Zuari Agro Chemicals Limited

Instrument	Amount In Rs. Crore^	Rating Action
Long-term Fund-based Limits	1,200 (reduced from Rs 1500 crore earlier)	Reaffirmed at [ICRA]BBB+ (Stable)
Long- term Unallocated Limits	300	[ICRA]BBB+ (Stable) assigned
Short-term Non-fund Based Limits	2,600 (increased from Rs 2565 crore earlier)	Reaffirmed at [ICRA]A2+
Short-term Unallocated Limits	100* (reduced from Rs 135 crore earlier)	Reaffirmed at [ICRA]A2+
Unallocated Limits	15	Reaffirmed at [ICRA]BBB+ (Stable) / [ICRA]A2+

*earlier included in short term non-fund based limits

The rating for the Rs. 1,200 crore fund-based facilities (reduced from Rs 1500 crore earlier) of Zuari Agro Chemicals Limited (ZACL) has been reaffirmed at [ICRA]BBB+ (pronounced ICRA triple B plus). The rating of [ICRA]BBB+ has been assigned to the Rs 300 crore long term unallocated limits of ZACL. The outlook on the long-term rating is Stable. The rating for the Rs. 2,600 crore non-fund based facilities (enhanced from Rs 2565 crore earlier) and the Rs 100 crore short term unallocated limits (reduced from Rs 135 crore earlier) has been reaffirmed at [ICRA]A2+ (pronounced ICRA A two plus). The ratings of [ICRA]BBB+ (Stable) and [ICRA]A2+ have been reaffirmed for the unallocated limits of Rs. 15 crore.†

The ratings continue to factor in the established position of the company in the fertiliser and other agri-businesses, diversified product portfolio and healthy operating efficiency and its strong marketing network and leading market position in Karnataka and Maharashtra. The ratings also factor in the financial flexibility on account of being part of the Adventz Group (part of the erstwhile K.K. Birla Group), which was instrumental in the company getting indirect support through purchase of land to counter the losses during FY2014. ICRA notes that the Adventz Group is also looking to consolidate its fertiliser operations by the integration of different departments of ZACL and group company Paradeep Phosphates Limited to derive operational and financial synergies, which may be favourable for the companies in the medium to long term.

The ratings are continuing to be constrained by the continuing high debt levels due to significant subsidy delays by the Government of India and the resulting weak debt coverage indicators, modest core profitability metrics and cash outflows for the acquisition of majority stake in Mangalore Chemicals & Fertilisers Ltd. (MCF) through its subsidiary Zuari Fertilisers & Chemicals Limited (ZFCL). The ratings also factor in the decline in gas costs for the company following the implementation of gas pooling for the urea sector by the Government of India, although the company has also lost out on energy savings to some extent, thereby leading to moderately lower profits from the urea business compared to the earlier levels. Besides the already high debt levels owing to subsidy delays, ZFCL had also contracted a term debt of Rs. 300 crore (now reduced to Rs 210 crore) for the acquisition of the MCF shares. Besides, ZACL has also provided inter corporate deposits to ZFCL for the acquisition. Further, the MCF acquisition may not generate any major returns for ZACL in the medium term, although long-term synergies and growth opportunities exist. ICRA also notes that the New Urea Policy 2015 (NUP 2015) requires the company to reduce the energy consumption of its urea operations to 6.5 GCal/MT by FY2019, which would entail significant capex. While the scale of the investment is not clear, ICRA anticipates that the investment required would be large and may require significant debt funding.

The ratings are also constrained by vulnerability of profitability of the industry to agro-climatic conditions, regulated nature of the industry and seasonality associated with the fertiliser business. The performance of the non-urea sector is relatively more vulnerable to regulatory (subsidy) as well as economic variables (such as supply-demand, commodity prices and currency movements); profitability for the segment can be volatile depending upon ruling international prices of raw materials as well as ability to raise retail prices in an adequate

^ 100 lakh = 1 crore = 10 million

† For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications

manner. Demand for the segment has also been affected in recent years due to high retail prices of these fertilisers resulting in a price differential with urea.

In June end 2016, GoI directed fertiliser public sector undertakings to cut prices for non-Urea fertilizers such as DAP (reduced by Rs 2,500/MT) MOP (reduced by Rs. 5000/MT) and NPK complexes (reduced by Rs 1000/MT) owing to the decline in raw material prices in the international market. Due to decline in prices in the market private players had to follow suit which led to large inventory losses on unsold inventory in Q1 FY2017. Accordingly Zuari Agro Chemicals recognised an exceptional loss of Rs 43.9 crore leading to a net loss of Rs 40.6 crore in Q1 FY2017. ICRA notes that GoI intervention in pricing of non-Urea fertilizers is credit negative for the industry as it limits the pricing power.

ZACL has faced certain operational issues in recent years; the urea unit of the company was shut down for two months during FY2016 due to technical issues, although operational efficiency of the plants remained healthy in FY2016. The company did not produce beyond reassessed capacity as the average variable cost was higher than international parity price plus incidental charges owing to consumption of high priced gas prior to implementation of gas pooling.

The company expanded the capacity of its P&K units to ~0.86 MMTPA from ~0.73 MMTPA in FY2016 at a debt funded capex of Rs 110 crore besides which the company took an additional Rs 140 crore term loan for working capital purposes. The operating profitability declined from 4.9% in FY2015 to 3.8% in FY2016 owing to second consecutive year of weak monsoons due to which additional cash discounts were passed on and operational issues related shutdowns of plant. Owing to modest operating profits and increased interest expenses (due to higher levels of debt) the company posted a net loss of Rs 15.9 crore in FY2016. Owing to losses at net level, higher debt levels and low capitalisation vis-a-vis its scale of operations, the gearing of the company increased from 3.0 times as of end-FY2015 to 4.3 times as at end-FY2016 leading to weak coverage indicators (interest coverage of 0.7 times and total debt/OPBDITA of 17.0 times as of end-FY2016). To correct the capital structure the company is planning to come out with a rights issue of Rs 200 crore within FY2017. Additionally the company is looking to infuse equity through a qualified institutional placement (QIP) of ~Rs. 400 crore in the near-to-medium term. Though the monsoon is expected to be healthy in the current year, ICRA expects the returns and debt coverage indicators of ZACL to remain at modest levels in the medium term vis-a-vis its historical levels as it recovers from the downcycle in performance witnessed in recent years. The liquidity position of ZACL is expected to remain moderate in the near-to-medium term due to expectations of continuing high subsidy receivables and short-term debt mobilised for MCF through the subsidiary. Nevertheless, equity infusion in the company through the rights issue and proposed QIP will be positive for the credit risk profile of the company going forward and is a key rating sensitivity.

ICRA notes that the Board of Directors of Zuari Agro Chemicals Ltd. has approved the scheme of amalgamation of Zuari Fertilisers and Chemicals Limited (ZFCL) (rated [ICRA]BBB- and [ICRA]A3), Zuari Specialty Fertilisers Limited (ZSFL) and Zuari Agri Sciences Limited (ZASL) with ZACL. The amalgamation shall be subject to the approval of the Scheme of Amalgamation by the High Court of Bombay at Goa. The appointed date of the amalgamation is April 01, 2015. As a consequence of amalgamation, there will be no change in the shareholding pattern of ZACL, given that all the transferor companies, ie, ZFCL, ZSFL and ZASL are wholly-owned subsidiaries of ZACL. Further, upon the scheme becoming effective, the transferor companies i.e. ZFCL, ZSFL and ZASL will be dissolved without winding up and the shares held by ZACL in the transferor Companies shall be extinguished. ICRA notes that all the transferor companies utilize the marketing and distribution network of ZACL and being a part of the same company would aid in streamlining of marketing operations besides rationalizing operational, administrative and overhead costs. ICRA believes that the amalgamation will not have a material impact on the merged entity as the transferor companies are small in comparison to the parent with more than 90% of the sales and net worth contributed by ZACL alone.

Company Profile

Zuari Agro Chemicals Limited (erstwhile Zuari Holdings Limited) constitutes the fertiliser operations of the Adventz Group following the demerger of Zuari Industries Limited (ZIL). It is also the holding company for the other agri-business operations of the Adventz Group. The group has interests in agri-inputs, engineering, infrastructure, real estate, consumer durables and services sectors. It was a part of the erstwhile K.K. Birla Group. In April 2011, the Bombay High Court (Goa bench) approved the demerger of ZIL's fertiliser business into Zuari Holdings Limited (later renamed as ZACL), while the residual entity ZIL (later renamed as Zuari Global Limited) retained the non-fertiliser business operations and investments. The demerger scheme was applicable w.e.f July 1, 2012.

The erstwhile ZIL was promoted in 1967 in financial and technical collaboration between the K.K. Birla Group and the U.S. Steel Corporation to manufacture urea, compound nitrogenous fertilisers and phosphates in Goa. In 1985, ZIL promoted Chambal Fertilisers & Chemicals Limited (CFCL) to produce urea using natural gas at Gadepan, Rajasthan. In 2002, ZIL acquired Paradeep Phosphates Ltd (PPL) - rated [ICRA]BBB+(Stable)/A2+ - through a JV company, as part of the disinvestment process of GoI. PPL manufactures DAP and NPK fertilisers, with its plant located at Paradeep, Orissa. While the equity shareholding of ZIL in PPL is now held by ZACL (~40% of entire shareholding of PPL through the JV company), the 13.3% shareholding of ZIL in CFCL continues to be held by ZGL.

ZACL's plant is located in Goa and comprises of a single stream ammonia plant of 0.22 million metric tonnes per annum (MMTPA) capacity, urea plant of 0.4 MMTPA capacity, complex (NPK) plant of 0.36 MMTPA capacity and DAP-cum-Complex plant of 0.36 MMTPA capacity, which is capable of manufacturing a range of complexes. ZACL completed its feedstock conversion project and is now using gas as a feedstock for manufacturing urea (it was earlier using naphtha). For complexes and DAP, it uses imported ammonia and phosphoric acid. As of end-June 2016, 73.8% of the shareholding of ZACL was held by the promoter group, while the rest is held by domestic and foreign institutional investors and public.

On a standalone basis, in FY2016, ZACL recorded a net loss of Rs. 15.9 crore on an operating income of Rs. 5,261.1 crore against net profit of Rs. 12.4 crore on an operating income of Rs. 5,510.9 crore in FY2015. As per unaudited and standalone results in Q1 FY2016, the company recorded net loss of Rs 40.6 crore on an operating income of Rs 966.2 crore.

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