 | 13 Sep 2018 | 10 Aug 2018 |
| 1 | Term loans | Long term | 824.0 | 189.5 | [ICRA]A @; Rating on watch with negative implications | [ICRA]A @; Rating on watch with negative implications | [ICRA]A @; Rating on watch with negative implications | [ICRA]A (Stable) | [ICRA]A (Stable) | [ICRA]A (Stable) |
| 2 | Fund based-long term facilities | Long term | 1,365.0 | - | [ICRA]A @; Rating on watch with negative implications | [ICRA]A @; Rating on watch with negative implications | [ICRA]A @; Rating on watch with negative implications | [ICRA]A (Stable) | [ICRA]A (Stable) | [ICRA]A (Stable) |
| 3 | Non-fund based facilities | Short term | 2,570.0 | - | [ICRA]A1 @; Rating on watch with negative implications | [ICRA]A1 @; Rating on watch with negative implications | [ICRA]A1 @; Rating on watch with negative implications | [ICRA]A1 | [ICRA]A1 | [ICRA]A1 |
| 4 | Commercial Paper | Short term | 250.0 | - | [ICRA]A1 @; Rating on watch with negative implications | [ICRA]A1 @; Rating on watch with negative implications | [ICRA]A1 @; Rating on watch with negative implications | [ICRA]A1 | [ICRA]A1 | [ICRA]A1 |

*@= Under watch with negative implications*

## Complexity level of the rated instruments

| Instrument | Complexity Indicator |
|---|---|
| Term loan | Simple |
| Long-term Fund based limit | Simple |
| Short Term-Non fund based | Simple |
| Commercial Paper | Simple |

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 analyzing 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](http://www.icra.in)

## Annexure-1: Instrument details

| ISIN No | Instrument Name | Date of Issuance / Sanction | Coupon Rate | Maturity Date | Amount Rated (RS Crore) | Current Rating and Outlook |
|---|---|---|---|---|---|---|
| NA | Term Loan-I | 29 September 2016 | NA | December 2023 | 140.0 | [ICRA]A@; Rating on watch with negative implications |
| NA | Term Loan-II | 7 January 2020 | NA | October 2025 | 214.0 | [ICRA]A@; Rating on watch with negative implications |
| NA | Term Loan-III | 22 January 2021 | NA | October 2025 | 170.0 | [ICRA]A@; Rating on watch with negative implications |
| NA | Proposed term loan | - | - | - | 300.0 | [ICRA]A@; Rating on watch with negative implications |
| NA | Fund Based Limits | - | - | - | 1,365.0 | [ICRA]A1@; Rating on watch with negative implications |
| NA | Short term – Non-fund based limits | - | - | - | 2,570.0 | [ICRA]A1@; Rating on watch with negative implications |
| NA | Commercial Paper (Unplaced) | - | - | - | 250.0 | [ICRA]A1@; Rating on watch with negative implications |

***Source:*** *Company*

## Annexure-2: List of entities considered for consolidated analysis

| Company Name | PPL Ownership | Consolidation Approach |
|---|---|---|
| - | - | - |

***Source:*** *PPL*

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